Cornell Real Estate Review

Volume 12 Article 9

7-2014

Collaborate or Compete: How Do Landlords Respond to the Rise in Coworking?

Rebecca Green
Cornell University

Recommended Citation

Green, R. (2014). Collaborate or compete: How do landlords respond to the rise in coworking? *Cornell Real Estate Review*, *12*, 52-59.

Collaborate or Compete: How Do Landlords Respond to the Rise in Coworking?

Abstract

Changes in technology, attitudes toward work, and the new 'shared economy' have created an environment in which people have more options for how, when and where to work. Working from home, telecommuting, hoteling, and collaborative workspaces are on the rise nationally. According to 2010 Census data, 4.3% of the 137 million workers in the United States telecommuted compared to 3.7% in 2005.1 Technology has been a major catalyst, helping to disseminate knowledge, increase communication, and allow people more independence and control over their work and life. The ubiquitous 'coffee shop entrepreneur' that migrates from their home-based office to the nearest cafe has largely given way to a new group of start-up oriented individuals and businesses that recognize the need for innovative and functional space.

Keywords

Cornell University, real estate, Cubicle, Collaboration, technology, work, economy, telecommuting, hoteling, workspaces, communication, start-up, independence, control, innovative, functional, leases, capital, credit-quality, scaleable, space, office, market, landlords, vacancy, landlord, coworking, operator, trend, New York City, manage, location, lease, sublease, Executive, Entrepreneurial, Creative, square footage, traveler, floor, plate, rentable, volume, collaborative, open, Regus, The Yard, The Centre for Social Innovation, margins, events, community, access, memberships, Millenials, demographic, economic, work-life, balance, strategies, shifting, WeWork, business, sector

Collaborate or Compete: How Do Landlords Respond to the Rise in Coworking?

By: Rebecca Green

From the Cubicle to Collaboration

Changes in technology, attitudes toward work, and the new 'shared economy' have created an environment in which people have more options for how, when and where to work. Working from home, telecommuting, hoteling, and collaborative workspaces are on the rise nationally. According to 2010 Census data, 4.3% of the 137 million workers in the United States telecommuted compared to 3.7% in 2005.[1] Technology has been a major catalyst, helping to disseminate knowledge, increase communication, and allow people more independence and control over their work and life. The ubiquitous 'coffee shop entrepreneur' that migrates from their home-based office to the nearest cafe has largely given way to a new group of start-up oriented individuals and businesses that recognize the need for innovative and functional space.

In recent years, funding for start-ups and small businesses, particularly in technology, has also improved. The Kauffman Index of Entrepreneurial Activity shows that sources of seed and venture capital have reemerged.[2] The National Venture Capital Association and PricewaterhouseCoopers reported that venture capitalists allocated $3.2 billion into New York City start-ups in 2013, a 33% increase over 2012, and $1.2b in Q1 of 2014, which denotes the most in any three-month period since 2001.[3]

Presently, traditional office spaces and leases conflict with this evolution of the workforce. Many start-ups cannot rent traditional office space because they lack the required capital, are not credit-quality rated, and need scalable space. This is a large and growing share of the office market that landlords have so far largely failed to recognize as a major player. Exacerbating the landlord's problem, vacancy has increased as larger more stable and corporate tenants have downsized their footprints, lowering their operational costs and meeting the desire for more integrated work spaces. According to the CoreNet Global Corporate Real Estate 2020 Survey of 500 corporate real estate executives, the average amount of square feet per worker has decreased from 225 SF in 2010 to 176 SF in 2012, and projected to drop to 151 SF by 2017.[4] Landlords who have not responded to the trend of scalable office space and smaller footprints are susceptible to obsolescence. Many landlords are being challenged by a new breed of office providers who are meeting the growing demand for flexible, collaborative, scalable, short term office leases – the so-called "coworking" spaces.

This article explores the relationships between landlord, coworking operator and start-up in New York City specifically and offers potential implications for wider dissemination of this burgeoning trend.

