August 2018

COWORKING

AND FLEXIBLE OFFICE SPACE

Additive or Disruptive to the Office Market?

CUSHMAN & WAKEFIELD

Additive or Disruptive?

A growing and influential sector, coworking is changing how occupiers, workers, and investors think about the office workspace. However, questions remain about the sustainability of the model and what its ultimate impact will be on traditional office space. Cushman & Wakefield's coworking and flexible office space report delves into where the coworking sector is and what to expect for its future.

Flexible offices will maintain momentum

Currently accounting for 1% of total office inventory, expect the sector to triple in size in the foreseeable future and represent between

5% and 10%

of inventory in many markets.

Investors comfortable with

15-30% of building

allocated to coworking tenants without material adverse impact on valuations.

Well-positioned to withstand an economic downturn:

During a prolonged downturn coworking occupancy could potentially decline by

up to 6%.

We expect the larger players to withstand declines of this magnitude as they are bolstered by significant reserves and a more diverse service offering.

Coworking demand has been strong

in recent quarters. While coworking ostensibly adds to net absorption, we estimate

only 30-40%

of it is accretive demand. The rest is taken from traditional office space by relocation and increasing of density.

COWORKING

Increasingly perceived as a **strategic necessity** by landlords and investors. Coworking or flexible offices are becoming a staple in buildings.

Flexible space does come with its own share of **downsides:** higher upfront costs, hidden costs in the form of higher wear and tear on buildings, security, and IP concerns for occupiers.

CUSHMAN & WAKEFIELD

Set to become a staple for corporate occupiers seeking increased
lease flexibility
with the added advantage of limited capital expenditure costs, increased collaboration, and networking.

Watch out, however, for increased
M&A activity and consolidation
along with bankruptcies as the market matures.

Blurring of lines
with large coworking providers bundling other service offerings such as project management and asset services, and even becoming the landlord in some instances.

COWORKING

The growth in coworking inventory has accelerated over the past three years, with more than *5 million square feet* of new space coming online in each of the past three years.

Coworking: State of the Market

We live in a world that offers and values flexibility and convenience. The smart phone, the internet, transportation options, and the sheer range of offerings in retail enable us to have more flexibility than ever before. This is now extending to the lives of millions of office workers as well.

One way in which the commercial real estate world has responded to the requirement for flexibility is through coworking. The fundamental concept of coworking is simple and ingenious: create accessible, fully fitted out, communal office space on short-term leases.

The concept is not new—even if the buzz is. Regus, now International Workplace Group (IWG), was founded in 1989 and remains the largest provider of flexible office space in terms of total square footage. However, it is relative newcomer WeWork (founded in 2010) that is arguably the most influential and fastest-growing firm in the coworking space.[1] By the close of the second quarter of 2018, WeWork had nearly 200 locations in the U.S., nearly 150 additional sites around the world and is reported to be valued as high as $40 billion,[2] more than 10 times the current valuation of Regus ($3.5 billion[3]).

Cushman & Wakefield estimates there are over 200 coworking companies across the country operating at least one location 5,000-plus square feet (sf). There are nearly 20 companies with at least 10 locations in the U.S. They include not only the aforementioned players, but also firms with substantial portfolios such as Premier Business Centers, Carr, Knotel, Davinci, MakeOffices and Industrious. The industry is, however, dominated by a small number of large players.

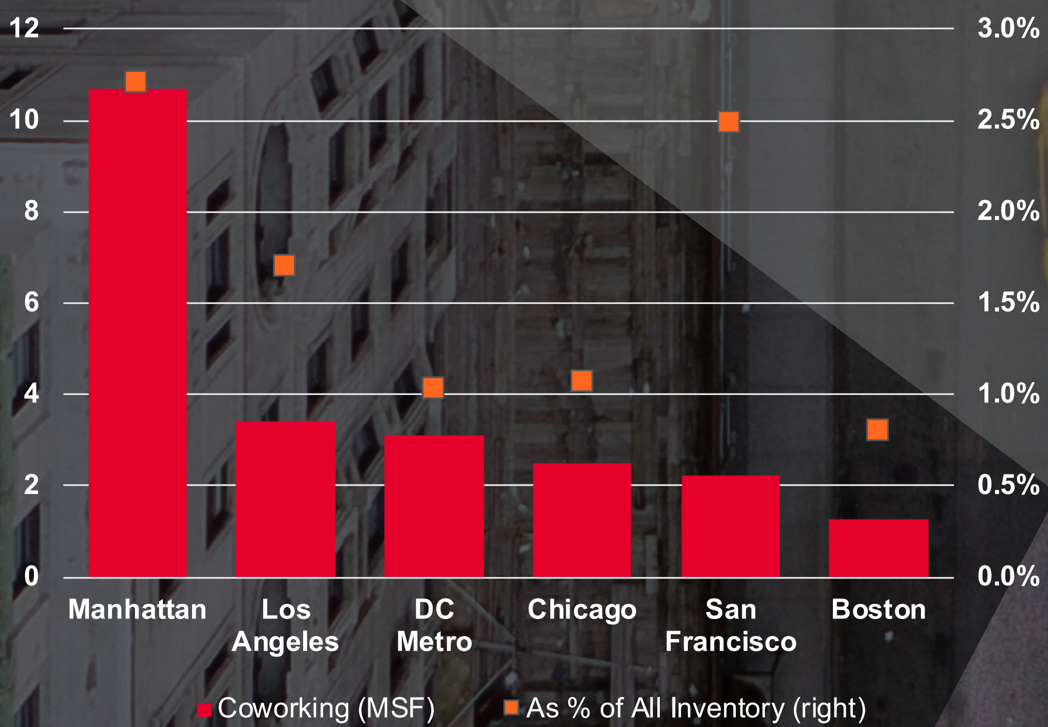
The growth in coworking inventory has accelerated over the past three years. In fact, half of all current U.S. coworking space has opened since early 2015, with over 5 msf of new space coming online each of the past three years. Another 3 msf of new space has opened in the first half of 2018. WeWork has consistently been the largest lessee of new space, accounting for over 8 msf between 2015 and 2017. That trend is not expected to change in the near future. In the first half of 2018, WeWork accounted for eight times as much newly leased space in the U.S. as the other nine largest firms did combined[4].

