

Spotting the opportunities: flexible space in Asia Pacific



Executive summary

Flexible space is evolving rapidly in Asia Pacific. While serviced office firms have been active since the 1990s, 2016 was an inflexion point, with the entry of international players such as WeWork and the rapid expansion of local coworking operators. In fact, over the last three years flexible space in Asia Pacific grew faster than the US and Europe though admittedly off a lower base.

Cultural differences

While there are many similarities in how flexible space is evolving globally, the Asia Pacific region has some unique characteristics. Government support and policies, the need to adapt to Asian cultural workplace norms, shorter lease terms, as well as the power of a handful of landlords who dominate key markets are some main points of differentiation that will shape the evolution of flexible space in Asia Pacific.

What's the impact?

Flexible space operators have been increasingly active in Asia Pacific leasing markets and have provided support to occupancy levels in a number of cities. However, there has been no noticeable impact on office rents. We have also observed a growing convergence within the flexible space sector, with serviced office operators developing coworking brands, and many coworking brands specifically targeting the traditional corporate client base of serviced office operators.

What's driving the demand?

Flexibility, plug-and-play simplicity, and the need to foster innovation and a sense of community for employees are sparking corporate interest in flexible space solutions. And whilst domestic companies and global MNCs in the region are keen to explore the use of coworking space, most are still in the experimentation and pilot stage. A few companies are seeking greater flexibility within their existing portfolios by incorporating some of the more attractive features of coworking spaces into their own facilities.

The future of flexible space

For landlords, flexible space is becoming an attractive option to those looking to create active, vibrant spaces and differentiate their buildings. Many are considering developing these facilities on their own or in partnership with an operator. Assuming that demand endures, such spaces could become a standard amenity – much like a café or gym. We also foresee further consolidation in a very fragmented landscape of players.



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Methodology

This report analyses the evolution of flexible space in Asia Pacific. It contains unique data collected by our research team in 12 cities across the region, as well as in-depth insights gathered through internal surveys, and interviews with clients, operators, leasing teams and industry subject matter experts. The report aims to provide balanced guidance to real estate owners, occupiers and investors – and anyone fascinated by the future of work. All figures are quoted on net lettable area basis unless stated otherwise.

Operators

This report covers the largest and highest-profile local, regional and international coworking and serviced office operators in each market. This includes operators that lease their space on the open market. Incubator and accelerator spaces as well as corporates' internal coworking spaces are excluded.

Locations covered

The locations covered in this report correspond, but are not limited to, the REIS office market boundaries. In some instances, our geographical coverage is much wider than REIS boundaries. However, all comparisons to Grade A office stock are consistent with REIS geographies.

Building formats

Most operators mentioned in the report are housed in office buildings, but some are in other non-traditional office formats such as shopping centres or shophouses.

Data are as of Q4 2017.

Figure 1: Market coverage



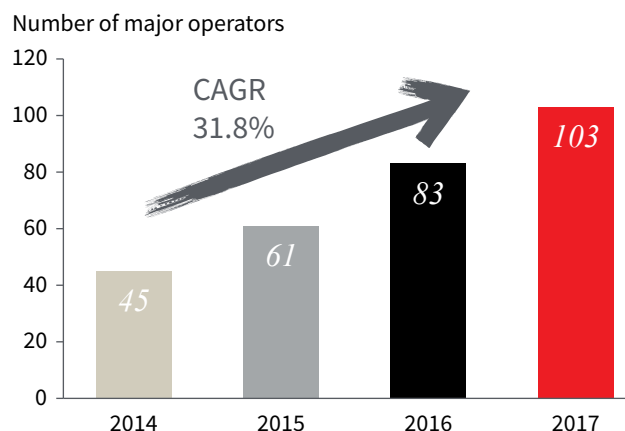
Flexible space expands across Asia Pacific

The flexible space sector in Asia Pacific is expanding rapidly. From 2014 to 2017, flexible space stock across the region recorded a compound annual growth rate of 35.7% in Asia Pacific - much higher than in the United States (25.7%) and Europe (21.6%) over the same period. The number of major flexible workspace operators in Asia Pacific more than doubled (Figure 2), as did the overall stock of floor space (Figure 3).

