RESEARCH

Knight Frank

Co-working

The office of the future?

Co-working
The use of an office or other working environment by people who are self-employed or working for different employers, typically so as to share equipment, ideas and knowledge.

CHANGING PERCEPTION OF THE WORKPLACE

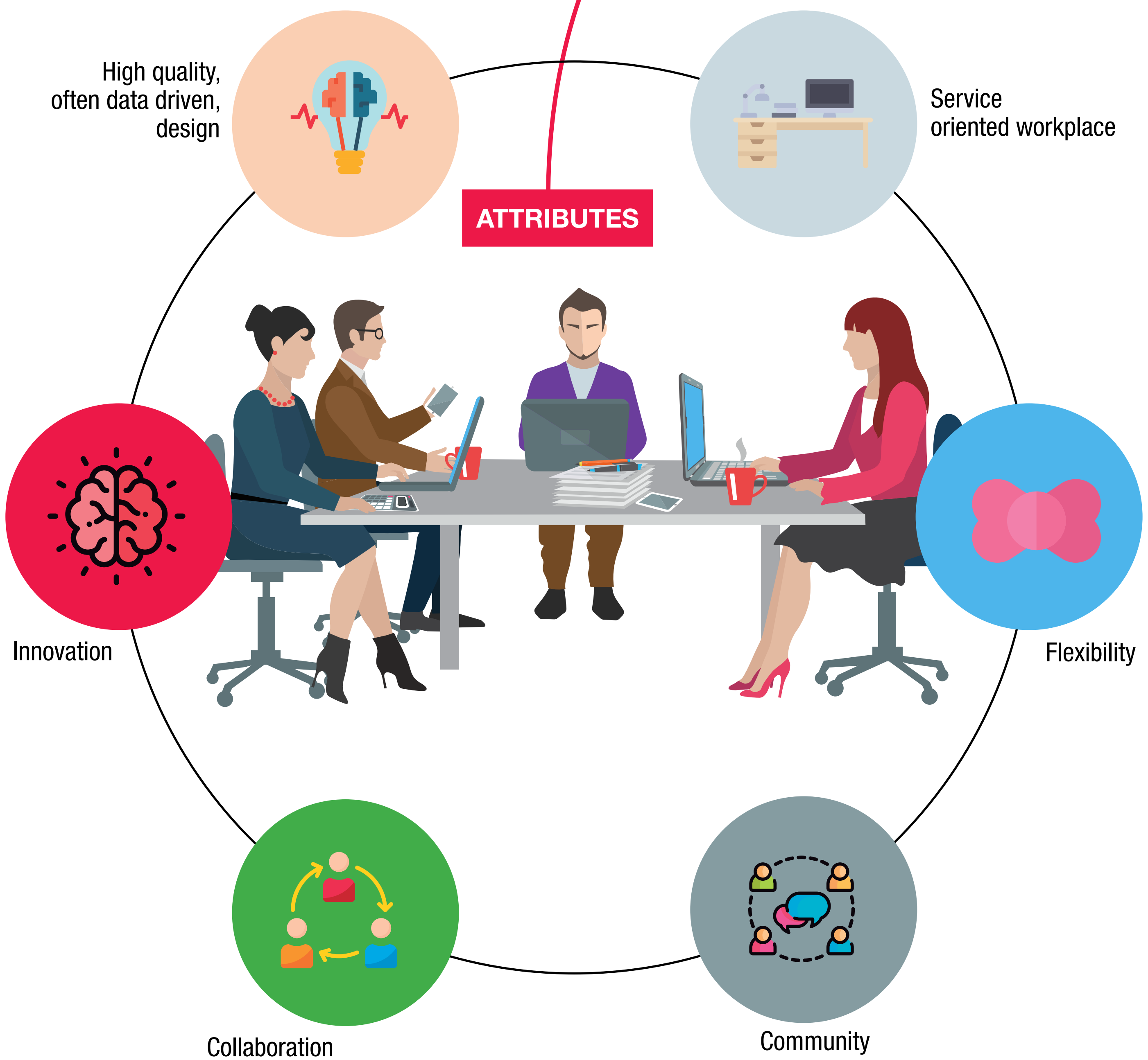
The office space format has come a long way since it was regarded solely as a place of work at a convenient location, with plain desks, chairs and cabins comprising the set up. Over the past few decades we have seen the workplace evolve significantly in terms of space utilization, equipment placement and automation. Over the past decade especially, the role of the work environment in enhancing employee productivity has been acknowledged as office design, amenities and even colour have been observed to have a significant impact on the operational efficiency of the employee.

