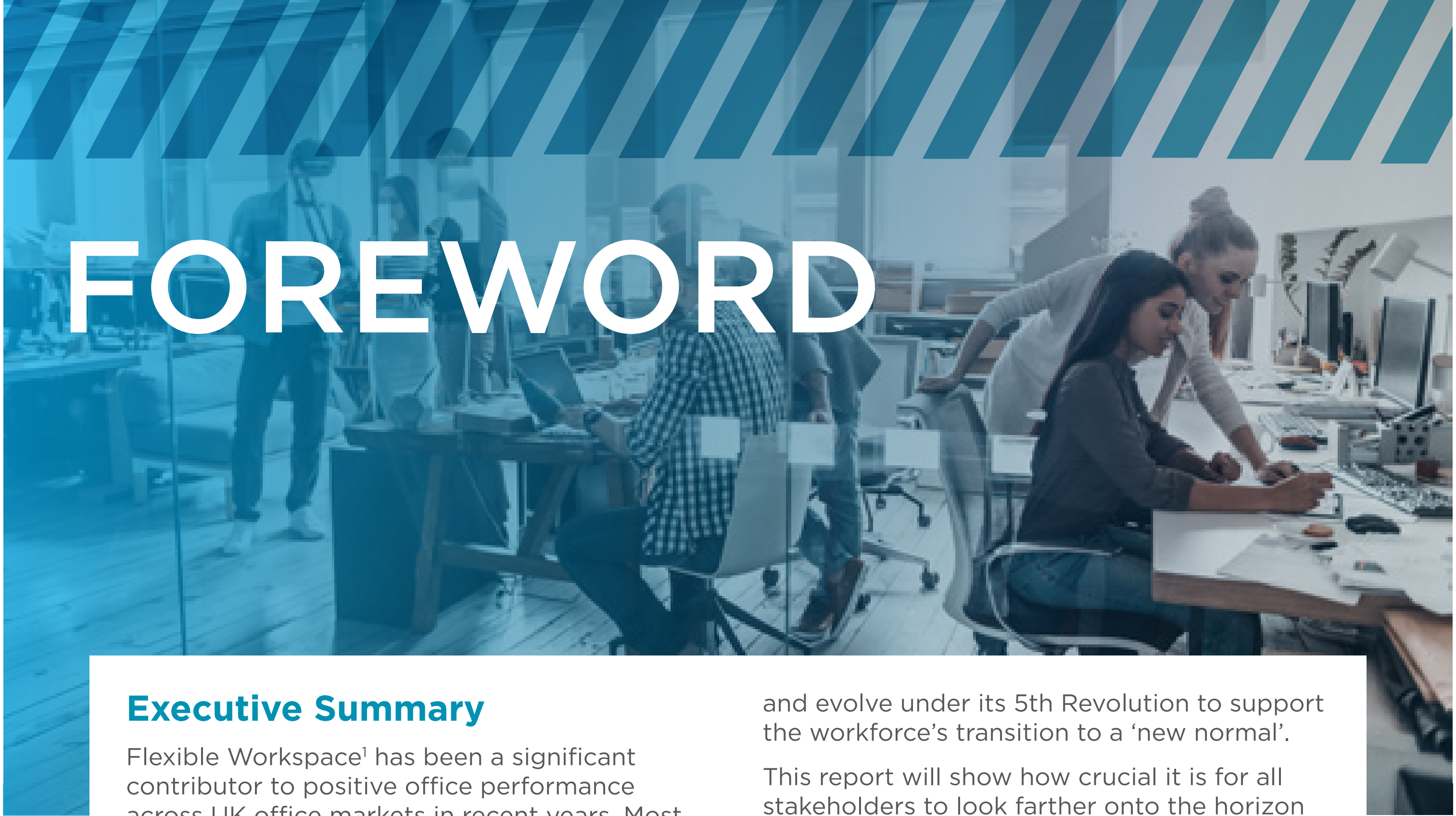
CUSHMAN & WAKEFIELD RESEARCH & INSIGHT PUBLICATION

UK COWORKING 2020: WHAT'S NEXT ON THE FLEXIBLE WORKPLACE HORIZON?

October 2020

CUSHMAN & WAKEFIELD



Executive Summary

Flexible Workspace[1] has been a significant contributor to positive office performance across UK office markets in recent years. Most notably, 19% of take-up in Central London was attributed to Flexible Workspace in the 18 months between January 2019 and June 2020.

With one of the biggest influencers in the market retrenching and focussing on profitability with limited new acquisitions planned, we were already anticipating a slower rate of growth in 2020 compared with preceding years. Despite this, the outlook at the beginning of 2020 was still positive for the sector with numerous smaller Operators starting to look at expansion opportunities.

The arrival of the global COVID-19 pandemic dramatically altered the trajectory of all sectors in real estate, not just Flexible Workspace. Inevitably for a sector that has faced sceptics and advocates in almost equal measure, real estate industry stakeholders started asking the question 'what does this mean for the future of Flexible Workspace'?

This COVID-19 pandemic and the resultant recession, undoubtedly poses an unprecedented challenge to the status quo of how and where we will work in the future. In this report, we review how the short term disruption caused by lockdown and the associated knee jerk reactions, do not translate into long term trends.

Instead, now a significant landmark on the office horizon, Flexible Workspace must adapt and evolve under its 5th Revolution to support the workforce's transition to a 'new normal'.

This report will show how crucial it is for all stakeholders to look farther onto the horizon to define their future workplace strategy. In an increasingly uncertain world, strategic questions could well be answered with a flexible solution.

Landlords and Investors, consider your current portfolio and exposure to Flexible Workspace. Do you have sufficient Flexible Workspace to accommodate changing demands and increased flexibility sought by occupiers? How is existing Flexible Workspace operated, does it align with your objectives?

Occupiers, is it time to reflect on how you wish to work in the future? Does your current office set up provide you with the necessary tools and spaces to collaborate and work effectively? Are your offices located in the right locations?

Flexible Operators, how does your presence in a building maximise value for both Occupiers and Landlords? Where are the next hotspots for expansion and on what contractual basis should this be? Is your product mix correct for your market or for your target Members?

Take a read of our report to find out about 'what's next on the horizon for Flexible Workspace?'.

1 **Report Terminology:** Flexible Workspace is an umbrella term we will use throughout the report to describe the depth & breadth of the sector. The term includes multiple flexible products such as coworking, dedicated desks, serviced offices, and managed offices. When we talk about Flexible Workspace, unless otherwise specified, we are talking about all products. Although coworking as a term is frequently used to describe the sector as a whole, it is also a product in its own right.

What's on the Horizon?

In recent months, we have been closely monitoring all activity amongst Flexible Workspace Members ('Members'), Flexible Workspace Operators ('Operators') and Landlords and Investors ('Landlords') to enable us to advise each of our Clients on "what's next for Flexible Workspace?".
In collating these experiences and learnings from across the market, it is apparent that Flexible Workspace could play in key role in the return to the office.

Undoubtedly though, COVID-19 represents the biggest challenge yet for Flexible Workspace. But, it could also provide the answer for many facing an uncertain future and provide the multi-faceted, flexible solution that the market needs to support the safe return to the office in the short term, but also a return to pre-pandemic prosperity in the medium and long term.

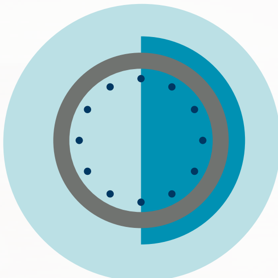
Our previous report, **Coworking 2019: The Flexible Workplace Evolution Continues** explored the impact Flexible Workspace was having on both London and Regional City office markets. Now, however, with the UK economy entering, what looks to be, its worst recession in history, Flexible Workspace is set for change and reinvention in order to survive its 5th recession and embark on its 5th revolution.

Flexible Workspace has been around in some form for decades, starting with the creation of OmniOffices in 1962. In this report, we go right back to the beginning and look at how the sector has evolved in recent years, in order to project forwards and see what the short, medium and long term horizons hold for the sector. With much more to the sector than just coworking, it is crucial to think about all of the different Flexible Workspace products in order to understand the role the sector has to play in the recovery of both the office market and the wider economy.

FLEXIBLE WORKSPACE TIMELINE

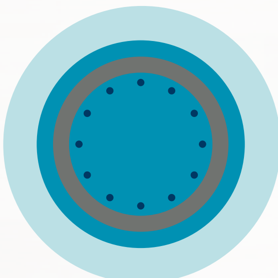
Short Term (2020)

- 2020 State of the Market
- Central London
- Regional Markets
- Initial Response to COVID-19 from Stakeholders



Medium Term (2021)

- Occupiers – how will they react?
- Tenant-Released Space: A Challenge for the Flexible Workspace Market?
- Operator Responses
- Managed Space



Long Term (2022+)

- Location, Location, Location
- The Office isn't Dead
- Management Agreements vs Leases
- Valuation of Flexible Workspace
- Future Growth

FLEXIBLE WORKSPACE TIMELINE

1ST

1962
OmniOffices Group Inc founded
Early provider of executive suites.

1973-1975
Oil Crisis
Recession hits

2ND

1978
Servcorp founded

1979
Lenta Business Space (now Lenta Business Centres) founded
OTSS (now Office Space in Town) founded

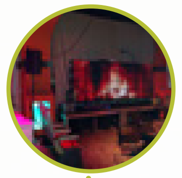
1980
Thatcher & De-Industrialisation
Recession hits
Businesses forced to consider cash flow and long term liabilities, making serviced offices seem more attractive.

