Research Report 2019

US Market Summary: The Pioneers and the Pathfinders

Instant
RETHINKING WORKSPACE

Contents

US Market Report 2019: Introduction

The workspace market has three key opportunities to respond to – the war for talent, employees choosing to pursue better quality of life, and digital innovation that continues to create new, agile roles for workers.

In the US, flexible workspace, from coworking to space-as-a-service is continuing to meet these challenges and grow in terms of both supply of space but also the variety of options available.

There is now an astonishing array of spaces and this diversity of offering will only continue as new entrants come into the market and established players shake up their products.

Clients are becoming more discerning in their choice, both in location and variety of space. And operators are becoming smarter at defining their market proposition and using data to track success.

Established operators are expanding at an impressive rate while landlords and brokerage houses are making a play to get their foot in the door, although niche operators still make up the largest percent of market share.

Never has there been more choice in this industry

As we have reported in previous market reports, flexible workspace adoption in the US has been growing consistently over the last five years.

Our latest data highlighted in this report shows not only more of the same but also increased growth in key markets such as Phoenix, San Francisco, Chicago, Atlanta and Seattle.

The US market for flex space is now the largest in the world with 5,300 centers (overtaking the UK)

The US market is diversifying NOT consolidating - the 10 largest operators now make up 36% of the market (less market share than prior year)

The average size of centers opened in 2019 is 50% larger than the average of all US centers

Instant forecasts 10,000 US centers by 2023

Flex space makes up less than 1% of total office space across the entire US market

"It has been a remarkable year for flex space as we start to see a proliferation of choice, with client demand forcing operators and landlords to aggressively evolve their models to differentiate and specialize. We now have more than 5,300 centers across the US but the core supply from the largest operators has dropped as an overall proportion of the market to less than 30% of total supply. This is a market founded on choice and diversification – and despite the growth, it continues to evolve and adapt to market demand."

MICHELLE BODICK
MANAGING DIRECTOR, SALES & MARKETING
THE INSTANT GROUP

US Market Trends: Supply

For the first time, the United States has now surpassed the UK with over 5,300 centers for flex space – compared to 4,563 in the UK.

Throughout the year, The Instant Group has seen supply not only increase by 10% year on year but also morph from a start-up focused sector built around core cities into one focused on providing solutions for more mature businesses across the breadth of the US.

HOW DOES SUPPLY COMPARE YEAR ON YEAR – IS THE SUPPLY TREND SLOWING?

During the year, we have seen rapid expansion from the larger, multi-location, operators who have expanded outside of core markets and into secondary cities due to growing demand.

> **But despite the 10 largest operators now making up 36% of the market in the US, this is actually less market share than they held in the previous year.**

The faster growth of independent and start-up flex space providers is a clear indication that with the low barriers to entry and increased awareness of the industry, those willing to invest in the industry at a local level remain the dominant force.

These are the players that are providing the niches and choice of spaces that continue to provoke demand and evolve the industry. They are also ensuring that the sector is expanding outside of core urban areas and becoming a significant alternative for companies and workers that want offices space outside of traditional city markets.

This is a trend that is increasing in velocity over the past five years – they are now more operators of flex space than ever before. And this has come about despite the rapid expansion of the larger players in the market.

The need to fire up regional growth of supply has been recognized by many operators and they are responding to the need to quickly expand into local markets by creating a franchise model.

> **Companies such as Venture X, initially expanding during 2018 and cementing their position during 2019, have shown high growth into localized markets using this franchise model.**

Many of the challenges for operators in these markets has centered on sourcing the right space and understanding the nuanced demand of the local working population. Working with a local partner, with business experience in-market, is a way to share risk and expand the brand.

Demand

As the market develops in the US and we see increased demand from larger requirements and increased investment into the industry, the size of centers is quickly increasing.

Our data shows that the average size of a flexible center in the US is 18,741 sq ft. Depending on layout this could seat anywhere from 180 people in large private offices to over 450 workstations in a open coworking space.

> **If we look at the data for locations solely opened in 2019, the average size has increased to 28,526 sq ft- over a 50% uplift.**

In New York, in particular, demand for 25 or more desks has increased from 6% to 13% in the last year. On the other coast, in San Francisco demand for 10 or more desks has increased 27% from last year to 60% of total demand.

THE AVERAGE SIZE OF A FLEXIBLE CENTER IN THE US IS 18,741 SQ FT

US Forecast

Forecasts for the flexible market vary widely, partly due to the immature nature of the market and the lack of available data within the industry. But a crucial way in which the full extent of the market is being misrepresented is that much of the existing research is focused only on the major city centers and for spaces over 20,000 sq ft.

As we have shown earlier in this report the vast majority of flexible spaces are far smaller than 20,000 sq ft and increasingly being run outside of major metro areas.

> **This is a fragmented and niche industry, and one that is growing rapidly outside of traditional urban bases.**

IF YOU BUILD IT, THEY WILL COME

Using our data and primary research we continue to see an uplift in supply across the US matched by exponential growth in demand.