While flexible space operators such as IWG and The Executive Centre have been active since the 1990s, an inflexion point was reached in 2016–17, as international players such as WeWork entered the Asia Pacific market and local operators expanded rapidly. Some examples of prominent local operators include the Workstyling Project in Tokyo, The Working Capitol in Singapore and Awfis in India. In addition, Ucommune (formerly UrWork) is one of many coworking brands catering to the rise of mass entrepreneurship in mainland China. A vibrant startup culture is also fuelling demand in emerging market cities such as Manila, Jakarta and Ho Chi Minh City.

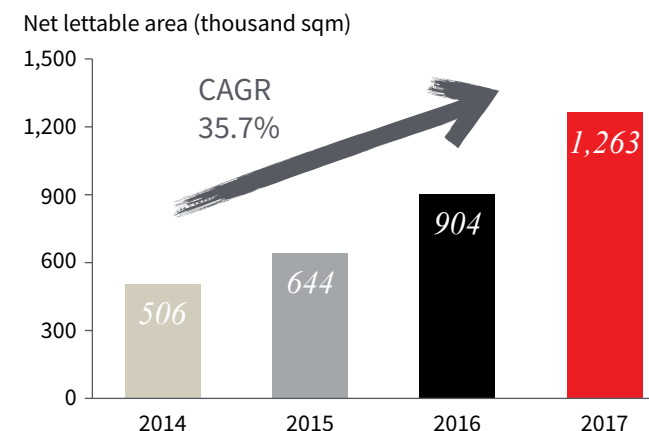
Overall, our analysis indicates that the total stock managed by major flexible space operators, including coworking and serviced office players, grew 150% from 2014 to 2017, with Auckland, Beijing, Bengaluru, Delhi, Seoul and Shanghai recording growth of over 100%.

Figure 2: Flexible space operators in Asia Pacific



*Based on a sample of 11 key Asia Pacific markets
Source: JLL Research

Figure 3: Growth in flexible space stock



What's the impact?

Flexible space operators have become increasingly active in Asia Pacific leasing markets and the area they leased was equivalent to over 8% of gross leasing volume (GLV) in 2017¹. While these operators have provided support to occupancy levels, their leasing activity has had no noticeable impact on rent levels across most Asia Pacific office markets. This is mainly because operators often secure space for long periods, to ensure rents remain competitive. Despite the solid growth and leasing volumes, total flexible stock, relative to Grade A office stock, is still relatively limited.

The supply of flexible space is expected to grow in 2018 and beyond, thanks in part to the ambitions of major global and regional operators. For example, as of April 2018, WeWork's pipeline for Asia Pacific includes 31 centres in 13 markets across the region. While these expansion plans are significant, it is important to keep them in perspective. So far, the footprint occupied by major flexible space operators is equivalent to less than 4% of Grade A office stock in all the key markets studied, and about 2% on average (refer to appendix for detail).

Demand is also projected to continue increasing. Small Business Labs forecasts that the number of people in coworking spaces will grow globally from just under 1 million in 2016 to 3.8 million by 2020. JLL predicts that as much as 30% of corporate portfolios could be flexible space by 2030.

1 Gross Leasing Volumes represents space leased for occupation. A unit is registered as leased when a legally binding agreement has been completed. As such, space that is 'under offer' at the survey date is not included. ('Under Offer' refers to space where terms have only been agreed between parties and legal representatives, but legally binding contracts for leasing have yet to be exchanged and/or completed.) It includes pre-leases (i.e. pre-commitments on space under construction or planned). It excludes lease renewals and rent reviews. Renewals that refer to a bigger space than before the renewal are included with the additional space signed only. It excludes owner-occupied/self-use space.