1 GreenDesk was created in 2008 as an eco-friendly coworking location. WeWork's founders, Adam Neumann and Miguel McKelvey, sold GreenDesk in 2010. The company continues today with 10 locations in the Brooklyn and Queens boroughs of New York City.
2 The Wall Street Journal, "WeWork in Talks With SoftBank to Double Valuation to as Much as $40 Billion," June 13, 2018.
3 Bloomberg, "Regus Owner Seeks More Time for Bids," July 21, 2018.
4 According to CoStar Group leasing data.

COWORKING

New York City boasts significantly more coworking space than any other market, with approximately 12 msf as of midyear 2018, of which 10.7 msf are in Manhattan.

Coworking Inventory in Gateway Markets



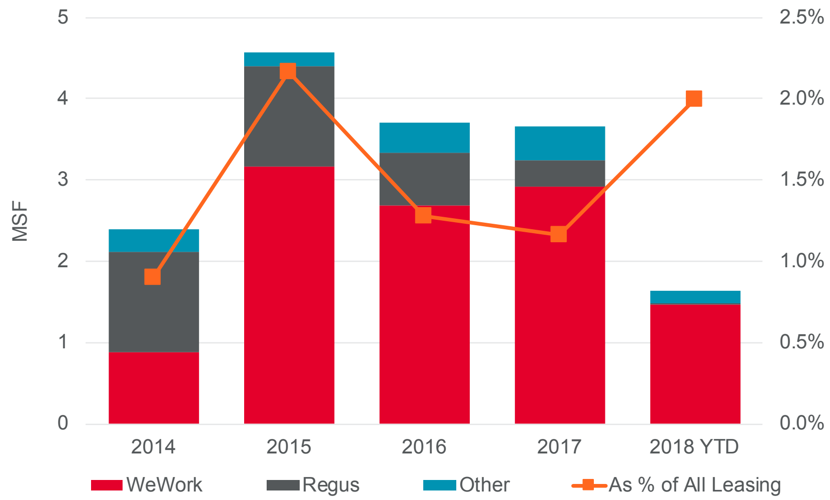
Source: Cushman & Wakefield Research; CoStar Group

The Instant Group estimates there is approximately 47.8 msf of coworking space in the 87 markets tracked by Cushman and Wakefield. Approximately half of all coworking inventory is in the six gateway markets: Manhattan, Los Angeles, San Francisco, Chicago, Washington DC Metro, and Boston. Coworking is, however, not only a phenomenon in major metro markets. There is also one growing number of non-gateway markets with over one million square feet of coworking space—including Atlanta, Dallas/Fort Worth, Denver, San Diego, and Seattle. In total, there are 20 markets that have at least 500,000 sf of coworking inventory.

Manhattan boasts significantly more coworking space than any other market, with just under 11 msf as of midyear 2018. WeWork recently became the second-largest renter of office space in Manhattan (4.6 msf), behind only JPMorgan (5.2 msf). New York City (Manhattan, Brooklyn and Queens) coworking inventory totals 12 msf—nearly equal to the five other gateway markets combined.

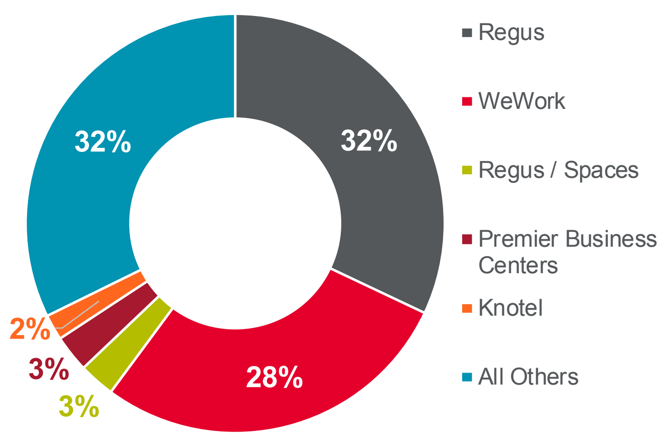
In the first half of 2018, leases for coworking space accounted for over 10% of all new leasing deals in three of the six gateway markets: Washington DC Metro (14%), San Francisco (10.8%) and Manhattan (10.5%). Despite all of this growth, coworking still accounts for only 1% of the total 5 billion square feet (bsf) of office inventory across the 87 markets tracked by Cushman & Wakefield. In the largest U.S. coworking market, Manhattan, coworking space accounts for less than 3% of office space. The other gateway markets are in a similar range with somewhere between 1% and 3% of inventory in coworking space.