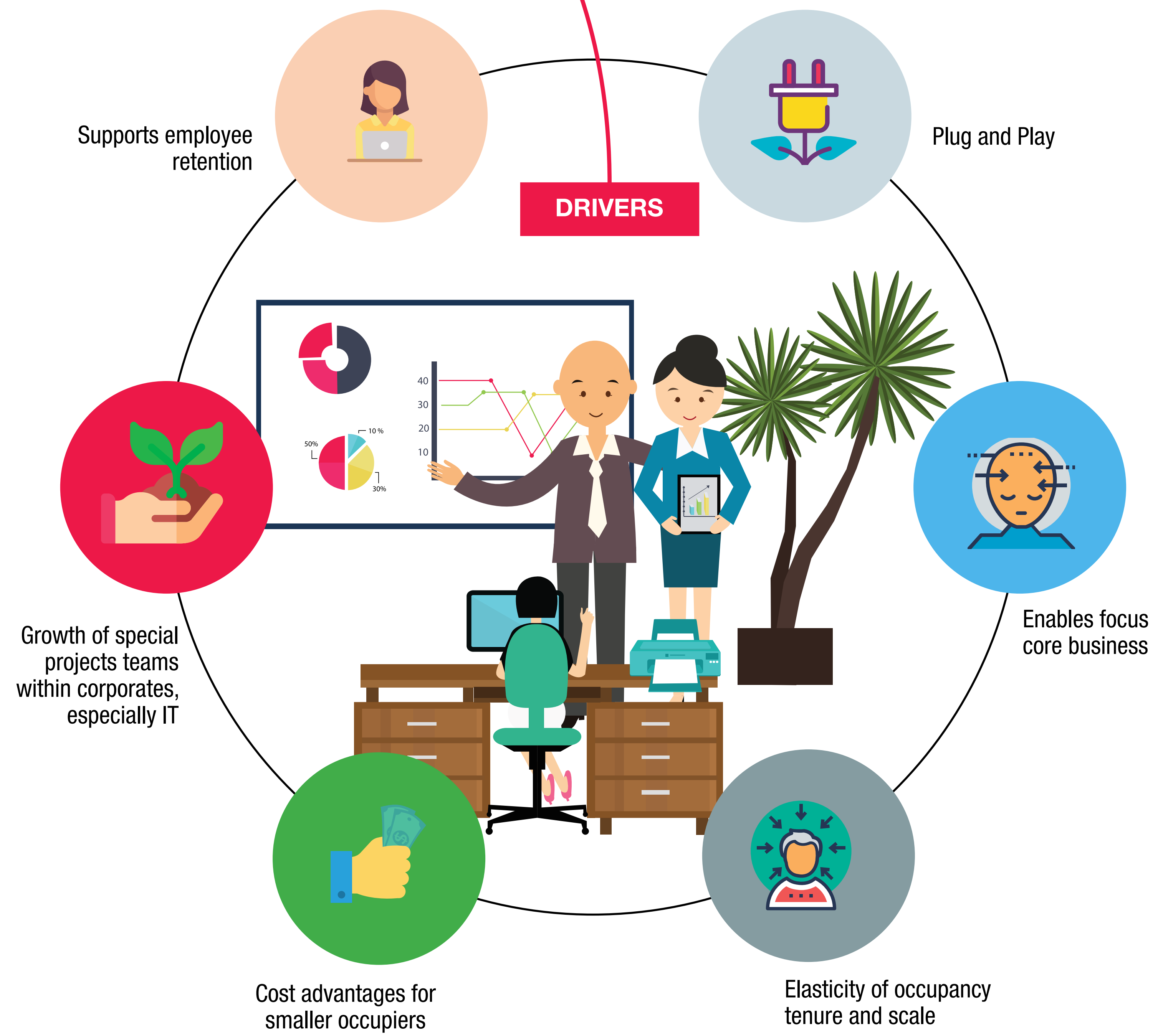
Recent research has also shown that the introduction of natural elements such as fresh air, sunlight, greenery and even natural smells and sounds in a workplace play an important role in reducing the employee's work stress and enhancing his creativity. With newer business avenues opening up, office space design continues to evolve at an incessant pace, covering not only its structural facet but also involving aspects such as amenities and the digitalisation of the office.

It comes as no surprise that with improvements in office space design and development and the varied priorities of the new age employer, a workplace today has ceased to be a single, fixed address in a commercial district. Like most commodities in present times, workplaces, too, have come to be re-defined as space that can be accessed anytime and from anywhere, providing Just-In-Time services enabled by technology.

While this forms one aspect of co-working, the concept of co-working spaces essentially involves groups of individual professionals and small and increasingly large-scale businesses who share workspaces and breakthrough ideas, enhance their business horizons and gain a fresh standpoint on their own businesses by the virtue of sharing workspaces. In an age when business cycles have dramatically reduced and companies need to constantly innovate to survive and remain competitive over the long term, a co-working workplace may provide the environment that fosters fresh thinking and innovation.

HALLMARKS OF A CO-WORKING ENVIRONMENT

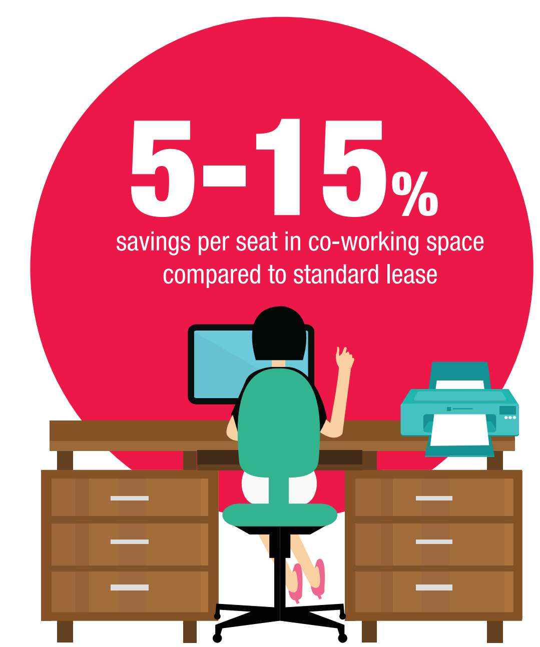




CO-WORKING IN INDIA

India, today, is witnessing a proliferation of start-ups and SMEs, buoyed by the government's concerted efforts to create a sustainable eco-system for entrepreneurs in the country. On their part, the entrepreneurs—a large number of them being millennials—believe in harbouring global aspirations with a staggeringly ambitious mind-set that was not in evidence a few years back. This provides a perfect platform for dynamic co-working business centres to cater to the office space needs of these aggressive growth-seeking start-ups. Besides companies, people such as business nomads, expats or those travelling to the country for a limited period are amongst those preferring to work out of plug-and-play co-working spaces. Another constituent is the growing volume of freelance workers (gig economy) who support corporate entities with specialised outsourced services in the advisory, consulting and designing domain such as recruiting and advertising. It is apparent that corporate supply chains are broadening and lengthening in India today. Till a few years ago, these businesses would have opted to work from coffee shops or so called 3rd spaces. Thus, with the increasing number of new and growing businesses, there is a palpable demand for co-working spaces in metro cities that had hitherto been lying untapped.