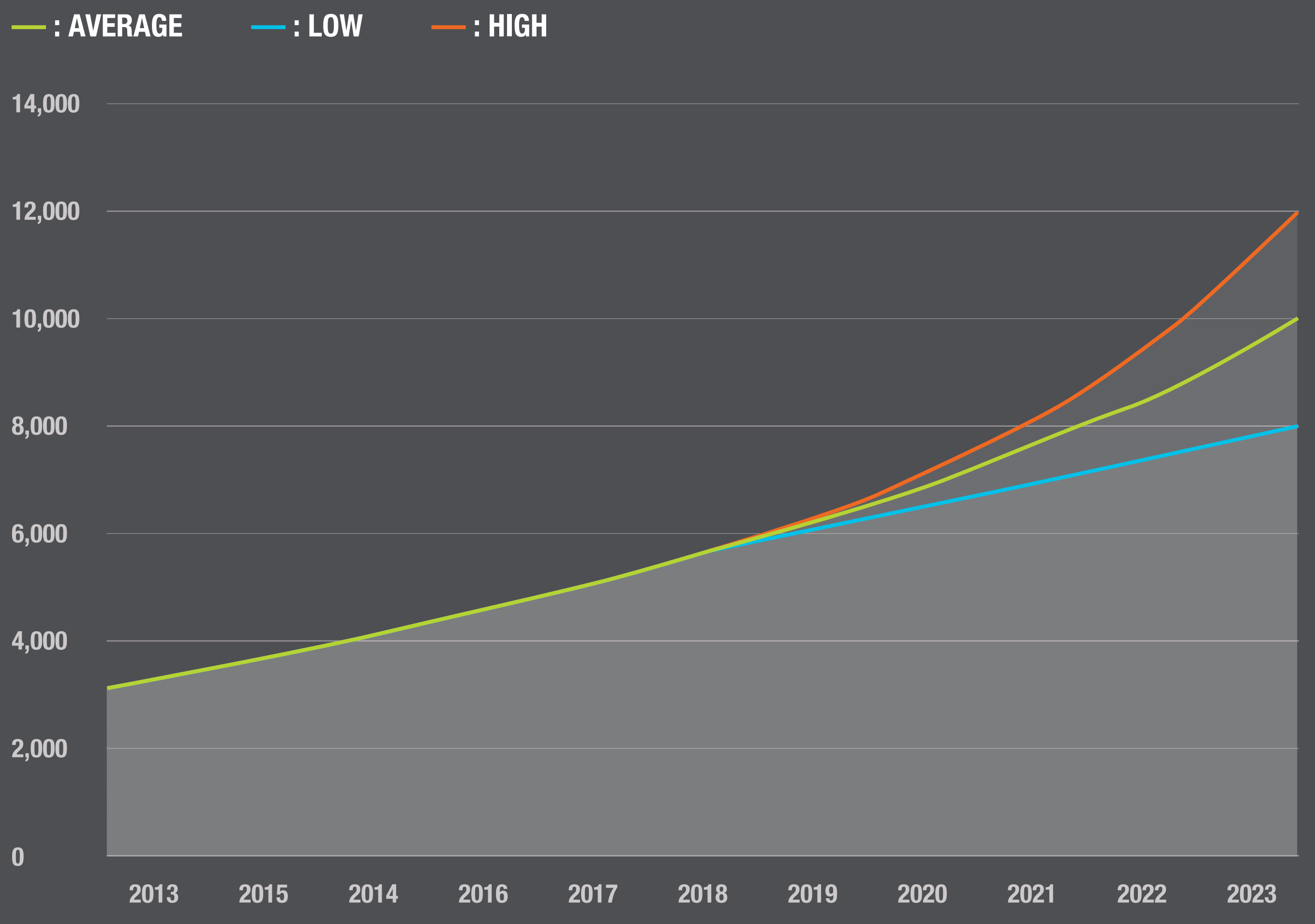
This growth is being driven by larger companies incorporating greater amounts of agility into their portfolios. As supply improves, and awareness increases, employees are demanding more from their office spaces.

If the growth in rural markets and smaller towns continues at the same rate we are currently seeing, in addition to the continued spread of flexible locations into major metropolitan suburban markets, we could see upwards of 10,000 flexible locations across the US by 2023. This would make it substantially the largest flex market in the world.

