

5 Minute Guide: The Impact of Coworking Spaces on Real Estate

As real estate investors, we have seen the coworking concept develop from a minor trend to a mainstream movement. This development has impacted not only the way people work together but also the real estate industry in general, including landlords, developers, and, of course, investors. When searching for a way to invest in this industry, we decided to partner with Mindspace. This partnership allows us to invest in what we believe is the fundamental rule of real estate: a location with constraints on space supply with a steady cash flow. (To be continued on last page)

How the Coworking Movement Developed

The rise of coworking environments has been sudden, but the demand is set to continue.

1995

1st Workspace Sharing

Opened in New York City in 1995, when 42 West 24 offered flexible desks that could be rented for short leases.

2005

1st Coworking Space

Appeared in San Francisco in 2005, with unrelated official coworking hubs opening in London and Berlin the same year.

2018

The number of coworking spaces is projected to boom by the end of 2018 to

37,000

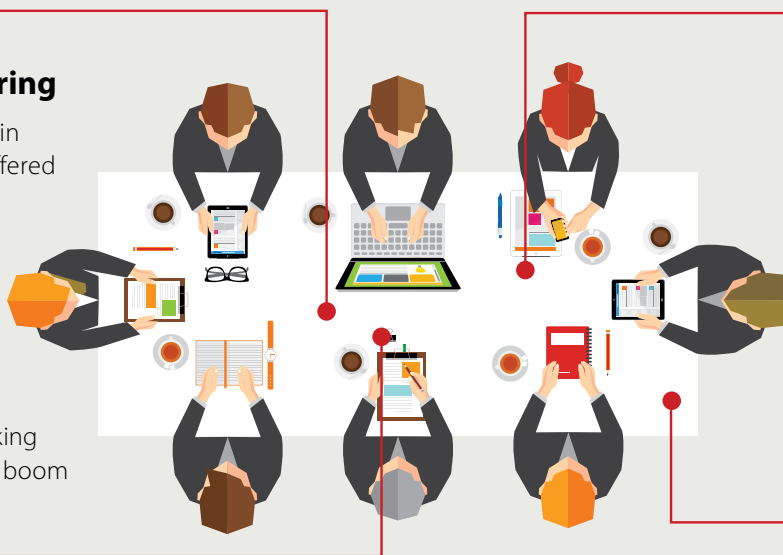
Coworking spaces worldwide.

2017

By 2017 there are approximately

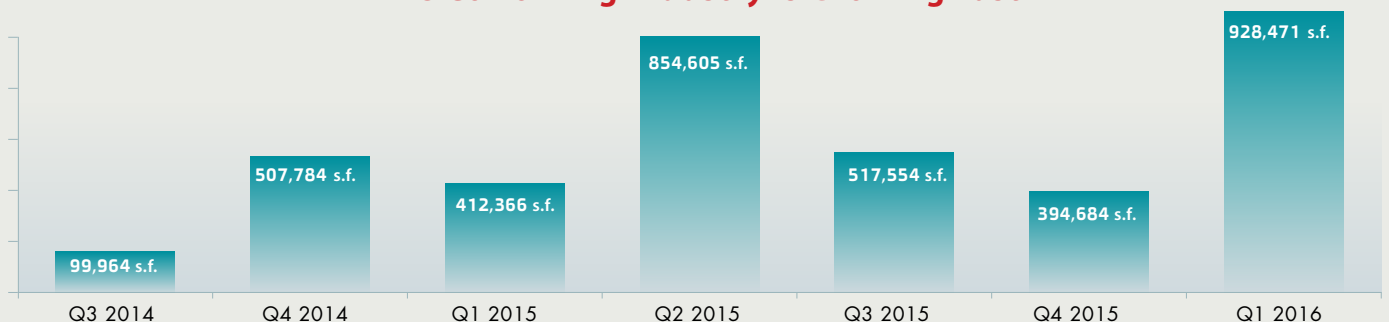
13,800

Coworking spaces worldwide.



According to JLL Research, since mid-2014 shared office companies in the U.S. have leased more than 3.7 million square feet in leases of 20,000 square feet and larger, bringing the total size of this industry to more than 27 million square feet. As of the end of Q3 2016, coworking spaces represented only 0.5% of the total office inventory, one of the lowest among tier I, II, and III cities in the US. The world of entrepreneurs and small business is growing exponentially and it is estimated to reach 40% in the next five years. This represents a unique growth opportunity for shared & flexible office space.