1989
Regus founded by Mark Dixon

1990
Exchange Rate Recession

3RD

1993
Citibase founded
The first serviced office brokerage launches in the UK



1995
C-Base, Berlin
THE original coworking space in all but name.

1999
OmniOffices acquire HQ Business Centres to become HQ Global Workplaces
DeKoven officially launched the word 'coworking'

2000
Bizspace founded
Regus completed an initial public offering on the London Stock Exchange

2001
Dotcom bubble burst

58%

2002
Regus sells 58% of UK business to Rex 2002 Ltd.

Regus entered Ch. 11 Bankruptcy in the US
The high fixed rental agreements signed at height of dotcom boom put pressure on operating model

2004
HQ Global Workplaces (originally OmniOffices) acquired by Regus

2005
Impact Hub launched in London
Point in time at which Apple sells more laptops than desktops

"Coworking"

2007
Coworking seen as a trend on Google for the first time and gets its own page on Wikipedia

2008
The Great Financial Crisis ('GFC')

2009
The first claim in writing that the office is dead (11 years later and the office is still standing strong).

4TH

2010
WeWork founded in NYC
First #CoworkingDay celebrated on August 9th
First Coworking conference takes place in Brussels
600 coworking spaces worldwide

2015
Knotel Founded

2016
UK votes to leave the European Union

2017
C&W Serviced Office Advisory Team Founded

2019
WeWork withdraw from IPO in Q3 and valuation drops from $47bn to $5bn.
Expansion and new acquisitions halt with Adam Neuman stepping down as CEO, replaced by Sandeep Mathrani

5TH

2020
COVID-19 arrives in the UK and by the end of March, the country goes into lockdown
After every recession, Flexible Workspace has experienced a period of growth and change, passing through four revolutions in recent decades. 2020 marks the start of a new era for the sector as we now enter the **5th Revolution: The Sector Matures**

1ST **REVOLUTION** - Initial Transition to a new way of Working with Early Pioneers

2ND **REVOLUTION** - Growth of Providers to deliver to a bigger market

3RD **REVOLUTION** - The Arrival of Coworking and Renewed Growth of Sector

4TH **REVOLUTION** - Mainstreaming & Growth of Flexible Workspace Globally

5TH **REVOLUTION** - The Sector Matures

FLEX | ECONOMIC

2020 STATE OF THE MARKET

IT ALL STARTED SO WELL

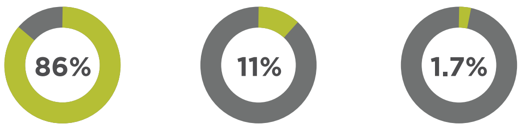
33,000+

Flexible workspaces worldwide as at the end of 2019

(Source: GCUC; Instant Group)

The UK alone has 5,923 spaces, which is 17% of the worldwide total

(Source: GCUC; Instant Group)



86% of the global Flexible Workspace market is made up of independent small scale operators. The largest market share is IWG with 11%, with WeWork at 1.7%.

(Source: BCO Report, Oct 19)

$26BN

the global value of the Flexible Workspace market

(Source: Allwork.space, 2020)

63%

of global organisations currently use coworking somewhere across their portfolio

(Source: C&W CRE Executive Perspectives on Coworking, 2019)

1 new centre opened every **5 days** in London pre COVID-19

(Source: Coworking Resources)

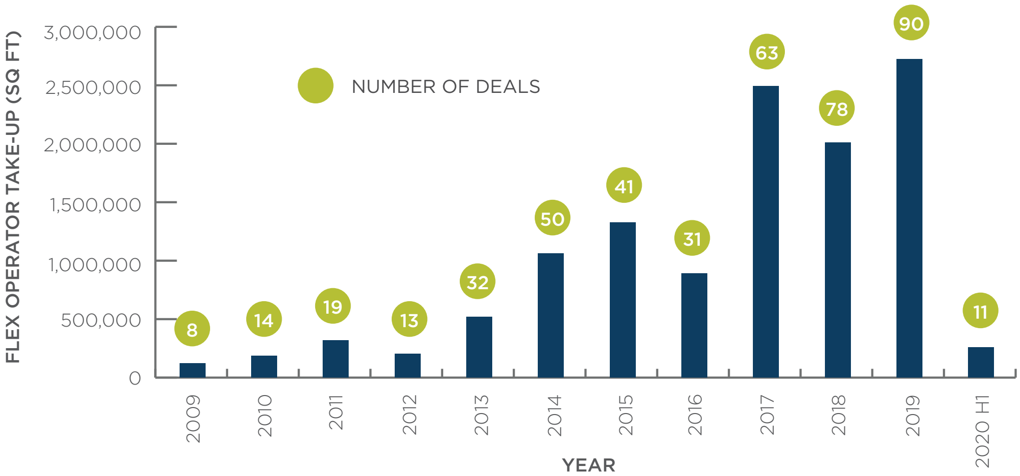
SHORT TERM HORIZON (2021)

2020 has been a year like no other. In this section we look at what has happened in the last 6 months and how things are changing as we head into Q4 of 2020.

CENTRAL LONDON FLEXIBLE WORKSPACE UPDATE

Since our last report, the Central London office market has undergone significant change. The COVID-19 pandemic has stalled the occupational market, and many requirements have been shelved or postponed. The Flexible Workspace market has not been immune to this decline in market activity, as can be seen in Figure 1 where 2020 H1 take-up volumes from Operators reached just over 260,000 sq ft. This represents 11 deals in H1 2020 compared to 40 in H1 2019, c. 73% decrease year on year.

FIGURE 1: CENTRAL LONDON TAKE-UP BY FLEXIBLE WORKSPACE OPERATORS

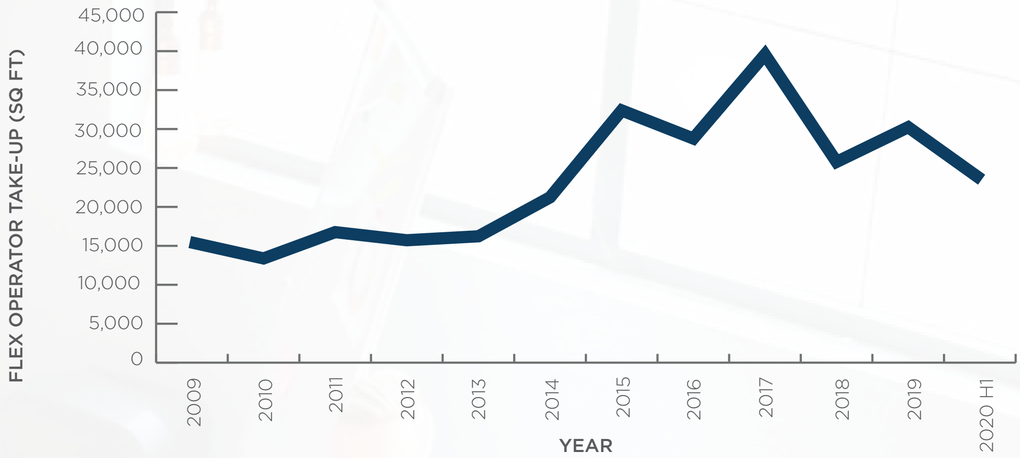


Source: Cushman & Wakefield Research

Whilst the slowdown in take-up activity has only happened in the first half of 2020, the average size of letting by Operators has been in decline since it peaked in 2017. With that said, the largest recorded transaction took place in 2019, with WeWork acquiring 288,000 sq ft from EMA at 30 Churchill Place.

In the first half of 2020, the largest transaction that took place was The Office Group's 70,000 sq ft acquisition at 210 Euston Road. This means that in 2020 so far, this is the first time since 2014 where an Operator hasn't committed to 100,000 sq ft in a single location.

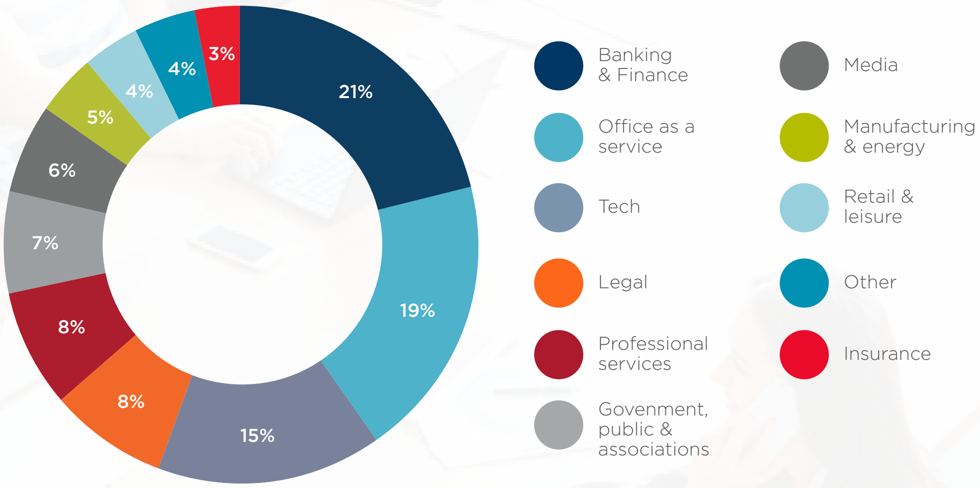
FIGURE 2: AVERAGE DEAL SIZE FOR FLEXIBLE WORKSPACE OPERATORS



Source: Cushman & Wakefield Research

The Flexible Workspace sector continues to play a significant role in the Central London office market. This is even though WeWork have drastically slowed down their acquisition activity since Q4 2019, demonstrating that several other Operators remain willing to expand.