Author

Prior to starting her Masters in Real Estate at Cornell, Rebecca Green lived in New York City where she was a Vice President in Risk Management at BlackRock and later worked in Real Estate Brokerage. Her focus at Cornell has been in Real Estate Development and Entrepreneurship. Rebecca has successfully competed and earned notable distinctions in several competitions including, the Cornell Hospitality Business Plan Competition and the Hospitality Asset Managers Association Case Competition. Rebecca is currently involved in helping to launch a Coworking and Incubator space for start-up companies in Ithaca, NY.

[1] Haya El Nasser, The office is shrinking as tech creates workplaces everywhere, USA TODAY, June 5, 2012, http://usatoday30.usatoday.com/money/workplace/story/2012-06-05/tech-creates-workplace-everywhere/55405518/1

[2] See Kauffman Index of Entrepreneurial Activity, EWING MARION KAUFFMAN FOUNDATION, Apr. 9, 2014, http://www.kauffman.org/multimedia/infographics/2013/kiea-interactive

[3] Aaron Elstein, Tech employment is catching up to Wall Street, CRAIN'S NEW YORK, Apr. 1, 2014, http://www.crainsnewyork.com/article/20140401/BLOGS02/140409990/tech-employment-is-catching-up-to-wall-street

[4] NAIOP, Changes in Average Square Feet per Worker, September 2012, https://www.naiop.org/en/E-Library/Perspectives/Changes-in-Average-Square-Feet-per-Worker.aspx

What is Coworking?

Coworking as a use of space is not a new concept but this type of real estate has seen tremendous growth in the last half decade. According to Deskmag, an online magazine about coworking spaces, the growth of coworking spaces has been 100% annually for the last seven years.[5] Coworking, in its most basic form, offers ultra-short office leases – anywhere from a day to a month - that give people space to work independently, collaboratively, or in small teams.

In New York City, 108 coworking spaces and 55 operators were identified offering a total of 2.4m square feet.[6] The majority of these spaces are run by coworking operators, who lease from property owners and then sublease to start-up companies or individuals. In some cases, a coworking operator will manage just one or two locations, however several operators manage multiple locations. There are also landlords, such as SL Green Realty Corporation and Vornado Realty Trust, that have entered the market directly by subdividing floor plates and self-operating shared work stations.

Regardless of who operates the space, a broad overview of each coworking class is needed. Here coworking is divided into three distinct classes: Executive, Entrepreneurial and Creative.

The Submarkets of Coworking

In New York City, the Executive coworking group offers the most square footage and locations. The Executive coworking group predates many Creative and Entrepreneurial operators and caters to business travelers and executives. Historically, operators in the Executive space have been less concerned with collaboration and information sharing, and more focused on efficient floor plates that maximize the number of rentable offices that can be turned over quickly and rented at high volume. In 1989, Luxembourg-based Regus was one of the first operators to offer Executive offices and office suites on a short term basis. Today, Regus is the largest operator in the Executive business sector of office sharing. Regus has 40 locations in New York City and in the past two years been developing more "open, collaborative" designs in its facilities.[7]

The Entrepreneurial coworking space is the fastest growing. Operators including WeWork, NeueHouse and Grind have become market leaders in size, number of locations, and brand recognition. Most operators in this space go beyond what's offered in Executive-oriented platforms by offering classes, lectures, networking and business services to help facilitate knowledge sharing and a collaborative and energetic work culture. Several Entrepreneurial operators have noted that renting out event space and hosting classes are becoming an important source of revenue. For example, The Centre for Social Innovation, a large operator with locations in NYC (Starrett-Lehigh building) and Toronto, hosts workshops and lectures on business plan development and sourcing seed capital by reputable practitioners in the field. Another large operator, The Yard, hosts regular happy hours for coworking members and non-members to network and share ideas.[8] These events attract a majority of members and operators can drive revenues by often requiring additional fees for access to highly demanded events beyond members' dues or rent. Many coworking operators are seeing an increase in margins attributable to these types of events.

