Yardi® Kube

The Redefined Office
& the Rise of Flex Space

A return to office environments—with a twist—paves the way for a new surge

MAJOR ISSUES ADDRESSED IN THIS ARTICLE

- The pandemic's impact on the short-term growth of the flex space market
- How the new office protocols will influence the model
- Why shifting needs have accelerated trends in motion before COVID-19
- Opportunities that await office property operators as uncertainty diminishes

INTRODUCTION

At the start of 2020, the economy and commercial real estate market were enjoying a record-breaking upcycle. When COVID-19 swept the nation, flexible workspaces were affected by the quarantines and lockdowns that kept millions of workers away.

An estimate by the Business Research Co. projects that after a dip in 2020, adjustments to the pandemic will help expand the global market from $8.1 billion in 2021 to $13 billion by 2025. And according to a January 2021 report

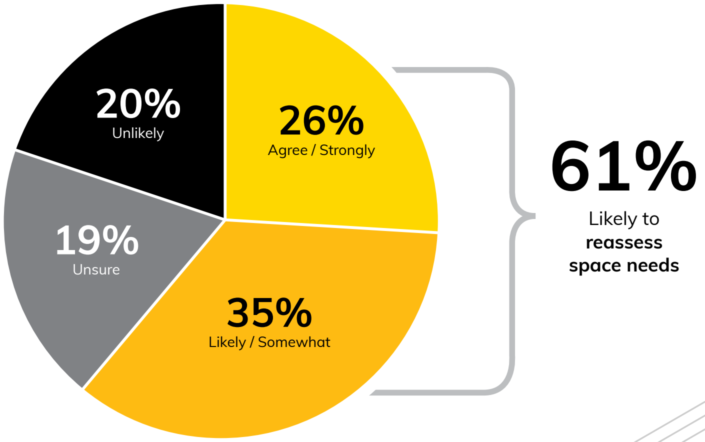
from 360iResearch, the U.S. coworking market is expected to grow from $4.5 billion in 2020 to nearly $6.8 billion by the end of 2025.

As those projections imply, the office industry seems to have finally turned a corner. Companies are still practicing social distancing and sanitation protocols, but “vaccine and recovery” have replaced “quarantines and lockdowns” as watchwords.

Yet the early stage of recovery is marked by caution and a major redefinition of how corporate occupiers see their use of space. A groundbreaking survey of more than 3,000 corporate decision-makers commissioned by Building Owners and Managers Association International late last year revealed that 61% of respondents are reassessing their space needs, with only a fraction, 9%, planning to expand.

But a potential reduction in space doesn't equate to a diminished view of the value of the office. Countering media coverage that has questioned the future of office environments, the survey also revealed that nearly 77% of C-suite executives and business owners and nearly three-quarters of tenants surveyed see the office as vital to conducting a successful operation. (The study was conducted by Brightline Strategies and sponsored by Yardi.)

So, the office isn't going away. It will look different, and flexible space will figure heavily in that reassessment. Of note, 57% of respondents to the BOMA study state that complimentary access to flex space by their landlord will aid them in their social distancing strategies. And therein lies a major opportunity for landlords.



A SHIFTING VIEW OF NEED

Pat Wellen personifies the U-shaped ride of the past year. In his capacity as director of new services for Staples, Inc., he heads Staples Studio, the retailer's coworking initiative. But Staples, like so many other companies, scrambled to keep its own employees safe and productive when COVID-19 hit.

A major result of that scramble was a widespread rethinking of work-from-home policies. Wellen explains that Staples entered 2020 without a flexible protocol. The pandemic changed all that. "We're adopting a remote working policy for the first time ever," he said. "And obviously, we're not the only company that's doing so."

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>
> *– Patrick Wellen, Staples Studio*

Underscoring Wellen's observation, Nicholas Bloom, an economist at Stanford, **reported in mid-2020** that 42% of the U.S. labor force was working from home (WFH).

But WFH is evolving into remote work as the number of national COVID cases begins to dwindle, as vaccines become more widely available and as more corporations rethink their space needs to avoid the density that threatens social distancing guidelines.