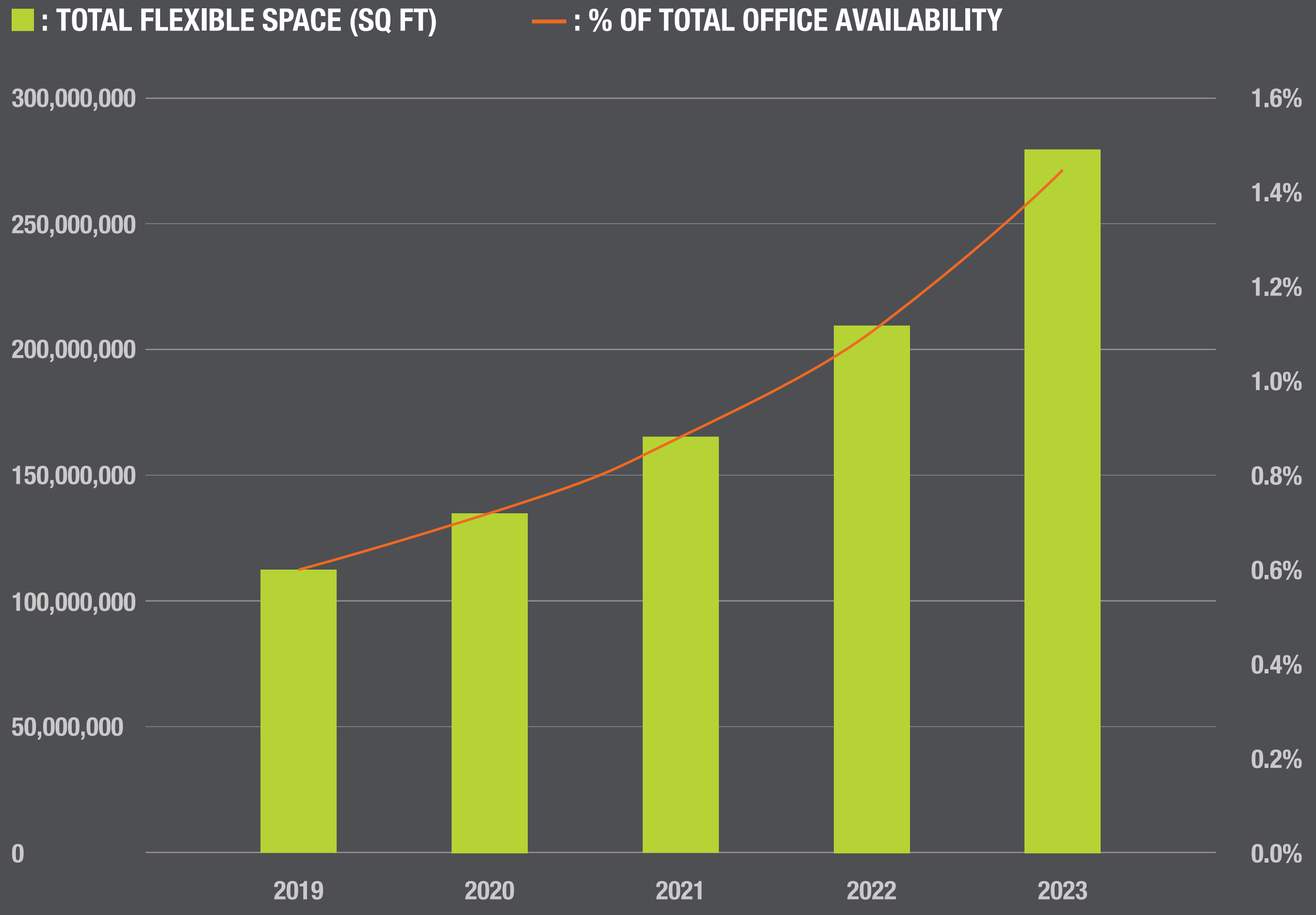
> **Premium space is already proving harder to find in many major US cities and operators will need the support of landlords to match current growth levels going forward, something that is not certain by any means, despite a slow shift of some of the larger landlords within the market.**

WE COULD SEE UPWARDS OF 10,000 FLEXIBLE LOCATIONS ACROSS THE US BY 2023

US CENTER SUPPLY FORECAST (NUMBER OF FLEX LOCATIONS)



FLEXIBLE SPACE AS A % OF TOTAL OFFICE AVAILABILITY
BASED ON HIGH LEVEL AVAILABILITY



US Forecast

DESPITE DEMAND, SUPPLY IS STILL LESS THAN 1%

While many central business districts have reached market penetration levels of between 4 and 6 percent, the wider cities themselves still see flexible providers take up less than 4 percent of the total office availability within the city.

If we look at the wider US market using total office space statistics from the US Energy Information Administration and factor in a 2 percent year on year total market growth rate, we see that today the flexible market makes up less than 1 percent of total US office supply, despite the amount of activity seen to date. Whereas in the more established flex market of the UK, this figure is just above 7%.

Looking ahead and factoring in the average size of flexible locations increasing, even at our higher estimate the flexible market is likely only going to make up 1.5% of total office availability within the US.

Our forecast shows that even with strong growth in supply for the foreseeable future there is a huge amount of room for this industry to expand into new markets.

THE EFFECTS OF AN ECONOMIC DOWNTURN

Many industry commentators appear concerned that the industry may still be just a temporary phenomenon and that an economic downturn could spell disaster for flexible workspace.

In our opinion, and looking at the impacts of an economic downturn on the industry in 2008, if anything this market thrives in uncertain market conditions where flexibility in lease terms and employee retention gives companies an advantage.

Combine this with changing occupier demands and expectations and our predictions only point to the market moving in one direction: up.

TODAY THE FLEXIBLE MARKET
MAKES UP
LESS THAN 1%
OF TOTAL US OFFICE SUPPLY
DESPITE THE AMOUNT OF ACTIVITY SEEN TO DATE

Inquiry and Deal Size

Across the US, inquiry sizes have largely remained the same between Q1 2018 and Q1 2019 with just a slight increase in the number of inquiries for 1-2 desks and a slight decrease in 3-9 desk inquiries.

As we see larger requirements coming into play, it is important to note that across the US, the demand for one to two person offices has not vanished. Smaller requirements are still seen across the country, with Atlanta and Dallas absorbing most of the demand.