---

5 See deskmag.com.

6 Information was gathered through interviews and primary and secondary sources during 2013-2014

7 Stephen Kleege, Startups find places to grow, CRAIN'S NEW YORK, May 19, 2013, http://www.crainsnewyork.com/article/20130519/REAL_ESTATE/305199980/startups-find-places-to-grow#

8 See A creative Space to Work, and Network and http://brooklynbased.com/blog/2014/02/04/a-creative-space-to-work-and-network/

These operators recognize the importance of location and service to their business model and as such, it is not uncommon for these operators to have real estate personnel on their teams to lead leasing, landlord and tenant relations, operations and marketing.

The Creative submarket is the smallest submarket. This submarket is typically made

Coworking by Market Segment		
Model	**Square Feet**	**Locations**
Executive	1,316,583	50
Entrepreneurial	978,715	45
Creative	158,802	13
Total	**2,454,100**	**108**

Source: Data collection through primary and secondary sources

up of individuals that serve an immediate and local community. These spaces often cater to individuals, rather than businesses, which use these spaces for artistic and other creative endeavors. It is estimated there are less than 20 Creative coworking spaces in New York City, though there could be more as they tend to be informal spaces found through word of mouth. Examples include 3rd Ward (now defunct), Brooklyn Writers Space and coworking space offered at Brooklyn Lyceum.

Access to coworking spaces and membership varies depending on the operator but credit checks, large down payments and long term commitments are typically not required which make them an attractive option for many individuals and start-ups. Most coworking operators vet applicants before being granted membership, and often include nontraditional screening methods. The Community Manager at WeWork Bryant Park emphasized "fit" as being important. "We like to see our members contribute to the collaboration and information sharing here at WeWork so everyone is working toward creating a sense of community".[9]

Can Coworking Expand Its Urban Origins?

Coworking typically exists in high density urban markets. New York City is one of the largest markets for coworking. Other locations with a notable coworking presence include Austin and Seattle, as well as the Bay Area. It is clear that coworking often emerges in markets with strong technology sectors, as evidenced by coworking growth in the tech hubs of Austin, Seattle, and along New York City's 'Silicon Alley.'

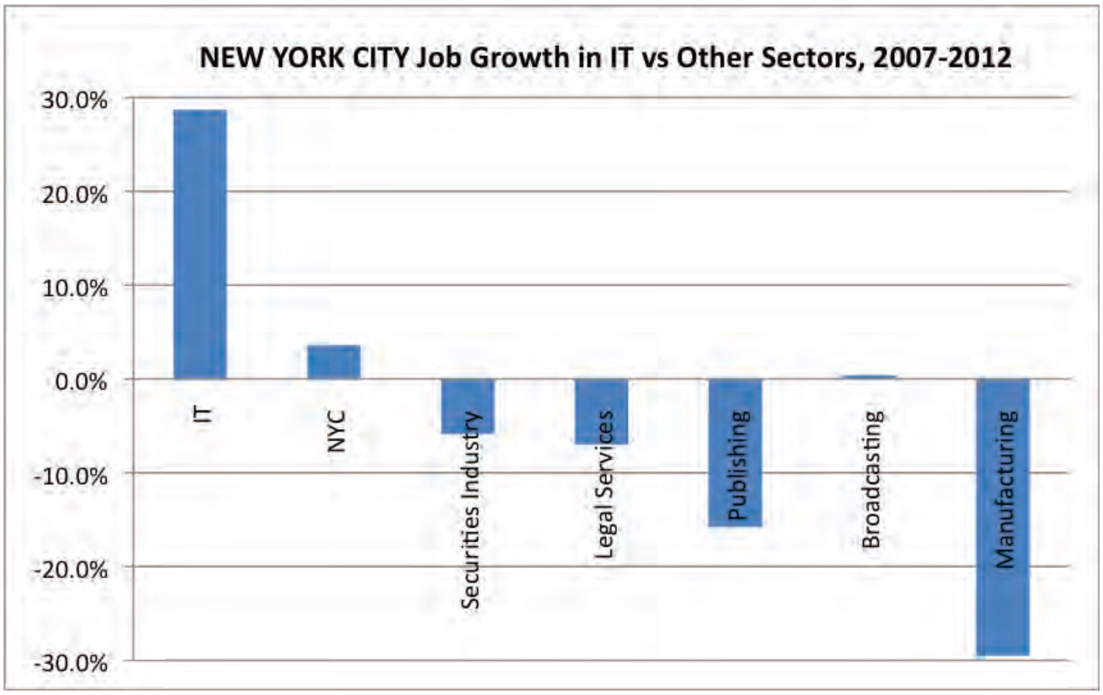
The coworking model works in large urban areas because the cost of real estate is high, there are a large number of start-ups and it is often difficult to find available smaller floor plates to accommodate the needs of a start-up. Start-ups tend to locate in high density urban markets for the positive effects of knowledge spillover, clustering, and access to capital.

