CoWorking Culture – Challenges and Opportunities for Office Landlords

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Abstract

Coworking relates to the use of space, which can be in the form of very short office leases ranging anywhere from between a day to a month and longer. Workers have the option to occupy and work in the space independently, collaboratively or in nominated teams. Australia has recorded the highest growth of coworking spaces in the world in the last 3 years. As of January 2017, there are 239 coworking spaces throughout Melbourne, Sydney and Brisbane; with a very rapid current growth rate, industry predicts approximately 1.2 million members globally would be using coworking space by the end of 2017. Many landlords are being challenged by this growing demand for flexible, scalable, collaborative spaces with short term leases. A desktop analysis of the top 12 coworking providers in Melbourne is undertaken. The findings identify two main challenges confronting landlords. Firstly the reliance on coworking operators and their survival with changing market conditions, and secondly, transforming traditional office spaces into engaging coworking vibrant hubs.

Keywords: challenges and opportunities, collaborative spaces, coworking spaces, office landlords

Introduction

Advancements in information and collaboration technologies and globalisation of business have created a need for flexible office environments in which people have more options for how, when and where to work (Kojo and Nenonen, 2016). Co-working which provides independent spaces in shared office spaces to members from diverse organisations and individuals is a rapidly emerging workplace phenomenon in today's knowledge-based economy. It mainly aims to provide spaces for start-up businesses, freelancers and entrepreneurs who like to work in environments which facilitate creativity, critical thinking, knowledge sharing, communication and collaboration

(Spinuzzi, 2013; Parrino, 2013). Coworking spaces provide spaces where members can work alone or interact with like-minded people on a pay-as-you-go basis (Bouncken and Reuschl, 2016). Since originating in San Francisco in 2005, the coworking movement has become a global phenomenon over the last decade with annual growth rates as high as 250% at the global level by the year 2014 (Leclercq-Vandelannoitte and Isaac, 2016). Approximately 160,000 employees functioned in coworking spaces in 2014 globally (Deskmag, 2014), and it is expected that this number will grow up to 1.2 million members by the end of 2017 (Knight Frank, 2017). Australia is one of the earlier adopters of the coworking culture outside of the US, with coworking spaces opening in the country as early as 2006 (Knight Frank, 2016). The industry has evolved rapidly over the past decade with the availability of 116,955m2 of coworking spaces in the main capital cities of Sydney, Melbourne and Brisbane as of January 2017 (Lindsay, 2017). The majority of these spaces are run by coworking operators, who lease office spaces from traditional landlords and then sublease to start-up companies and individuals from a variety of industries.

Coworking culture has major implications on the performance and utilisation of commercial real estate. One of the slowest adaptors to this growing work practice has been office landlords (Green, 2014). Many landlords are being challenged by the coworking practice as it is a new working phenomenon where traditional office space requirements and leasing principles may no longer apply. Historically with the preference to lease spaces to large-scale corporations and professional service firms, landlords have been cautious in welcoming coworking operators into their buildings (Green, 2014). However, coworking spaces have potential to create several tangible and intangible benefits to office landlords. These benefits are discussed in conjunction with the analysis from this research.

Despite the growing demand for coworking spaces in Australia, there is currently limited empirical research on the impact of coworking culture on the performance and utilisation of office property assets. With the preference to lease spaces to established tenants on long leases, many landlords have been cautious in welcoming coworking operators into their buildings or incorporating corworking spaces into their office developments. In particular, the objectives of this research are:

- to examine the challenges faced by traditional office landlords with the growing demand for coworking culture
- to examine the new opportunities created by coworking culture for office landlords
- to examine how office landlords could adapt to changing demands for corworking spaces in office buildings

Overall, the aim of this paper provides an overview of the coworking environment as it exists in the Melbourne (Australia) office market today and establishes a foundation for further exploration of the implications on the traditional office environments and leasing practices. The first part of the paper discusses the literature with regards to the adoption of coworking spaces both nationally and internationally. The research continues with an examination on the contextual analysis of Melbourne's coworking spaces, and concludes with a discussion on the challenges and opportunities currently prevailing.