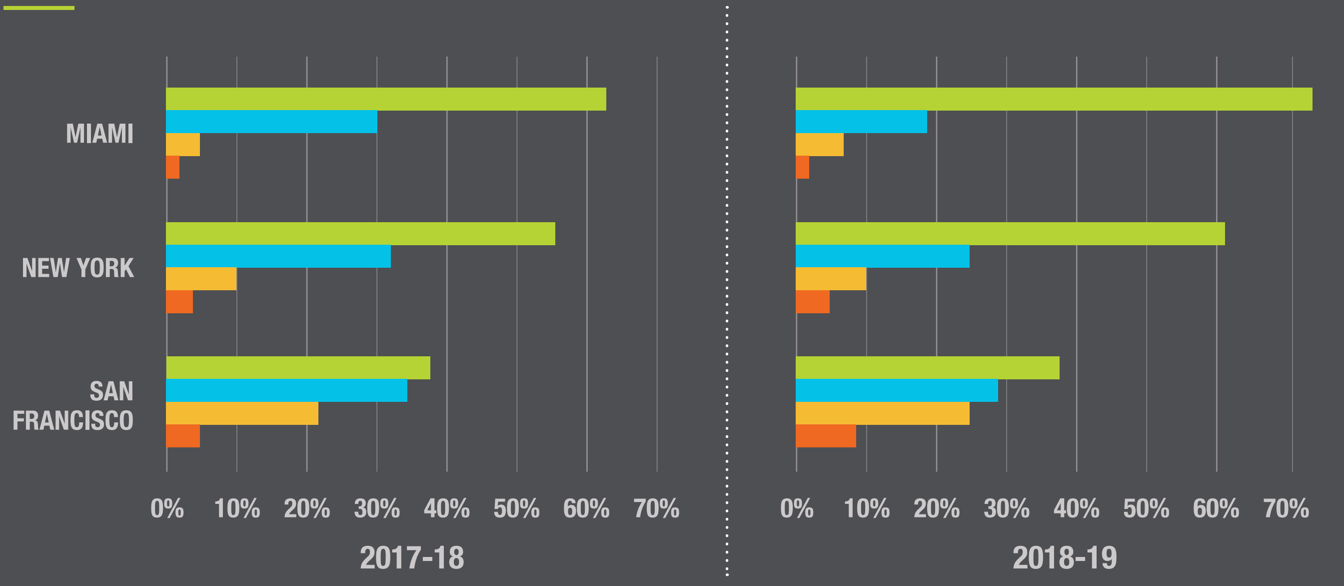
Unlike inquiry size, deal size has seen a slight decrease in 1-2 desk deals and an increase in 3-9 desk deals. Over 80 percent of deals closed between Q1 2018 and Q1 2019 has been for 1-2 desks showing that the industry is still finding solutions for its original clientele - the smaller start-ups.

However, broken down by city, the split is much more uneven compared to that for inquiry size. In Q1 2018, the deals closed in Dallas, Atlanta and Chicago were primarily for 1-2 desks.

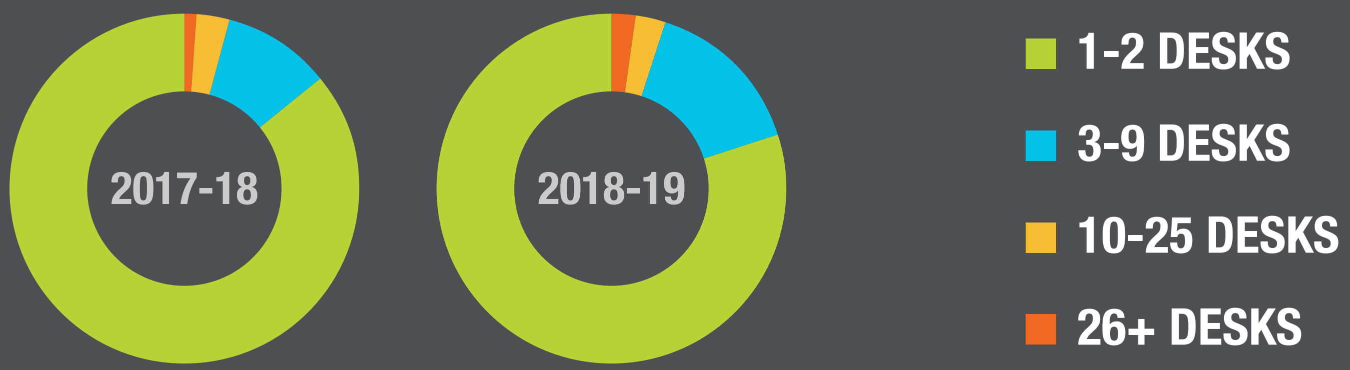
In Q1 2019, whereas Dallas and Chicago remain top for deals closed for 1-2 desks, in Atlanta only 50 percent of deals were for 1-2 desks, compared to 81 percent in Q1 2018. Instead, 35 percent of deals in Atlanta were for 10-25 desks increasing an impressive 23 percent from the previous year.

However, there was a significant shift towards larger deals in other cities in Q1 2019. For example, in Atlanta 39% of deals closed in Q1 2019 were 10+ desks compared to just 13% in Q1 2018. Similarly, in San Francisco 60% of deals closed in Q1 2019 were 10+ desks compared to just 11% in Q1 2018.