The Coworking Industry is Growing Fast



Source: JLL Research

What Provoked and Shapes it Today?

The sudden explosion of coworking spaces may seem unprovoked, but it's shaped by deep changes in the way that we live and work.



The Urban Renaissance

The global movement of populations from the countryside and suburbs back into the cities impacted the demand for urban services. City-dwellers became accustomed to the idea of sharing models as certain services couldn't keep up with the stresses placed upon them. As concepts such as car-sharing became more familiar to local residents, the idea of a coworking space gained popularity.

Tech Trends

Technological innovations enabled employees to move their work out of fixed office spaces, as information can be stored on the cloud and accessed from anywhere in the world. Remote meetings, online bookings and virtual assistants enable work to be done anywhere.



The job-for-life pattern

Today, some workers maintain a flexible mindset, expecting to move on to a new job every few years. Millennials shun the earlier working model of finding a stable job in one of the bigger companies and working oneself up the totem pole. Instead, they prefer to work for small- to medium-size companies, start-ups, or for themselves. Around 35% of the workforce in the USA work as freelancers or are self-employed, a number that is projected to rise to 50% by 2020.

Change in Work Environment

Although freelancers and sole companies need somewhere to work, they are not likely to pay for a traditional office. The kitchen table is often too isolated; coffee shops, while popular to an extent, are noisy and lacking in vital office facilities. Coworking spaces are the perfect solution. The range of amenities on offer at many coworking environments are also enticing to small and medium-sized businesses and startups who are wary of committing themselves to permanent office space. As coworking spaces become more popular for employees, even large multinational companies such as Samsung and Volkswagen have taken up occupancy in coworking environments in order to attract and retain top talent.



More Cost- and Time-Efficient & Greater Flexibility

In a traditional office framework, landlords need to fill a large space. Each new lease necessarily imposes upon the landlord additional lawyer and agent fees, as well as money lost while they wait for the tenant to renovate the space before moving in. It causes large gaps in their cash flow as well as great uncertainty as each lease approaches its end. Due to the time and money involved in shaping traditional office space to the needs of new occupants, leases are usually for ten years or more. This is an obstacle to young company management who can't be sure how much space they will need over the next ten years. If they sign a lease on premises which are a good fit today, they stand a good chance of having to break their contract - and pay the concomitant charges - when they outgrow the space and endure the upheaval of moving into bigger premises. On the other hand, a young business which attempts to future-proof itself by paying for space to expand will be paying rent and taxes for unnecessary empty square footage. They also run the risk of never growing into the space at all.

How Coworking Impacts Real Estate?

The coworking movement has had a multi-directional, disruptive impact on the commercial real estate market.



The Use of Space

Coworking sites have brought down vacancy rates across the commercial real estate market. Discarded or unused buildings, such as factories and warehouses that were previously difficult to fill have proven ideal for reconfiguration as coworking sites. Companies building new commercial properties are including dynamic, reconfigurable spaces and integrating facilities and amenities that attract coworking tenants. Coworking has brought new young businesses into prime commercial locations, which may otherwise be unaffordable. Most coworking spaces are designed in a more dense occupation levels than traditional offices, which has raised concerns about the overpopulation of commercial centers. However, on average, workers at coworking spaces tend to only fill approximately 70% of the potential space on any given day, mitigating this potential pressure.



Banks

Overall, the new coworking movement impacts positively on banks and financial institutions. Coworking spaces are seen by many financial institutions as a safe investment because of the high diversification of underlying tenants. Single-purpose office spaces or factory buildings are dependent upon the success of the one business which occupies their premises. If the factory fails or if the business becomes insolvent, the bank has no way to recover most of the investment. Coworking spaces, however, do not depend on any one customer or company for their success. While a bank would struggle to take over the running of a bankrupt factory, an empty coworking space is far easier to fill.



Real Estate Agents

Coworking spaces were greeted by many real estate agents with hostility, as they saw the traditional commercial real estate market consumed by the popularity of subscription-office space. Some others however, decided to embrace the possibilities of coworking spaces. Some agents have commission deals with coworking spaces in exchange for recommending new members. Others are motivated by the potential of connections with young enterprises, freelancers and start-ups; hoping to capitalize on the relationship once these businesses are ready to move out and into their own premises.



