



Valuation of flexible workspace

October 2019



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Glossary

Approach (valuation)	The overall manner in which the valuation task is undertaken in order to determine the value of a particular asset or liability. The term ‘valuation method’ refers to the particular procedure, or technique, used to assess or calculate the result. [Also see <i>RICS Valuation – Global Standards</i> [‘Red Book Global Standards’] VPS 5.]
Basis/bases (valuation)	The fundamental measurement assumptions of a valuation. [Also see Red Book Global Standards VPS 4.]
Brand	An intangible asset value linked to the identity, marketing and reputation of a product, service, company or institution.
Broker	Facilitates the provision of flexible workspace and sells related services, usually through an online platform, application, email or telephone service. A broker may have a direct relationship with the flexible workspace provider or charge a commission.
Business centre	A traditional term for flexible workspace. In a modern sense it sometimes refers to basic provision, or for quasi-industrial purposes.
Discounted cash flow (DCF)	Where the forecasted cash flow is discounted back to the valuation date, resulting in the present value of the asset. [Also see IVS 105, paragraph 50.2.]
Earnings Before Interest, Taxation, Depreciation and Amortisation (EBITDA)	A measure of a company’s profitability. EBITDA is a common unit of comparison for business valuation and also for the valuation of some other income-generating assets.
Equated value	Similar to net value, it is a gross value appropriately discounted to consider outgoings.
Equitable value	The estimated transfer price of an asset or liability between knowledgeable and willing parties that reflects the respective interests of those parties. [Also see IVS 104, paragraph 50.1.]
Freehold	A permanent and immutable legal interest in land and/or property.

Goodwill	Any future economic benefit arising from a business, an interest in a business or the use of a group of assets that has not been separately recognised in another asset. The value of goodwill is typically measured as the amount remaining after the value of all assets (adjusted for actual or potential liabilities) has been deducted from the value of a business. [Also see IVS 210, paragraph 20.6.]
Investor	An entity providing financial or other capital to another entity with the expectation of an additional future financial return or other benefit.
International Valuation Standards (IVS)	International standards for undertaking valuation assignments using generally recognised concepts and principles that promote transparency and consistency in valuation practice.
International Valuation Standards Council (IVSC)	An independent, not-for-profit organisation committed to advancing quality in the valuation profession.
Investment method	Traditional term for the simplest form of the income approach to valuation defined in IVS, for finding the present value of future income.
Investment value	The value of an asset to the owner or a prospective owner for individual investment or operational objectives.
Leaders' forum	A cross-industry discussion initiated and facilitated by RICS to achieve clear public interest objectives.
Leasehold	A formal legal interest in property, land or both, for a defined term and including recompense to the superior interest [landlord]. This is distinct from a licence for the use of property or a service, commonly used in flexible workspace provision, which is usually easier to amend or terminate. Note statute in individual territories may affect leasehold, licences and other forms of contract and agreement.
Lender	A bank, institution, company or some other entity offering finance to another entity with the expectation of an additional future financial return.
Liquid	Easily adapted or transferred. Value that is capable of being readily realised.