Interviews with coworking operators in revealed 0% vacancy and waitlists for memberships. Many operators were planning to expand their footprint by offering more locations under their umbrella—and these expansions are not just limited to the same market. The aforementioned WeWork has locations in New York, California, Seattle, Washington, and Boston and is opening new spaces in Chicago and London. Grind is also expanding from its native New York to Chicago. As coworking becomes a more acceptable—and even demanded—part of the office experience, many operators are fielding requests from current and prospective members for a seamless national platform that allows an individual or start-up to visit multiple locations in cities around the country under one membership.[10]

Coworking-type spaces have also influenced corporations. Major tenants including

[9] Based on a recent conversation with the Community Manager at WeWork Bryant Park NYC

[10] Interviews with several coworking operators revealed the race to becoming one of the first national coworking platforms that integrates user preferences and data across locations.



Source: NYC Department of Labor. Data is for 2007 and February 2012. IT jobs are measured by computer systems design and related services. NYC jobs include only private sector jobs.

Bloomberg, NBC, and American Express have created more open and flexible office layouts and aim to adopt the startup methodology to open up channels of communication, retain and attract employees and keep ideas in-house.[11] The federal government, which occupies millions of square feet in the Washington area, is also moving in this direction. When the General Services Administration completes its renovation in 2015, the new building will accommodate 2,000 more workers than it had previously because of shared work spaces and telecommuting.[12]

Finally, the changing demographics of today's economy dictate a rise in nimble, technology focused businesses and the eschewing of traditional, highly-populated manufacturing firms. In New York City there has been a 21% jump in Information Technology employment. Crain's recently reported that employment in the Technology industry is catching up to Wall Street.[13] In addition, shrinking square feet and increased VC investments all indicate that demand for flexible workspace will continue.[14]

Driven by Millennials

Individuals using coworking spaces vary across demographic and economic segments but Millennials are the most prominent group. This generation is large (approximately 80m people between the age of 18-33, twice the size of Generation X) and view cross collaboration as a core competency required to overcome business challenges. A healthy work-life balance and indifference to corporate structure and hierarchy are common sentiments held by Millennials which directly correlate with an increased demand for flexible and cohesive work environments. [15] By 2025, Millennials will be 75% of the global workforce and attitudes that do not subscribe to the traditional 9-5 work schedule will have a profound effect on the work place. Companies like Google have responded by

[11] TechStart Newsletter

[12] See El Nasser, USA TODAY.

[13] See Elstein, CRAIN'S NEW YORK.

[14] See NYC Jobs Blueprint, NYC is a Growing High Tech Hub, Apr. 1 2014, http://nycjobsblueprint.tumblr.com/post/81393732255/nyc-is-a-growing-high-tech-hub

[15] Ron Alsop, The Trophy Kids Grow Up: How the Millennial Generation is Shaking Up the Workplace. October 13, 2008.

shifting their benefits and work environments to be more accommodating to Millennials preferences, and going forward, creating workplaces that attract this generation will be imperative to any property owner or landlord.[16]

The Real Estate Angle

Based on primary and secondary research, it is estimated that in New York City approximately 85% of coworking spaces are located in Manhattan and 15% are in Brooklyn. Coworking operators have expressed the view that locating in Manhattan provides a better service to sub-tenants than if they were to locate elsewhere; this is primarily driven by the perception of lack of office space for small businesses and start-ups in Manhattan.