Literature review

As mentioned previously, coworking spaces are beneficial for those who desire an environment which facilitates creativity, critical thinking, knowledge sharing and collaboration. However these requirements presented to landlords, challenge and contest the standard way of providing working space, when weighted against the traditional office space environment. There is scant academic literature examining the landlords' viewpoint within this niche sector. Although the property industry has embraced the changing nature of the workforce, challenges and opportunities available to landlord are a worthy consideration when analysing the financial performance of corporate real estate and individual landlord holdings. Current research highlights the benefits of collaboration for start-ups to encourage creativity and innovation, and acknowledge that working in solidarity will not necessarily produce the required results (Gandini 2015; Gerdenitsch et al. 2016). The literature review in this section focuses on available research which examines these challenges and opportunities attributed to coworking spaces.

Challenges

Traditionally start-ups are associated with thoughts of innovation and entrepreneurship with recent research labelling the space as a "new form of urban social infrastructure" (Merkel 2015). However whilst these coworking spaces are designed to encourage networking and collaboration, the outcomes are also dependent on user mix and location (Gandini 2015). Recent research focusing on specific space environments, rather than a CBD metropolis, has explored the question of whether co working promotes entrepreneurship. In this regard, the research identified the need for a "supportive and a productive business climate" coupled with a "physical environment where creativity and innovation can flourish" (Fuzi 2015). This research and also earlier research, provides support to two points of consideration, being the notion that co location in isolation is insufficient to stimulate the necessary collaboration and synergies, and secondly the hosts/facilitators can extensively contribute towards inspiring and motivating interesting relationships and encourage entrepreneurship (Ibert 2010; Spinuzzi 2012; Fuzi 2015). Similarly, the relationship between social support and performance is high, with the expectation that co working spaces will provide flexibility, and opportunities to access social support (Gerdenitsch et al. 2016).

Additionally, the design and aesthetic surroundings of co working space, and how the space is used are all equally important. Freelancers and self-employed individuals working in isolation at home will require suitable fit out spaces. For instance, if working in concentrated areas requires privacy, and a need for no disturbance, this will encourage the development of soundproof cubicles, and so the intent of coworking spaces is defeated (Liegl 2014).

Therefore, the landlord faces the scenario of now embracing additional encumbers. This includes considerations such as offering a head lease to enable an operator to co ordinate the space requirements; or engaging a facilitator to oversee and assist the users of the co working space; or redesign and modify existing office space from the traditional blueprints to a vibrant engaging hub. However if the alternative decision for the landlord is to accept a vacancy factor or low rental for their existing office space, with no potential to improve the rental cash inflow, the conversion of the space to meet the changing needs of the business community, would appear attractive.

Transforming Challenges into Opportunities

Serviced offices, which were introduced many decades ago into the commercial market offered a different package of benefits which included reception and secretarial services, phone lines, faxes and postal services; dedicated office space to the same users i.e. the right to occupy the same space during the term of the tenancy and short term leases. However with the changing nature of the work force and the technological improvements many of these benefits have been superseded due to the advancement of mobile phones, internet and cloud based access (Waters-Lynch and Potts 2017). Therefore a key consideration for landlords is how to better utilize existing office space, simultaneously meet the changing nature of the workforce, and obtain maximum cash inflow of rentals.

An area of significance is the regional scene as opposed to the CBD location. There appears to be an increasingly popular demand to position co working centres in key regional areas (Cameron 2012; Forbes 2014). Commercial landlords may consider this as an exciting opportunity to transform difficult to lease commercial premises into coworking vibrant hubs. There are numerous benefits for users such as the cost elimination of setting up a home-based office and clearly separating home life styles and professional work commitments. A clear detachment is the elimination of merging the home and office environment (Land et al. 2012); and further research suggests co-workers have started to leave their computers at coworking centres, rather than taking their work home (Kjaerulff 2010; Cameron 2012; Forbes 2014). Therefore these changing work patterns provide a guide for commercial landlords to rethink their tenant mix and the design of spaces and how the spaces are used within industry. Where once upon a time, the traditional long term lease rental was the expectation for corporate businesses and freelance individuals chose to work from home, the last decade has witnessed a shift in the office environment (Dixon and Ross 2011; Bryant 2003; Brunelle 2013; Ross and Blumenstein 2013).

However research by Brown (2017) suggests the use of caution when setting up coworking hubs, as not all locations will meet the supply and demand expectations. This is further reiterated with the consideration of the financial viability for landlords and if the coworking business model can be sustained (Brodel et al., 2015; Chuah 2016). This recent research has identified the difficulties in attracting new clients to a coworking hub, and the viability to sustain the membership fee, with some landlords indirectly offering a subsidised fee structure. However, a traditional standard lease usually attracts a free rental period upfront and therefore an on par comparison of the financial viability would be necessary.