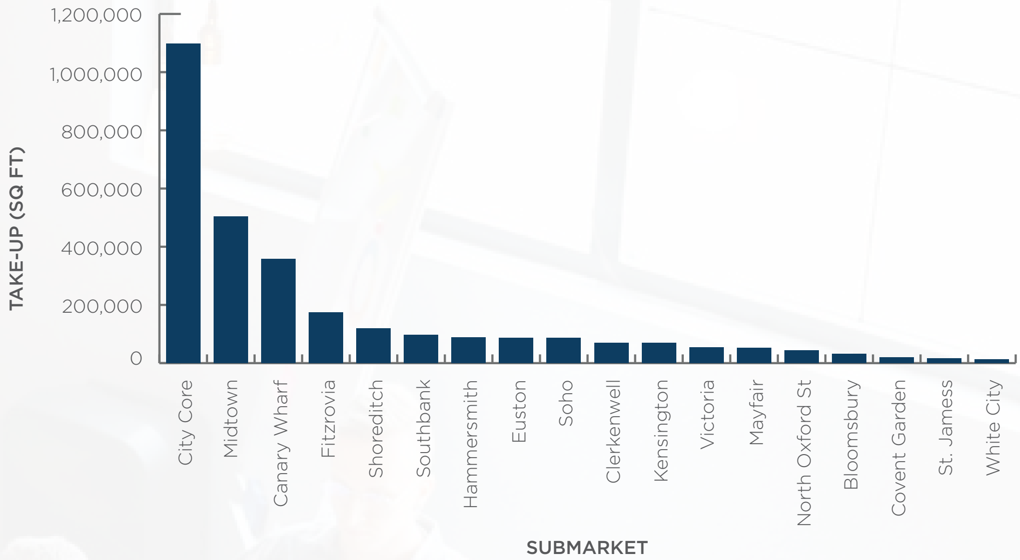
FIGURE 3: TAKE-UP BY SECTOR 2019-2020 H1



Source: Cushman & Wakefield Research

Since the beginning of 2019, the City Core has seen the most leasing activity from Operators, with nearly 1.1 million sq ft transacted.

FIGURE 4: FLEXIBLE WORKSPACE TAKE-UP BY SUBMARKET 2019-2020 H1

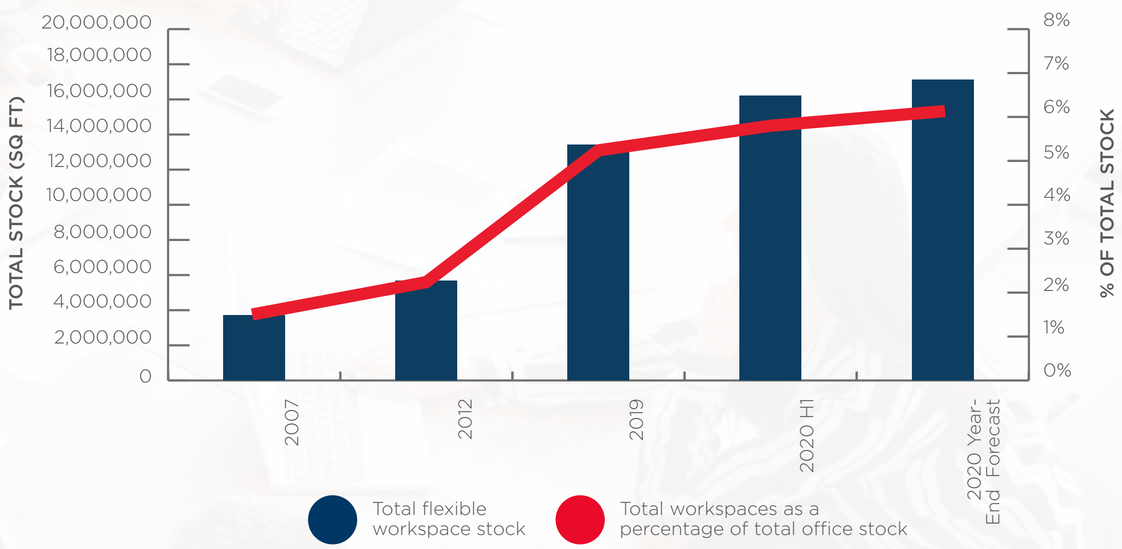


Source: Cushman & Wakefield Research

Since we last looked at individual submarkets, the top 3 remain the same, with only a slight repositioning after Canary Wharf overtakes Midtown to take second place (due to the WeWork acquisition and other transactions from The Office Group and IWG).

At the end of H1 2020, Flexible Workspace accounted for 5.80% of total Central London office stock. We forecast that this could reach 6.13% by the end of 2020, depending on the opening of new centres where the building is still under construction or undergoing refurbishment.

FIGURE 5: CENTRAL LONDON FLEXIBLE WORKSPACE STOCK

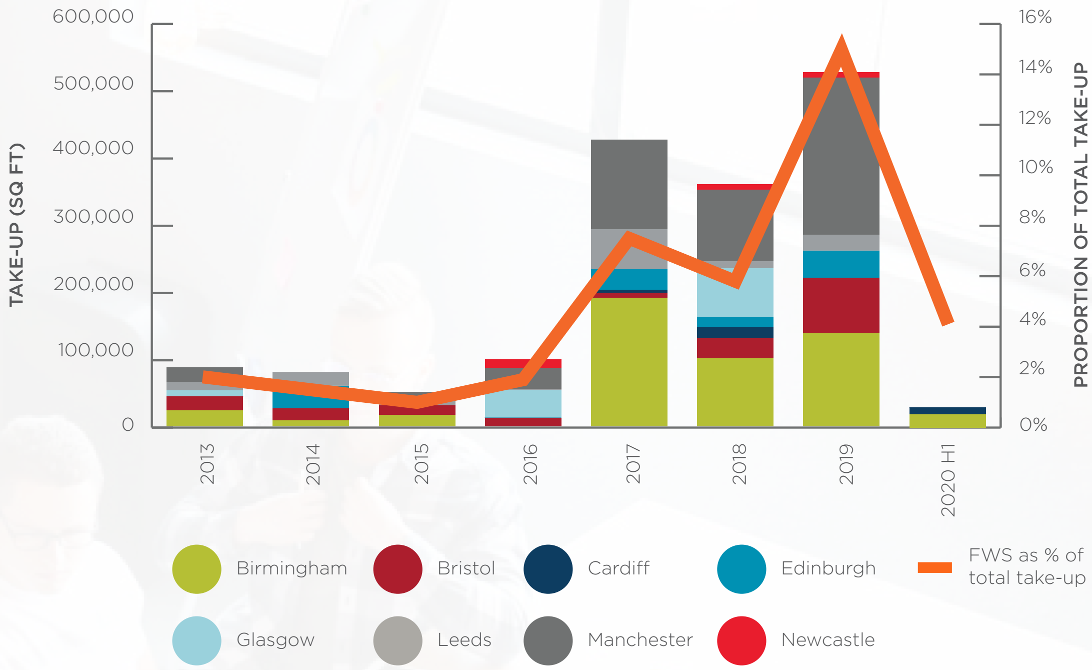


Source: Cushman & Wakefield Research

REGIONAL FLEXIBLE WORKSPACE UPDATE

Since our last report in H1 2019, the regional UK offices markets saw continued growth up until the first quarter of 2020, where the COVID-19 pandemic started to impact the UK real estate market. In 2019, nearly 530,000 sq ft was acquired by Flexible Workspace Operators, with Manchester and Birmingham cementing their status as the two most established UK Flexible Workspace markets outside of London.

