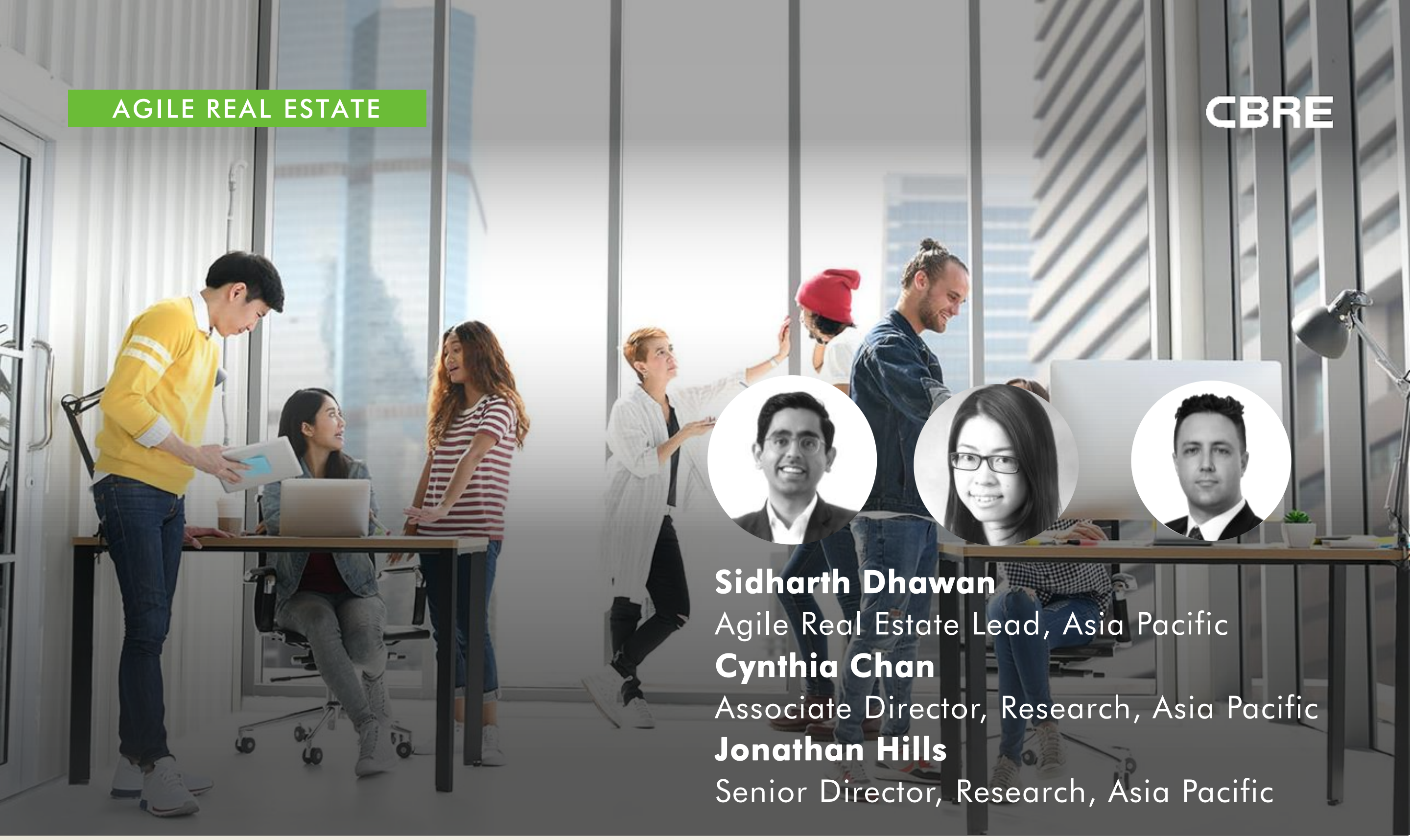
AGILE REAL ESTATE



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Delivering sustainable growth: New approaches for flexible office providers

INTRODUCTION

Flexible space providers including coworking and serviced office operators have undertaken dramatic growth across Asia Pacific in recent years, fueled by growing demand from a broadening base of end-users including start-ups, small and-medium sized enterprises, and large corporates.

CBRE data show that since 2016, flexible space operators have increased their Asia Pacific footprint by more than 300% following aggressive expansion in existing cities and new markets.[1]

As of March 2019, their total office footprint in the region stood at 54 million sq. ft., accounting for more than 3% of overall office supply.[2]

China and India host the largest volume of flexible space, with Shanghai (9 million sq. ft.) and Bangalore (6 million sq. ft.) the largest city markets within each country.

With the sector occupying just 2% of total Grade A office stock in Asia Pacific, there is still considerable room for growth. However, in recent months, CBRE has observed many providers adopting a more measured pace of expansion.