30%



By 2030, 30% of corporate commercial property portfolios could be made up of flexible space

Flexible space - focus shifts to corporates

What initially began as a platform for freelancers and startups is now firmly on the radar for large corporates. To cater to this demand, flexible space providers have started tailoring their offering to accommodate corporate users. While coworking operators in particular were originally known for fitting out heritage or quirky buildings, major operators are now leasing larger spaces, in many cases across contiguous floors, in Grade A office buildings.

WeWork signed the largest single Grade A office lease of 2017 in Shanghai by leasing an entire building of approximately 290,000 sq ft (gross floor area) in 2017. The Working Capitol opened a large coworking space of nearly 75,000 sq ft at 140 Robinson Road in the heart of

the Singapore CBD in 2017. In 2018, Chinese coworking operator Distrii leased over 60,000 sq ft of space at Republic Plaza, to create one of the largest coworking facilities in Singapore. Within the spaces themselves, up to 80% of flexible space now comprises enclosed offices rather than open plan spaces, according to interviews with leasing specialists across Asia Pacific.

Our interviews with domestic companies and global MNCs in the region reveal that while they are keen to explore the use of coworking space, they are still in the experimentation and pilot stage. There are examples of corporates shifting some employees or teams into flexible space – for example, Lendlease is trying its hand at coworking and has housed

100 of its 550 Singapore staff in The Work Project at OUE Downtown. WeWork in Seoul has prominent corporate tenants such as Dyson, Microsoft, Airbnb and TripAdvisor. Similarly, Salesforce has leased a floor of the Bourke Street WeWork location in Melbourne. But examples of large-scale flexible space arrangements in Asia Pacific are not yet commonplace.

We have also observed a growing convergence within the flexible space sector: IWG and other serviced office operators have developed coworking brands, while WeWork's enterprise division is targeting the traditional corporate client base of serviced office operators.



How is Asia Pacific different?



Government intervention and policy

Many governments in Asia Pacific are encouraging entrepreneurialism to offset slowing growth in traditional industries such as manufacturing. Offering financial resources and backing for startups can help lure talent from other cities and create a ready-made market for flexible space.

On the supply side, the public sector is developing or supporting flexible space in some locations. For example, the Singapore government has set up LaunchPad, while in Sydney, the New South Wales government has supported the creation of a 17,000 sqm tech hub in the city's central business district. In Japan, the government's work-style reforms driven by concerns around productivity, work-life balance and improving women's work force participation are providing impetus to companies operating in Japan to explore more flexible ways of working.



Concentration of holdings

Office stock in many Asian markets is controlled by a relatively small number of landlords. Compared with the United States where commercial holdings are much more dispersed, in some Asia Pacific markets a handful of landlords dominate the market. For example, while the top 10 landlords in New York own around 13% of buildings, the 15 largest landlords control 75% of Grade A office buildings in the Singapore CBD. In the Hong Kong East submarket, three landlords control roughly 80% of office buildings, while in Tokyo's Akasaka/Roppongi submarket five landlords control nearly 90% of Grade A office buildings.

This gives these property owners considerably more leverage to determine the shape of the flexible space sector. A single landlord's decision not to lease space to a flexible space operator has a far greater impact, as it leaves operators with limited options.



Shorter lease terms

Flexible space is an attractive option for end-users in markets where typical lease terms are long, such as in the United States and Europe where lease terms can be 10 years. In Asia Pacific, landlords typically offer lease terms of around three years, which makes the value proposition of flexible space relatively less attractive. Tokyo and Australian cities are exceptions. We expect to see pressure on landlords, particularly in these markets, to offer more competitive lease terms as flexible space operators continue to grow and corporate occupiers seek more flexibility.



Cultural and workplace norms

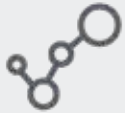
Cultural factors could shape the adoption of flexible space in different Asia Pacific markets. There could be a slower transition toward flexible models, particularly for larger companies.