FIGURE 6: REGIONAL UK FLEXIBLE WORKSPACE MARKET TAKE-UP



Source: Cushman & Wakefield Research

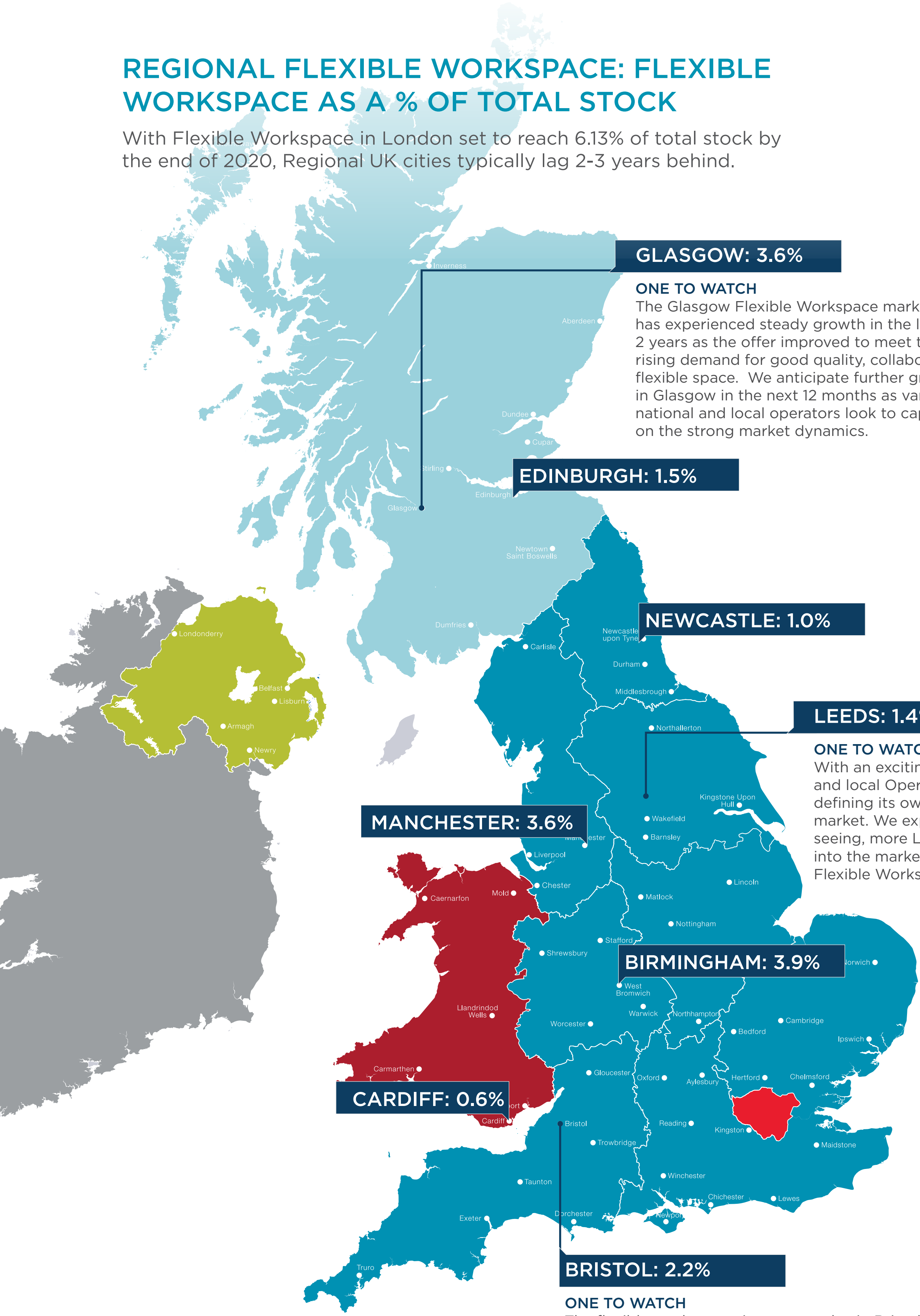
Take-up from Flexible Workspace Operators accounted for 15% of total regional office take-up in 2019, compared to just 6% in 2018. So far in 2020, activity has been significantly impacted by the ongoing pandemic, and take-up from Flexible Workspace Operators has reached just under 30,000 sq ft, accounting for 4.2% of total take-up across the "Big Eight" regional cities.

The largest transaction by an Operator since the beginning of 2019, was Space's acquisition at 124 Deansgate in Manchester (122,000 sq ft). Since January 2019, WeWork acquired four regional locations, comprising two in Birmingham, one in Manchester and another in Edinburgh. Most of the smaller regional transactions since January 2019 have been from small Operators. With WeWork reducing their acquisition activity as of Q4 2019, this will have impacted not only the take-up figures by Operators for the regions, but also potentially the shape of the markets in what would have been target regional cities for WeWork.

When WeWork entered Manchester and Birmingham, it's growth trajectory was steep, acquiring several sizeable buildings in a matter of months. On the coattails of their expansion, a host of smaller Operators entered the regional markets with WeWork providing the catalyst the markets needed to grow. However, this will evidently not be seen moving forward. Instead, there are real opportunities to take learnings from other cities and markets, and expand on their own terms. In Leeds and Bristol, we are already seeing some exciting new Operators and Landlord operated Flexible Workspace centres open in markets unaffected directly by the 'WeWork Effect'.

REGIONAL FLEXIBLE WORKSPACE: FLEXIBLE WORKSPACE AS A % OF TOTAL STOCK

With Flexible Workspace in London set to reach 6.13% of total stock by the end of 2020, Regional UK cities typically lag 2-3 years behind.



GLASGOW: 3.6%

ONE TO WATCH

The Glasgow Flexible Workspace market has experienced steady growth in the last 2 years as the offer improved to meet the rising demand for good quality, collaborative, flexible space. We anticipate further growth in Glasgow in the next 12 months as various national and local operators look to capitalise on the strong market dynamics.

LEEDS: 1.4%

ONE TO WATCH

With an exciting mix of national and local Operators, Leeds is defining its own Flexible Workspace market. We expect, and are already seeing, more Landlords dip a toe into the market and operate their own Flexible Workspace.

BRISTOL: 2.2%

ONE TO WATCH

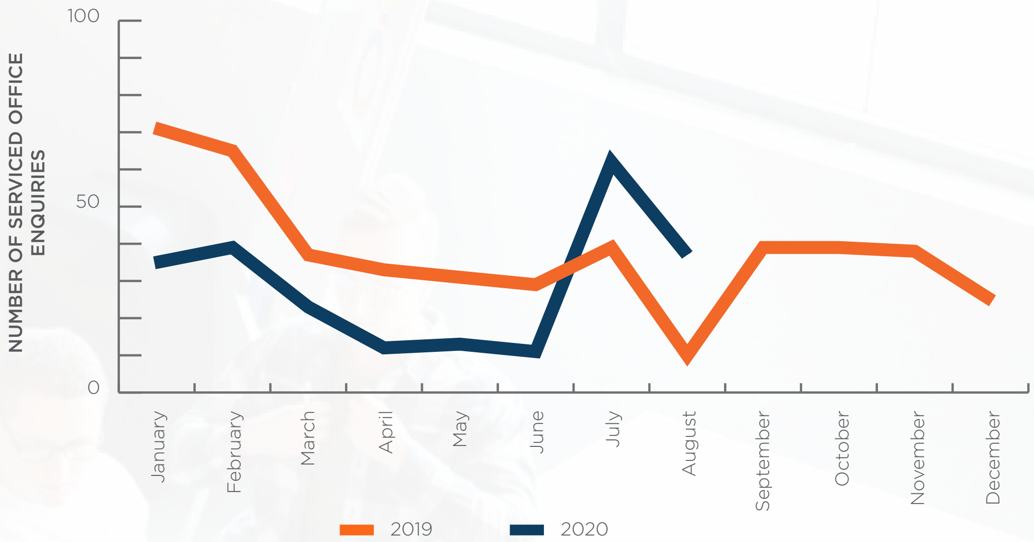
The flexible market continues to evolve in Bristol, particularly post COVID-19. We are starting to see increased demand from Operators seeking to implement managed solutions across the city, as well as increased appetite from Operators to pick up second hand tenant space, as Occupiers look to increase the flexibility in their real estate.

Source: Cushman & Wakefield Research; CoStar

C&W SERVICED OFFICE ADVISORY

Typically, when considering the profile of Flexible Workspace enquiries over the year, there are some clear markers for us. January sees a renewed sense of purpose for many businesses, and similarly to joining gyms and starting the year with a fresh routine, enquiries start off high in January. Then inevitably, as is seen in many sectors, enquiries and transactions naturally dip in August, with summer holidays happening across the UK and Europe. With schools back in September, enquiries pick back up before tailing off prior to Christmas as businesses focus on reaching their year-end targets. This can clearly be seen in our 2019 figures in Figure 7.

FIGURE 7: C&W SERVICED OFFICE ADVISORY ENQUIRIES 2019-2020 YTD



Source: Cushman & Wakefield Serviced Office Advisory

2020's profile unsurprisingly looks slightly different. There has been a 50% - 70% rise in enquiry levels across the Operator community towards the end of Q2. We reported a 12.5% enquiry increase within Q3 when compared to 2019.

INITIAL RESPONSE TO COVID-19 FROM STAKEHOLDERS

When the pandemic hit the UK in March 2020, key industry stakeholders responded in different ways, leading to a slightly different after effect than seen in previous crises. We look at the ways in which Members, Operators and Landlords reacted in the early days and months of the pandemic.

1 FLEXIBLE MEMBERS IN MARCH 2020

Switch to Working From Home Reduced Day-to-Day Utilisation. Day-to-day utilisation of desks plummeted in both flexible and traditional office space as people were encouraged to work from home where possible to curb the spread of the virus. This is different however to contractual occupancy. To date utilisation has dropped to c. 10% of pre COVID-19 levels, and has been increasing steadily with a jump in September, whereas contractual occupancy has not dropped anywhere near this much.

Cancelled Membership Agreements. Depending on the nature of the business sector and licence agreement terms, some Members capitalised on the advertised flexibility and cancelled their contracts in order to control cashflow and reduce liabilities. In some cases, Members withheld licence payments to keep their cash flow under control.

Reflected on their Office Requirements. Some touted this pandemic as being the end of the office as we know it, many businesses started to consider their office needs in the medium-long term. With employees successfully working remotely – was there even a need for an office at all or could this significant overhead be discarded completely? However, as lockdown continued, and people began tiring from the cons of remote working, businesses began considering the evolution of their office needs rather than mourning its death.

