NAIOP
COMMERCIAL REAL ESTATE DEVELOPMENT ASSOCIATION
CHICAGO CHAPTER

"What You Need to Know About Coworking… The New Mega-Billion Dollar Trend in CRE"

by Matt Baron, NAIOP Chicago Staff Writer

This is a summary of the April 9, 2019, meeting of the Chicago chapter of NAIOP, the Commercial Real Estate Development Association.

Its members gathered at WeWork's 515 N. State St. location in Chicago for a lively discussion centered around how coworking entities are disrupting the local and national commercial real estate markets. Key market leaders shared their ownership, brokerage and agile real estate market perspectives.

The session moderator was Victoria Noonan, *Managing Principal*, Cushman & Wakefield.
Panelists included Jillian Brown, *Enterprise Account Director – Chicago,* Convene; Beth Moore, *Head of Broker Development*, WeWork; Greg S. O'Neal, *Senior Vice President*, Beacon Capital Partners; and Bill Rogers, *International Director, Leader Tenant Representation – Central Region,* JLL.

Already in the midst of a highly publicized rise, coworking is projected to grow even more rapidly in coming years. Today it represents less than 2 percent of commercial real estate occupancy, and that figure is projected to skyrocket—to as high as a 30-percent market share by 2030. The outlook isn't speculative crystal ball-gazing: last year, coworking deals accounted for 58 percent of net absorption nationally, up from 22 percent of net absorption in 2017.

In Chicago, there are 35 coworking companies; nationally, over 400 companies have swarmed into this hot space.

Whereas the term "coworking" implies—and still provides—working space that is shared by various entities, panelists noted that the more compelling and appealing feature of this product type is the flexibility it offers to clients. Powering this paradigm shift is expanded demand for flexible work space that accommodates a wide spectrum of businesses. Coworking cohorts range from solo freelancers to Fortune 500 companies that are turning to the model for relatively tiny portions of their operation.

At WeWork, for example, tenants operate under a membership-based month-to-month arrangement. In the five months since its November 2018 opening, the location at 515 N. State, covering five floors, has already attained more than 85% capacity.

More than shared space, shared technology and "shared community" are what is propelling the flexible office industry forward, said Jillian Brown.

Along with that trend, Beth Moore emphasized that the shift is being fueled by heightened unknown variables in the business world.

"We're living in an age where it's harder and harder to predict the future…increasingly our biggest segments are medium- and large-size businesses and our enterprise businesses--companies above 1,000 employees locally," said Moore.

Those types of operations account for about one-third of WeWork's tenancy, and that figure is expected to climb, she added.

Pointing out that coworking has been around for decades, albeit on a lesser scale, Victoria Noonan inquired why it has surged in recent years.

“It’s really driven by the employee and the user who is asking for more in their workplace experience,” said Bill Rogers. “Companies are trying to respond to that in order to retain and recruit talent. As part of that, they’re looking for ways to be flexible, they’re looking for ways to make their employee base more productive, (and) they’re looking for ways to save capital costs.”

“There are a lot of factors that are driving it,” he added. “Then you have the players and the providers who are answering the need and adding to the workplace strategy for these companies.”

JLL research calls for coworking space to grow to 30 percent by 2030, so, added Rogers, “there’s still a long runway to go.”

The coworking category is pushing landlords in non-coworking spaces to provide shorter lease terms as well as more amenities and programming to tenants, said Greg O’Neal, whose real estate investment firm, Beacon Capital Partners, owns 515 N. State.

“At Beacon, we’ve been open to coworking the past several years as well,” O’Neal continued. “We welcome the shift…we’ve also seen (coworking) activate buildings as well… The minute WeWork moved in (at 515 N. State), it has been animated, it’s active.”

Coworking companies share plenty of common ground, but among those that are emerging, Moore said they can be assigned to any of three different broad categories: local, niche-focused companies that provide specially curated experiences around a single community (such as artisans or a collaborative of working women); a “middle tier” model that is “more of a price, location, convenience play”; and organizations such as WeWork, Regus, Convene and Industrious “that are handling a lot of larger flexible requirements.”

As to whether tenants are looking to be treated differently when they are in a coworking environment within a building, Rogers said, “They are definitely asking those questions.” One example he cited is Walgreens, which is moving into the redevelopment of Chicago’s Old Main Post Office and has expressed interest in a potential coworking arrangement in the future.

“The larger users are looking at coworking as a way to manage their long-term growth,” Rogers said. “It’s almost becoming a kind of ‘gotta have.’”

Whereas tenants used to be more “binary” about coworking spaces in their building—they either liked it or didn’t—now there is universal acceptance because of its ability to accommodate short-term projects or other needs flexibly, said O’Neal.

Also on the rise, according to Rogers: large companies that dedicate portions of their own spaces to flexible designs that enable scaling up or down. “It’s not just specific to the coworking companies servicing that need,” he continued. “It’s these corporates starting to get smart.”

Panelists addressed the question of “proximity threshold”—whether multiple locations close to another may be in danger of crowding out demand.

With nine locations in Chicago, WeWorks “gives members access and choice based on where they have meetings” as well as the ability to create customized office space for larger enterprises, noted Moore. Rogers added that many coworking companies have yet to venture into the suburbs, which represent a potential growth area.

Tenants are also demanding consistently high standards that do not compromise their operations across any number of priorities, including information technology, security, branding, and culture, said Moore.

Although most of Rogers’ clients, such as law firms, want traditional space, more “traditional corporate-type users and smaller clients are getting over the hump quicker and really considering as a real option a (co-working) solution,” he said.

Overall growth in the coworking trend will likely mean acceptance among investors for a higher proportion of a given property's use as a coworking space, according to O'Neal.

In the capital and debt markets, the general rule of thumb has been anything over 20 to 25% coworking space may spark "push-back," but he said that the tolerance threshold will probably bump up to 25-30% soon and continue growing from there. "There's no hard and fast rule at this point," O'Neal added.

When Noonan raised the specter of a future market bubble burst, Moore said "in times of uncertainty that's where our product yields the best."

"In bad times, people aren't going to want to take 10- or 15-year bets," she continued. "Whether the market is up or down, what we are offering our clients is flexibility. That's why we continue to grow and I think as companies are looking toward the future, looking where and when they can attract the best talent, and where their business needs are, flexibility will hopefully yield in good times and bad."

Measuring work productivity is an elusive data point. However, when employees connect effectively with one another—a process aided by well-designed and curated spaces—then it spurs on better work output, said Moore.

"If people are happy about coming to work—they like the people they work with and they have meaning in their work and they're fulfilled—they're going to be more productive," she added.

Consolidation among companies in the coworking sector is happening in other parts of the world, notably the Asia Pacific region. Mergers and acquisitions are "naturally" bound to happen more frequently in the United States as well, said Moore. She cited acquisitions by Industrious, including in the Chicago market, as one current example.

Some landlords are starting to build out coworking spaces and managing those spaces on their own, said O'Neal, but they tend to do so without devoting enough attention given to creating a strong culture or programming. "The hardest part is that qualitative piece that WeWork and Industrious and the like do a really good job at," O'Neal observed. "I think that's the hardest part to get right."

During a wide-ranging closing question-and-answer segment, one audience member inquired about the relative importance of tenant improvements in this emerging category. Panelists agreed that tenant improvements are a major consideration.

"When these companies come in, you're investing in that space if you want 'em," said Rogers. "You're already becoming a sort of pseudo-partner with them, anyway."

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