Midtown South is the most desirable location for coworking and demand has escalated the price per square foot for commercial leases in all building classes. Many start-ups perceive Midtown South as rich in connections, social amenities and knowledge sharing and therefore are disinclined to move to other parts of the city. This has resulted in the highest number of coworking spaces and square feet in New York City, which in turn has

Top 10 largest			
Sub Market		Square Feet	Locations
East Midtown		513,964	17
West Midtown		350,255	12
Financial District		255,778	7
Columbus Circle		210,058	6
Flatiron		188,655	9
TriBeCa		184,776	6
Crown Heights		140,000	2
Gowanus		104,826	5
Times Square		90,595	8
Chelsea		63,354	5
Sub-total		2,102,261	
Percentage of Total		85.66%	
Source: Data collection through primary and secondary sources			

influenced the affordability of real estate in this area.

As of Q2 2013, Cushman Wakefield reported that Class A office rents in Midtown South (defined as Canal Street to 30th Street) were higher than East and West Midtown for the first time due to increased demand by media and technology companies. While companies like Google and Facebook, both of whom have opened offices in the area, are partly responsible for this increase, the plethora of information and technology start-up companies are also making meaningful contributions.[17]

Emerging businesses generally prefer coworking spaces because of their collaborative layout, scalability, short-term leases with cancellation rights, low overhead and minimal capital investment. Many operators have traditionally found homes in Class B and Class C buildings for their lower rent and attractive physical attributes. These preferences differ from traditional office users. A recent study conducted by Cushman & Wakefield found a downward trend in Class B and Class C inventory over a 15 year period from 2006-2021. Part of this downward trend is explained by historical and projected residential conversions of Class B and C buildings which will continue to constrain supply and push asking prices upwards.

Alternate locations are emerging in the Financial district as vacancy rates continue to

[16] National Chamber Foundation, The Millennial Generation, http://issuu.com/mhendrix/docs/millennialgeneration/27?e=0

[17] New Tech City, Center for an Urban Future, May 2012

vanish in Midtown South. WeWork recently signed a lease for 121,000 square feet at 222 Broadway and Tech-Space would prefer to establish its fourth New York location back in Midtown South, but acknowledges that there's a better chance of finding rents in the $30 range in the Downtown market.[18]

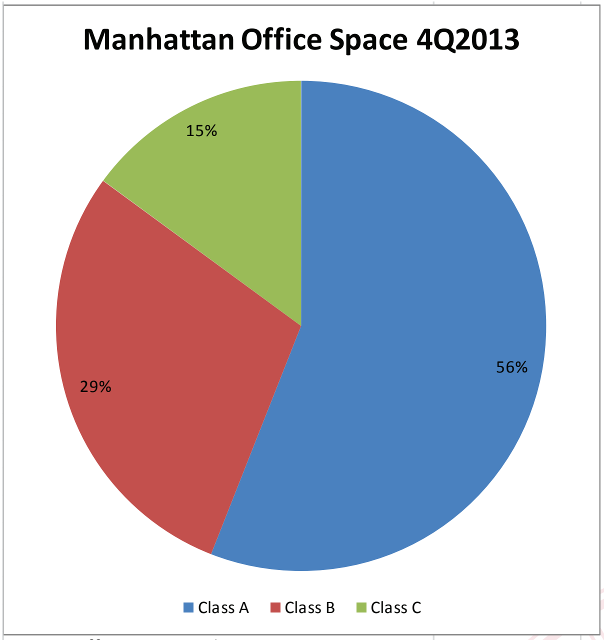
Cushman & Wakefield Marketbeat Office Snapshot - Q2 2013			
Area	Vacancy Rate	All Classes Gross Rental Rate	Class A Gross Rental Rate
Midtown	10.8%	$ 68.2	$ 75.3
Midtown South	7.2%	$ 59.5	$ 82.3
Downtown	11.6%	$ 45.9	$ 51.7

Source: Cushman & Wakefield Marketbeat Office Snapshot - Q2 2013

Downtown Brooklyn and Long Island City Queens also offer attractive submarkets to locate. Newmark Grubb Knight Frank reported that the average asking office rent in Downtown Brooklyn was $33 PSF in Q1 2014 and $22 PSF in Long Island City in the same quarter. Both areas offer excellent public transportation and have seen a robust and growing residential market which have created vibrant retail and social amenities.[19]

Landlord Strategies

There are three leading strategies for landlords to enter the market. These include: 1) renting out space to coworking operators, 2) entering the market directly by subdividing floor plates and self-operating shared work stations, which can yield new companies that grow into tenants in their own right, or 3) providing "step-out" space for smaller companies.