2 FLEXIBLE OPERATORS IN MARCH 2020

Contractual Occupancy Dropped. Whilst the day-to-day utilisation of the space by Members dropped significantly (c.10% of pre COVID-19 levels above), contractual occupancy also took a hit but nowhere near as significantly. Unlike previous recessions where flexible demand has typically remained high, Operators started to see occupancy drop as some Members began to cancel their licence agreements. For many Operators, a break-even scenario hovers around 65%-75% contractual occupancy. The extent to which this contractual occupancy changed during the early months of the crisis was dependent on each Operator, with some reporting little change and others seeing immediate and more substantial drops. Even within some Operator's portfolios, some buildings have fared better than others. The severity of the drop was dependent on each Operator's membership structure and business model, with those who have a larger proportion of enterprise clients faring considerably better than those with a heavy start-up focus.

New customer leads 'dropped off a cliff'. With people encouraged to work from home where possible, new Flexible Workspace enquiries disappeared across all channels. Instant Offices reported that whilst 91% of Operators still received lead flow in some form during the peak of the crisis, for some it dropped to 10% of pre COVID-19 levels after lockdown was announced. There has been a 50% - 70% rise in enquiry levels across the sector towards the end of Q2 resulting in both physical and virtual tours being booked.

To Pay or Not to Pay - that was the question? Some operators, like other tenants in other market sectors, chose to withhold rent payments to preserve their cashflow. This approach is not representative of the whole sector and was adopted by only a few. The most well known and one of the longest standing incumbents, IWG, is threatening to take more drastic action across their extensive portfolio in the UK, having already filed for bankruptcy across many assets in the US.

Staff go on Furlough. Some of the largest, and most well known market Operators such as such as Convene, Knotel and WeWork chose to furlough staff.

Open or Closed? Operators made a choice between keeping centres open on skeleton staffing and closing centres altogether. Only 30% of centres closed in the short term as a result of COVID-19 (Instant Offices, 2020). Where centres stayed open, Operators were able to continue charging membership fees although implemented far more stringent cleaning routines.

Stabilise Cashflow or Pursue Take Over Opportunities. In the early months of lockdown, Operators, like most businesses, looked to stabilise their operation and cut costs to ensure the continued viability of their business. For many, this meant pausing expansion to focus on existing sites. Others however, began to actively market their ability to take on or take over new and existing operations where competitors may be failing.

Preparing for the Return to Work. Operators started to consider how to encourage and enable Members to return to their centres. The 6ft Office was adapted to the Flexible Workspace sector, with every Operator adopting a bespoke set of rules and regulations to ensure safety within their centres.

REGUS GOES TO WAR WITH LANDLORDS

IWG, run by Mark Dixon, is set to put Jersey-based subsidiary Regus plc into insolvency in a matter of days, dissolving £790m of lease guarantees across 500 centres. Doing so would be hugely controversial.

Source: The Times, September 2020

3 LANDLORDS IN MARCH 2020

Rent Free or Re-Gear. Some Landlords were approached by Operators for several reasons, primarily though to request rent concessions and for some a restructuring of existing leases to management agreements.

Transparency proves most valuable tool for survival. Open dialogue and transparency between Operator and Landlord has been the key to survival in the current market. Now more than ever, Landlords who have a partnership with their Operators have been better able to have open conversations about rental obligations and work together towards a solution.

Threat or Opportunity? Landlords have started to explore their options for taking over Flexible Workspace where Operators were looking to dispose of space and began reconsidering the place of Flexible Workspace in their portfolios in the longer term. Many have seen this as an opportunity to take control of Flexible Workspace within their estate and either bring in a preferred Operator or look to self-deliver.

'We have proactively implemented the 6ft Flex Office in our Flexible Workspace – Adapt by Arlington in Uxbridge. Not only does the 6ft office ensure the health and safety of both our members and staff, but it also engenders trust in us as a workspace and office provider and demonstrates our commitment to delivering industry best practice in our buildings. We strongly believe the role of the office will evolve and flexibility will be key to giving people the confidence to return to work'.

Daniel Pagella,
Commercial Director,
Arlington

MEDIUM TERM HORIZON (2021)

Immediate reactions from Flexible Workspace stakeholders were not dissimilar to other real estate sectors and the market data across the board showed a sharp drop in activity in H1 2020 when compared to 2019. However, as we realise this pandemic will not be short lived rather something we must learn to live and work with, this will inevitably change thinking in the medium term as businesses adjust to a ‘new normal’.

With the UK economy officially entering a recession in August 2020, we set our sights on the next 12-15 months for the sector and its stakeholders. We take a look back at how Flexible Workspace has performed in the wake of previous recessions so that we can start to anticipate how the sector will react in the medium term and where we might see possible growth.

What happens to Flexible Workspace in a crisis?

Flexible Workspace in some form is no stranger to a downturn – in fact, the sector has technically been through four since the first version of serviced offices opened in 1962 (see Flexible Workspace Timeline). However, unlike previous recessions, Flexible Workspace has never been such a significant landmark on the real estate landscape nor been under so much scrutiny.

During the GFC, Regus was the only one of the major Operators who exist today with any scale and were around at the time and can serve as an example from which to learn.

Reflecting back on the GFC, evidently the UK economy has learnt some lessons, reacting in a matter of days not years to curb longer term impacts. The current recession is unique, but we can still use lessons learnt from the GFC to predict Flexible Workspace’s response to a crisis.

THE DOTCOM BUBBLE AND THE GFC - WHAT HAPPENED TO FLEX?

The Flexible Workspace sector, or at least Regus, showed signs of distress immediately after the bursting of the dotcom bubble in 2001. Regus had acquired a number of leases at the peak of the market, and when the bubble burst struggled to pay rent, ultimately filing for Chapter 11 bankruptcy in the USA in 2003. This highlighted the pressure that the rental arbitrage model can face in a downturn if growth is pursued without regard for the fundamentals of the business model – a high fixed cost base restricts an Operator’s ability to survive. Regus however continued and lived to survive another crisis in 2008.

During the 2008 financial downturn, when headline rents on traditional offices declined, occupancy in Flexible Workspace centres tended to remain high due to the growth of start-ups and entrepreneurs. In order to maintain the high occupancy however, desk rates reduced to a level whereby only Operators with a robust business model could retain their required margins.

In any recession, managing risk and cost is key for all businesses. In the wake of the GFC, businesses of all sizes started questioning costs and closely scrutinised expenditure. Fewer businesses wanted to sign 5 or 10 year leases and then on top of that provide a significant capital sum in order to fit out the space. Companies were looking for agility and flexibility in case of another Lehman Brothers casualty and economic shock. This mentality lead to the rapid rise of Flexible Workspace, and a sector that had been relatively dormant for decades entered its 4th revolution and began to boom.

THE COVID-19 RECESSION - WHAT WILL HAPPEN TO FLEXIBLE WORKSPACE?

Whereas occupancy remained high, and pricing dipped during the previous GFC recession, the current pandemic has driven a slightly differently reaction in the short term. Operators have offered support through deferrals on licence fees, offering the option to downsize offices, discounted renewals and offering lower cost locations as an alternative. The uncertainty of lockdown has meant Operators have had to change strategies when compared to previous recessions.

'As result of COVID-19 real-estate strategy is becoming an increasingly important issue for our Global corporate clients. Many clients are already leveraging flexible space as part of their overall portfolio but the current environment is causing them to evaluate not only what quantum of flexible space they use but also what type of space and for what purpose. In the short-medium term whilst there is still significant uncertainty regarding what the future holds, occupiers are increasingly considering flexible workspace as an interim solution whilst they define their long term strategy'.

James Maddock, Head of Global Occupier Services - EMEA, Cushman & Wakefield

Social distancing and lockdown evidently impacted day-to-day centre utilisation, contractual occupancy and subsequently started negatively affecting Operator cash flow. When trying to work out how pricing might be affected, the general consensus from Operators across the sector is that a price war is seen to be in no one's interest in the long term. However, in order to recover 2020 occupancy and improve cash flow where impacted, Operators began offering short term incentives. With additional rent free and up to 50% licence fee reductions for new Members taking up occupation in 2020, it's an occupier's market for price and space solutions.

In addition to attracting new or returning Members back to their centres, Operators have also supported the businesses who chose to stay. Operators with strong Member relationships have fared well, and have offered support through deferrals on licence

The short-term reactions were an inevitability given the circumstances. In the medium term, this is where we start to see the resilience of the Flexible Workspace sector and perhaps the effect that COVID-19 might have longer term. As we learn to adapt and live with the virus, it is likely that previous recessionary responses will be exaggerated; growth of entrepreneurs and new businesses, and flexibility for occupiers over their liabilities such as rent, unwillingness to spend CAPEX and need for social interaction outside of the home. As we have seen in the short term, sector stakeholders are likely to adopt different strategies in the medium term as the recession hits and we move into 2021.

Occupiers - how will they react?

The Flexible Workspace sector continually battles the preconception that it is solely used by freelancers and SME's. The growth in use of Flexible Workspace by larger corporates in enterprise deals has changed the make-up of memberships in the sector and the associated risk profile. All companies, big and small, are now entering into a period of consultation and reflection to identify their future office needs and identify how they want to work moving forwards.