Landlords

Overall, landlords have benefited from the coworking movement. Traditional business tenants require a large injection of capital at the beginning of their tenancy as they reshape the space to fit their needs. Landlords lose money while their premises lie empty during renovations, and face further costs in the form of lawyer and agent fees when seeking new tenants. Like banks, landlords too are dependent upon their tenants' success, facing a large loss if a big tenant fails or moves elsewhere. The income of coworking space smooths out the bumps associated with renting to single users and having periods of vacant property.



Regulatory

Coworking leasing law is still evolving to meet the needs of this new market. Legal details such as subletting clauses and restrictions on business use can hamper the establishment of successful coworking spaces. Legal issues which could arise when leasing coworking sites include property rights, allocation of responsibility for unexpected costs, and liability issues. Landlords tend to use licensing or membership arrangements for workers using their coworking space, but this often dilutes the control a landlord enjoys over his tenant population. A landlord, however, who uses leasing arrangements to maintain too tight a hold over his coworking tenants may find that the coworking environment fails.

The Coworking Space Market

Differences Between the Various Coworking Spaces

Although all coworking spaces share the same basic premise, both the environment and set-up differ widely across the market.

1

The Balance of Areas within a Space

The balance between different use areas at coworking spaces - what designers call I/ we space - affects the vibe of a coworking environment, impacts the type of workers who choose to occupy it, and ultimately shapes its success.

2

The Blend of Occupants

Coworking spaces often host a varying mix of occupants. Some deliberately curate a diverse blend, ensuring that there is a mix of freelancers and startups, small businesses and more mature ones, while others may only admit startups. There is also variety between coworking sites which are focused on a single sector and ones which cultivate a range of industries to provide a richer environment and encourage cross-sector inspiration. In some coworking sites, the blend of workers changes every few months as people move in and out, while other sites host a more settled body of companies and self-employed individuals.

3

Design

Small touches such as flooring, wall art and seating options do more to convey the personality of a coworking site than any larger investments. Soundproofing, electrical outlets and charge-points are make-or-break items for new members.

4

Community

Community is a buzzword for coworking spaces but it, too, varies from one site to the next. Many coworking spaces feature an on-premises manager to help build connections between members looking for support, collaboration or professional services. Occupants are encouraged to share their details via a communal database. Coworking spaces with rapid turnover of occupants tend not to offer the same level of community-building.

5

Services & Amenities

Although some coworking spaces are simply shared, managed office space, other offer a great deal of extra value to their members with add-on services in addition to the expected basic office facilities.

6

Location

The location of a coworking space makes a big difference in the overall character of the space, in ways ranging from the average age of members to the work atmosphere. Coworking spaces in central business or financial districts tend to be more formal than those in gentrified industrial areas. Even the building itself affects the coworking site; one housed in a repurposed factory has a different vibe to it than a site that occupies one floor of an office building.

Differences Between the Different Business Models

Coworking sites follow different business models. Many offer monthly or yearly membership options, with different price plans depending on the amount and type of space needed and how many extra facilities are included. There are also desk-free membership options, so that individuals can take advantage of networking events. Some coworking sites price by the day or even the hour, and those which don't usually offer day passes to visitors. Non-profit or sponsored coworking sites are sometimes built on a partnership basis, where members can work for free in exchange for a commitment to give back to the coworking community. Some multi-location coworking spaces permit flexible memberships which can be used at any of their branches.

Sector Mapping

The coworking industry is highly fragmented, where the vast majority are small, local operations and only few are large, high quality global players.

Mindspace

Mindspace is an Israel-based company which manages an international network of well-designed, well-managed upscale coworking spaces in prime locations since 2014. Mindspace's coworking sites include well-planned work spaces that include coffee bars, kitchen facilities, closed and open-plan offices, and fully equipped meeting rooms of varying sizes, event spaces and other facilities. Currently, Mindspace sites can be found in Tel Aviv and Herzliya in Israel, Berlin, Hamburg and Munich in Germany, Warsaw in Poland and London in the UK. Mindspace stands out through their emphasis on forging communities, curating a diverse mix of freelancers, entrepreneurs, early- and middle-stage startup companies and large global enterprises. Mindspace offers its member a range of exclusive events, high-value content, attractive discounts with local providers and fun social activities.

Regus

Founded and based in Brussels, Belgium; Regus has been offering flexible managed office space since 1989. After a near-collapse in 2003, the company was restructured. Now operated by IWG, Regus manages close to 3,000 branches in 100 countries, offering office space, virtual offices, coworking desk space and meeting rooms, worldwide. Frequent business travelers can purchase a flexible membership which gives access to any Regus workspace around the world. Their office and desk space is bookable by the day, the month or the year, and their meeting rooms can be rented by the hour or the day. Regus prides itself on inspirational, cutting-edge workspaces that provide flexible office solutions.