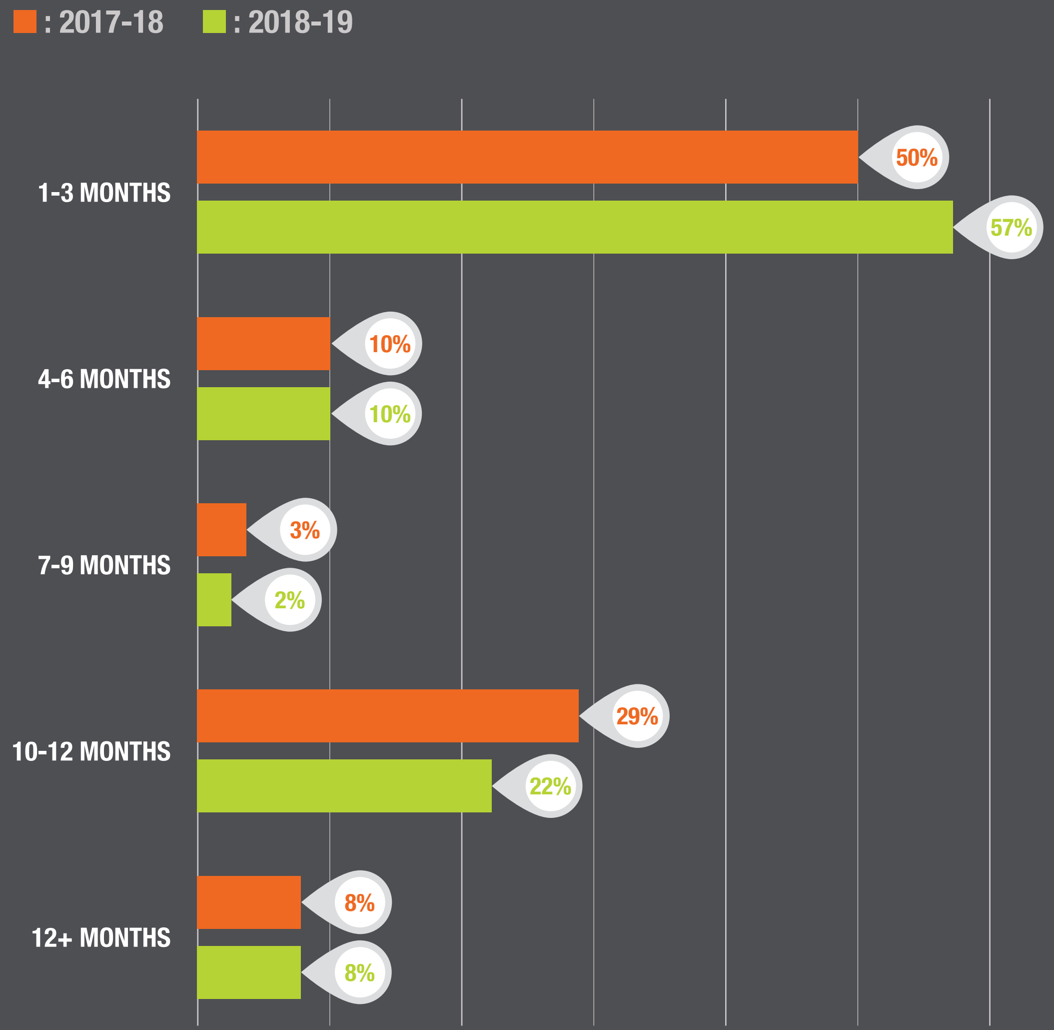
AVERAGE INQUIRY SIZE BY CITY



AVERAGE DEAL SIZE ACROSS THE US



AVERAGE LEASE LENGTH ACROSS THE US



Length of Term

On average in Q1 2018, a higher number of shorter-term deals were closed in San Francisco and New York with 60% and 57% of deals signing for 1 to 3 months in those cities respectively. Deals with longer terms in Q1 2018 were signed in Miami and Chicago with 75% and 71% of deals signing for over 10 months respectively.

Compared to Q1 2019, New York has fallen out of the top two and shorter-term deals were seen primarily in San Francisco and Denver with 85% and 73% of deals signing for 1-3 months in these cities respectively.

> **Deals with longer terms in Q1 2019 were again signed in Miami and Chicago with 60% and 44% of deals signing for 10+ months in these cities respectively. These figures have notably decreased from Q1 2018 even though they are still the highest in Q1 2019.**