Not only has the pandemic forced us to consider the way in which we want to work longer term, but there are some other drivers for companies needing Flexible Workspace in the short-medium term. These drivers include:

- Slipped completion dates on development schemes therefore delaying office moves;
- Requirement for more space in the short to medium term to accommodate social distancing.
- Delayed decision making or desire by companies to commit to long term liabilities in current climate;
- Tight business cash flows force Occupiers to look at alternative routes to acquiring space, namely where high upfront CAPEX can instead be converted into monthly costs;
- The start of a shift by companies looking to new geographic locations to fundamentally change the way in which they distribute their workforce.

In addition to the above driving Occupiers into Flexible Workspace and increasing demand, we are also starting to see some Occupiers downsize and look to find new tenants for their excess space.

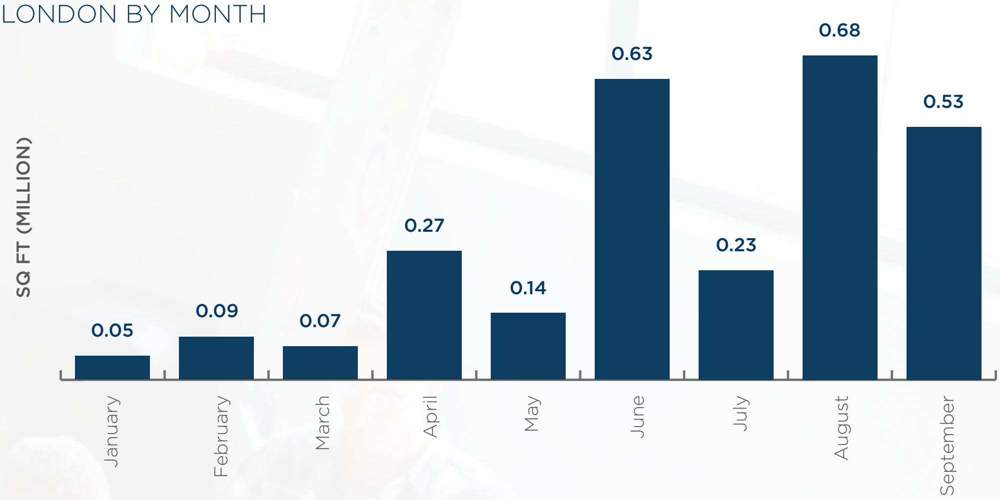
'Occupiers were already demanding increased flexibility within their real estate portfolios, and the impact of COVID-19 will certainly accelerate this trend. We see that a core and flex approach will become more standardised, enabling businesses to increase and decrease space during the course of a lease as business drivers evolve. A number of large corporates already had a presence within the flex sector to accommodate their needs, and the flexibility offered by that sector will increase the attractiveness of that proposition going forwards'.

James Meikle,
International Partner,
Head of Occupier Representation London Markets, Cushman & Wakefield

Tenant-Released Space: A Challenge for the Flexible Workspace Market?

The COVID-19 pandemic has impacted both the number and volume of leasing transactions that are being signed, as occupiers delay decision-making until there is more clarity on the immediate future. This lack of take-up, combined with the delivery of newly built or comprehensively refurbished space, has compounded the increase in supply levels across Central London, with 14.3 million sq ft available at the end of Q2 2020, equating to a vacancy rate of 5.12%.

FIGURE 8: ADDITION OF TENANT-CONTROLLED SPACE IN CENTRAL LONDON BY MONTH



Source: Cushman & Wakefield Research

There has also been an increase in the level of tenant-released space that is available on the market, particularly since the UK lockdown started. Of the 14.3 million sq ft, 1.73 million sq ft of tenant-released space was marketed between April and August 2020, bringing the total volume available to 4.66 million sq ft, across 237 units.

This means that tenant-released space accounts for 31% of total supply, compared to the five-year average of 27%. Early indications are that unless there is a significant increase in letting activity, supply levels are likely to continue to trend upwards until the end of 2020.

So, What Does this Mean for the Flexible Workspace Market?

On face value, there is an argument to say that nothing changes in the short term. Operators have been under the same COVID-19 related pressure as traditional Landlords and will be working hard to attract new tenants as the economy starts to re-open.

However, there is a growing trend where tenants are releasing high quality, often fitted-out space, some of which has never been occupied. 11% of the tenant-released space currently being tracked is newly built or comprehensively refurbished space, with occupiers releasing space that they had originally acquired as part of a pre-let. This space is often available at a discount to traditional Landlord space, but, and probably more importantly, is often available with greater flexibility in terms of the length of commitment.

The increase in the volume and variety of tenant space available on the market means that occupiers have greater choice, which could mean that certain Operators will be competing with both traditional Landlords as well as high-quality tenant space.

There is, however, the potential for the increase in tenant space to serve as a positive for Flexible Workspace Operators. There may well be opportunities for Operators to acquire some of the tenant-released space at a discount to market rents. The likes of Knotel, Frameworks and Penine Way have all acquired tenant space so far in 2020, and this trend could well continue as Operators search for cost-effective space.

Operators

Following a stabilisation of their existing operation, Operators will be looking to new opportunities. We asked five Operators for their views on the next 12 months for the Flexible Workspace sector.

"The way people think about the office has become broader and more democratised. Future-facing companies are now looking for places to house their business while also giving their employees the ability to work both professionally and flexibly in many locations across the city. However, each company, and each individual, is different and has different needs. As always, we are working hard to make sure we understand these needs so that we can create the best possible work space solutions as ways of working continue to evolve, ensuring these businesses and their people thrive."

Charlie Green, co-CEO and co-Founder at TOG

"IWG have experienced a surge in interest in flexible space outside the big cities, as well as in its homeworking packages, which include furniture rental, insurance, telecoms lines, video conferencing, stationery and repairs.

A gradual shift towards the hub-and-spoke model – where companies have their headquarters in a big city such as London or Birmingham and smaller satellite offices in the regions – was under way prior to the crisis, but the pandemic has given this a big push. Since the pandemic, overall demand in the M25 commuter belt, for example, has grown by approx. 45%. We expect this trend to continue and accelerate into 2021."

IWG

"In an uncertain time the need to be agile and react quickly is only ever going to increase, especially once we start to see a little more normality and consistency in the world. Flexibility as a word is extremely broad; whether it be the ability to contract, expand, change the furniture or layout. Regardless of where you hang your hat; flexibility within the wider scope of a company's workspace is going to be at the forefront of every C-suites focus going forward. "

Knotel

"Whilst LABS has enjoyed strong performance throughout 2019 and into 2020 the impacts of COVID-19 cannot be underestimated within our business. We have seen a number of businesses, mainly smaller SME type businesses, depart from our premises as they have mobilised work from home strategies. That said we are now seeing increasing demand for our flexible workspace with lead flow and viewings on the increase. Likewise, we are now witnessing the return to work of many businesses and indeed new transactions are happening at a regular pace. We know the market will remain challenging, but we feel optimistic about the prospects for flexible workspaces and LABS over the coming months and years. Our anticipation is that companies will seek a balance between home working and office working which we believe will result in increased demand from enterprise clients and corporates who are seeking flexibility within their real estate strategy."

Matt Watts, CRO, LABS

"The impact of the recent pandemic has definitely opened doors in the regions – with "hub and spoke" models becoming a considered approach for businesses with demand for people to be closer to home. Secondary cities were already in demand pre-covid and our belief is the Flex market will continue to grow post vaccine in a similar way, albeit I fully expect there to be a "survival of the fittest" scenario as some operators drop out of the market due to their incompatible operating models and high debt/high liability lease contracts with Landlords."

Zachary Douglas, CEO, Orega

SPOTLIGHT: MANAGED WORKSPACE

Under the Flexible Workspace banner, different products (i.e. coworking) sit on a spectrum, with each product offering varying degrees of flexibility and autonomy.

Managed Offices are one step farther along this spectrum than coworking and serviced offices and are more akin to taking a traditional lease, although provide comparatively greater flexibility. Crucially however, these spaces are offered fully fitted (reducing/eliminating any up-front Capex investment) and with a range of added value services such as utilities, IT and cleaning included in the monthly fee.

In the medium term, we explore why Managed Offices could be a potential growth area in the Flexible Workspace sector.

MAXIMUM FLEXIBILITY
Services provided by Operator

MINIMUM FLEXIBILITY
Services provided by Occupier

What's the difference?

	COWORKING AND SERVICED OFFICES	MANAGED OFFICES	TRADITIONAL LEASE
TERM	Licence terms available from as little as 1 month. Coworking desks can be as little as one hour.	Flexible terms either on short form lease or licence often 1 -4 years depending on market.	Typically on market terms with a 5-10 year lease.
PRICE	Typically priced per workstation per month.	Priced on a single monthly fee, typically including service charge, business rates & utilities amongst all other agreed costs.	Priced on a £ per sq ft basis with additional costs for service charge, business rates & utilities.
SPEED	Depending on size of requirement, move in can be as quick as 24 hours. Coworking can be on a walk-in basis.	Move in can be done quickly in 6-8 weeks.	Long lead time before occupation to finalise legals and agree Heads of Terms.
DESIGN	Design of space is pre-determined by Operator with no capital investment required.	Design & fit-out of space organised by managed space operator and cost wrapped into monthly fee.	Occupier responsible for sourcing contractor to fit out space as well as investing a significant capital sum upfront for fit-out.
BRANDING	No 'hard' branding options available as space is homogenous and one of several standard spaces in a centre.	Branding can be tailored to the occupier, often through different 'packages' then factored into monthly fee.	Branding & identity of space bespoke to the Occupier.
SERVICES	Included in monthly desk rate dependent on level of membership.	Able to pick & choose which services to wrap into monthly fee and provided by the Operator	Responsible for sourcing services required and additional cost for Occupier.
DILAPIDATIONS	No dilapidations liability, but there can be a charge for redecoration.	Dilapidations liability included in monthly fee.	Responsible for dilapidations at end of lease.
FLEXIBILITY	Ultimate flexibility subject to availability of space within each centre or network of centres.	Many Managed Operators offer the ability to flex space if headcount grows during term.	Fixed quantum of space for duration of lease term.