WeWork

Based in Midtown New York, NY, WeWork was founded in 2010. WeWork offers flexible office solutions, open desk space and conference and meeting facilities at over 150 locations in 16 countries. Members can rent desk or office space by a monthly arrangement or longer, based on their space and time requirements, while conference rooms can be reserved in advance and are bookable according to a paid credit system. Alongside office facilities, WeWork provides health insurance (in some markets), fun activities, social events and networking opportunities as part of its vision to create physical and virtual workplace communities.

NextSpace

NextSpace is based in Santa Cruz, California, where it opened its first cowork space in 2008. There are currently 7 NextSpace branches across California and one in Chicago, with plans to continue to expand. NextSpace offers virtual membership for access to events and meeting rooms facilities, with day passes and monthly membership for virtual offices, shared and dedicated desk space and private offices. NextSpace members also receive unlimited day passes to other NextSpace locations. NextSpace's amenities include entrepreneurial events, networking opportunities and social events. NextSpace positions itself as building working environments that are both comfortable and professional, in order to grow a vibrant work community.

ImpactHub

Based in Vienna, Austria, ImpactHub opened their first cowork location in London in 2005 and now operate over 80 Hubs in 45 cities worldwide. ImpactHub's selling point is their vision of a vibrant community of mutual creativity, producing an inspirational work environment. Offering private offices as well as shared and dedicated desk space, ImpactHub markets itself as an incubator of great ideas and a catalyst for innovation and workplace productivity. ImpactHub also provides supportive programming to further encourage startups and young enterprises to thrive.

Advantages of Coworking Spaces

Location

A city center address is a valuable commodity, but young enterprises can't afford the price tag. In popular commercial districts which have no further natural expansion, such as Manhattan or London, sometimes there simply isn't the space available. Buying membership in a coworking space in a prime location brings the benefits of working in the heart of the industry as well as the prestige of a central zip code.

Cost

High-speed internet, printing, scanning and fax services, even tea and coffee, add up to sizeable expenses for small and medium companies. At a coworking space, occupancy costs per employee are lower due to efficient planning and economies of scale. By paying a monthly subscription, companies can change uncertain variable costs into fixed predictable costs, an important difference for large or small enterprises balancing their budget and liabilities.

Services

Maintaining a full office environment occupies company time and energy. At a coworking space these processing tasks are dealt with by the administrative management instead of an employee. Start-ups are usually operating with just enough employees to cover their base, and sidestepping the headache of maintenance and management is a saving greater than merely the financial costs.

Work Environment

The benefits of a coworking space extend beyond that which can be priced. Shared working spaces are designed to be inspirational and innovative. Many offer amenities like social events, lectures, and even an on-site gym and pool. By operating out of a coworking space, a small start-up can provide the same rich work environment as the largest multi-nationals, but without the organizational hassle. Multiple reports show that workplace wellness and enriched employee experiences bring greater productivity and lower employee turnover.

Flexibility

A year is a long time for new enterprises, let alone signing a three, seven or ten year lease. At a coworking space, companies are free to expand and contract as needed, always paying for the space they actually use. Even large, long-established companies see the benefit of such efficiency as compared to the rigid traditional lease model. Coworking spaces enable companies to risk-proof themselves for future expansion or contraction.

Motivation & Productivity

85% of workers say that they were more motivated once they moved to a coworking environment. The greater flexibility of coworking sites permits employees to choose their own work hours, and workers who are in control of their working time arrive mentally ready for work. Being part of a community of work-minded people stimulates concentration and productivity far more than when working from home. It is admittedly harder to get into a working mindset in your pajamas at the kitchen table.

Networking

Carefully designed shared spaces and networking events at coworking sites provide both formal and informal opportunities for relationship building. Members of a diverse coworking space are able to benefit from the skills and services that each company can provide, forging valuable cross-industry connections. Start-ups housed in coworking spaces have a higher rate of success, mainly thanks to the expertise and advice they can mine from their fellow workers.



(Continuation from Advantages of Coworking Spaces)

Social

With the rise of flexible working, people expect to interweave their work and their play, all the while waves of migration to large cities has left many people lonely. Natural communities have been broken but coworking spaces are filling the vacuum with an atmosphere of camaraderie. Happy hour Fridays, movie nights, on-site coffee shops and communal spaces that encourage socializing are just some of the ways that coworking spaces add social value to their work environments.