There are several benefits of working in a co-working environment. Start-ups are characteristically capital poor and need to keep their cost structure at the bare minimum. Real estate expenses make up approximately 9% - 12% of overall operating costs (can differ from market to market) for an established corporate and could account for more in a start-up. Co-working spaces also enable the typical start-up to bypass the fixed rental cost with the additional capex requirements of fit outs and operational hassles of a traditional office space and opt for the flexibility of a co-working office. This not only allows the new business to occupy a contemporary workplace on a per seat basis but also the flexibility to increase, reduce or to exit the workplace. This is a critical feature in early stage businesses particularly. More importantly, it allows them to focus on their core business rather than non-core operational areas such as real estate. This is also why additional services such as print-room and repo offered within co-working facilities are an attractive proposition



CO-WORKING SWOT ANALYSIS – THE OCCUPIER PERSPECTIVE

S — STRENGTHS

- Ability to scale up / down quickly
- Ease of entry & exit (turn-key solution)
- Exposure to external innovation
- Accommodation of corporate supply chains
- Alternative to corporate mother-ship
- More productive space ?

W — WEAKNESSES

- Expense @ scale
- Disruptive influence of others in the space
- Security challenges
- Dilution of corporate identity
- Customer service standards may slip
- Lack of control over space & service

O — OPPORTUNITIES

- Rise of enterprise model – allows scale
- Greater agility to business change
- Leverage pricing due to depth of provision
- Opportunities for tie-up with provider
- Rapid expansion in new markets
- Managed but effective space

T — THREATS

- Provider failure
- Mainstream market movements reduce benefit
- (OR) lack of mainstream alternatives
- Service failure leads to staff churn
- Exposure to cost inflation (services and space)
- Appeal lessons

Source: Knight Frank Research

The co-working phenomenon is just taking root in India as operators endeavour to wean large-scale occupiers from conventional office spaces and give them a taste of modern flexible office space more in keeping with a more disruptive, uncertain, collaborative and innovation heavy operating environment. To this end, co-working players are adopting aggressive pricing strategies in order to poach the large occupier and showcase their service focused real estate offering as a turn-key business solution for all their real estate requirements. As evidenced by the rates for dedicated desks offered by a prominent co-working operator in BKC (New CBD) and Andheri (Prominent SBD) in Mumbai, the occupier actually gets a deal that is 5%-15% lower priced in the serviced workspace than if he leased in a similar property in the vicinity. Thus, the co-working option is quite viable for the small start-up and corporate occupier alike because it comes bundled with the promise of a plug and play facility. Single occupancy cost (No CAM, OPEX etc) and the wider added benefits of adding further capacity as required and perks such as being able to access other office spaces of the operator across different locations, only sweeten the deal further. Thus, ease of working in such pocket-friendly and hassle-free set-ups is quickly increasing the popularity of co-working space across occupier groups. Corporates have increasingly been taking up co-working space and currently account for approximately half of the occupier base of this operator. We believe that the operator is currently investing heavily to acquire and retain customers and hence pricing his bouquet of co-working services extremely competitively. The market also seems to have responded well with the operator maintaining 80% to 85% occupancy consistently, while more established players in the vicinity have not fared as well. This depicts the strong underlying demand that this flexible office workplace format commands.

TABLE: VALUE PROPOSITION OF A CO-WORKING SPACE

	Andheri East		BKC	
Cost Profile	Standard Lease	Co-working	Standard Lease	Co-working
Office rent (INR/ sq.mt./ month)	1,292 (120)	NA	2,583 (240)	NA
CAM (INR/ sq.mt./ month)	129 (12)	NA	161 (15)	NA
OPEX (INR/ sq.mt./ month)	194 (18)	NA	161 (15)	NA
Occupancy Cost (INR/ sq.mt./ month)	1,615 (150)	NA	2,906 (270)	NA
Occupancy cost/seat/month (INR)	15,000	14,300	27,000	23,800

Source: Knight Frank Research

Note: Area allocated to a single seat in a standard lease assumed to be 9.3 sq mt (100 sq ft); NA = Not Applicable; Numbers in brackets ( ) are in sq ft: CAM = Common Area Maintenance; OPEX = Operating Expenses