In conclusion, whilst these issues are challenging for the commercial landlord, the development of coworking space can provide good opportunities for previously unlettable areas to transform spaces into good cash flow ventures.

Research methodology

This paper presents preliminary findings from the first stage of a wider study that explores the implications of the coworking phenomenon on property markets and key market participants. Due to the explorative nature of this research, a qualitative approach was adopted as the most effective research methodology (Silverman, 2013). Qualitative research is particularly important when prior insights about the phenomenon under scrutiny are modest (Ghauri and Gronhaug, 2005; Mariampolski, 2001), which is the case in this study. The preliminary explanatory results of this study are drawn from a desktop analysis of the top 12 coworking providers in the Melbourne (Australia) office market.

These operators' websites were thoroughly analysed to collect secondary data in relation to the nature and operation of their coworking practices. Several topics related to their business were examined, including: their business location, distance to CBD, nature of the buildings used, target markets, membership categories and fees, total coworking space offered, main facilities available to members, and secondary facilities available. Qualitative data collected were analysed using within-case analysis together with across-case analysis between different coworking providers to obtain an in-depth understanding as to the nature and operation of the coworking practice in the Australian property market.

Results and discussion

In the first phase of the data analysis, the current status of the coworking industry in the Melbourne office market was examined.

Coworking market in Melbourne

The coworking industry across Melbourne has witnessed an exponential growth since the first space was established in 2007. Particularly, the arrival of WeWork, one of the world's fastest-growing coworking businesses, into the Melbourne market has increased its market share and created greater awareness of the coworking concept. Table 1 below, illustrates the top 12 coworking providers in Melbourne who have different models of membership and leasing arrangements for their members. These operators allow their members flexibility on the type and size of space they occupy by offering flexible membership arrangements ranging from day passes to full time fixed monthly desk memberships. They report having over 90% occupancy rates in their coworking spaces with an increasing demand for high-tech, creative and community driven office environments.

Table 1: Major coworking providers in Melbourne

Provider	**Total area**	**Target market**	**Location**	**Charges**
WeWork	11,300	Start-ups, big businesses, and creative entrepreneurs	CBD	• Standard private office – from $730 p.m. • Dedicated desk – from $550 p.m. • Hot desk – from $370 p.m • Custom private space – varies
Hub Melbourne	3,900	Scaling businesses, freelancers, growing	CBD	• Day pass – $40 • Casual user – $300p.m • Frequent – $700 - $750 p.m.

		businesses, global teams setting up satellite offices		
The Commons	3,200	"Businesses and individuals looking to connect, focus and grow"	South Melbourne (3km from the CBD)	• Day pass – $35 • Full-time – $1,600 p.m.
Team Square	3,100	Entrepreneurs, consultancies, agencies, small businesses	CBD	• Flexi desk - from $50 p.m. • Dedicated desk – from $700 p.m. • Private office – from $800 p.m.
Inspire9	2,900	From individual creative entrepreneurs to established and high growth start-ups	Footscray (8 km from the CBD)	• Casual – $40 per day or $165 per week • Part-time residency – $360p.m • Full-time residency – starts from $550 p.m.
Launchpad	2,500	Grown-up, scale-up or start-up businesses	Cremorne (4 km from the CBD)	• Early stage business – $99 p.m. • Established – $345 p.m. • Dynamic business – $690 p.m. • Growing business – $ 1,518 p.m.
The Cluster	2,500	Diverse business community	CBD	• Flexi – from $130 per week • Permanent desk – from $195 per week • Private office – varies • Day pass – $40
ACMI X	2,000	Businesses and individuals from creative industries	Southbank (4 km from the CBD)	• From $600 p.m.
Space&Co.	1,863	Diverse business community	CBD	• Daily – $60 • Part-time – from $210p.m. • Full-time – from $850p.m.
The Arcade	1,230	Not for profit space tailored to game developers	South Melbourne (3km from the CBD)	• $434.72 p.m. • $33 per day
Spaces	1,200	Businesses and individuals from creative industries	Richmond (4.5 km from the CBD)	• From $740 p.m.
One Roof Women	1,000	For women-led businesses	Southbank (2 km from the CBD) CBD	• Part-time – from $320 p.m. • Full-time – from $450 p.m.