The Buzz

With company loyalty at a low, businesses face the challenge of attracting and retaining top talent. Companies that operate out of coworking spaces find that the buzz of the shared workspace makes potential employees perceive them as an attractive place to work. Hiring top-performing employees is easier, cheaper and faster for companies in coworking spaces.

Challenges of Coworking Spaces

Noise & Distractions

A coworking environment can be lively and vibrant, but it can also be noisy and distracting. Sometimes there is too much socializing and networking going on, making it difficult to focus on work. Many workers perform better in closed offices within a coworking site, so that they can enjoy the communal atmosphere but also close the door and focus on work. This is especially true for those who rely on phone conversations for much of their business activities, since open work spaces tend to be too noisy for official work phone calls.

Lack of Company Culture

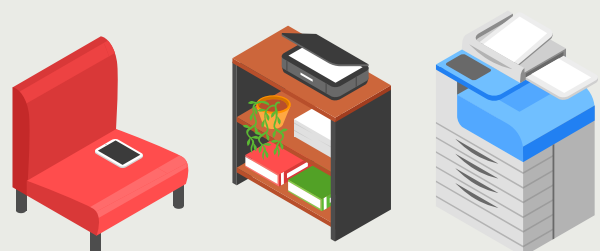
When sharing work space with many other enterprises, it can be difficult to forge a specific company culture. Celebrating a breakthrough feels churlish when the company at the next table is experiencing a dry patch, and holding a company bonding game is awkward in a shared environment.

Privacy, Confidentiality & Security

It can be difficult to maintain privacy at a desk in a crowded open space. Holding phone conversations in a shared space risks leaking trade secrets or accidentally compromising a client's personal security. Shared Wi-Fi and public desks also present potential security breaches, although sometimes automatic screen locks and lockable filing cabinets are sufficient solutions. Some sectors are simply not suited to work in shared spaces, such as lawyers or financial advisors who need to be particularly careful about maintaining client confidentiality. Preserving intellectual property rights is a further challenge in coworking environments, especially when one is working in the same space as one's direct competition. Many companies have struggled with the awkwardness of sharing space with competitors in the same field.

Too Informal

Although a relaxed and creative atmosphere is part of the attraction of a coworking space, it can also be a disadvantage to companies that want to project a formal and serious image. This can be avoided by careful matchmaking between companies and coworking management.



Mindspace

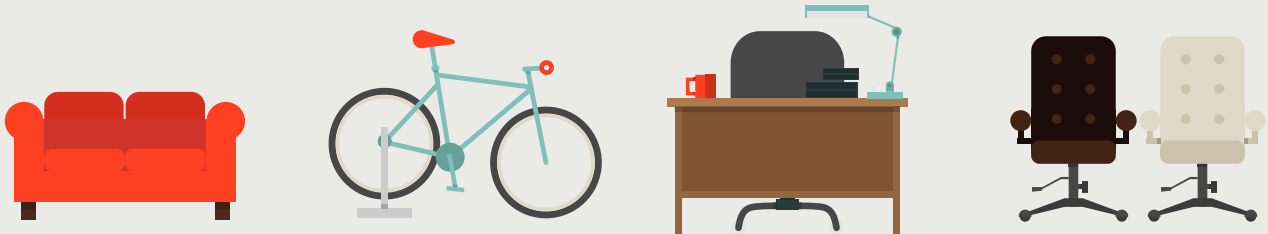
Mindspace's strategy is unique for several reasons:

1. Their coworking spaces are located only in major employment centers with a limited supply of space;
2. Mindspace has developed a global platform that includes Israel, Germany and Poland, and is expanding into the US and the UK;
3. Mindspace stands out from its competitors by investing significantly in their community;
4. As part of Mindspace's business model, Mindspace leases large spaces to companies that want to be located near and inside the coworking space;
5. The leases that Mindspace sign always have an option to sublease, which creates a real value for the lease itself;
6. The Mindspace strategy has elements of a "Recession-proof Business Model" which allows companies to have maximum flexibility with limited leasing and equipment liability in case of a downturn in the economy.

While **PROFIMEX** is a real estate company, we are motivated to invest in people. After having spent a significant amount of time becoming acquainted with and evaluating the founders and management of Mindspace, we firmly believe that we have a strong fit with both the business strategy and core values of Mindspace. We are enthusiastic about this new partnership and hope that you join us too.

Asaf Rosenheim

Head of Investments, Profimex



Sources & Additional Reading

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