Coworking Spaces Test Shopping Center Waters

**Daytime Users Boost Centers’ Potential Visitor Base**

**Abstract:** This report examines how coworking spaces, an element of the expanding “sharing economy,” have become shopping center tenants as part of their vigorous expansion plans. It also discusses design, operational and marketing issues, as well as how future trends might affect the industry. This analysis is based in part on interviews with Cory Scott, Senior Vice President, Asset Management, Macerich; Rob Downing, Regional Director of Real Estate—Western/Southern U.S., IWG; and Dr. Shawn Moura, Research Director, NAIOP.

I. Macro U.S. Coworking Trends

In the past few years, coworking companies in North America have embarked on vigorous expansion plans. In the U.S., 25 percent annual growth is expected through 2023, reaching approximately 3.4 million square feet.\(^1\) Altogether, estimates call for U.S. flex office space—which includes coworking space, serviced offices and large-scale enterprise solutions—accounting for at least 13% of total U.S. office supply by 2030.\(^2\) In Canada, the flexible office market has grown 79% since year-end 2017.\(^3\) Yet, with all this activity, less is known about the current place of coworking locations in retail real estate. This report seeks to fill that information vacuum.

Part of the larger recent phenomenon of “real estate as a service,” coworking spaces are commonly understood as locations “where entrepreneurs, freelancers, remote workers, and anyone else who wants access to a fully-equipped space can get a membership.” Their employee spaces tend to be open, with “huddle rooms” designed to encourage transparency and teamwork.\(^4\)

Due to the developments surrounding its recently announced IPO, WeWork is the most widely recognized U.S. flexible space operator.\(^5\) As seen in Figure 1, it also has the greatest amount of square footage leased. But its list of competitors is large and growing.

<table>
<thead>
<tr>
<th>Company</th>
<th>Total Square Feet Leased</th>
<th>Number of Sites</th>
</tr>
</thead>
<tbody>
<tr>
<td>WeWork</td>
<td>12,162,000</td>
<td>154</td>
</tr>
<tr>
<td>Regus</td>
<td>4,705,000</td>
<td>224</td>
</tr>
<tr>
<td>Knotel</td>
<td>2,500,000</td>
<td>120</td>
</tr>
<tr>
<td>Spaces</td>
<td>835,000</td>
<td>29</td>
</tr>
<tr>
<td>Convene</td>
<td>538,000</td>
<td>14</td>
</tr>
<tr>
<td>Industrious</td>
<td>525,000</td>
<td>22</td>
</tr>
<tr>
<td>Level Office</td>
<td>513,000</td>
<td>8</td>
</tr>
<tr>
<td>MakeOffices</td>
<td>428,000</td>
<td>12</td>
</tr>
<tr>
<td>Premier Business Centers</td>
<td>291,000</td>
<td>19</td>
</tr>
<tr>
<td>Jay Suites</td>
<td>260,000</td>
<td>8</td>
</tr>
</tbody>
</table>

* Based on the top five operators in each of the 19 office markets surveyed.

### Key Takeaways

- Coworking companies are expanding vigorously, with 25 percent growth projected annually in the U.S. through 2023.
- Flexible space in the U.S. continues to be highly fragmented, with the top 10 operators controlling only 34% of the market.
- Currently, coworking spaces are located in 15 malls and 11 non-mall (i.e., open-air) settings.
- Coworking space users are income-producing, employed, daytime potential customers.
- Depending on the need to retrofit the space, landlords may need to provide major pre-delivery work and expensive build-outs.
- The HVAC system and electrical load demands of coworking tenants are likely to exceed those of retailers.
- Future trends of the next several years will likely involve even more intensive engagement with technology, expansion into secondary markets, migration beyond the office sector, and new partnership agreements and renegotiated leases with landlords.

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2. The 13% figure derives from CBRE Research, “Let’s Talk About Flex: The U.S. Flexible Office Market in 2019,” September 2019. (CBRE itself has entered the coworking space with its new Hana brand.) However, 13% may be a conservative estimate, considering that it may not account for multiple small operators that may expand, or traditional office space operators that may convert to this format.
The presence of coworking locations in shopping centers is currently small: only in 15 malls and 11 non-mall settings, according to data from CoStar Group, Inc. (See Figure 2.) This early stage of development, though, provides opportunity for shopping center landlords, as good locations are still available and oversaturation is not a concern.

As these spaces have evolved, they have fallen into four major types:

- **Retail launchpads**: retail incubators with demo space, concentrated in high-income areas (e.g., Cowork at the Mall, Water Tower Place, Chicago);
- **Telework hubs**: comprehensive telecommuting (e.g., Union Cowork, La Jolla, CA);
- **Business boosters**: growth vehicles for entrepreneurs (e.g., CTRL Collective, Pasadena, CA); and
- **Creative coalitions**: artists, makers and creatives (Spaceus, Boston, MA).