Flexible space providers stand to regain considerable lost ground in those post-COVID plans, and Staples Studio is a prime example. While the retailer itself remained open because of its designation as an essential service, the Studio closed its seven flex office locations, all in the Boston area, when COVID first hit. "We made the decision that we didn't know enough about the virus to feel confident that we could offer a safe and healthy environment," Wellen recalled.

By the time Staples Studio reopened this past June, the units had been revamped to offer touch-free environments throughout, down to touchless utensil dispensers in the kitchen. Full-time sanitation crews clean the facilities between uses.

Although Studio members have been understandably leery of leaving their WFH environments, they are being enticed to return by the new protocols. “My priority this year is to maintain and grow the profitability of the current spaces and prove the theory that coworking is going to come back,” Wellen said. After that, the plan is to launch an aggressive marketing campaign, on the presumption that COVID accelerated what was already a growing awareness of remote working’s benefits. Warren Hersowitz, regional manager at Yardi Kube, agrees. In the first few months of the pandemic, he recalled, “we were just trying to figure it all out.” There’s more clarity in the market now, and the immediate impact is that “coworking spots not located in heavily populated downtowns are already seeing growth.” Yardi Kube’s client operators are now growing an average of 30 to 70% annually, particularly in the suburbs, he reported.

Suburban office occupancy is outpacing that of central business districts (CBDs) by nearly three to one; CBRE reports that suburban key swipes have been averaging 33% of capacity, compared to 12% for Manhattan office assets. The good news here is that occupancy in both cities and suburbs is finally on the rise.

“The efficiencies gained by having one portal are immense.”

– Warren Hersowitz, Yardi Kube

The emphasis for Shift is on hospitality-rich accommodations, such as this one in Littleton, CO.

While COVID was a disruptor of the industry's upward trajectory, the pandemic, as Wellen indicated, only accelerated trends that were already growing: the work-from-home culture and the acceptance of flexible space as a viable alternative, to name two. "The structural shift toward a more fluid workforce, which is less dependent on any one physical location, is making more agile real estate options top of mind for occupiers today," the CBRE report states, citing the flexibility those options bring in the face of changing tenant behaviors.

"The traditional office model is difficult for a lot of companies to sustain," said Grant Barnhill, a former real estate developer who launched Shift Workspaces in Denver nine years ago. Shift currently operates three locations, two in the city and a third in the southern suburb of Littleton. All offer a strong menu of amenities, such as open bars and catering services. In the current climate, it is next to impossible to make staffing projections more than a year out, much less over the course of a 10-year lease, Barnhill noted.