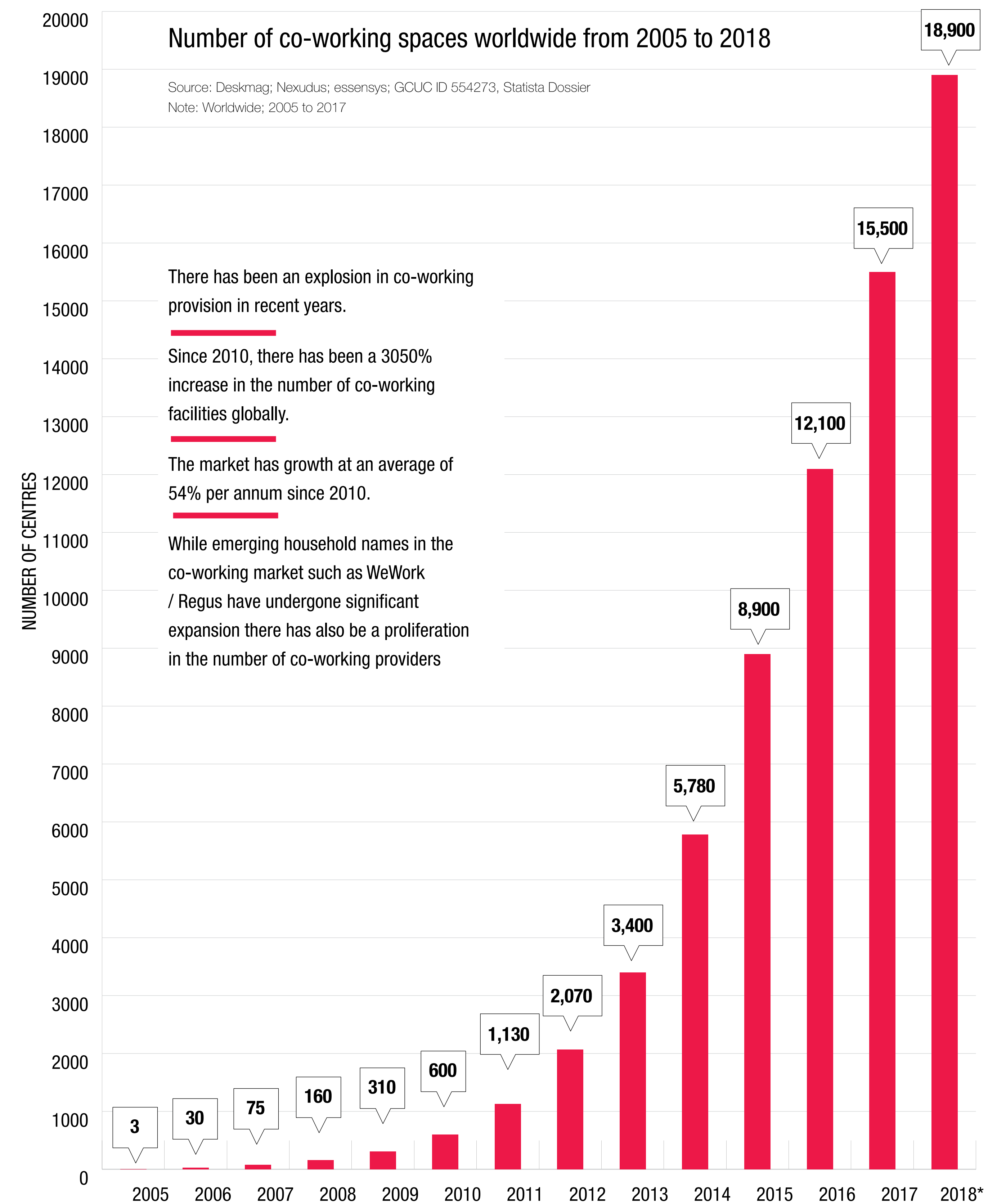
Due to the changing perceptions of the office, the workplace is now being looked at as an environment that needs to be managed and optimised. It is being viewed as an instrument that could drive a dynamic and vibrant culture of corporate productivity impacting the financial, cultural and environmental ethos of the organisation. This far reaching agenda warrants an element of specialisation. The co-working operator is filling this niche and is fast being regarded as a specialist in workplace design and management who can cultivate an environment of collaborative enterprise that yields tangible benefits to the occupier. People costs make up a much more significant 50% - 60% of operating expenses of a company and real estate can have a key role in retaining staff within a business. Good working environments can support worker contentment and this is a great cost mitigation as it is much more expensive for a business to lose an employee than it is to accommodate them. Thus, while the occupancy cost of a co-working space in today's competitive context works out cheaper than a similar conventional office, the enormous value that a co-working space generates for the occupier can in fact warrant a premium over its conventional counterpart. An increase in real estate occupancy cost can be easily absorbed if it results in a corresponding increase in employee productivity.

Co-working spaces are geared to offer an organised and synergised working environment along with business networking opportunities with the other members. Moreover, the co-working business model also provides access to a number of shared amenities and services such as conference rooms, Wi-Fi connection, refreshments and recreational space, as well as the flexibility to scale up or decrease the number of seats, based on business needs. Companies can also base their key project teams out of co-working places in order to let them be located close to their clients. While co-working business centres provide a viable model for corporates looking for flexibility in work locations, companies are slowly realising the fact that a collaborative work environment is in stark contrast to the standard corporate workplace and at one with the needs of the talented employee that corporate employers need and must retain. They are also becoming aware of the wider corporate benefits of fostering a corporate environment of creativity and innovation that directly impacts employee productivity. As co-working spaces have a wide range of occupiers, they are spaces that expose corporates to external ideas and inputs that are critical to being truly innovative and which are totally necessary in the context of a collaborative economy.

Much like Uber, new-age co-working operators are using big-data generated from their existing facilities to better understand how to optimise their services, maximise the utilisation of their facilities and establish what is working and what is not. The result is a virtuous feedback loop which ensures that service is maintained at levels relevant to the occupier and also that future investment decisions are smart and based on hard evidence. Data is thus being efficiently used to optimise occupancy and investment decisions.

INDIAN CO-WORKING MARKET PLAYERS

While Co-working as a concept is a fledgling phenomenon in India, it is part of mainstream office parlance in the much more evolved markets of the west such as New York and London. The global acceptance of this category is no mean feat considering that the concept that was conceived as a grassroots movement of freelancers, start-ups and solo entrepreneurs seeking to establish collaborative co-working communities, opened its first modern day co-working space in 2005. The number of Co-working spaces across the globe has grown by 3,050% since 2010 while the number of people working in these facilities has exploded by close to 8,000% in the same period by growing from 21,000 seats to 1.7 mn seats, according to Statista Dossier.



Co-working companies such as WeWork who occupy 0.2 mn sq mt (2.6 mn sq ft) in Central London and has recently become the largest single occupier in that market, feature prominently on the tenant roster of prestigious office markets globally. Co-working is thus creating a structural change in commercial office markets with a growing need for the supply side to provide flexibility, services, turn-key solutions, scalability & well-designed, optimal space.