Banks have been among the more interesting firms to offer coworking spaces, as coworking provides them with an opportunity to work closely with customers to better understand key markets like small businesses or millennials while allowing them to keep their permanent footprint comparatively small. Capital One Cafés are a prominent example of this.

Two sets of long-range factors now drive the coworking industry:

First are demographic factors. Overall, the movement toward shared office space is driven by millennials, who are now entering the workforce in full, where they are making their presence felt by building and joining startups. Sharing office space appeals to them because it means lower costs, fewer responsibilities, no long-term commitment—but also abundant networking opportunities, support for start-ups, and urban-centric locations.  

Additionally, office work and space arrangements are shifting, particularly driven by technology that facilitates mobility and connectivity. That same technology is encouraging millennials to pursue a stronger work-life balance, and to erode the traditional 9-to-5, Monday-to-Friday routine. (For instance, millennials have been at the forefront in advocating for telecommuting, and are the age group that agrees most that access to a professional coworking space would be useful.)

This, combined with companies’ need for a lean workforce, has produced a market in which one in three American workers are freelancers. These factors are inducing employers to reduce their footprints.

The second major set of factors concern expenditures. A more mobile, adaptable workforce and accounting rule changes about the treatment of fixed leases on balance sheets have reduced the need for long-term leases. Moreover, efficiency may suffer when a lease no longer makes sense, particularly if growth is unpredictable or if the company focuses on particular projects.

In contrast, coworking presents real cost savings. A coworking space might involve anything from a single desk, a communal table, or a 10-person office, so pricing is typically based on need. Although long-term lease agreements between landlords and third-party operators remain the norm, other arrangements are becoming more common, including partnership and operating agreements between landlords and operators and even flex units launched by landlords (e.g., Tishman Speyer with Studio and BXP with Flex).

A membership-based model can facilitate both leasing and tenant movement into the space. Users can sign up for a month, a

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**Figure 2**

Coworking Locations in Shopping Centers, 2011-2019

<table>
<thead>
<tr>
<th>Year</th>
<th>Malls</th>
<th>Non-Malls</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>88,898</td>
<td>161%</td>
</tr>
<tr>
<td>2015</td>
<td>231,726</td>
<td>21%</td>
</tr>
<tr>
<td>2017</td>
<td>280,072</td>
<td>35%</td>
</tr>
<tr>
<td>Q2 2019</td>
<td>378,431</td>
<td>15%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Malls</th>
<th>Non-Malls</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>269,627</td>
<td>20%</td>
</tr>
<tr>
<td>2015</td>
<td>323,961</td>
<td>18%</td>
</tr>
<tr>
<td>2017</td>
<td>382,715</td>
<td>3%</td>
</tr>
<tr>
<td>Q2 2019</td>
<td>392,664</td>
<td>11%</td>
</tr>
</tbody>
</table>

Source: CoStar Group, Inc.
year or longer. Especially for small firms and freelancers who might face barriers to obtaining a traditional lease because of high costs and lack of credit, such a comparatively no-frills space can be attractive.\(^{11}\)

At the same time, the need to clamp down on costs is also important to Fortune 1000 companies, which are, more and more, looking to coworking companies to provide them with flexible real estate arms.

II. Coworking in Retail Real Estate: General Considerations

Unlike mature markets in Europe such as the United Kingdom, France and Germany, flexible space in the U.S. continues to be highly fragmented, dominated by independent players, with the top 10 operators controlling only 34% of the market.\(^{12}\) The local focus of such smaller companies can equip them with excellent knowledge of area needs. But, even as performing due diligence becomes more imperative, landlords may find a short paper trail in trying to assess these new entrants’ financials.

At the extremes, coworking spaces can range from 8,000 to 110,000 square feet, but the “sweet spot” for most companies runs from 25,000 to 40,000 square feet. Below that range, it becomes more difficult to achieve economies of scale; above it, the value of the space might be diluted.

In selecting sites, coworking firms keep several criteria in mind:

- They desire a healthy retail location in a high-demand submarket.
- In a highly competitive landscape, they must obtain the most attractive location within each market.
- The daytime population in an area must be significant.
- Retail vacancies must be kept in mind.

Development lengths for these spaces can vary. A retail-to-office space conversion will take longer than a simple office-to-office conversion, as it may involve adjusting different ceiling heights and flooring repairs. The construction process itself can take approximately six months.