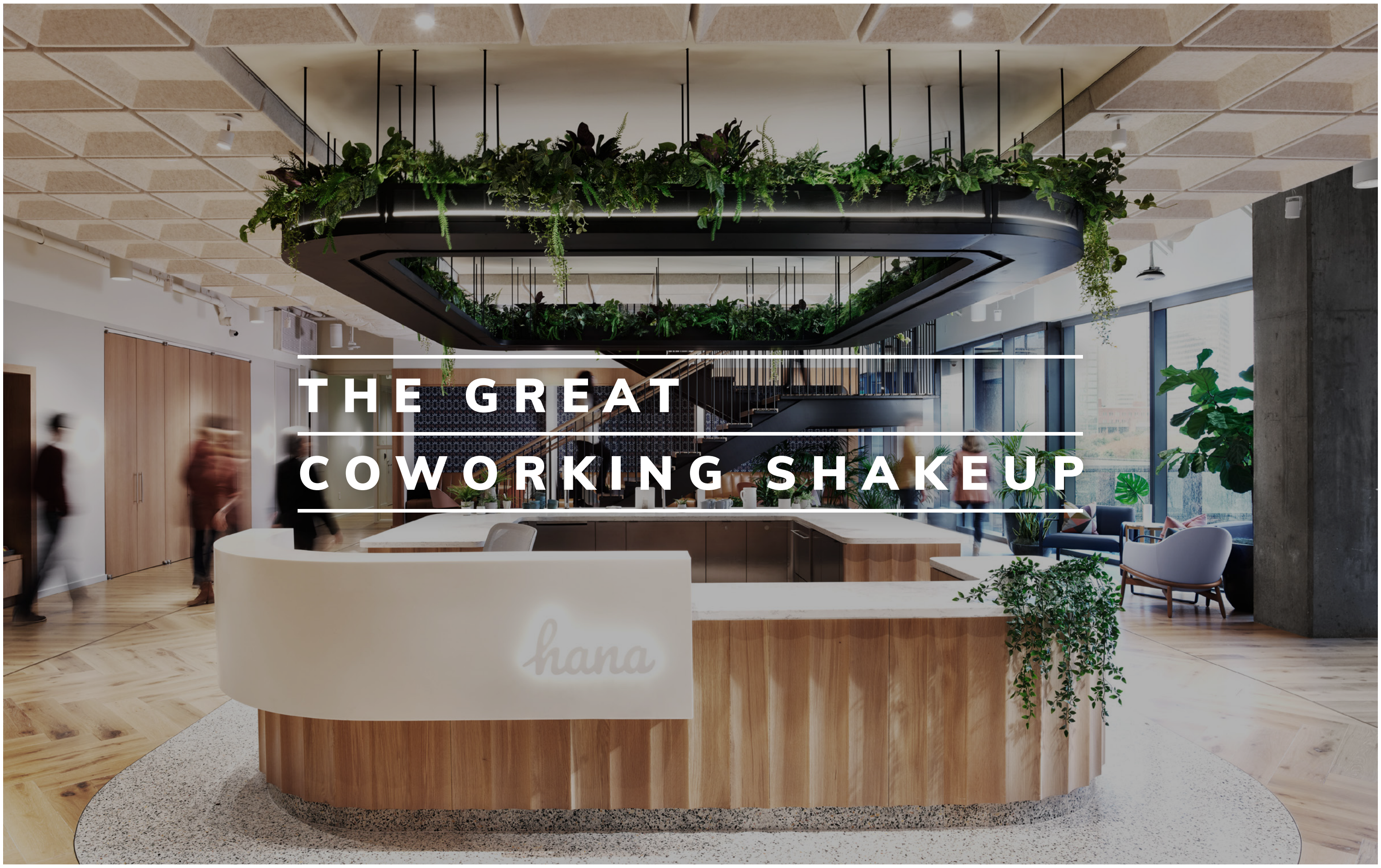
"The old way of thinking was that if I have 100 employees, I need 100 desks."

– Georgia Collins, Hana

That's why executives at Hana, CBRE's shared-space affiliate, refer to "average" rather than "peak" demand and why the flex space model fits into this rightsizing approach. "The old way of thinking was that if I have 100 employees, I need 100 desks," noted Georgia Collins, Hana's executive vice president of client solutions.

But rarely, if ever, do all 100 of those workers show up at once, and Collins puts the average population on any given day for most corporate occupiers at 65 to 80%. "If I rightsize around the average, I can accommodate the peak—the 90 or even the 100—in different ways," flexible spaces being a prime solution. "COVID solidified that approach."

THE GREAT COWORKING SHAKEUP



In the Park District in Dallas, a Hana entrance area "hub" and center of activity for food and beverage service.

It should be noted here that Hana itself has undergone an upheaval of sorts. Much like Staples Studio and other flex-space providers, Hana temporarily cut back on operations in mid-2020.

"Essentially, we knew it wasn't going to be a long-term pullback," said Hana CEO Andrew Kupiec, who **describes the operational slowdown as "being market aware."** The time frame for units under construction was also "elongated." But like other providers, he says that the recovery is "getting real again," and sites whose schedules were stretched out are at last preparing to open.

But they'll open with a twist. In a deal valued at $200 million, in February CBRE **took a 35% stake in fellow flex operator Industrious**, with plans to hike that to 40% in the near term. The agreement calls for Industrious to operate Hana's 10 sites under the Hana flag. A spokesperson explained that long-range branding will not be considered until the deal closes.

> ***"There are opportunities for landlords to satisfy a whole new category of demand."***
>
> *– Andrew Kupiec, Hana*

And this was only the latest in a series of industry shakeups, just some of which were pandemic-driven. Such was the case with Knotel, which in January filed for Chapter 11 bankruptcy protection. That followed the Chapter 11 filing in October 2020 by RGN Group Holdings, the U.S. affiliate of the flex space pioneer formerly known as Regus.

As the recovery gains a foothold, greater flexibility will figure significantly in corporate occupiers' rightsizing strategies. "The flexibility and capability that coworking offers will grow overall," Hersowitz predicted. But managing the ebb and flow and disparate locations of workers will demand a greater focus on technology, especially for larger corporate occupiers. This focus, much like the shift to WFH, was already growing prior to 2020, with COVID only accelerating the awareness.