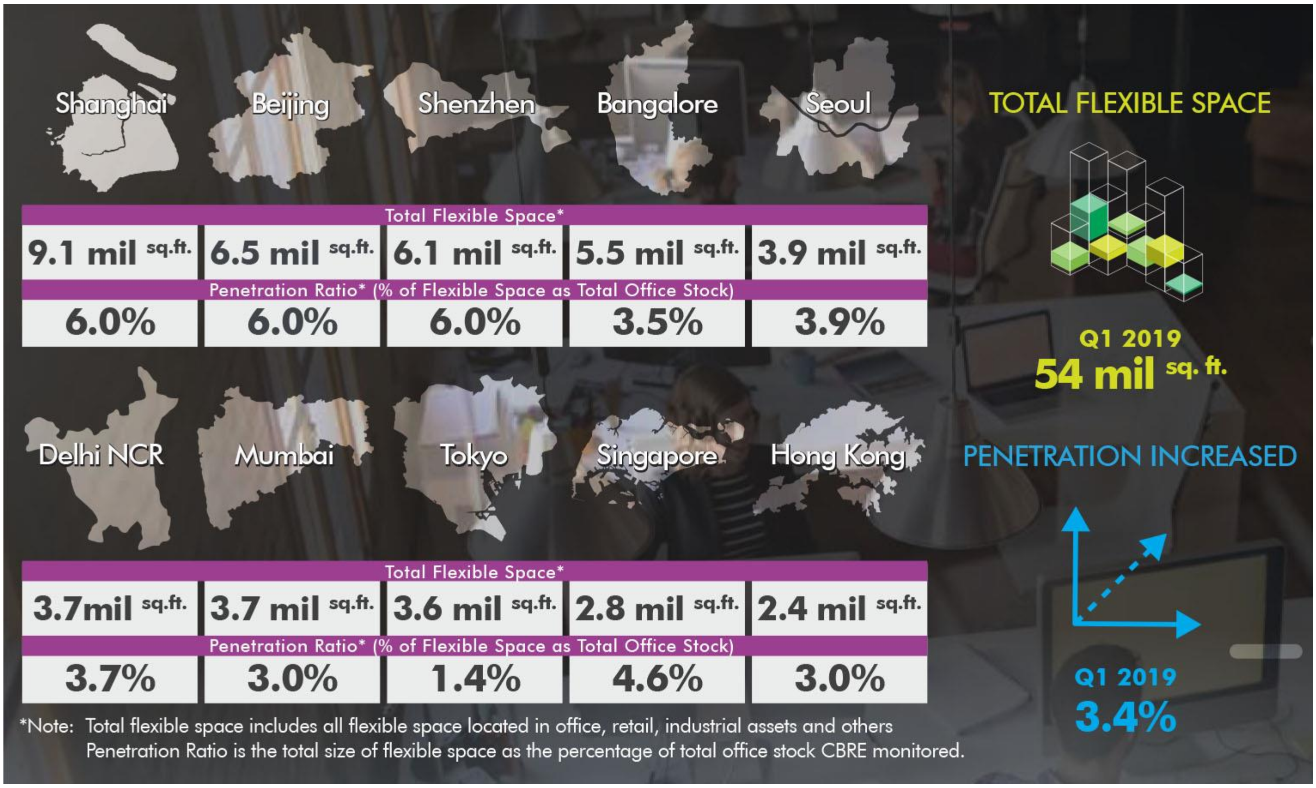
This shift in sentiment comes amid the onset of the late business cycle. As often happens after a period of exponential growth, many flexible space operators have already built critical mass for their service offering.

At the same time, it is becoming somewhat more challenging to achieve high occupancy amid intense competition between a mounting number of providers. Certain operators, especially Chinese-based groups, are also experiencing a funding squeeze.

CBRE believes these factors will drive the implementation of more sophisticated and nuanced strategies designed to improve occupancy and ensure operational profitability, especially on a per centre basis.

[1] Asia Pacific 2019 Real Estate Market Outlook, CBRE Research, January 2019
[2] From Expansion to Efficiency: Coworking Space Operators Redefine Their Strategies in 2019, CBRE Research, May 2019

FIGURE 1: TOP 10 FLEXIBLE SPACE MARKETS IN ASIA PACIFIC



Source: From Expansion to Efficiency: Coworking Space Operators Redefine Their Strategies in 2019, CBRE Research, May 2019

These strategies will include customising enterprise solutions; forming creative partnerships with landlords; targeting specific niche segments; and adopting a more prudent approach towards site selection.

CUSTOMISING ENTERPRISE SOLUTIONS

Large companies in traditional office occupying sectors such as finance and professional services are displaying growing demand for flexible office space such as coworking, serviced offices and turnkey space operated by mainstream landlords and third-party providers.

This trend is being driven by advances in technology, new lease accounting rules, a more mobile workforce and unpredictable economic growth, which have transformed the occupier approach to real estate decision-making and led to a strong focus on portfolio flexibility.[3]

Although many large corporates have been utilising flexible space for some time, there has been a gradual shift in how flexible space operators are approaching enterprise clients, as well as the scope of services being offered to them.

Previously, large occupiers would have been offered memberships or seats in a coworking centre, an arrangement which may have included the right to configure a designated portion of the workspace shared with other companies.