HOW WILL THIS GROW AS AN OFFER IN THE MEDIUM TERM?

Managed Offices encapsulate so many of the demands we are seeing from Occupiers – it is significantly more than just shorter more flexible lease terms. The modern Occupier is looking for more than just four walls for their employees to work in. COVID-19 has further shortened the horizons to which businesses look when planning their office needs, and has exacerbated the need to ensure the office is more than just a physical place but a collaborative space where people can connect and focus on their core business.

In the same way companies outsource IT Support to experts, or hotels outsource cleaning or laundry to dedicated specialists, so too are businesses outsourcing their office requirements to specialist Operators.

Furthermore, given the ease and autonomy for the Occupier of the Managed Office solution, coupled with the low upfront capital required to acquire and occupy space, we see the Managed Office market as a key area of growth in a post COVID-19 world. As businesses seek to preserve cash, opportunities where fit-out can be depreciated over the term of the agreement and paid in monthly installments becomes more attractive as an offer.

WHO ARE THE OPERATORS?

In the Flexible Workspace sector, the 'hybrid' model comprising coworking desks, dedicated desks and serviced offices, has been the dominant form adopted most Operators globally including the sector incumbent, IWG, for years.

Managed Operators are far less prevalent and renowned in the market. The most well-known is perhaps Knotel, who grew out of the United States and are frequently touted as a competitor to WeWork albeit they offer at their core, very different products. Looking more broadly at this part of the sector, there are three principle categories of Managed Operators and below we highlight some of the key ones:

PURE MANAGED OPERATOR

These are Operators solely dedicated to offering a Managed Office solution from the start. We are now starting to see new market entrants.

COWORKING OPERATOR - PRODUCT EXTENSION

Many Operators have branched out from just offering the hybrid solution, and have used their platform to provide a Managed Office solution. This solution has grown organically from existing Member demand who want to progress into a space of their own.

LANDLORD OPERATOR

Landlords are now looking at how they can provide a flexible solution in their portfolio, with the proximity to traditional leases making Managed solutions an attractive entry route for many.

'We believe that Managed Solution will grow in demand. The attraction of this product with a simple monthly cost, no initial capital outlay and extra services being managed for customers is starting to become even more attractive. Deals with HPE, Channel 4, JLR amongst others in 2019 is testimony to this.'

Andrew Butterworth,
Commercial Director, Bruntwood

LONG TERM HORIZON (2022+)

Once we have established a new normal in 2021, how will this affect Flexible Workspace longer term? There are some key areas we anticipate the sector evolving in order to play a part in the future of work beyond 2022.

1 The office isn't dead … it's just different

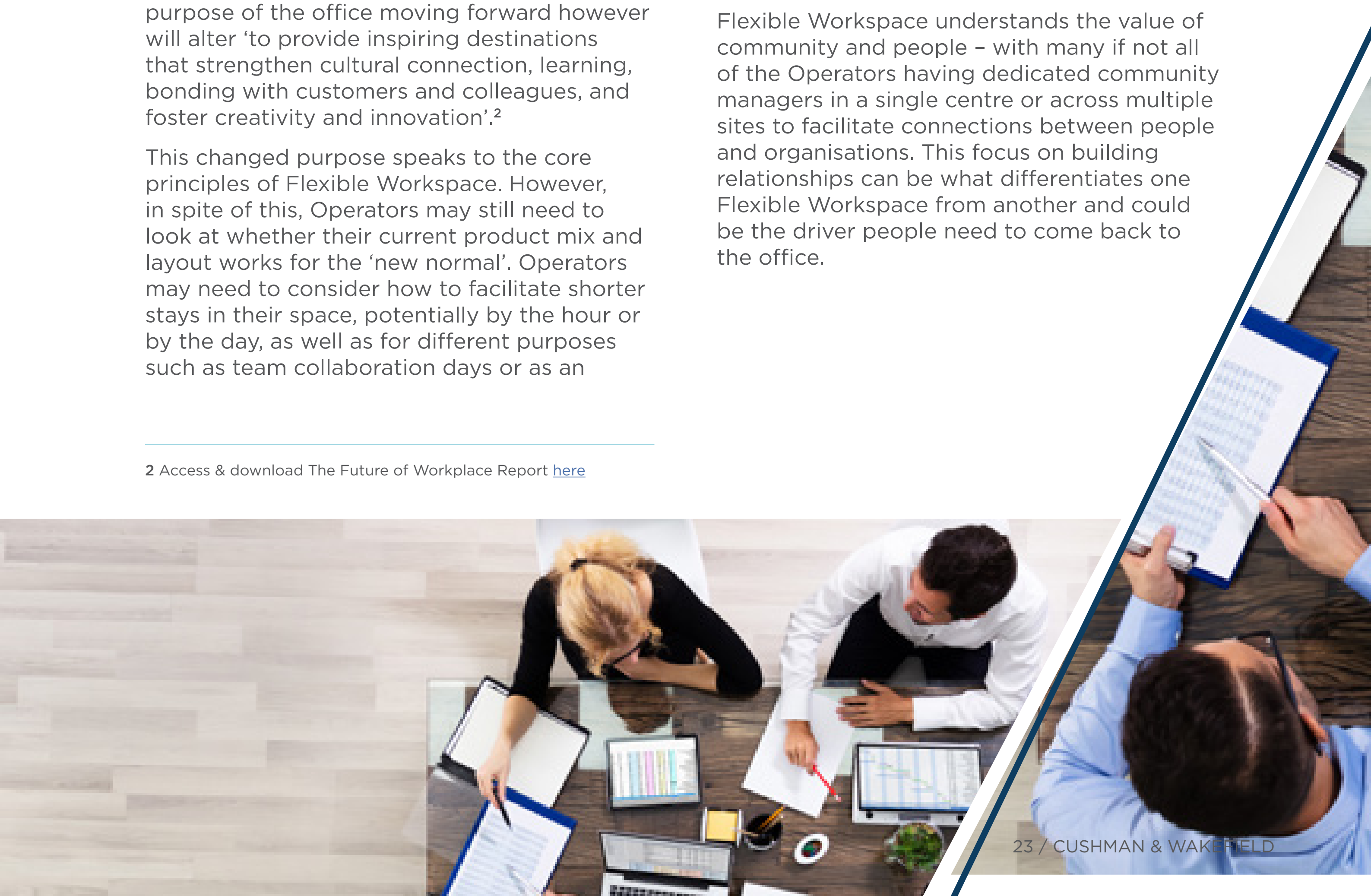
The office and what it stands for still has value, and despite what some might say it isn't going anywhere.

The pandemic has forced the rapid adoption of a completely new way of working, and for the sake of people's jobs and business survival, the workforce has adapted. The purpose of the office moving forward however will alter 'to provide inspiring destinations that strengthen cultural connection, learning, bonding with customers and colleagues, and foster creativity and innovation'.[2]

This changed purpose speaks to the core principles of Flexible Workspace. However, in spite of this, Operators may still need to look at whether their current product mix and layout works for the 'new normal'. Operators may need to consider how to facilitate shorter stays in their space, potentially by the hour or by the day, as well as for different purposes such as team collaboration days or as an escape from working from home. When WeWork disrupted the traditional market, it did so by building a space and community that people wanted to be a part of. They transformed the concept of office space from functional to fun. With C&W's offices having been open since it was safe to do so, it became clear why we still need the office. Video call fatigue and the absence of spontaneous interactions with your own and other teams meant coming back to the office for just one or two days per week not only mixed up the environment, but also provided invaluable social and cultural exchanges that for many had been missing in remote working lockdown.

Flexible Workspace understands the value of community and people – with many if not all of the Operators having dedicated community managers in a single centre or across multiple sites to facilitate connections between people and organisations. This focus on building relationships can be what differentiates one Flexible Workspace from another and could be the driver people need to come back to the office.

2 Access & download The Future of Workplace Report here



2 Location, Location, Location

C&W's recent Future of Workplace Report[3] highlighted a possible shift to a Total Workplace Ecosystem balancing working from 'the office, home and a network of third places'. This prompts the question whether the current stock of Flexible Workspace is suitably located to fulfil the role of the third place?

Historically, most Operators have focussed on major cities and urban hubs, with proximity/integration into traditional office markets deemed crucial as flexible demand is a function of traditional office demand. Suburban areas tended to see lower demand from prospective Members and therefore deliver lower margins, making them less attractive to the major Operators (other than IWG who have generally pursued a strategy of delivering nationwide coverage).