Corporate culture in Asia tends to be more hierarchical and not always in sync with the casual, flexible atmosphere of many coworking hubs. According to one industry observer, “In many markets across Asia Pacific, space is a reflection of status and that’s still entrenched.”

While this may be less of a concern with SMEs and startups, it could be more prominent for corporates. The industry’s ability to expand further across a broader cross-section of Asia Pacific industries and age demographics may depend on operators incorporating more design features that satisfy traditional cultural preferences.



What's driving corporate demand?



Flexibility

Short term contracts allow organisations to adjust headcount and accommodate changes to underlying business strategy, without being constrained by longer-term leasing commitments. Some occupiers are moving towards a 'core/flex' strategy in which they take on a traditional office space lease for their core staff and lease workstations from a flexible space operator, ideally in close proximity to their core space, to accommodate headcount changes.



Cost

Flexible space appears to be more cost-effective than traditional office space. For example, our initial estimates show that a workstation in a typical flexible space in Singapore could be up to 50% cheaper than a workstation in a traditionally leased office. But coworking space is often much denser than traditional office space. When adjusted for density and like-for-like costs², the cost differentials decrease substantially, or disappear altogether. In Singapore, for instance, when density is taken into account, traditional leases cost only about 5% more than flexible space leases.

It is important to note that flexible space operators also tend to have additional charges for services beyond basic refreshments and office services. This could involve bookings for meetings rooms and events, which can increase the actual cost of using flexible space.

² Workstation cost for an enclosed 4-6 seat office, amortized capex, office administration and overheads, and reinstatement costs



Simplicity and convenience

In addition to lower workstation costs, flexible space offers compelling plug-and-play simplicity and convenience, particularly for larger companies. The ability to move in and out of an office space at short notice, and avoid complicated contract negotiations, fit out work, and dealings with brokers, landlords, and property managers, is an attractive proposition.

In some cases, it's worth paying for. As one large global conglomerate noted in an interview with JLL, "Companies are generally happy to pay a premium for convenience of perks and the flexibility and agility of workers." JLL leasing specialists confirm that for larger corporates, "Convenience makes a difference as they want to avoid hassles. Coworking firms provide an integrated one stop service, and address issues such as fit out and facility management for clients."



Collaboration and innovation

As companies try to collaborate beyond their four walls to remain competitive, more organisations are turning to shared workspaces as a way to foster innovation through exposure to new business concepts and the cross-pollination of ideas. Some companies have even started their own internal coworking facilities, or begun to incorporate features of flexible space into their existing offices to make the work environment more comfortable, stimulating and engaging. For instance, JP Morgan Chase has renovated one of its floors and incorporated flexible design into its Chater House office in Hong Kong, to make the business more technologically-enabled and create a modern workplace that fits the preferences of its new generation of staff.



Community

Flexible space operators typically offer activities and amenities to enhance member wellbeing and promote social and business networking including yoga classes, guest speakers, free lunches and after-work drinks. Many coworking operators also employ community managers who effectively act as concierges, and some have proprietary apps to drive social and business networking. These features and amenities help build a community and can be a differentiator, particularly when it comes to attracting and retaining young talent. According to JLL's 2017 *Workplace: Powered by Human Experience* global research report, more than 60% of employees surveyed globally said that access to external coworking spaces had a positive or very positive impact on their engagement and productivity at work.



What the future holds

We foresee a modest increase in corporate demand for flexible space in the short to medium term, based on interviews with large multinational clients in Asia Pacific. There is a genuine interest among firms to explore coworking spaces – to set up satellite offices, foster innovation, enhance employee experience, and to accommodate fluctuating headcount and business priorities.

According to one client, “We like the hub-and-spoke model; taking traditional space and supporting it with flex satellite offices.” Another client told us: “We will certainly not replace dedicated offices in Beijing or Shanghai with flexible space. However, we could possibly do this in tier 2 cities in China.” But as of now, few companies express interest in making large long-term shifts in their real estate portfolio toward externally managed flexible space.