New Coworking Leasing Activity in the U.S.
Midyear 2018 (Top 10 Providers)



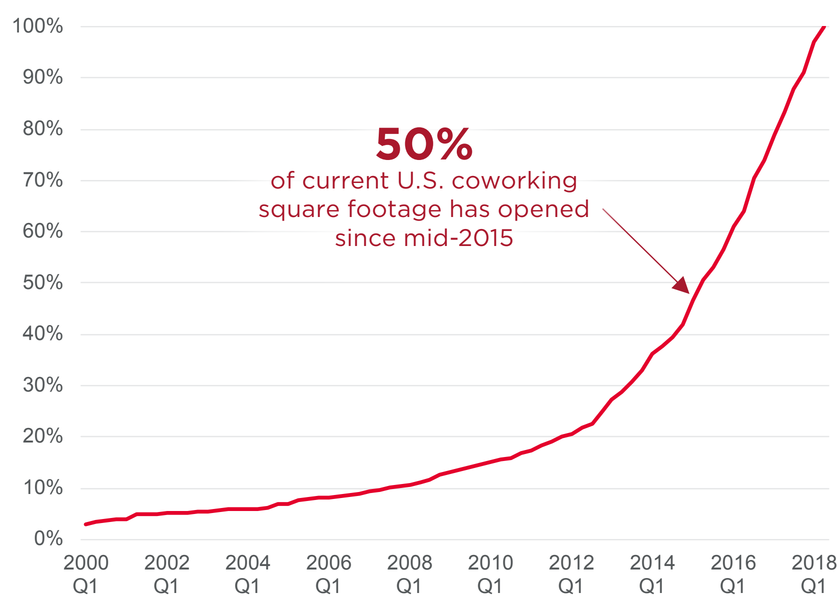
Source: CoStar Group; Cushman & Wakefield Research

Current National Occupancy by Provider
Midyear 2018



Source: CoStar Group; Cushman & Wakefield Research

National Coworking Inventory Growth



Source: CoStar Group; Cushman & Wakefield Research

Coworking Totals and % of Inventory Numbers for Gateway Markets

Market	Coworking Space and Executive Suites (msf)	Spec Suites Available (msf) *as of August 2018	Total Flexible Office Space (msf)	Total Flexile Space as % of Total Inventory
United States	**45+**	**15.0**	**60.0**	**1.1%**
Gateway Markets	23.0	7.0	30.0	2.5%
Boston	1.3	0.1	1.4	0.9%
Chicago	2.5	1.8	4.3	1.8%
Los Angeles	3.4	1.0	4.4	2.2%
Manhattan	10.7	1.0	11.7	3.0%
San Francisco	2.0	0.3	2.3	2.9%
Washington DC Metro	3.1	2.7	5.8	1.9%

Source: CoStar Group; Cushman & Wakefield Research

Any discussion of flexible workspace is incomplete without talking about speculative suites. Speculative suites are one way landlords can provide small spaces with shorter leases for tenants looking for turnkey locations with greater flexibility. As of August 2018, a total of 7 msf[5] of spec suites—over 2,900 spec suites averaging 5,000 sf each—was available in the six gateway markets: Washington DC Metro (2.7 msf), Chicago (1.8 msf), Los Angeles (1.0 msf), Manhattan (1.0 msf), San Francisco (0.3 msf), and Boston (0.1 msf).

Implications for the CRE Markets & Players

The impact and outlook for coworking will vary depending on the commercial real estate players and their needs.

Occupiers

Corporate occupiers can use coworking within their real estate portfolio, either just as a provider of space at a single location or, on the other end of the spectrum, as an integrated partner across an entire portfolio. Large occupiers are looking to coworking as a part of their commercial real estate strategy for several reasons:

- **Flexibility**: Coworking offers companies the option to quickly and easily expand or shrink their office portfolios on the margins. Coworking "swing space" can be used to manage space if a company needs to ramp up hiring or tamp down headcount quickly.
- **Talent attraction/Retention**: Many employees are attracted to the "feel" of a coworking environment. Coworking can be a part of a company's human resources workplace planning which offers employees flexibility to work from outside the traditional, "corporate" office and in a desirable location. With the heightened focus on employee experience in a highly competitive job market, coworking can be a tool in attracting and retaining talent.

5 CoStar Group

- **Cost Savings**: Even at a higher cost per square foot, flexible office space can help reduce overall commercial real estate costs in the long run. With a small, but growing proportion of a global portfolio in coworking, the remaining long-term, traditional leases can be tighter since organizations don't need to allow for as much expansion space that is not utilized or is underutilized for the first several years of the lease term. Coworking allows for the rest of the portfolio to be right-sized.
- **Innovation**: Specific teams or departments can be located in coworking facilities in order to develop a separate culture. These innovation labs can be a strategic tool for collaboration and creativity and/or can be designed to encourage employees to connect with other businesses outside of their organizations that may be future partners or customers.
- **Subleasing**: Corporate occupiers have partnered with real estate services firms or coworking providers to manage and monetize unused space by turning it into coworking space. This can be a creative alternative to leaving a location underutilized or subletting to a single tenant with a traditional sublease structure.

The demand for flexibility is not going to decline. The largest coworking providers continue to expand their portfolios at a dramatic pace. While an eventual economic downturn may reduce the demand from coworking among freelancers, entrepreneurs, and small businesses, it also will cause large occupiers to think even more seriously about the need for flexibility in their portfolios. Occupiers will trim space from their traditional lease structures and augment the portfolio with coworking space on the margins.

Risks: For occupiers, many of the risks are similar to working with any provider or partner. When hiring any firm to create turnkey spaces and/or to manage space on one's behalf, the question is if the service delivery standards will be met or not. The unique concern for occupiers when using coworking—whether just for membership space or to build out turnkey space—is whether or not the client company loses the chance to build and reinforce its own culture as it would with a more traditional build out.

COWORKING

Currently, 11% of all coworking locations globally are joint ventures between a coworking provider and the landlord.