Source: Authors

As indicated above in Table 1, the membership fees vary significantly with the quality and location of the coworking spaces. For instance, locations in the CBD or within two kilometre CBD proximity, advertise higher prices. There is also a competitive standard including benefits such as private offices, dedicated desks, flexi desks and access to meeting rooms. And a variety of locations offer increased access to other amenities such as gyms, showers, onsite cafés, childcare centres, shared spaces, event spaces and wellness rooms. These coworking spaces distinguish themselves from serviced offices by offering social and collaborative spaces, knowledge sharing environments, networking events to promote interaction, along with one-to-one educational sessions with industry leaders with the intention of increasing the sense of belonging and community. The majority of the providers analysed above in Table 1, focus on start-up businesses, creative industries and freelancers as their target market; and *One Roof Women* aim for a more specific group such as a women-led business. All space providers have property personnel on their teams to lead and manage leasing, landlord and tenant relations, operations and marketing.

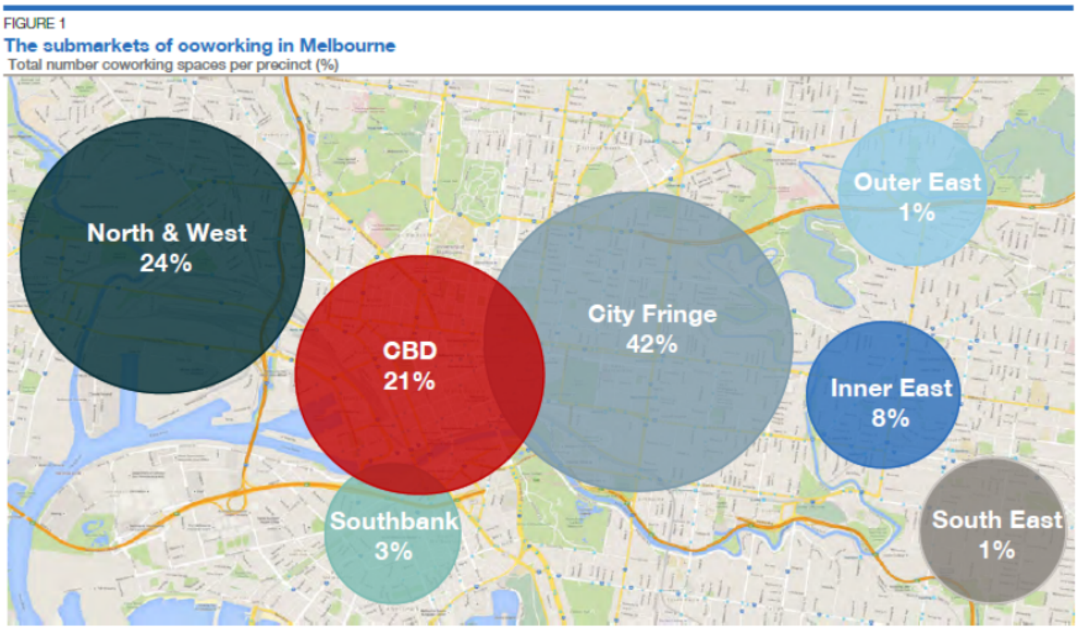
Many landlords are being challenged by the proliferation of the coworking industry as it has significant implications on the traditional office format and leasing models. The next section of the paper discusses the opportunities and challenges created by this new space phenomenon as opposed to the traditional office landlords.

Opportunities to office landlords

There are a number of strategies for landlords to enter this emerging market. These include – leasing space to coworking operators, entering the market directly by developing their own co-working platforms, or partnering with coworking operators to develop coworking spaces.

The first strategy which is leasing space to coworking providers has several benefits for landlords, particularly landlords who own less desirable office properties. As shown in Figure 1 below, approximately 80% of coworking spaces in the Melbourne are located in the fringe or decentralised areas where tenant demand is lower and rents are cheaper. However, Table 1 above indicates 58.33% of coworking providers in the study sample are located in the CBD fringe area. Most of these spaces are located in older, secondary grade office buildings with floor plates that are hard to lease for corporate tenants or in converted warehouses and factories. In addition, some traditional industrial areas closer to the city have been revitalized into commercial hubs by introducing coworking spaces targeting technology and creative industries.