There are still significant barriers to the widespread use of flexible space. Large corporate organisations place a high value on retaining their brand identity and culture. Such concerns, along with the need to protect trade secrets and secure their IT infrastructure, must be addressed to the satisfaction of tenants before takeup of flexible space becomes more widespread. In the meantime, these companies are happy to import many of the most attractive features of flexible spaces, such as collaboration and event spaces, into their own facilities.

Some key themes that we see developing in the future include:



Landlords getting in on the act

Joint ventures or management contracts between landlords and flexible space operators are likely to become more common. Recent academic research³ suggests the joint venture model is the best choice for expansionary coworking operators and investors who want to participate in the market. Some major landlords in Asia Pacific are also moving to create their own flexible space offerings. Doing so can add value to their buildings, and maintain or even extend their relationships with tenants by offering a diverse portfolio of core and flex space to meet their changing needs. Some examples of landlords pursuing this strategy include Swire in Hong Kong, Ascendas in Singapore, Dexus in Australia and Mitsui Fudosan in Japan.

³ Zhai, W. (2017). *A Study of the Co-Working Operating Model*. Master of Science. Massachusetts Institute of Technology.



An essential feature of property developments

Corporate occupiers prize the agility of having flexible space that is co-located or in very close proximity to their traditionally leased space. This provides a buffer for changes resulting from underlying business growth, as well as swing space to accommodate employees during transitions. It is no surprise that developers are increasingly including flexible space in plans for new developments. Assuming that demand endures, such spaces could become a standard amenity – as essential to a business district as food and beverage outlets or a gym. In Singapore, about 10% of space will be dedicated to coworking at Lendlease’s new headquarters in Paya Lebar Quarter; CapitaLand is pursuing a similar strategy in developments in China.



Market consolidation

The rapid growth of the flexible space sector in Asia Pacific has created heavily fragmented markets with little differentiation between some operators. In Shanghai, for example, there are over 1,000 flexible space locations, many of them very small. We have already seen instances of individual operator failures, and mergers and acquisitions activity. China's largest coworking operator Ucommune, acquired coworking rival Woo Space in March 2018, just a few months after it acquired New Space. As part of an aggressive expansion push in Asia, WeWork is acquiring some of its competitors. For example, WeWork acquired its Singapore based counterpart Spacemob in August 2017 as part of its US\$500M investment to ramp up expansion and growth in Southeast Asia and South Korea. As part of its expansion push in China, WeWork acquired the Shanghai headquartered Naked Hub in mid-April 2018.

However, operators need to be selective about these deals. Two of the biggest operators in Asia Pacific, Naked Hub and JustCo, announced a merger in July 2017, which subsequently failed. We expect industry consolidation to persist over the near- to medium-term, with a few major coworking and serviced office operators likely to co-exist and dominate different segments of the market.



Services, not just space

Operators are increasingly offering office space or community 'as a service' platforms and tech-driven solutions, in addition to physical spaces. One such example is WeWork's white label 'office space as a service' offering – 'Powered by We'. This delivers companies a full range of services across the property life cycle, from fit out and construction to workplace strategy, enabled by technology. In late 2017, UCommune (formerly Urwork) announced plans to build a business community, supported by an online platform, for companies to connect and network with potential business partners.