Investors / Landlords

The largest operators will continue to expand their service offerings to become landlords, reducing cycle risk across their portfolios and attempting to create additional value for the property. Approximately one-sixth of global coworking locations are owned, and one-third of new, large locations (i.e. 100+ desks) are being purchased by the coworking provider.[6]

The flip side of this transition is the movement within the traditional real estate community to replicate the coworking offering. Landlords will allocate a portion of their portfolio to coworking either by developing that expertise internally, by providing speculative suites, or by partnering with existing coworking providers. Currently, 11% of all coworking locations globally are joint ventures between a coworking provider and the landlord, while another 5% of locations are operated through a management contract with the building owner.[7]

Other options for landlords to enter the space include white labeling with a partner, or proactively recruiting a coworking provider for certain buildings. For example, Brookfield Partners has partnered with Convene, a "real estate-as-a-service" provider, to design and manage portions of Brookfield's portfolio that offer flexible lease terms and on-demand meeting and event space. In 2017, Blackstone Group purchased the Office Group, a UK-based coworking provider, for £500 million ($650 million USD).[8]

Risks: As with any tenant, landlords have to be concerned with leases being broken. Most coworking companies do not have substantial credit histories and could end up giving back space if membership declines. Even larger, well capitalized firms may end up walking out on unprofitable leases in a small number of locations. There are also hidden costs that landlords—and investors as well—need to take into account. Coworking spaces typically experience greater wear and tear due to their higher densities and communal nature. Coworking tenants have higher usage of total building infrastructure—from physical systems such as HVAC and elevators to services such as security and cleaning. The average life of coworking fit-outs is also less than the 10 years typically attributed to standard office fit-outs. All this implies higher property management and maintenance costs for buildings with coworking tenants.

Service Companies

Coworking providers are expanding their service offerings in an attempt to diversify their income streams and meet additional needs of their clients/members. Some of those services look similar to what established real estate services firm provide, such as project management, facilities management, leasing support, and PropTech solutions. Real estate services firms are also expanding their internal expertise to help their clients with implementing coworking in their investor or occupier portfolios.

Consolidation is likely among the current coworking providers. Those providers that survive and thrive will continue to expand their lines of service, and traditional commercial real estate firms (both on the landlord and occupier sides) will be players in the coworking space. In other words, coworking will be a more integrated part of the office inventory and real estate services universe.

6 deskmag 2018 Global Coworking Survey
7 deskmag 2018 Global Coworking Survey
8 The Wall Street Journal, "Big Landlords Pile Into Co-Working as WeWork's Ascent Continues," January 23, 2018

Questions & Answers

How does coworking differ from the traditional office leasing market?

Let’s establish a common definition of three types of office space:

Coworking
Turnkey workspace housing people who are self-employed or working for different employers sharing space, equipment, and services that are provided by a third-party provider. Coworking providers typically enter into traditional, long-term lease arrangements with landlords and then sell short-term, all-inclusive memberships—typically on a monthly basis. The occupier is buying a membership, not signing a lease.

Speculative Office
Small, move-in ready spaces dedicated to a single tenant. The leases tend to be slightly shorter than many traditional space offerings, but are not nearly as short as coworking memberships. Responsibilities for services and expenses allocated the same as in a traditional office space lease.

Traditional Office Market
The most common lease arrangement between an occupier and landlord. Leases are longer term and space is dedicated to a single tenant. The tenant is responsible for building out the space, but is typically provided with a tenant improvement (TI) allowance. Landlords are responsible for services in the building such as cleaning, exterior maintenance, etc., and the costs associated with those services are passed through to the tenant.

	Coworking	Speculative Office	Traditional Office Market
Cost in Gateway Markets	**$500-$1,100 per workstation** (approximately $60-$200 psf)	**$40-$45 psf**	**$50-$55 psf**[9] (with TI allowances net effective rent is $30-$40 psf)
Density in Gateway Markets	**55-85 sf** per workstation	**110-140 sf** per workstation	**145-175 sf** per workstation[10]
Average lease lengths	**1** year or less	**4-6** years	**5-10** years
Space delivery	**Turnkey**. Highly improved, fully "plug and play" (infrastructure, equipment, furniture, IT, etc.)	**Turnkey**. Spec build out to landlord-delivered scope. High market standard. Does not include equipment or furniture.	**Occupier responsible for build out.** Average landlord contribution of $107 psf in gateway markets.[11]
Branding	**Low**. No ability for cultural and company specific branding.	**High**.	**High**. Ability to connect space with company brand and culture.
Amenities	**Wide ranging and innovative.** In addition to building standard amenities, offerings can include beers-on-tap, coffee, bike storage, WiFi, printing, onsite staff, phone booths, many pet friendly, community activities/event, and app technology.	**Building standard amenities.**	**Building standard amenities.**
Community	**High levels of community engagement/events.** Provides environments that connect members and provide access to leaders and influencers.	**Limited**.	**Limited**.
Pros	Flexible term. Little to no upfront time and capital investment.	Limited up front time and capital investment. Relatively immediate occupancy. Greater control of company identity/culture. Rents in excess of a year are capitalized.	Potentially lowest recurring costs (rent). Highest up front time and capital investment. Longest financial commitment (lease term). Rent in excess of a year are capitalized. Greatest control of company identity/ culture.
Cons	Highest recurring cost (rent). Little to no privacy. Extremely dense space. Potential loss of company identity/ culture. Cybersecurity, intellectual property data risks.	Higher recurring costs (rent). Less flexible on lease term.	Highest up front time and capital investment. Least flexible on lease term.