Now, however, flexible space operators are strategically targeting large enterprise clients by customising their product offering and offering a far broader range of solutions ranging from basic membership packages to leasing, fitting-out and operating multiple office floors, all of which typically require less capital input.

Some flexible space operators are even managing and operating coworking spaces created in-house by large multinationals.

With start-ups and SMEs especially vulnerable to sudden shifts in economic conditions and unstable cashflow, flexible space operators are expected to develop further business with large corporate clients, most of which have the financial means to fulfill their obligations for the duration of lease or membership contracts.

At a time when end-of-cycle concerns are growing, these approaches can provide flexible space operators with new and more stable sources of income.

[3] Exploiting the Agile Revolution: Prospects for Landlords and Investors, CBRE Research, October 2018

PARTNERING WITH LANDLORDS

While more flexible space operators are becoming receptive to forming partnerships with commercial property landlords, the coming years may see them more actively seek such opportunities as they look to go asset-light, slash the large upfront CAPEX required to open new centres, and significantly reduce rental overheads.

Although some commercial property owners have entered the flexible space market and now operate their own brands, the time, cost and expertise required to create a standalone platform deters many landlords from doing so.

However, the rapid growth of the flexible space industry has prompted many office landlords to seek greater engagement with their tenants from an agility perspective and become more actively involved in managing their properties.

While most landlords retain asset-specific strategies, many owners are now seeking to provide flexible space as part of a broader amenity offering to tenants, not only by leasing space to flexible space operators, but also by offering fit-out subsidies, entering into revenue sharing agreements and even permitting third-party providers to operate building amenities themselves.

With many large occupiers focusing on reducing underutilised space in their portfolios, demand for space as a service is creating new requirements for managed offices, meeting and event rooms, in addition to the standard amenity offering.

This creates opportunities for flexible space providers to enter into formal partnerships with landlords to operate such space in their portfolios.

While these types of arrangements may offer lower rewards for operators, they can nevertheless provide new revenue streams, access to a wide range of potential future tenants, and a reduced reliance upon the previous asset and capital-intensive approach towards expansion.

TARGETING SPECIFIC NICHE SEGMENTS

CBRE believes there are considerable opportunities for flexible space operators to provide offices and services catering to specific niches, functions and industries.

Examples include Campfire's facility in Wong Chuk Hang, Hong Kong, which specifically serves creative industries including fashion, design and media, by providing photography studios, sound recording rooms and even a catwalk.

Other industry-focused co-working spaces have been designed to host certain units or functions from large corporates.

For example, teams from large financial institutions working on fintech projects are already being housed in specially configured and secured flexible workspaces specifically designed to cater to their working style and enhance their workflow.

Elsewhere, providers such as HelloHERA, which recently opened its first space in Kuala Lumpur, are customising their offering to women's needs and preferences by fitting out offices with smaller scale furnishings and amenities such as child care facilities.

Several flexible space operators have also created high-end business clubs providing members with upscale locations to conduct business meetings and entertain clients.

These include International Workplace Group (IWG), which recently announced plans to open its first space in Asia for its No18 brand in Capitol Singapore.

"*As the flexible workspace market evolves, strategies offering **holistic solutions that go beyond mere space** are becoming important.*

Advances in technology and big data analytics are enabling us to optimize space efficiency and offer community services beneficial to our members"

KONG Wan Sing
Founder & CEO of JustCo

PRUDENT SITE SELECTION

The transition from expansion to efficiency and focus on improving occupancy in existing centres is prompting flexible space operators to adopt a more judicious approach towards the selection of new locations and to lease negotiations for new space.

The selection of new sites is now subject to significantly heavier underwriting and internal review before decisions are approved.

CBRE expects more flexible space operators to consider leasing space in Grade A- and Grade B buildings. Such properties can provide a rental cushion for sustainable operations, rather than the previously favoured Grade A buildings in prime CBD areas.

Site selection will also increasingly utilise creative options including opening centres in underutilised real estate such as shopping malls with high vacancy. Recent examples include The Work Project leasing 24,000 sq. ft. in OUE Downtown Gallery in Singapore and Awfis taking 20,000 sq. ft. in Ambience Mall in Gurgaon in the New Delhi NCR.

Hotel business centres are expected to be another area of focus, with The Great Room occupying 15,000 sq. ft. of space in the recently restored Raffles Hotel Singapore.

CONCLUSION: FROM EXPANSION TO EFFICIENCY

Many flexible space operators continue to expand aggressively in Asia Pacific, especially in emerging Southeast Asia where talent and real estate are cheaper and market penetration is relatively thin, which makes it easier to hit growth targets. Australia also remains a growth market for larger operators.

However, other markets such as China, where expansion has been aggressive and competition remains intense, will see a stronger focus on improving operational performance, rather than opening new centres.

The coming months will see flexible space operators introduce more nuanced strategies, such as those identified in this report, as they transition from expansion to efficiency.

CBRE GLOBAL RESEARCH

This report was prepared by CBRE Asia Pacific Research Team, which forms part of CBRE Global Research – a network of preeminent researchers who collaborate to provide real estate market research and econometric forecasting to real estate investors and occupiers around the globe.

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