1.7 mn

Number of co-working seats globally in 2018

MAJOR CO-WORKING PLAYERS IN INDIA

Regus

wework

cowrks

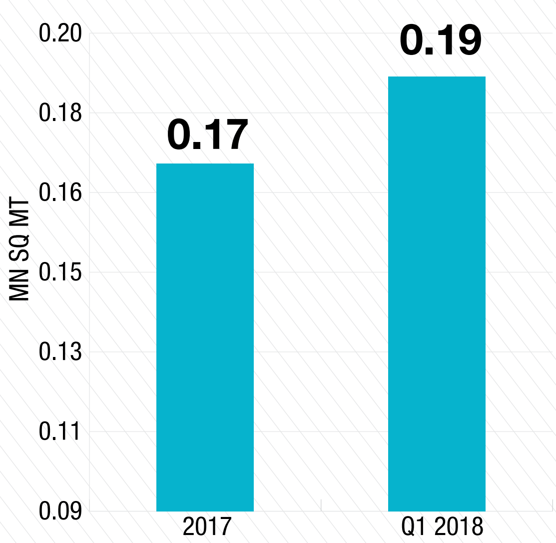
awfis

smartworks

Major 5 players have 0.79 mn sq mt (8.5 mn sq ft) operational space; with plans for additional 0.65 mn sq mt (7 mn sq ft) by 2020.

India is at the cusp of a co-working revolution with several large players spread across the country. There are close to 200 co-working operators running an estimated 400 shared workspaces across the country today, compared to just Regus and few localised players in 2010. While co-working companies took up a modest 0.2 mn sq mt (1.8 mn sq ft) in 2017, the first quarter of 2018 itself has exceeded the annual tally of 2017 at 0.19 mn sq mt (2 mn sq ft). In Q1 2018, the highest co-working transaction activity was witnessed in Bengaluru, NCR and Hyderabad markets, that accounted for 43%, 16% and 15% respectively.