Sources: Cushman & Wakefield; company websites; CoStar Group; Bureau of Labor Statistics

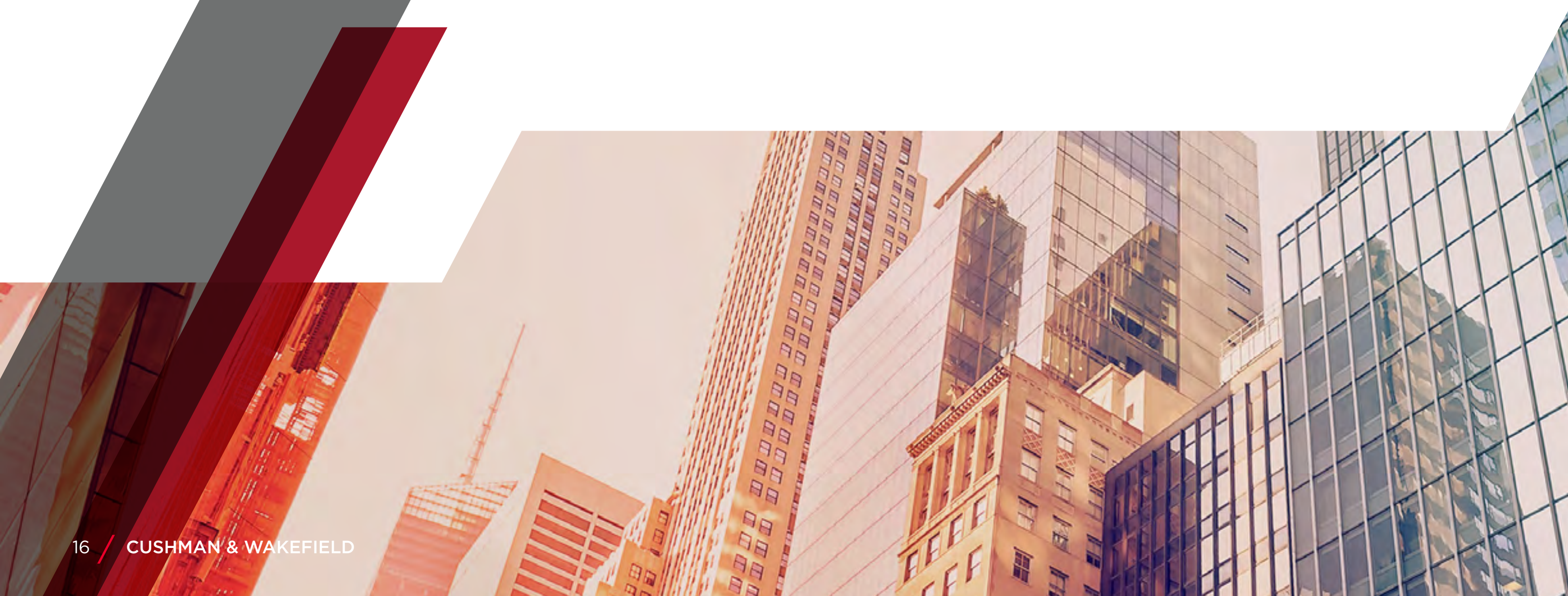
9 Weighted average rent among the six gateway markets.
10 Cushman & Wakefield's 2018 *Space Matters* report calculates the national average at 194 sf per employee. Assuming 15%-20% of an office is common area / communal, the average per workstation allocation would be in the 155-165 range.
11 Cushman & Wakefield's 2018 *Space Matters* report. Other markets average substantially lower tenant improvement (TI) allowances. The regional average for TI allowances is highest in the Northeast ($52), followed by the West ($35), South ($33) and Midwest ($27).

How does coworking affect the valuation of a building?

The data on trades of buildings with a significant coworking tenant is relatively thin.

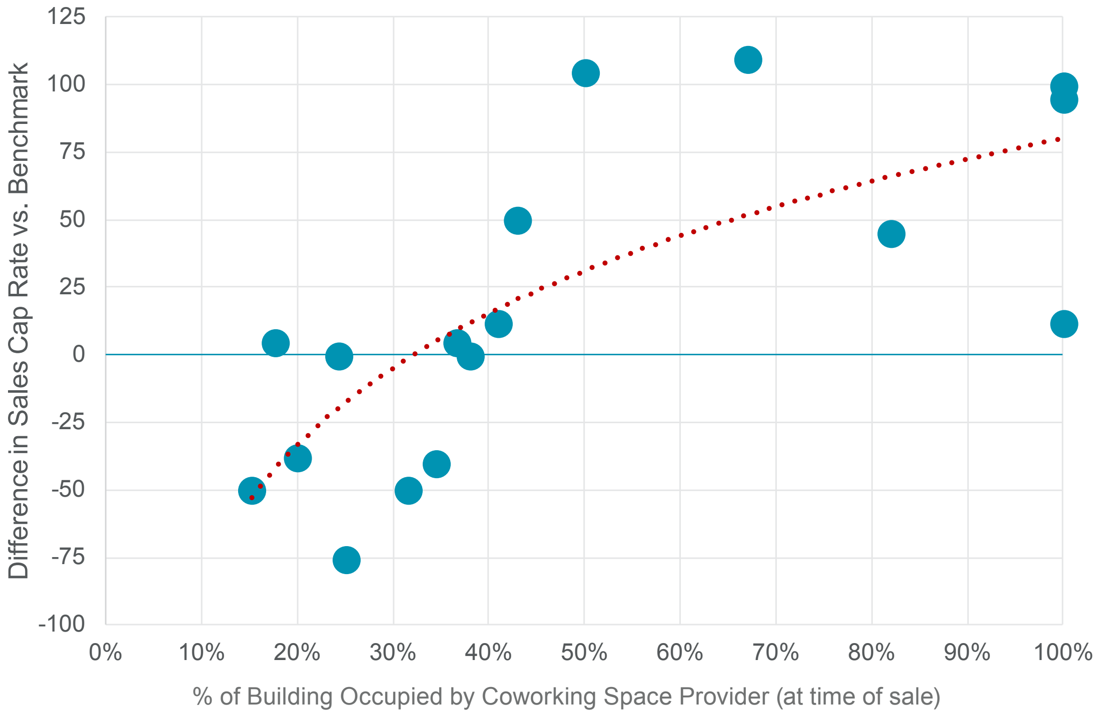
An analysis of 17 building sales with coworking tenants from the past two years indicates a relationship between the reported cap rates and the proportion of a building's square footage allocated to coworking. In those cases where 40% or less of the building was leased as coworking, the cap rate was within range or below that of other comparable sales in the area. However, the gap between cap rates for comparable sales and the building(s) in question expanded as the proportion of space allocated to coworking increased. The initial results do suggest that investors seem to apply a discount as the percentage of the building that consists of coworking increases.