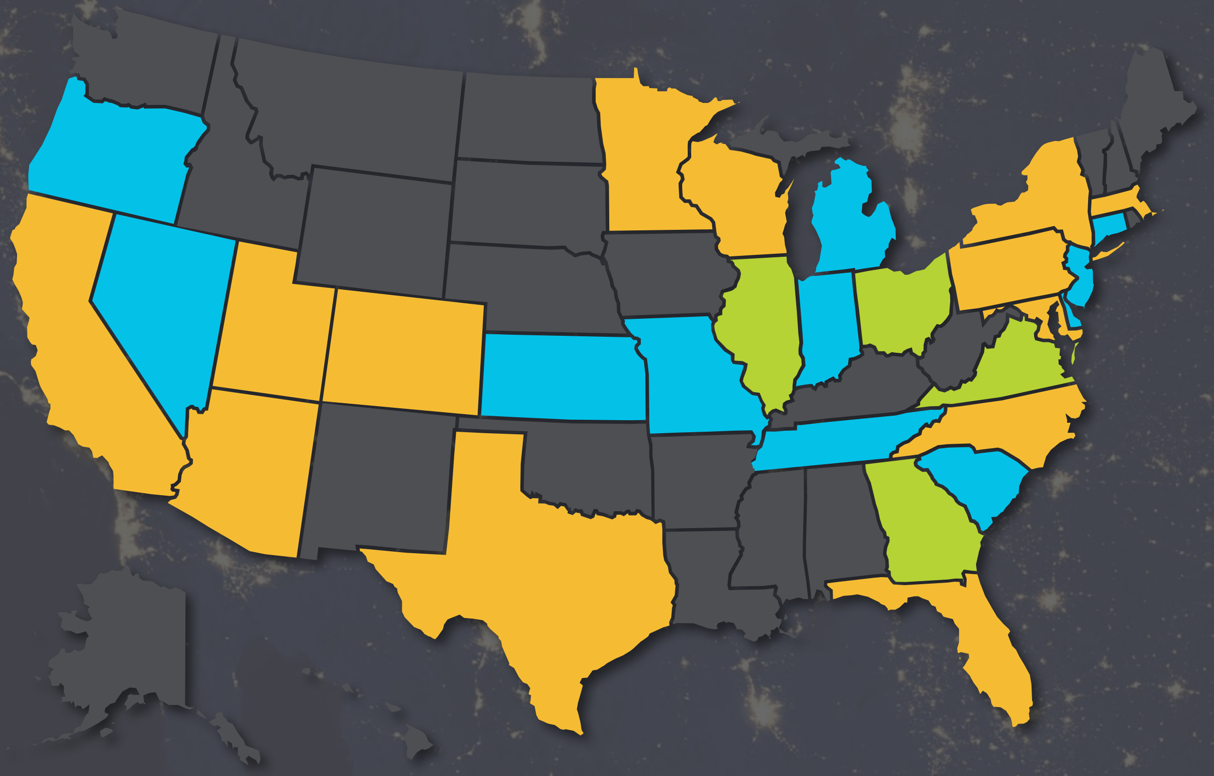
Looking at the short-term flex end of the market, we can, perhaps, see the start of clients hedging their bets ahead of the risk of a downturn. Interestingly, they are not turning away from flex deals – as demand is definitively up in these markets – but they are looking at slightly shorter terms in some cities.

This is just year-on-year data, however when looking at a slightly longer-term view over the past decade, flex deals are more than 50% longer than those of even five years ago.

State by State View

In the states that have 30 or more centers (29 states in total including Washington D.C.), we see growth up to 15% with Washington D.C. and Georgia leading the charge.

As we predicted last year, we are seeing the rise of the secondary markets across the US, as companies look for flex space in urban centers which have historically had less supply. This fits with wider societal trends, as we note that there has been employment growth in these markets.



YEAR ON YEAR GROWTH 0% - 5% GROWTH 6% - 10% GROWTH 11% - 16% GROWTH

STATE	NO. OF CENTERS Q1 2019	YEAR ON YEAR GROWTH
District of Columbia	97	15%
Georgia	161	15%
Ohio	126	13%
Maryland	82	12%
Virginia	103	12%
Illinois	231	11%
New York	666	11%
California	1100	10%
Minnesota	57	10%
North Carolina	103	10%
Wisconsin	44	10%
Arizona	123	9%
Massachusetts	176	9%
Pennsylvania	153	9%
Florida	451	8%

STATE	NO. OF CENTERS Q1 2019	YEAR ON YEAR GROWTH
Texas	497	8%
Colorado	180	7%
Utah	49	7%
Missouri	76	6%
Washington	124	6%
Indiana	80	5%
Connecticut	57	4%
Kansas	29	4%
Oregon	75	4%
Michigan	61	3%
Nevada	90	3%
South Carolina	40	3%
New Jersey	121	1%
Tennessee	77	1%

However, the New York market is still one of the fastest growing across the country in terms of supply, as is California where flex supply continues its double digit growth and eats into the markets where conventional space has previously dominated.

The Key Players

The business model for flex space is spinning off into different angles as operators seek new forms of revenue generation and audience capture.

The market is evolving to meet more sophisticated, niche-specific client demand, but also responding to demand from larger, corporate customers with very different dynamics.

> **From this, we have seen the average size of flex space centers radically shift from less than 10,000 sq ft to 18,741 sq ft, with some flagships locations from WeWork and others coming to over 100,000 sq ft.**

Small independently run businesses still make up the largest proportion of operators in the US market thanks to the low barriers to entry.

These companies, in particular, continue to focus on core community values and often remain most closely aligned to the original image of coworking in coffee shops.

In contrast, these values are slowly becoming lost in some larger providers as demand from larger tenants and corporates changes the focus.