Coworking space transacted

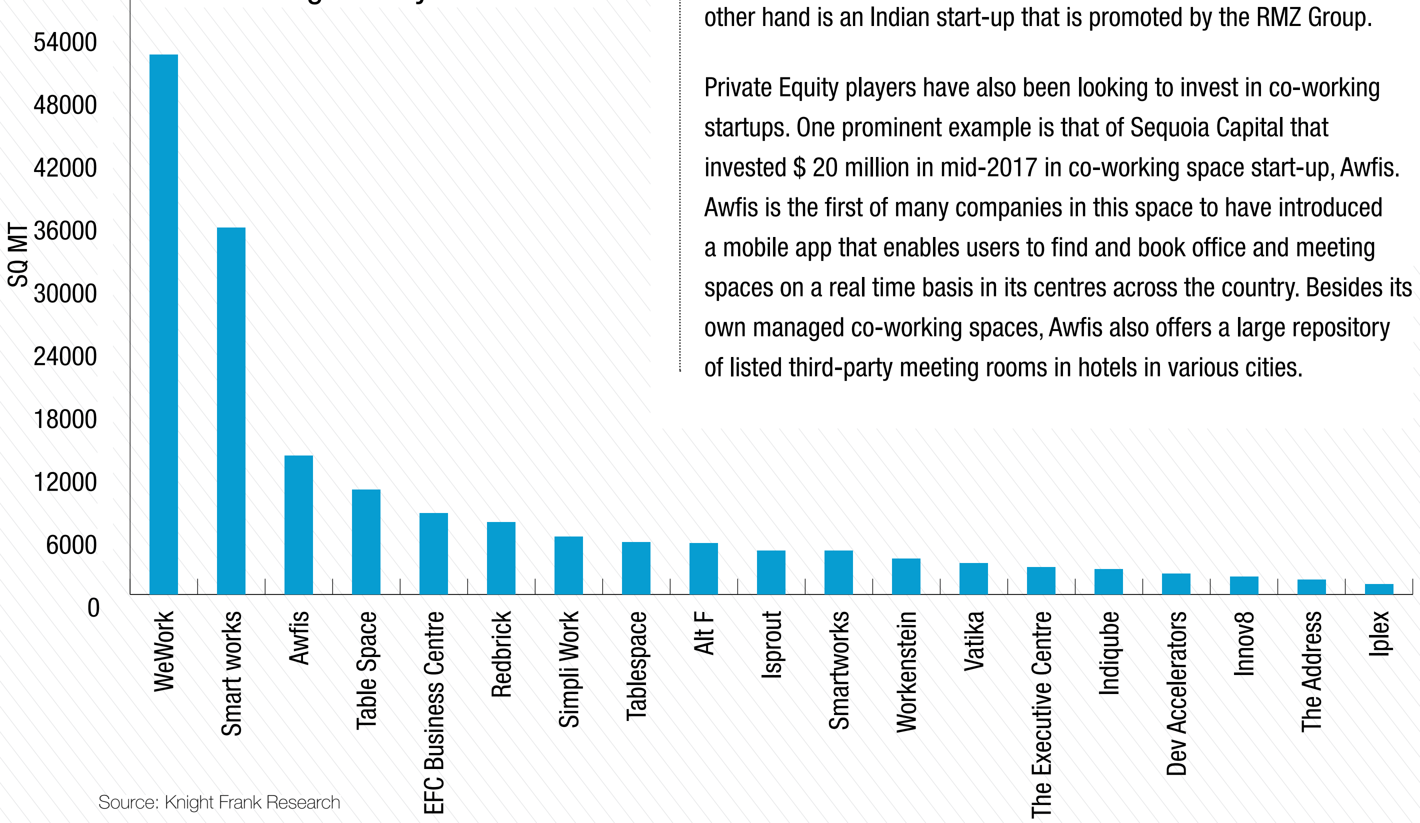


Source: Knight Frank Research

While Regus is arguably the most established shared workspace operator in the country today with approximately 0.2 mn sq mt (2 mn sq ft) and 20,000 seats under operation, WeWork and CoWrks are among the newest and most aggressive players in the co-working space. These companies started their India operations since 2016 and already operate approximately 0.4 mn sq mt (1.5 mn sq ft) and 0.1 mn sq mt (1 mn sq ft) respectively with plans well underway to more than double their footprint by the end of 2019. Both these companies have acquired 65,000 sq mt (0.7 mn sq ft) each of co-working space in Mumbai, Bengaluru and the NCR in the six months since October 2017. While both companies are expanding aggressively, there is a stark difference in their market entry strategy. The US based shared office space giant WeWork has adopted a franchising model and partnered with the Embassy Group in 2016 to operate a facility in Bengaluru at an estimated investment of $100 million. The Embassy Group will provide the capital and handle the real estate and construction aspects while operations will be handled by the American company. CoWrks on the other hand is an Indian start-up that is promoted by the RMZ Group.

Private Equity players have also been looking to invest in co-working startups. One prominent example is that of Sequoia Capital that invested $ 20 million in mid-2017 in co-working space start-up, Awfis. Awfis is the first of many companies in this space to have introduced a mobile app that enables users to find and book office and meeting spaces on a real time basis in its centres across the country. Besides its own managed co-working spaces, Awfis also offers a large repository of listed third-party meeting rooms in hotels in various cities.

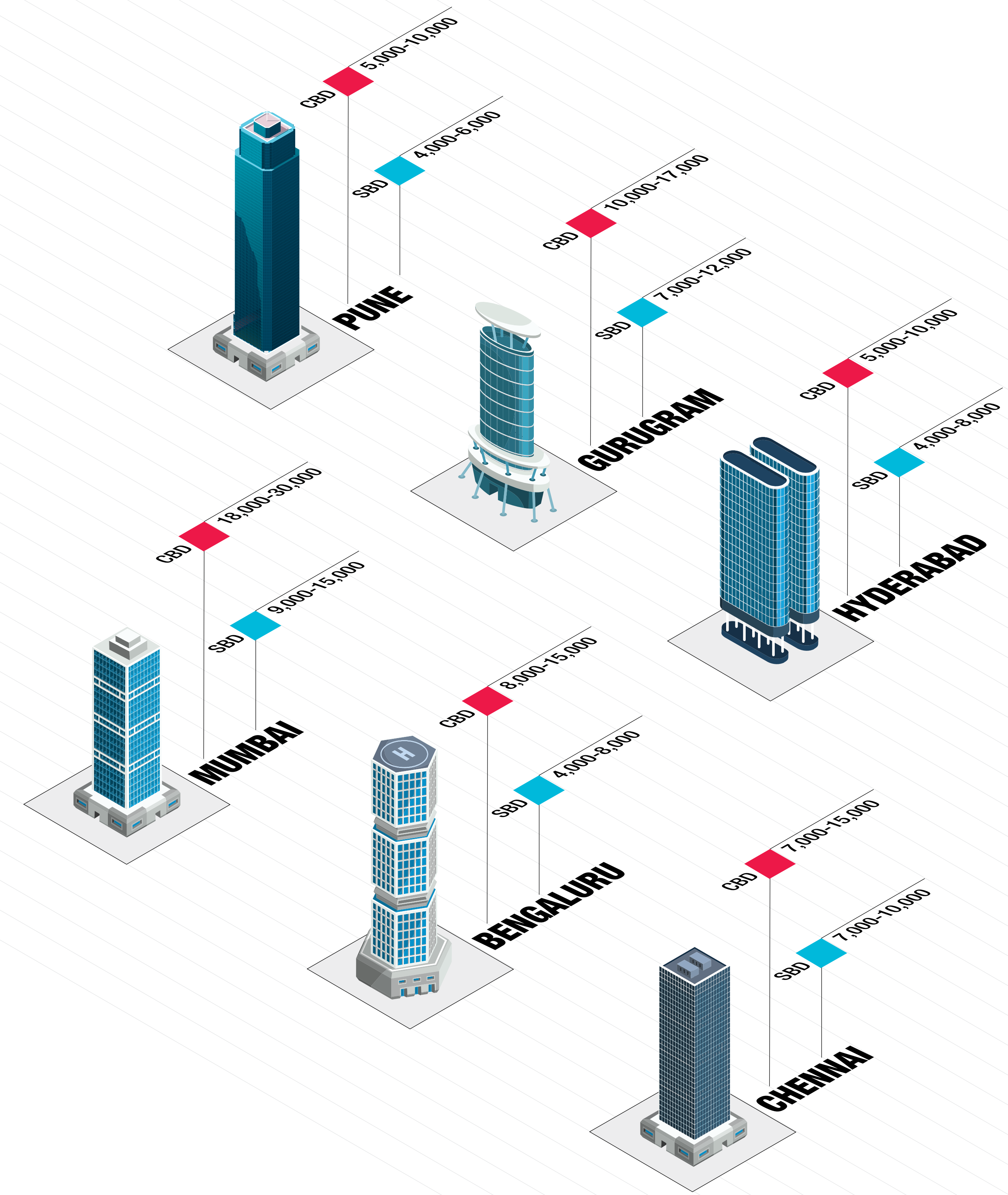
Co-working activity in Q1 2018



Source: Knight Frank Research

Of late, several developers are planning on starting their own co-working offices or collaborating with a co-working operator to provide incubation spaces, or divide large floor plates for smaller occupants. This serves to further the shift of the property sector from a product to a service based platform.