In our view, the market currently seems to be comfortable with 15%-30% of a building/asset being allocated to a coworking provider with relatively strong credit. Anything above that may currently be viewed adversely. However, we expect that the range of comfort will increase over time as investors and lenders have more experience trading assets with significant coworking occupancy. Additional factors in play that would also affect valuations are the quality of the build out, the creditworthiness of the coworking tenant, the strength of the rental rate being paid, and the location of the building. The lease structure also matters. Some coworking leases are backed by a single-purpose entity, which may increase the perceived risk to a buyer/investor. Profit-sharing leases are also becoming more common and create more potential upside and downside for the building owner.



Cap Rates Impacted by Coworking Occupancy

Sales of Buildings with Coworking Space Occupancy (Q1 2016 - Q1 2018)



Represents individual sale

Source: Real Capital Analytics; Cushman & Wakefield Research

Investors have been giving a cap rate premium for buildings with a cowork space provider occupying a third or less of the building. However, as the proportion of the building leased to a cowork space provider increases, so does the gap between the building's sale cap rate and the cap rate benchmark for other sales in the same submarket.

What impact will a recession have on coworking?

> The leading coworking companies are more conservative with their pro formas, have raised significant venture capital that offer cash reserves, and are diversifying their service offerings in ways that will provide continued income even during a downturn.

While the probability of a recession is currently relatively low, the U.S. economy will encounter another downturn at some point. Cushman & Wakefield forecasts real GDP to increase by 3.0% in 2018 before growth decelerates in 2019 and 2020. Net office absorption will also slow. This, combined with a large number of new deliveries, will lead national vacancy rates to increase from 13.4% in Q2 2018 to just over 14% by the end of 2020.

While most modern coworking firms have not been around long enough to have survived a recession, an analysis of the impact of the previous recession on occupancy at the legacy firms in the office-sharing space provides some clues.

Occupancy levels: Regus (now IWG), the oldest flexible space operating company, has weathered two recessions (although a bankruptcy restructuring was required after the 2001 recession). During the most recent downturn, overall occupancy declined 6% (between 2008 and 2010), according to the company's annual reports. In the company's Americas-based locations, the occupancy decline was similar but slightly lower (5.5%). The Americas recovered by 2011 when occupancy surpassed 2008 levels by 2.6%. Global occupancy was also 1.3% above its pre-recession levels by 2011.

The declines in occupancy were significant from a profitability standpoint but not sufficient to materially impact the long-term prospects of the organization. We believe today's largest coworking providers are better placed to withstand a decline in occupancy similar to that experienced during the Great Recession. The leading coworking companies are conservative with their proformas, have raised significant venture capital that offer cash reserves, and are diversifying their service offerings in ways that will provide continued income even during a downturn.

Slowing growth: The next economic downturn is likely to slow coworking's meteoric growth. Some locations—especially those run by very small coworking providers—will close, and the growth trajectories of companies opening up the majority of locations currently may flatten. Since the majority of locations and two-thirds of coworking square footage are managed by the two largest and best capitalized providers, the risks to the industry as a whole are small.

Industry-level Consolidation / Diversification: There will likely be a consolidation among providers. Currently, there are hundreds of different companies in the coworking space, most of which are very small. It is likely that a recession would induce the bankruptcy of some providers followed by eventual consolidation of the majority of coworking locations under the umbrella of a handful of well-capitalized companies. Those with the most robust cash reserves and the broadest suite of services are likely to do the best.

Despite potential perils awaiting the industry when the next downturn occurs, it is clear that the trend towards flexibility is here to stay. Occupiers will continue to seek ways to add flexibility on the margins of their portfolios. This demand will lead to a number of solutions in the marketplace including coworking, spec suites, and more flexible lease terms in traditional leases.

How big can coworking inventory get?

Currently, coworking space accounts for less than 1% of total U.S. office inventory. Even in the largest markets it accounts for only 3%-5% of office inventory.

In addition to coworking, there currently is 7 msf of spec suites in the gateway markets (accounting for less than 1% of total inventory in those six markets). Thus, the current inventory of flexible space totals approximately 30 msf, or 2.4% of all gateway market office space. Growth in coworking space is likely to continue. According to CB Insights, WeWork alone is planning to add between 500,000 and 1,000,000 sf of new space globally each month,[12] the majority of which is scheduled to be outside of the U.S.

> Based on current near-term projections, coworking space could easily triple from its current share of 2% in gateway markets over the next decade.

To estimate how large the coworking sector could grow, the United Kingdom (U.K.) serves as a good standard of a mature coworking marketplace. A recent Cushman & Wakefield report on the London coworking market estimates that total flexible space—coworking and serviced offices—in the U.K. represents 5% of the total U.K. office stock. In Central London, the 11 msf of flexible workspace accounts for approximately 4% of the urban office stock. With the additional 4 msf of tenant-controlled spec space, workplace solutions with shorter terms and turnkey suites account for 5.5% of London's office inventory.