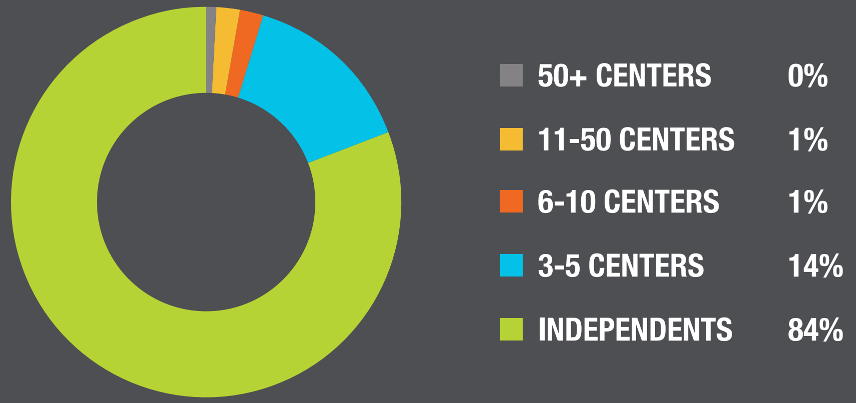
> **Larger providers are now able to provide private space for bigger requirements of 50 plus desks with meetings rooms within the private section, where niche providers are sticking to slightly smaller offices, ranging from 5 to 15 desks with meeting rooms outside the private area.**

Both types of providers are, however, not forgetting about the membership model of encouraging entrepreneurs to work in the space without a dedicated desk.

From our perspective, we do not anticipate the larger model cannibalizing the market for smaller spaces - niche operators are operating to very specific audiences and adding to the comprehensive choice which makes the flex market so compelling.

Ultimately, it is choice that is the key trend driving demand and tailoring the office space to specific client requirements.

OPERATOR MARKET SHARE
BY SIZE OF OPERATOR



“We are really starting to see a “two-pace” market with the ongoing expansion of the independent and niche operator, who now make up more market share then ever before, but also the larger operators taking bigger spaces that in some cases are four or five times the industry average.

In some ways, this is symptomatic of the larger operators catering for corporate demand for companies with bigger requirements and therefore needing larger floorplates. But also the independent operators are doing more to adapt to their core markets, diversify their offer and generate more niche space.”

MICHELLE BODICK
MANAGING DIRECTOR, SALES & MARKETING
THE INSTANT GROUP

The Customer

WHAT INDUSTRIES ARE USING FLEX?

In 2018, technology and finance firms had the highest volume of deals closed for flexible space. Not far behind were customer service and consulting firms. In 2019, this has shifted so that the majority of deals closed were from the consulting industry at almost double the rate compared to technology.

This shift was seen specifically in Denver, where technology was the top industry for deals in Q1 2018 whereas consulting was top in Q1 2019, following the trend seen across the US.

> **In San Francisco, technology has remained the industry with the highest number of deals closed. Legal was one industry we have seen coming into flexible space in 2019 compared to their virtual non-existence in 2018.**

CHANGING AMENITY NEEDS

Service provision remains a core focus for the flex workspace market with the community ethos still a central tenet of the offer. Service provision remains a core focus for the flex workspace market with the community ethos still a central tenet of the offer.

> **However, unlike the early days of the flex industry in the US, free coffee and beer on tap no longer cut it.**

Amenities that keep a business running such as HR advice, stable internet connectivity and accessible conference rooms were valued higher than the perks such as bar facilities or pet friendliness.

Our latest research shows that 81 percent of end users said they would be willing to pay a premium for business related services that truly added value.

81% OF END USERS SAID THEY WOULD BE WILLING TO PAY A PREMIUM FOR BUSINESS RELATED SERVICES THAT TRULY ADD VALUE

Our research reports that 57 percent of end users pay for additional services once they are in a flexible space.

Traditionally these were related to phone and internet services, but as operators offer internet and dedicated phone lines slowly become a thing of the past, we are seeing that end users are paying for more event space, meeting rooms and F&B services.

All three require large amounts of additional space, meaning that the larger the building, the lower percent of total usable space needs to be dedicated for these services, helping drive overall profitability for centers.

> **As choice in the market becomes more prevalent, end users expect more from their providers from both a space and service perspective. This is not surprising, considering that the average US employee spends over 8.5 hours a day working.**

Space-as-a-service

Space-as-a-service, workspace procured on-demand and most commonly without a direct lease from the landlord, is allowing clients to radically reduce the timeline for finding and moving into workspace.

By entering into an agreement with a 3rd party operator that holds the relationship with the landlord and provides required workspace services, corporates are benefiting from a faster, more agile route to occupancy.

> **The dynamic growth of this element of the flex workspace market has been founded on the customizable element of the offer – clients are finally able to procure space when they want it, where they want it and at the right price.**

In turn this allows occupier organizations to better focus on employee retention and their core business activities rather than juggling lengthy real-estate leases that increasingly put strain on corporate liability sheets.

For commercial real estate, this equates to a radical shift from a model founded on asset-management – with an accompanying focus on the investors and/or landlords – to a service-based model.

Technology and the increasingly flexible role of employee have been the leading factors to this change in the way we work and where we work thus far. But as real estate itself becomes more agile, then this will enable a more radical shift of how organizations structure their office portfolio.

The shift from asset-centric models to the provision of services has been seen in many industries such as the automotive industry, taxis, hotels and computing – the impact in each has been the reduction of capital-intensive investment in assets to a more agile, service-based approach. Space-as-a-Service is very much the CRE response to this “rental economy”.