Source: Office Space Seeker

According to Michael Chen at Colliers International, the first strategy has grown in popularity as landlords looking to include coworking in their portfolios have found standard leases for operators the easiest way to enter the market.[20] Because coworking operators have been able to create destinations for technology companies and hubs, landlords might consider leasing to an existing coworking operator if they have a building in a less desirable area or a floor plate that is hard to lease. Because coworking spaces offer interactions between members and flexibility of workspace, irregularly shaped space is less problematic to rent to operators. This strategy is attractive because it allows property owners to take an otherwise underperforming asset and improve its financial performance by creating a technology destination that brings credibility to a building. An early example of this strategy is Thomas Campenni who fifteen years ago leased out 20,000 SF at 41 East 11th Street to TechSpace. Like its competitors, TechSpace manages shared workplaces for start-up enterprises and has

[18] See Kleege, CRAIN'S NEW YORK.

[19] Primary research conducted by the author

[20] See Kleege, CRAIN'S NEW YORK.

tripled its footprint in the 11-story, 220,000-square-foot building.[21] This is also an attractive strategy because the coworking operator attracts next generation tenants who occupy the building but the landlord does not take the credit or rent risk. This strategy may also offer lower build-out costs and tenant improvements because many coworking operators prefer to take their space relatively raw and incorporate their own design in the fit-out.

The second strategy includes landlords who have entered the market directly. This group includes SL Green Realty Corporation and Vornado Realty Trust. By leasing to start-up firms by offering coworking space directly, landlords can provide homes for new firms. This strategy may have cost advantages if the landlord is able to "oversubscribe" the space to multiple parties. For example, because of the hoteling concept often used in coworking spaces, and the varying uses of the space at different times, it may be possible for landlords to lease out 120% of the space knowing that only 85% will be used at one time. This may require a sophisticated back end system that tracks usage so that vacancy can be estimated and optimized.

The last strategy is less defined but offers landlords the ability to offer smaller floor plates to start-ups who need step out space. As is often the case with many successful start-ups, once teams grow to a certain size and products becomes more specialized, teams needs more privacy and space than what coworking operators are typically able to provide. While WeWork's Bryant Park location offers teams private office spaces to grow, more often than not members need to step out into new spaces to accommodate their growth and size. In such a case, creative options could be explored, for example, landlord-start-up partnerships where landlords rent space to emerging small companies with no name recognition but high growth potential. In these cases, the landlord hopes that the emerging business may grow and need additional space to expand their businesses. In some cases, a landlord may offer a discount on rent but take an equity stake in the company, meaning the landlord is entitled to a portion of profits of the company.

Overall, renting to existing coworking operators, or choosing to enter the market directly and cutting out operators is an opportunity for landlords to meet a growing demand of short term flexible leases and capture a market segment that otherwise would not fit under a traditional lease.

Towards a Coworking Future

Changes in technology, space needs, and attitudes towards the traditional work environment have combined to create a new paradigm in office space usage—coworking. Often more efficient than long-standing office designs and more socially integrated than its predecessors, coworking spaces and their operators take many forms. The spectrum from Executive-style office suites to niche offerings in the Creative segment has developed and expanded as more people and businesses embrace this market trend. New York City has seen a rapid increase in these types of spaces and coworking's popularity is traversing the nation—and the globe—as individuals, corporations, and start-ups alike recognize the need for flexible and collaborative work space. One of the slowest adaptors to this burgeoning trend have been office landlords. Historically more inclined to rent to large-scale corporations and professional service firms, landlords have been cautious in welcoming these seemingly risky and 'edgy' coworking operators into their buildings. Those that have, however, have seen a number of tangible and intangible benefits. This article's intent was to offer an overview of the coworking environment as it exists today and provide a foundation for further exploration of what once was thought of as a trend and is now an integral part of today's business sector.

[21] See Kleege, CRAIN'S NEW YORK.