CITY LEVEL CO-WORKING COSTS TABLE



Source: Knight Frank Research
Note: Costs in INR per desk per month

Despite the demand for co-working space, there are several challenges that have to be tackled; for instance – changing the conventional mindset of a client who would want to book a meeting room based on the touch and feel factor rather than an app. Data security and privacy are also impediments in the way a corporate occupies co-working space, especially as the value of data becomes an ever greater source of competitive advantage. Corporate occupiers thus tend to lean toward co-working space with contained floors or spaces within the facility to overcome this risk and will move to managed solutions for significant scale operations.

The co-working model is based on the operator's ability to buy space long and selling it short. It enables the flexibility of tenure and scale that is the USP of the co-working space. However, this is also a double edged sword that makes it difficult to predict cash-flows of such an enterprise. The average tenure of co-working space occupiers can vary from under six months to close to two years depending on the operator and the occupier profile. This makes maintaining a deal pipeline one of the most important parts of this business, much more so than for a conventional office space lessor. Owing to the inherent risks involved in the sector, a few co-working operators strive to mitigate these by preferring to let out the major part of their area to companies that can act somewhat as 'anchor tenants', thereby helping them get a fixed-income stream. This tendency could compromise the collaborative environment essential to the co-working experience if one corporate entity dominates the occupier pool of the co-working space.

CO-WORKING GOING MAINSTREAM?

Co-working work-spaces used to be the domain of the quintessential start-up that required the flexibility of tenure as well as cost that a standard leased office space cannot offer. This office format naturally evolved as a collaborative community space that allowed and encouraged the dynamic and creative start-up community to interact and thrive. This shared workspace format also adopted the dynamism of its occupiers and was always the first to adapt, evolve and often pioneer changes in the workplace. The revenue model of the co-working space also demands that it earns more on a per square feet basis for its property than what it was leased for. This constant strife to outperform market rents and stay on the cutting edge of workplace design to attract and retain the demanding occupier also brought it to the attention of the more established and mainstream occupier.

The general flexibility around work, and the ability to reduce or increase real estate costs and capacity as the business requires have been persuasive factors for corporates to consider the co-working model. However, a co-working environment being seen as a major factor in improving work-life balance, employee productivity and talent retention that are critical and tangible business benefits, are major motivators for corporates to increase their co-working footprint. The growth of specialist project teams, often multi-disciplined, sensitive and short lived, are intended as game-changers for the organization, often with the mandate to initiate change. The co-working environment is a natural foil for these teams as is fosters a creative and dynamic environment ideal for their purpose. Approximately 50% of the client roster of an Indian co-working operator is made up of big corporates. This can go as high as 80% in the more premium priced offerings.

CO-WORKING IMPACT ON STAKEHOLDERS

CO-WORKING

NEIGHBOURHOOD

- Infuses an informal, collaborative vibe
- Clientele typically enjoy socialising and form a strong consumer base for local F&B and other entertainment options

LANDLORD

- Increased ability to attract new tenants
- Reduced pressure of leasing smaller spaces
- Incubation space for large tenants
- Unused spaces efficiently managed by operator
- Efficient utilisation of dead spaces
- Enhanced property visibility/marketing
- Improved property values

OCCUPIER

- Optimised work environment
- Flexibility of tenure and scale
- Minimum involvement in workplace management
- Talent retention
- Expanded professional networks

WeWork which is arguably the largest co-working company globally is valued at approximately $20 billion and has grown from 1,000 members in two locations in New York in 2010 to over 130,000 members across 163 locations today. This, along with the fact that its current client roster includes names such as Microsoft, GE, Dell, Sales Force, Deutsche Bank and HSBC is a testament to the fact that mainstream occupiers are definitely looking at co-working spaces as a longer-term option.

The changing appetites of mainstream occupiers have not escaped the attention of landlords as co-working players increasingly poach those occupiers that have been the exclusive domain of the quintessential Grade A office space. The fact that, a co-working operators' need to outperform market rents tends to improve the prospects of the entire property they occupy, has also led the landlord to consider the operator as collaborator rather than a competitor. Parallels can be drawn with E-tailers who were seen first as disruptors by established retailers but now co-exist as both online and offline retail formats are essential for the omni-channel experience that the modern retail customer has come to expect.

A recent Request For Proposal (RFP) floated by Equity Office, owned by the Blackstone Group and Hines, seeking partners in the co-working space to provide the best possible working environment for the Howard Hughes office complex in Los Angeles, underscores the undeniable leadership status accorded to the co-working operator as a doyen of the modern workplace. Though the Indian co-working environment is a long distance away from its western counterparts, aggressive expansion underway by the likes of CoWrks, WeWork and Smartworks suggests that we might not be so far behind after all.

CO-WORKING SWOT ANALYSIS – THE LANDLORD PERSPECTIVE

STRENGTHS

- Activates schemes & increases utilisation
- Creates occupier connection with building
- Supports occupiers scaling up
- Can reduce leasing risk through tenant diversification
- Can pass leasing risk to co-working provider
- Adoption of technology to make more effective assets

WEAKNESSES

- Covenant strength of co-working operator
- Churn of occupancy
- Irregularity of income if delivered directly
- Absence of a hospitality mind-set can limit effectiveness
- Investor perception of tenant covenant

OPPORTUNITIES

- Partnership with operator
- Best practice examples to drive self-provision
- Alternative revenue streams from services
- Increased density / utilisation = increased income per sq ft
- Upcoming lease accounting changes could drive greater demand

THREATS

- Enterprise model could erode large scale deals
- Operator failure
- Forces a focus on service and flexibility (structural change in operation)
- Co-workers will become investors creating competition for assets

Source: Statista Dossier, Knight Frank Research

As the shared workspace format gradually gains acceptance with the mainstream occupier, it is being regarded as positive workplace experience and slowly acquiring an aspirational quotient with the occupier and the employee. With industry leading paymasters such as Google, Microsoft, Oracle and Twitter engaging their top talent in large co-working spaces successfully, the co-working space is well positioned as a "Cool" place to work and is a significant attraction for prospective employees. Some co-working operators are going above and beyond the conventional amenities offered by the co-working industry by providing free beer, health club facilities and even a Jacuzzi to acquire the coveted "Cool" tag. Recent entrants such as WeWork, CoWrks and Smartworks have been pushing the limits and merging the services offered by pure play co-working spaces, serviced offices and business centres and these elements are fast coalescing into modern shared working environments that are collectively represented as the co-working phenomenon.