> **We have seen the rise of in the consumer rental market such as AirBNB, Stopp, and those that aid commuters such as Uber and Lyft.**

To quote Mintel research in this area, “consumers are weighing up if it is worth taking the risk of buying something that comes with responsibility, maintenance and often a considerable financial investment – or if simply renting it would be a better option.”

> **“The market is transitioning from asset management to service provision – for me, this is emblematic of the changing requirements of business demand.**
>
> **Clients need faster, more agile solutions for workspace problems. When they sign a lease, then that for many is just the start of their problems – the old style of procuring workspace entails the appointment of numerous third parties, to manage workspace strategy, design, delivery and management.**
>
> **Under the SAAS (space-as-a-service) model, clients are buying solutions that provide an end-to-end answer to their requirement managed by one partner.”**

GETHIN DAVIES
SENIOR DIRECTOR
THE INSTANT GROUP

The Landlord Response

Landlords are being forced to adapt from being rent collectors to the providers of services for occupiers of their space – and often without the luxury of a long-term lease.

As many of these “soft” services fall well outside their scope, landlords are quickly making the decision to either partner with, acquire or become a flexible space provider. Industry heavyweights such Blackstone Group, Tishman Speyer, Related and Boston Properties have all entered the space-as-a-service market.

Tishman Speyer introduced Studio in September of 2018, a flexible space provider that focuses on high tech solutions and high end finishes. As a Studio member, you get access to the Clubhouse that houses nap pods, outdoor access, and high-end amenities.

The key here is that Tishman Speyer doesn’t have to lease this additional space since as the landlord, they own it.

> **In a Wall Street Journal article, Rob Speyer, CEO of Tishman Speyer said coworking “may be the biggest disruption to real estate since the invention of the elevator.”**

Brookfield Properties, a leading landlord of Class A buildings, and Convene, a flexible space provider focused on luxury spaces, announced their partnership in March of this year.

Related Companies, the landlord behind New York’s Hudson Yards, has partnered with Industrious and Equinox so that members have access to both the flexible workspace and the premium fitness club.

Meanwhile, Blackstone has acquired majority interest in The Office Group, a leading flexible workspace provider in the UK.

> **Hines Interests LP launched its own coworking arm called Hines Squared partnering with providers Convene and Industrious. The partners opened their first four locations, “The Square”, in Houston, Atlanta, Salt Lake City and Calgary, Alberta.**

The trend has become so prominent that leading landlords including Hines, Brookfield Asset Management Inc, Blackstone Group LP, RXR and British Land have established an “owners council” aimed to discuss the threat of coworking, changes in technology and ways to join forces.

We are seeing a growing landlord presence in the leading flexible workspace cities, San Francisco and NYC, but particularly in Boston there is higher than average interest.

Not to be left out of the loop, brokerage houses are making their mark on flexible workspace as well. CBRE announced the launch of their flexible workspace solution Hana in October of 2018 and opened their first space in Dallas at the end of summer 2019.

> **The solution is targeted at large corporates providing amenities, technology, and full control over branding that large firms require.**

Each Hana facility will feature Hana Meet, providing conference rooms and event space that can be rented hourly, daily or weekly, and Hana Share, a traditional coworking space comparable to WeWork.

studio convene
INDUSTRIOUS
Hines TOG THE OFFICE GROUP hana

The Franchise Model

To expand quickly into new locations in the secondary and smaller markets across the US, some operators have now established franchise models; this includes firms such as Venture X, Serendipity Labs and Office Evolution.

Even the world's largest provider, Regus, has contemplated the business play stating on their website:

> "It's key to our growth strategy that we can enter new markets as well as increasing our presence in the 1,000 cities and towns where we already operate. That's why we're actively looking for franchise partners..."

Across the board, franchise models are selling the idea with additional revenue streams such as event and conference room rentals.

Great Flexpectations

> "Nearly every media interview we undertake ends with, "How far can this market go?".
>
> We believe that the media and much of the market are looking at flex space in the wrong way – this isn't a short term move towards coworking, community and all these other buzz words.
>
> This is a shift in client demand as businesses demand agile solutions. This is real estate providing answers to client problems founded on being responsive and adaptable.
>
> Flex space as a market now incorporates many different solutions, and more will avail themselves over the coming months and years. Momentum is there in terms of market supply of flex space, but it still not matching demand from the end user, and as long as that remains the case then we are going to see exciting innovation and evolution."

JOHN WILLIAMS
HEAD OF MARKETING, THE INSTANT GROUP

Rethinking Workspace.

Founded in 1999, The Instant Group is a workspace innovation company that rethinks workspace on behalf of its clients injecting flexibility, reducing cost and driving enterprise performance. Instant places more than 11,000 companies a year in flexible workspace such as executive suites, coworking or managed offices including Amazon, Barclays, Prudential, Booking.com, Shell, Capita, Teleperformance and Worldpay making it the market leader in flexible workspace.

Its listings' platform **www.instantoffices.com** hosts more than 15,000 flexible workspace centers across the world and is the only site of its kind to represent the global market, providing a service to Fortune 500, FTSE 100 and SME clients. With offices across the world, The Instant Group employs 300 experts and has clients in more than 150 countries. Instant is ranked #28 in the 2019 Sunday Times HSBC International Track 200.

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Note: All figures in this report were collated using The Instant Group's proprietary transactional data and market research surveys as at March 2019.

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