Figure 1: Submarkets of coworking in Melbourne



Source: Knight Frank, 2016

Instead of negotiating rental discounts with individual tenants, landlords are able to lease these spaces to coworking operators who bring credibility to buildings. Coworking spaces are therefore particularly attractive to landlords with underperforming or underutilised assets located in less desirable areas as they allow landlords to improve their financial performance. Coworking practice may also offer lower tenant improvement and fit-out costs as many coworking operators prefer to lease a ‘blank canvas’ where they are able to rearrange the premises to meet their specific requirements and preferred fit-outs. However, with the increasing demand, the next phase of coworking may possibly encourage coworking operators to move into prime quality buildings located in prime locations.

The second strategy includes landlords entering the market directly by developing and operating their own co-working platforms. Several corporate traditional landlords are already pursuing this option. For example, the GPT Group, one of Australia's largest listed property trusts, established its own coworking business named 'Space&Co.' in 2014 and further expanded its spaces in 2017.

The third strategy for landlords is to develop partnerships with coworking operators to develop more specific, purpose-designed coworking spaces. For example, Dexus, one of AREITs, announced a partnership with RocketSpace, a US based coworking space provider, to launch a network of Australian coworking spaces designed specifically to service high-growth tech start-ups. Alternatively, landlords could be able to sign an operating agreement with an experienced coworking where they are paid a monthly fee for running the space from an operational and community management standpoint. By developing partnerships with coworking space providers, landlords would be able to utilise the expertise of established coworking operators to improve their building stock.

Challenges to office landlords

The above discussed opportunities however come at a cost for traditional office landlords. There are suggestions that the coworking phenomenon is the new office market disrupter or the 'Uber' of the office market. Unlike renting space in traditional offices, members of coworking spaces are not required to sign long term leases, pay any deposits or spend large capital outlays on fit-outs. By simply subscribing to a membership, the occupants receive the right to use the office space and associated facilities. By leasing office spaces to coworking operators on long term leases landlords completely lose the control over the end-users of their premises.

Landlords may face issues with the operation of their assets if the lease agreement did not have sufficient provisions in relation to the use and operation of the premises by operators and their members. Therefore, well-defined provisions in terms of landlord consent on subleasing, terms between the provider and the end-user, restrictions on use of space and associated amenities, minimum space requirements per user, building operation and maintenance responsibilities and termination rights should be included in the head lease. Particularly when introducing coworking spaces into multi-tenanted buildings, landlords need to consider and address several issues such as appropriate tenant mix, compatibility between different end-users, relationships among other tenants and end-users, clarity as to the use of building common areas, and security issues within the building.

There are concerns that the coworking practice might have negative implications on the long-term demand for leased office premises and will also reduce the demand for reactive expansion space, resulting in smaller but more stable tenant requirements (Knight Frank, 2016). Coworking spaces also associate with higher occupation density which could cause additional structural stress on building services that are not designed for higher occupant density. Therefore many landlords are required to invest substantial capital on building upgrades and expansions before leasing spaces to coworking operators. However, it is difficult to conduct rational cost-benefit analysis for such upgrades as there is no hard quantitative evidence available on the benefits of leasing space to coworking providers.

Conclusions

In summary, there are two main challenges currently confronting landlords. Firstly, the reliance on coworking operators to perform and survive within changing market conditions in the property industry; and secondly, transforming traditional office spaces into engaging coworking vibrant hubs. In this regard, various strategic considerations, if adopted and implemented by landlords, will ensure an optimum growth for their property asset investment.

Strategic considerations include offering coworking spaces as a further amenity in mixed use properties, or offering coworking spaces to their larger existing tenants who seek adaptable spaces with flexible or shorter term leases. This approach will encourage corporate occupiers who seek buildings with traditional leases to house their core workforce, but may also require a large coworking space within the same building for the peripheral workforce. Additionally, there are many opportunities for landlords to partner with coworking operators, and capture a market segment of start-ups and freelancers that otherwise would not fit under their traditional leases.

Further Research

The coworking business model is an emerging area of research which will require testing under varying property market conditions. Therefore, as part of a wider study the research will expand to explore the implications of the coworking culture on the performance and utilisation of corporate real estate assets, coworking practice, and the role of coworking operators and their relationship with traditional office property landlords.

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