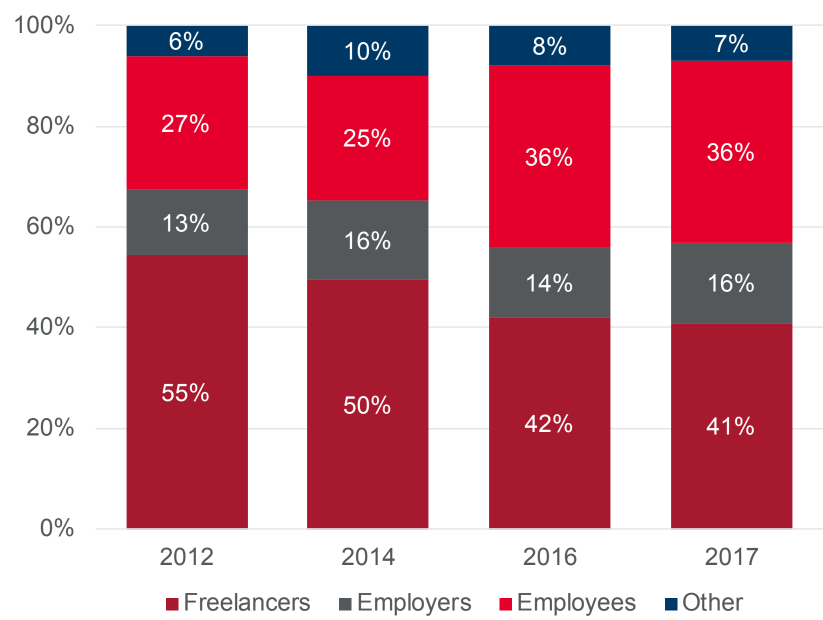
These figures suggest that the growth trajectory of coworking is sustainable. Based on current near-term projections, coworking space could easily triple from its current share of 2% in gateway markets over the next decade. Total inventory could increase to over 5% of office space in many urban markets and as high as 10% in some markets.

12 WeWork Strategy Teardown by CB Insights (May 2018).

Who actually uses coworking facilities?

Coworking providers are actively promoting their locations and services to large occupiers as the next frontier in their growth model. According to Emergent Research,[13] the percentage of WeWork members who work for companies with more than 100 employees quadrupled from 2010 to 2017; they now account for 12% of members. Over the same time period, freelancers/independent workers' share of memberships decreased from 68% to 39%. In 2017, half of all members worked for companies with fewer than 100 employees. This matches the trend in the broader industry in which freelancers have moved from 55% of all memberships in 2012 down to only 41% in 2017[14]. In that five year period, employees and employers went from 40% to 52% of all memberships.

Professional Status of Coworking Members



Source: deskmag 2017 Global Coworking Survey

13 As quoted in the CB Insights report previous cited.
14 deskmag 2017 Global Coworking Survey

Is coworking demand truly accretive?

Over the last three years, the entry and growth of coworking operators have driven real estate demand—measured by net absorption—in a variety of markets. For instance, in the Washington DC Metro region, coworking accounted for 28% of net absorption in 2017 and looks set to repeat that performance this year, driving almost 23% of new space demand in the first half of 2018.

However, not all of that absorption is truly accretive to the commercial real estate industry. When the demographics of coworking members are layered onto the leasing and net absorption figures, it is evident that only a proportion is truly new demand—for example, freelancers that otherwise would not be in office space of any kind. Corporate users, which are increasingly the targeted audience of coworking providers, typically cannibalize traditional office space in some shape or form when utilizing coworking space.

While the specifics are hard to quantify, we attempt to size the magnitude of new demand by applying the professional status[15] of coworking members: 41% are freelancers, 36% are employees of a company, 16% are employers (i.e., entrepreneurs and business owners with staff), and 7% are categorized as "other." For illustrative purposes, we apply some broad assumptions for every 1 msf of new coworking demand to measure the impact on the broader office market:

- Occupancy levels vary by location and across companies, but both WeWork and Regus have reported occupancy rates of approximately 80% in recent years. Any unused memberships (i.e. vacant coworking space) would be accretive to the commercial real estate market. (Impact: +200,000 sf)
- The demand from the 41% of members who are freelancers is largely accretive. If not for coworking, it is likely they would be excluded from the traditional leasing market—working from home or in a coffee shop for the most part. We also assume that the 7% of "other" users represent true new demand. Thus, a little less than half of new occupied coworking space is truly accretive. (Impact: +328,000 sf)
- 52% of the members are employers and employees ostensibly accounting for 416,000 sf (52% of the 800,000 sf of occupied coworking space).

15 According to the deskmag 2017 Global Coworking Survey

In the Washington DC Metro region, coworking accounted for 28% of net absorption in 2017 and looks set to repeat that performance this year.

- » However, only a portion of this is truly accretive demand from small companies and start-ups that otherwise wouldn't have office space. For illustrative purposes, we assume 25% is purely accretive. (Impact: +104,000 sf)
- » The majority of the employers and employees would be dilutive—not only because the corporate occupier is no longer leasing traditional space, but also because the square footage per employee is typically cut in half when moving from a traditional office lease to a coworking facility. (Impact: -208,000 sf)

- This would imply that approximately 30%-40% of new coworking leases is new net absorption for the market. That is, every 1 msf of new coworking space leased adds 300,000 sf to 400,000 of new absorption that would not otherwise be in the office market.

What structural trends drive the need for flexible workspaces?

The need for flexibility that is changing the office world is being driven not only by technology (WiFi, cloud computing networks, and improved security which enables remote and flexible working), but also by structural shifts in the workforce:

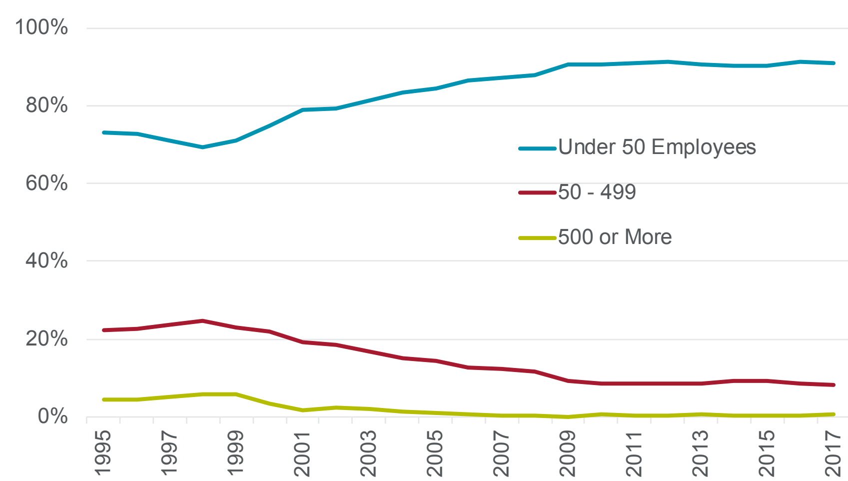
Decline in the number of traditional office workers and an increase in freelance and contract office workers: A recent analysis by Thumbtack based on data from the Bureau of Labor Statistics,[16] indicates that the business services industry—comprising office-using occupations such as accounting, consulting, computer systems design, and administrative support—added over 450,000 employees in contingent/alternative arrangements between 2005 and 2017. This was more than double the increased employment in the more commonly discussed industries of transportation and leisure/hospitality. Such growth in the freelance and contract workforce is a relatively new phenomenon. The independent workforce barely changed between 1995 and 2005 (increasing from 9.3% to 10.1%), but by 2015 the proportion of workers in independent positions jumped to 17.2%.[17]

16 Lucas Puente, "A Positive View of the Future of Work,"Thumbtack's Journal, June 4, 2018.
17 Thumbtack's sighting of data from BLS and RAND-Princeton Contingent Worker Survey, Katz and Krueger (2017)

Companies with under 50 employees create **9 out of 10** new U.S. jobs.

U.S. Job Growth Driven by Small Companies

Percentage of Total Private New Job Growth (YoY) by Company Size



Source: Bureau of Labor Statistics

Small businesses/entrepreneurs driving job growth: Flexible office space arrangements are particularly attractive to small businesses that have more difficulty acquiring/building up the capital required for traditional leases and are more uncertain about future space needs. These small businesses are propelling increases in office space demand. In 2017, businesses with fewer than 50 employees were responsible for 91% of all new private job growth,[18] an increase from the 75% new job growth in 2000.

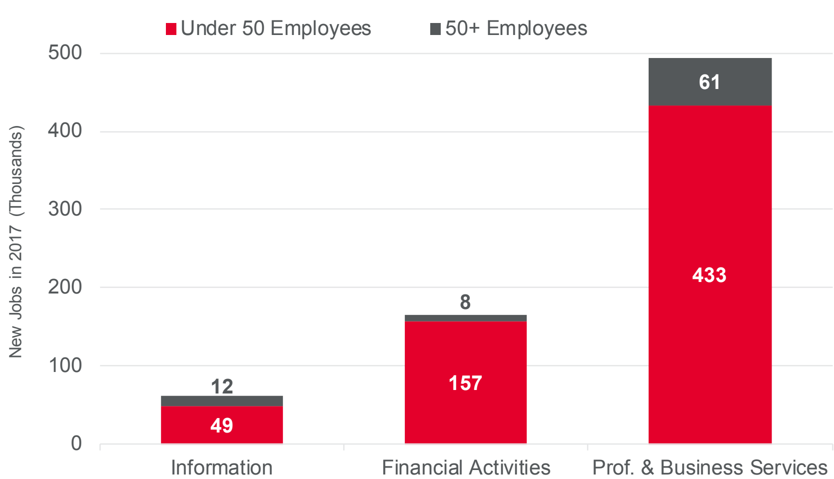
Job growth in office-using industries—information, financial activities, and professional & business services—is also being increasingly driven by businesses with fewer than 50 employees. In 2017, small firms accounted for 89% of new job growth, up from 69% in 2000. These firms created 640,000 new jobs last year, and just over half of those jobs were in companies with less than five employees (compared to 43% of new small business jobs in 2000).

> By 2015 the proportion of workers in independent positions jumped to 17.2%.

18 Bureau of Labor Statistics Quarterly Census of Employment and Wages (QCEW)

Small Companies Create Office-Using Jobs

Number of New Jobs in Office-using Industries (2017) by Company Size (Thousands)



Source: Bureau of Labor Statistics; Cushman & Wakefield Research

What impact will FASB have on coworking?

According to the Financial Accounting Standards Board (FASB), the new accounting standards going into effect at the end of 2018 require a lessee to recognize as a liability and right-of-use asset on its balance sheet any operating lease where there is an identified asset that the lessee has the right to control for a time period longer than one year. There are, however, exceptions that allow occupiers to exclude operating leases from their balance sheet when either of the following is true:

- The lease term is less than 12 months where renewal (or purchase) terms are not reasonably certain to be exercised
- The identified asset (in this case office space) is not under the lessee's control

Conceivably, coworking could offer an option that allows occupiers to get leases off of their balance sheet. This strategy may allow companies to shrink the square footage contained in traditional leases and move team members into coworking memberships. This would reduce the controlled portfolio on the margins and decrease the office lease liability and right-of-use assets on the balance sheet. This strategy is particularly feasible in major cities with vast coworking options (e.g., New York City, London, Los Angeles, et al.).

The accounting implications of coworking are unlikely to be a driving factor in occupiers' decisions to leverage coworking. It is not realistic for the vast majority of large companies to have their entire (or a significant portion of) portfolio(s) in uncontrolled, short-term leases. Enterprise relationships in which a coworking provider builds out a space and/or manages it for an occupier would still be considered long-term leases under the new FASB regulations. If coworking is used for a limited number of employees, this strategy will likely reduce the balance sheet impact across an entire portfolio of leases only to a minimal extent. However, occupiers may be able to reduce their swing space—which can account for up to 20% in certain locations—through the utilization of coworking in markets around the country and the world.

Coworking allows occupiers to get leases off their balance sheet.

COWORKING

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