Once the development process is complete and the coworking space opens, two major advantages may result:

1. **Co-tenanting synergies.** A 40,000-square-foot space, for instance, could have 400 workstations. Their users are income-producing, employed, daytime potential customers. Many are coming and going, with additional visitors and clients. Synergies are possible with such uses as fitness, services and certain retail types (e.g., electronics, apparel).
2. **Retail: an amenity-filled environment.** Coworking space users want walkable access to restaurants, banking, shopping and public spaces. They will find all of this in abundance in shopping centers.

At the same time, potential challenges exist when a coworking company considers a shopping center location:

- **Physical:** Natural light is the principal concern, sometimes necessitating the installation of new windows on the building’s exterior. Access through an exterior entrance is important, as coworking users may start earlier or end later than retail workers. In urban areas, walkability and a location near mass transit are beneficial. Sufficient parking close to the location in the property is also a concern in suburbs.
- **Visibility:** While less important than for retailers, it remains a consideration for coworking users. They may find it especially helpful to have an interior stairwell to move from a shopping center’s first floor through second-floor office space.
- **Lease negotiation issues:** Deals between landlords and potential coworking tenants do not necessarily come together quickly. Depending on the need to retrofit the space, landlords may need to provide major pre-delivery work and expensive build-outs. In exchange for such significant expenditures, coworking companies may need to agree to leases lasting 10 years or more. Larger companies may want to partner with major landlords on multi-city agreements.

III. Operational, Marketing and Design Issues

Shopping center landlords should also keep in mind three more matters related to their coworking tenants: design, operations and marketing.

- **Operations:** The most significant element here is staffing. Having a community manager attuned to creating the proper coworking environment by catering to client needs is essential. Landlords should be aware that the HVAC system and electrical load demands of coworking tenants are likely to exceed those of retailers. Interior partitions mean more mechanical zoning, and sound transference needs to be mitigated. Furthermore, access doors need to be open when users arrive early in the morning. Overall, understanding such matters as the number of offices and amenities comes into play, as it can affect the coworking firms’ profitability and landlords’ ability to set rents.
- **Marketing:** Coworking spaces bring energy to parts of malls that might not work as well for retail foot traffic (e.g., a second-floor corner, provided it has abundant light, good external visibility, and access to parking and a welcoming entry). One landlord, Macerich, has an app specifically for office users that provides access to marketing programs, specials and extra services. Other tenants can customize their messages to users they know will be on the properties daily.
- **Design:** Coworking tenants often find that the proper placement of huddle rooms and soft seating encourages high-level energy. Business lounge and conference room size is another consideration. In dealing with users’ rising concerns about privacy and proprietary information, coworking companies are also fine-tuning floor plan design, team room configuration and data security.

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IV. Future Trends

Now that they have established their niche in commercial real estate, coworking locations are likely to evolve even more rapidly over the next several years:

- **Technology** has been transforming virtually every sector of the American economy in recent years. In the case of coworking spaces, it promises to step up change in a sector already filled with tech-savvy users. "Smart" technology (desks that enable worker control of lights and heating, printing that eliminates courier costs) has already affected coworking spaces, and the near future will see an accelerating demand for the most up-to-date high-tech products and services.13

- **Expansion into secondary markets** will increase. Although major metros such as New York, Los Angeles, Chicago, Washington, D.C. and Boston will continue to be important, moving into secondary markets will help protect against oversaturation in the "gateway cities." Already, Phoenix, Austin, Texas and Nashville, Tennessee—all benefiting from good live-work-play synergies, as well as population and office-using job growth—have witnessed such activity.14

- **Migration beyond their office-building roots**, seen at an early stage in their locations in shopping centers, will pick up. Besides retail, coworking companies will seek out space in fitness facilities and hotels, where the presence of business travelers will enhance the brand and add convenience for users.

- The strongest firms will **renegotiate existing leases and enter partnership agreements** with landlords.15 In case of an economic downturn, then, demand may well be dampened but not devastated.

- **Sustainability**: Already, sharing workspaces lends itself to the more efficient use of space and materials characteristic of sustainability. But North American operators of these spaces may look to foreign models on how to enhance these environmental practices, such as bike-to-work initiatives in Dublin, Ireland, and a green terrace used by Innov8 at Connaught Place in New Delhi, India.16

V. Conclusion

Although the exact future of the coworking industry remains to be determined, it has already made a sizable impact on the office market. Visitors to these spaces can diversify a shopping center’s customer base, advancing it closer to the "live-work-shop-play" dynamic increasingly taking hold on retail real estate.

Even in its early stages, the coworking industry offers a variety of models that shopping center landlords might find desirable in considering new space uses. But that variety places a corresponding responsibility on owners to perform the necessary due diligence to ensure compatibility with their properties.

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13 Harriet Goffman, "How is Technology Changing the Coworking Environment?", [www.flexioffices.co.uk](http://www.flexioffices.co.uk), September 26, 2017 blog post.
15 CBRE, "Let’s Talk About Flex."