Key questions

As flexible space continues to evolve in Asia Pacific and worldwide, occupiers, investors and operators have many questions to consider, such as:

Investors

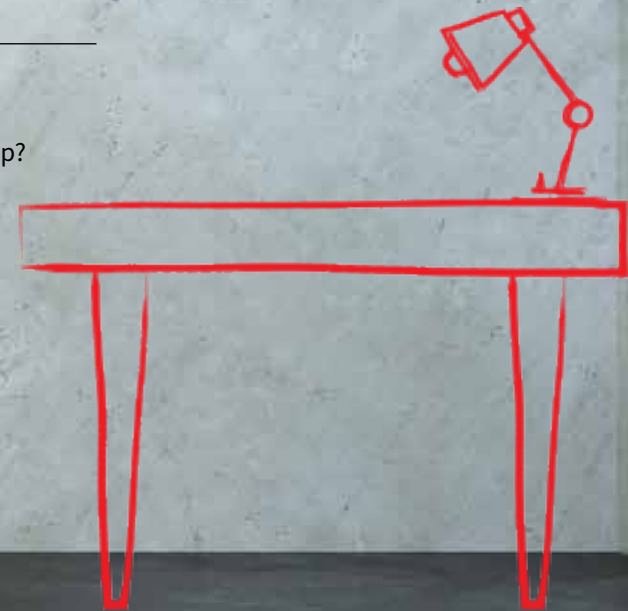
What will trigger consolidation among flexible space providers and when?
For how long can the market sustain the current levels of growth?

Occupiers

What model of flexible space is right for your business?
What effect will flexible space have on employee and firm performance?

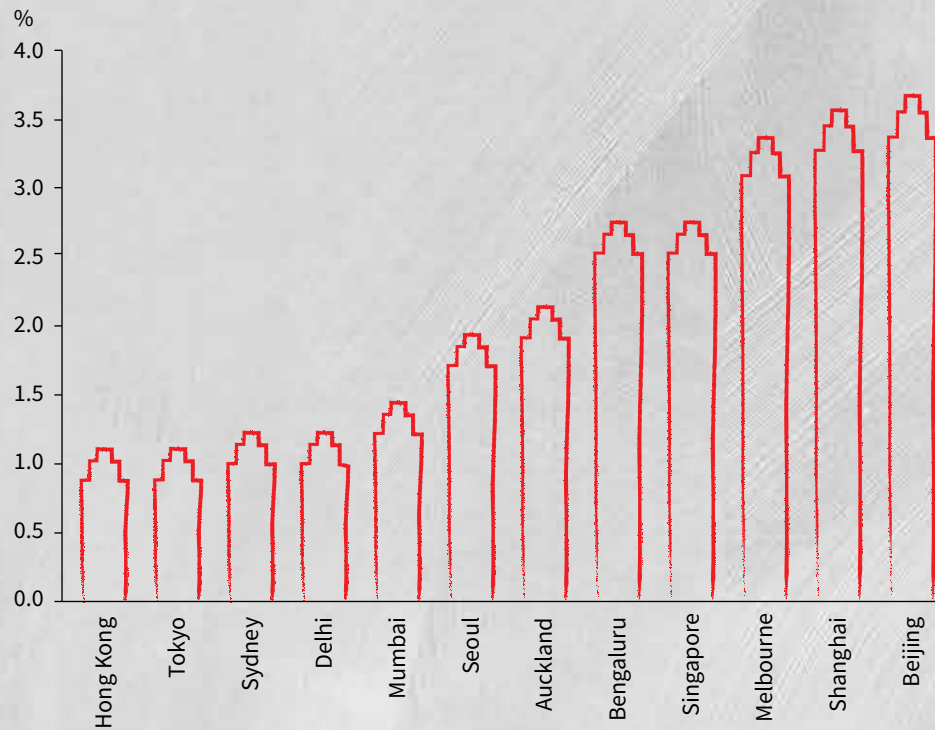
Landlords

Will flexible space disrupt market dynamics?
Will flexible space impact the traditional landlord/tenant relationship?