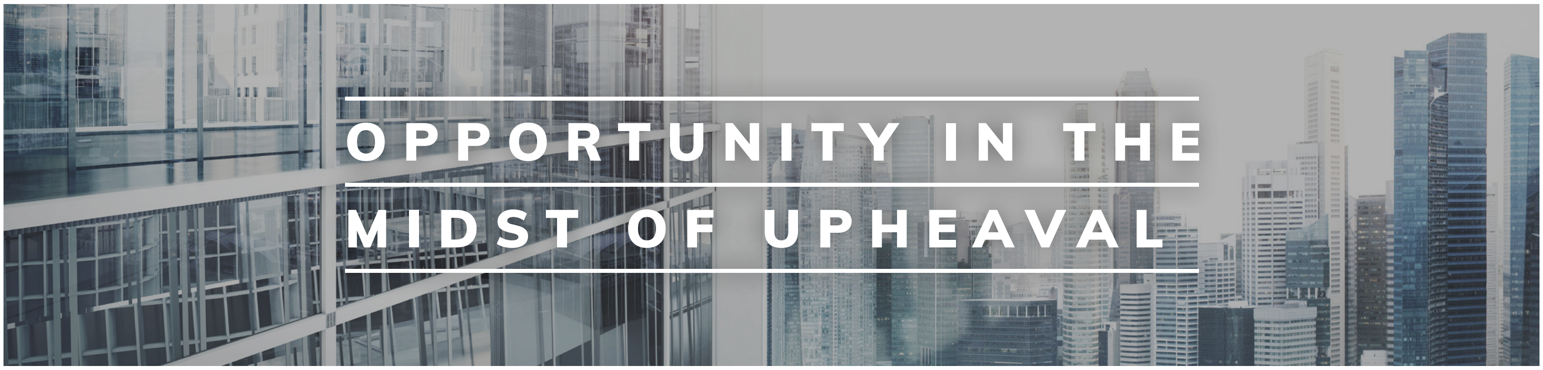
> ***"The need for automated IT systems has become the expectation of our members."***
>
> *– Grant Barnhill, Shift Workspaces*

"The commercial real estate industry is in the midst of exciting change," **EY noted in a recent report** citing the shift in adopting technology from an evolutionary to revolutionary pace. COVID-19 has only intensified the need for the industry to embrace technology in the cause of enhancing workspace flexibility, trimming costs and boosting efficiency, the report added.

For successful adoption of more flexible work policies, Hersowitz calls for a single connected solution. "The efficiencies gained by having one portal are immense," he noted, from virtual tours and contract generation to employee locators and door access.

Besides, automated IT systems have "become the expectation of our members," Barnhill reported. "The ability to reserve meeting space online in real time is highly important to tenants," who can also access critical data on their mobile devices, he added. That includes booking space but also extends to unlocking conference room doors. A key fob gives members flexible building access, including at times outside of traditional business hours. Every member also gets a private Virtual Local Area Network, a major boost to security and privacy. Data plans, customized by Yardi Kube, can be plain vanilla or ramped up to meet more advanced needs.

"Without the technology we have in place," Barnhill stated, "we'd be forced to open up the entire network to all members." The problems would be twofold: security and bandwidth. Today, he added, flex space and technology are joined at the hip. EY concurs: "Ultimately, the winners in this highly competitive space will be those who adapt and reap the cost savings and operational efficiencies that a fully realized technology platform can deliver."