Going forward, with the advent of major co-working players in India and an increasing number of such facilities coming up across cities to cater to the demand of start-ups and SMEs, the co-working sector is expected to thrive and could prove to be a significant disruptor on India's commercial real estate market. While co-working companies accounted for just under 0.2 mn sq mt (2 mn sq ft) of the 3.8 mn sq mt (3.8 mn sq ft) annual commercial office space transactions volume, the expansion plans of major players and the increasing appetite for this format from occupiers, property owners and co-working operators should see annual transaction numbers triple from current levels over the next 3 years. Currently, Bengaluru, Mumbai and NCR house most of the co-working stock in India followed by Hyderabad and Pune.

However, it is still early days for the co-working segment and not all the co-working operators are likely to be able to hold their own in the long run, owing to their inability to mitigate risks in their business models or have enough stronghold in non-prime markets. Globally, maintaining occupancy levels is the most challenging task of a co-working operator and the Indian market will be no exception. While the aggressive pricing being used currently will address this to an extent, the financial strain could lead to compromises on service delivery resulting in poor customer experience and could prove to be the biggest risk for the industry today. This would expectedly result in consolidation among co-working operators and the market would be divided amongst a handful of large players. The rapid growth of co-working facilities and more particularly providers, will inevitably lead to casualties and also drive consolidation in the sector as recently witnessed with the merger between Naked Hub and WeWork.

KEY FINDINGS

- Due to the changing perceptions of the office, the workplace is now being looked at as an environment that needs to be managed and optimised. It is being viewed as an instrument that could drive a dynamic and vibrant culture of corporate productivity impacting the financial, cultural and environmental ethos of the organisation. This far reaching agenda warrants an element of specialisation. The co-working operator is filling this niche and is fast being regarded as a specialist in workplace management who can cultivate an environment of collaborative enterprise that yields tangible benefits to the occupier.
- A co-working operators' need to outperform market rents also tends to improve the prospects of the entire property they occupy. This has also led the landlord to consider the operator as collaborator rather than a competitor.
- The number of Co-working spaces across the globe has grown by 3,050% since 2010 while the number of people working in these facilities has exploded by close to 8,000% in the same period by growing from 21,000 seats to 1.7 mn seats, according to Statista Dossier.
- India is at the cusp of a co-working revolution with several large players spread across the country. There are close to 200 co-working operators running an estimated 400 shared workspaces across the country today.
- While co-working companies took up a modest 0.17 mn sq mt (1.8 mn sq ft) in 2017, the first quarter of 2018 itself has exceeded the annual tally of 2017 at 0.19 mn sq mt (2 mn sq ft).
- The co-working phenomenon is gaining wider acceptance with the mainstream Indian occupier as big corporates today constitute approximately 50% of the overall client roster. This share can go as high as 80% in the more premium priced offerings.
- The expansion plans of major players and the increasing appetite for this format from occupiers, property owners and co-working operators should see annual transaction numbers triple from current levels over the next 3 years.

COMMERCIAL BRIEFING
For the latest news, views and analysis of the commercial property market, visit knightfrankblog.com/commercial-briefing/

RESEARCH

Dr. Lee Elliott
Partner, Department Head, Commercial Research
lee.elliott@knightfrank.com

Dr. Samantak Das
Chief Economist and National Director – Research
samantak.das@in.knightfrank.com

Vivek Rathi
Vice President, Research
vivek.rathi@in.knightfrank.com

Yashwin Bangera
Assistant Vice President, Research
yashwin.bangera@in.knightfrank.com

Pradnya Nerkar
Associate Consultant, Research
pradnya.nerkar@in.knightfrank.com

OFFICE AGENCY

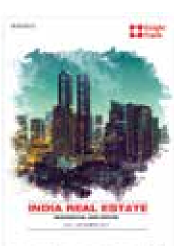
Viral Desai
National Director
viral.desai@in.knightfrank.com

PRESS OFFICE

Girish Shah
Executive Director – Marketing & Communications
media@in.knightfrank.com

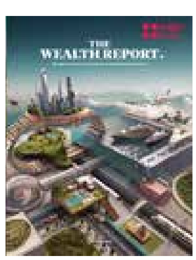
Knight Frank India Research provides development and strategic advisory to a wide range of clients worldwide. We regularly produce detailed and informative research reports which provide valuable insights on the real estate market. Our strength lies in analysing existing trends and predicting future trends in the real estate sector from the data collected through market surveys and interactions with real estate agents, developers, funds and other stakeholders.

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

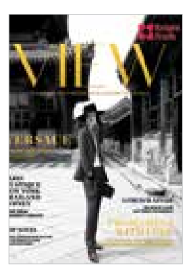


INDIA REAL ESTATE
JULY-DECEMBER
2017

INDIA WAREHOUSING
MARKET REPORT
2016



THE WEALTH
REPORT 2018



INTERNATIONAL VIEW

Knight Frank Research Reports are available at **KnightFrank.com/Research**

Knight Frank

CIN No. – U74140MH1995PTC093179