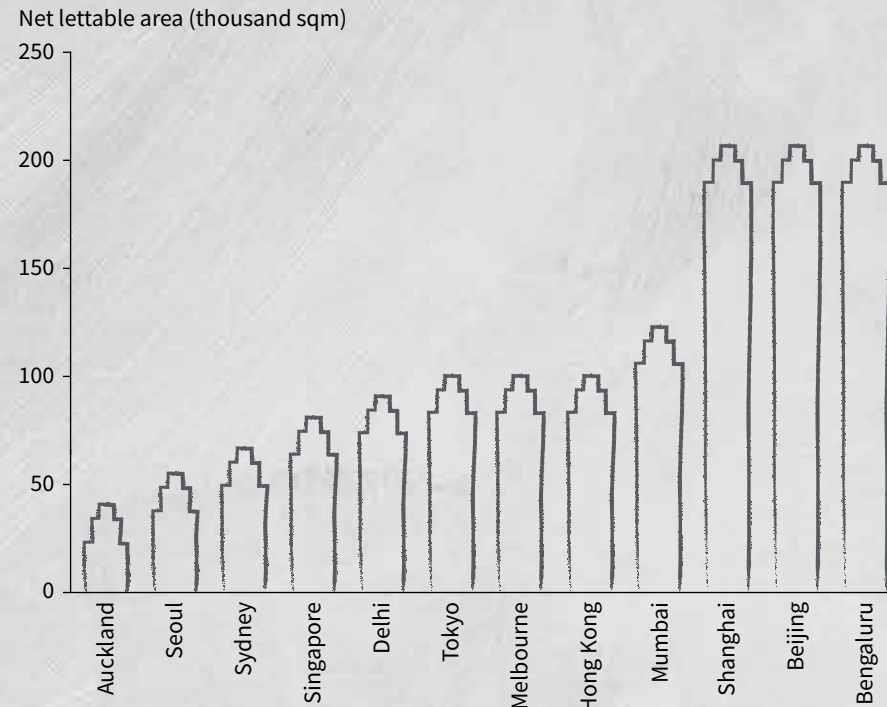


Appendix

Flexible space penetration rates by city



Flexible space stock



Source: JLL Research

Note: Penetration rates are in comparison to Grade A office stock. Flexible space operators often lease space in lower quality buildings and non-office formats such as shop houses and shopping centres.

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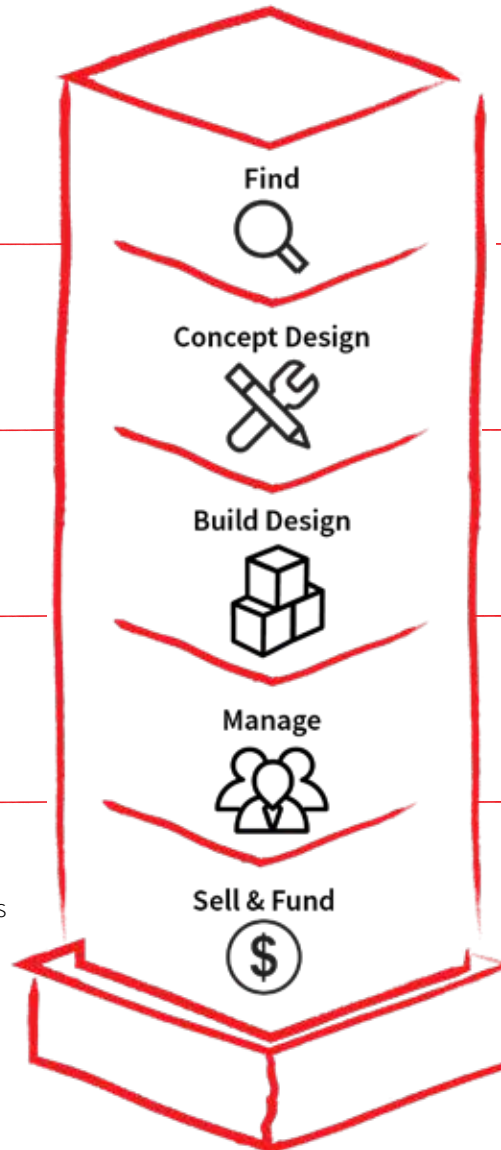
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