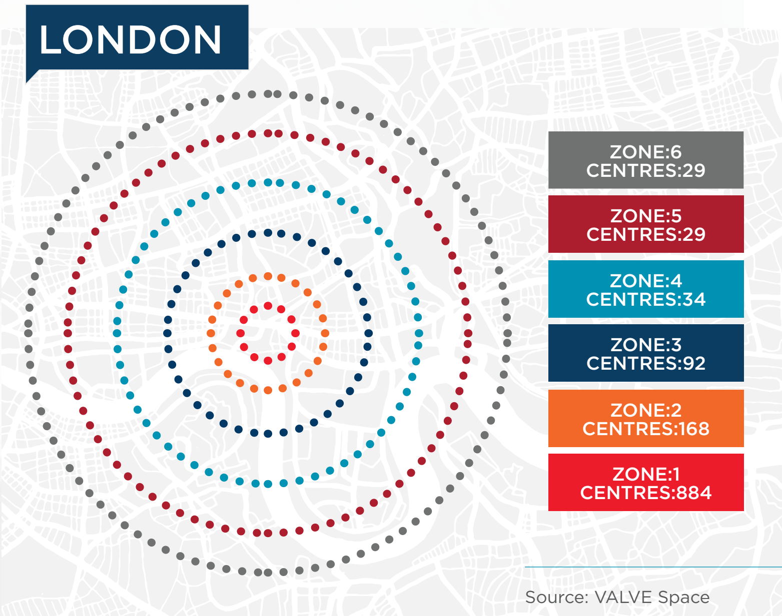
However, as it stands, the Flexible Workspace market is not set up to become the 'third place' in this new ecosystem. Looking at the current distribution of Flexible Workspace stock, density of supply reduces significantly as you move outwards from Zones 1 – 2 in London. In Zone 3 and beyond, there is very little Flexible Workspace provision, with it concentrated in hubs at key commercial centres. This is clearly shown when looking at Flexible Workspace broker platform Valve, and the concentration of their listings for the three biggest Flexible Workspace markets in the UK.

The current listings on Valve clearly show the options prospective Members have when looking for Flexible Workspace. What will be interesting is to monitor this over the next 12 months and see how this distribution changes. There are opportunities for Landlord's with vacant high street retail units, to consider re-purposing these to accommodate the changing workplace distribution. With people working more frequently from home, high street retail could see a new lease of life by becoming the 'third place' in the Total Workplace Ecosystem, offering flexible areas to work close to where people live.

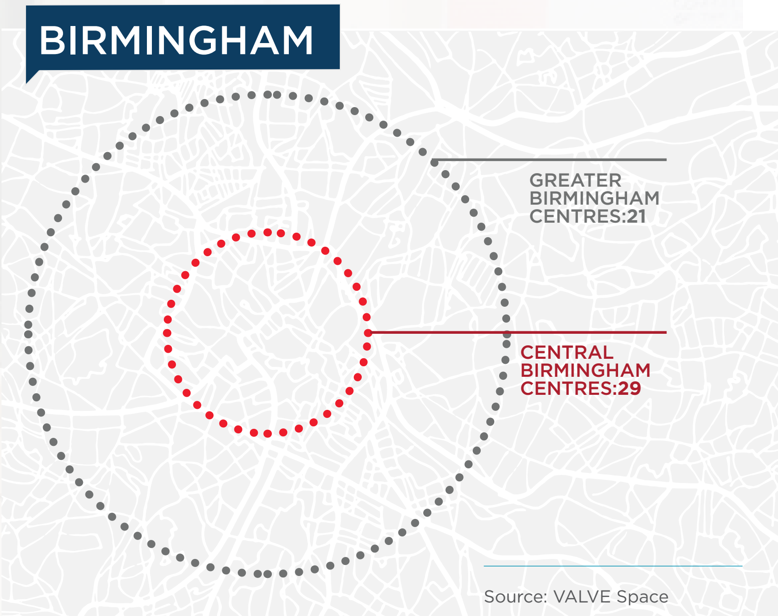
As this pandemic continues and we adapt the way we live, work and play, opportunities exist for both Landlords and Operators to transition their thinking around where the best location is for Flexible Workspace and maximise the latent value that could exist in previously less valuable suburban and non-core city assets.

3 Access & download The Future of Workplace Report here

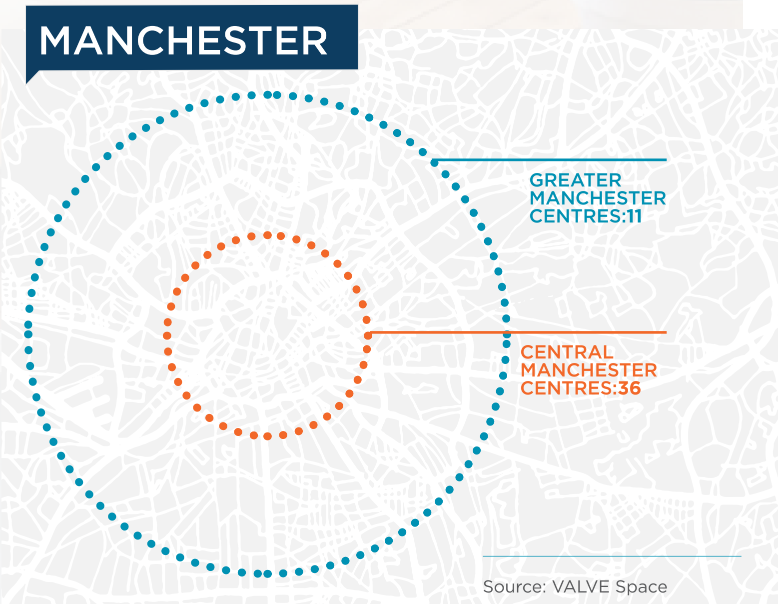
Maps are for illustrative purposes only. VALVE Space data is accurate for geographic zones and represents total number of centres on VALVE Space database.



Source: VALVE Space



Source: VALVE Space



Source: VALVE Space

3 Shift to Management Agreements Away from Traditional Leases

Already a hot topic of discussion over the last 12 months, the transition of the Flexible Workspace model from rental arbitrage to a sharing of risk and reward between Operator and Landlord, has only been accelerated by COVID-19.

Management Agreements have been around in the sector for some time, with Operators such as Orega and Citibase being successful examples of how this model can work. However, when WeWork entered the scene in 2010, their strategy focussed on taking leases with fixed cost bases. As proven in the wake of the dotcom bubble burst when IWG took leases at the peak of the market, this strategy can subsequently lead to Operators struggling to cover a high fixed cost base when a downturn hits.

The focus for many Operators in this crisis has been the retention of Members. As an Operator, being able to share some of the financial difficulties that this crisis has exposed through rent relief or payment plans enables everyone to make their way through the pandemic. For those who own and operate their own Flexible Workspace space either directly or on a management agreement, the ability to offer relief to end Members has been far easier than those with fixed lease obligations.

4 Valuation must keep pace with the evolution of the sector

As the property market becomes more educated about the Flexible Workspace business model, it is beginning to understand the potential upside that added flexibility can generate, not only to cash flow but even capital values.

C&W's recent whitepaper, **'Valuation of Flexible Workspace'** explores the valuation approach and implications that a new model could have on values in the sector. With increasing numbers of both Operators and Landlords moving towards partnership based or owner-operator models we anticipate the need to value and understand the business model being even more crucial for the wider real estate market moving forward.

To this point however, to see an office space as solely a cost that can be reduced, is to undervalue an office completely, flexible or not.

5 Growth, but not for growth's sake

To attempt to predict the % of stock in each market in 5 years or even 12 months' time would be unwise. If, as C&W foresees the office market transitions to a workspace ecosystem, the way in which the entire real estate industry tracks data and groups markets will need to change to accommodate this. With increasing numbers of Landlords entering the sector and delivering their own product, as well as a greater spectrum of products under the Flexible Workspace umbrella, crucially Managed and Cat A+ space, the quantum could easily reach over 20% in the next decade.

With WeWork's previously aggressive expansion strategy across the globe now somewhat curtailed, this may well encourage some competitors to accelerate their own growth strategies. What is clear is that growth by all players, will be more measured.

We also see this as an opportunity for more Landlords and Investors to follow the lead of the likes of Bruntwood (who have done this successfully for several years) and enter the space on their own terms, in order to maintain ownership of the end customer. When faced with four principal entry routes into Flexible Workspace, namely Build, Buy, Partner or Lease (see C&W Report Coworking 2019: The UK Flexible Evolution Continues), the current COVID-19 pandemic makes Build or Partner look more attractive. With some Occupiers delaying decision making, seeking to limit upfront CAPEX expenditure and looking at ways to take space on a flexible basis, it is really in the hands of the Landlords as to how they want to offer this. What COVID-19 has shown us, however, is that getting more involved in flexibility is no longer as scary as it once was, but is in fact a growing necessity for those wanting to compete.

ABOUT CUSHMAN & WAKEFIELD

Cushman & Wakefield (NYSE: CWK) is a leading global real estate services firm that delivers exceptional value for real estate occupiers and owners. Cushman & Wakefield is among the largest real estate services firms with approximately 53,000 employees in 400 offices and 60 countries. In 2019, the firm had revenue of $8.8 billion across core services of property, facilities and project management, leasing, capital markets, valuation and other services. To learn more, visit www.cushmanwakefield.com or follow @CushWake on Twitter.

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