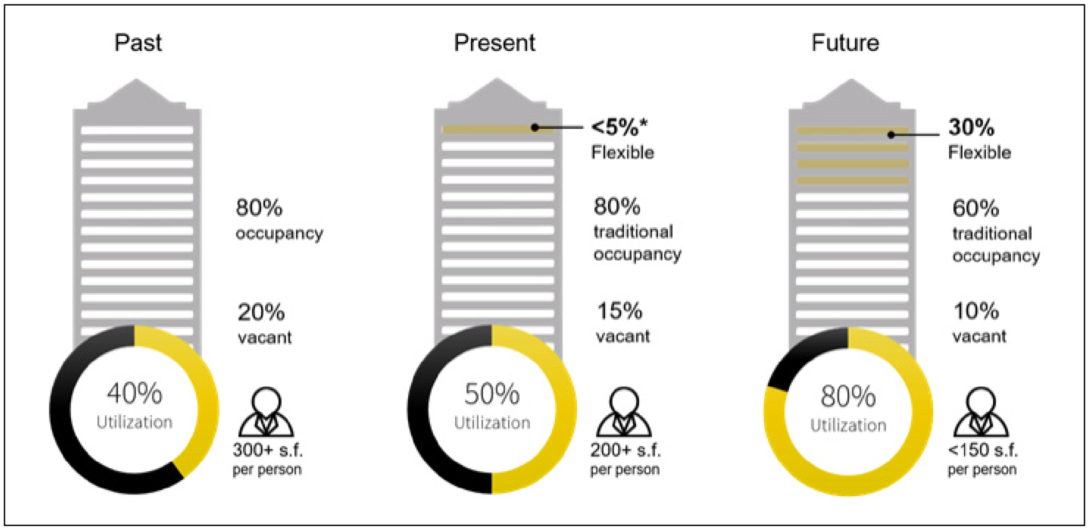


OPPORTUNITY IN THE MIDST OF UPHEAVAL

As signs of economic recovery appear on the horizon, the office market is characterized by a wait-and-see attitude toward long-term commitments. **According to JLL research**, renewals accounted for 29% of all office leasing activity before COVID-19; by the end of 2020, that figure had spiked to 70%. What's more, "around 43% of renewals in the final quarter of 2020 were five years or shorter, and .... weighted-average lease terms are falling."

That dovetails with the thinking of respondents to the BOMA survey, 56% of whom reported that they have considered negotiating reduced office space with ownership. Here is an area where flex space proves its worth: Fully 52% of survey participants are considering shifting some of their footprint to shared-space situations.

"We've seen a lot of corporate tenants give up leases in traditional office buildings," said Shift's Barnhill. "People want to be in smaller-scale projects that are closer to where they live." He pointed to the cost differential between CBDs and suburbs, along with the reduced density that provides a more approachable scale and a perceived quality-of-life upgrade.



But this major shift in workplace strategy needn't leave landlords out in the cold. Hub-and-spoke models of CBD headquarters and back-office satellite operations are an increasing part of occupiers' conversations. And the spoke occupiers need spaces to work, too.

"A smaller central office may still stay in the downtown core, but it will be augmented by several smaller offices or a coworking space near where their employees live," Fast Company **predicted in September 2020**. Rather than leasing a building in whole or in part, the magazine said, occupants may gravitate toward "smaller chunks of real estate that are spread across a broader geography."

** Under 5% of current U.S. office inventory is controlled by independent, third-party flexible space providers (spanning all operator types, from traditional executive office suites to coworking to incubators). Given industry shifts, flexible workspace and shared amenity spaces are projected to encompass approximately 30% of the office market by 2030.*

That scenario presents two significant opportunities for landlords. The first possibility is a hike in suburban leasing to occupants leaving the CBD behind, although this is admittedly something of a zero-sum game for regional market activity. In the second category is the opportunity to lease space long-term to coworking providers or to launch a branded flex space option.

"There are opportunities for landlords to satisfy a whole new category of demand," observed Kupiec, who said it's already starting to happen, especially through partnerships with established providers who can "white-glove" the offering. "This has been our model from day one."

Hana's Collins hears from occupiers that they don't want to be in a building unless it provides flex space. It's the latest on the short list of necessary amenities prospective tenants not only want but are insisting upon, along with fitness facilities and inviting lobbies.

At least two major truths about the office sector have emerged during the COVID crisis: First, the office is not going away anytime soon. Second, while the office business will recover, it will also reshape differently and more rapidly than its pre-pandemic trajectory would suggest. The future points to shorter and smaller leases, a corporate culture attuned more flexibly to the daily needs of its workers and a resulting increase in remote-work options.

However long the recovery takes, these options promise to satisfy the needs of all stakeholders: the corporate occupier, the individual workers, the owner and flexible space providers.

Contact us to discuss the Yardi Kube solution that's right for you.

yardikube.com | sales@yardi.com or (800) 866-1144

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