Liquidation value	The amount that would be realised if an asset or group of assets were sold on a piecemeal basis. Liquidation value should take into account the costs of getting the assets into a saleable condition, as well as those of the disposal activity. [Also see IVS 104, paragraph 80.1.]
Operator	The individual, company or institution directly providing flexible workspace services.
Management agreement	A contract, between a flexible workspace operator and an entity with an interest in a property, for the ability to provide flexible workspace services at that property in return for a defined financial return or some other benefit. This agreement does not necessarily create an interest in the property. The agreement may be based on the performance of the flexible workspace or be for a set amount.
Market rent	The amount for which an interest in real property should be leased on the valuation date, on appropriate lease terms and in an arm's length transaction [after proper marketing and where the parties have each acted knowledgeably, prudently and without compulsion]. [Also see IVS 104, paragraph 40.1.]
Market value	The estimated amount for which an asset or liability should exchange on the valuation date in an arm's length transaction [after proper marketing and where the parties have each acted knowledgeably, prudently and without compulsion]. [Also see IVS 104, paragraph 30.1.]
Net value	Similar to equated value, it is a gross value appropriately discounted to consider outgoings.
Portfolio valuation	A valuation finding the total value of a group of individual assets (including interests in property) held together, for example the valuation of a shopping centre.
Premium	An amount additional to that expected under normal market circumstances or in comparison with the wider market.
Profits method	Where a building is suitable for only a particular type of trading activity [such as a hotel, golf course, etc.], the income is often related to the actual or potential cash flows that would accrue to the owner of that building from the trading activity. The use of a property's trading potential to indicate its value is often referred to as the 'profits method'. [Also see IVS 400, paragraph 60.2.]

Purpose (valuation)	The specific reason for which a valuation is being undertaken. For valuations undertaken in accordance with Red Book Global Standards, the purpose must be clearly stated. A valuation undertaken for one purpose cannot be assumed to be suitable or relevant to another purpose – the answers may be very different.
Regular office market	The part of the office market relating to accommodation suitable for occupation for any office use (rather than being limited to a specific use).
Serviced office	A traditional term for flexible workspace highlighting the ‘all-inclusive’ nature of services provided for the space. The term is sometimes still used to refer to traditional short-letting accommodation, with less emphasis on, for example, coworking and communal space.
Special assumptions	An assumption that either assumes facts that differ from the actual facts existing at the valuation date, or that would not be made by a typical market participant in a transaction on the valuation date. [Also see Red Book Global Standards VPS 1.]
Special purpose vehicle (SPV)	A legal entity that shields a parent company from, for example, financial liability by attaching the liability to itself rather than allowing it to be held against the parent company.
Synergistic value	The combination of two or more assets or interests where the combined value is more than the sum of the separate values. If the synergies are only available to one specific buyer, then synergistic value will differ from market value, as the synergistic value will reflect the particular attributes of an asset that are only of value to a specific purchaser. The added value of the respective interests is often referred to as the ‘marriage value’. [Also see IVS 104, paragraph 70.1.]
Transaction	The transfer of a property, interest, product or service between two or more parties, usually for financial or other recompense.
Valuer	A person (usually a professional) who undertakes valuations. These may be of tangible assets such as properties, interests in property, businesses or shares, or intangible assets such as brands. An RICS member and valuer is required to undertake all written valuations in accordance with Red Book Global Standards, incorporating IVS.

Executive summary

Flexible workspace is real estate space of varying size provided for business or institutional purposes for varying periods of time, usually for shorter periods and with more inclusive benefits than a traditional lease. While the concept of flexible workspace has been around for a century or more, in recent years it has moved from a niche part of the office space market to become a dominant sub-sector of the market. As such, there is greater interest than ever before in appropriate ways to conduct valuations of properties that provide flexible workspace.

This insight paper includes insights and reflections from key players and commentators in the flexible workspace market. These include some of the largest operators, brokers, lenders and providers of valuation services in the world, as well as smaller regional stakeholders. It has been compiled and edited to develop and enhance the understanding of this market for the benefit of the wider flexible workspace industry, reaching beyond the needs of valuers and other real estate professionals to all stakeholders, including those with no technical expertise.

Insights that considered the challenges of flexible workspace valuation were sourced from a leaders' forum attended by major investors, lenders, operators and academics from companies and institutions acting mainly in the UK and Europe, although some broader contributions from the worldwide market added a necessary global perspective. More than 20 further detailed interviews and discussions took place with key stakeholders across the industry, as well as presentations and feedback on the subject throughout the UK and Europe. The leaders' forum discussed and sought answers to market issues and addressing the market's potential, considering issues raised in various press, academic and government sources, as well as personal experience. Detailed interviews by telephone or video conference developed these themes one-to-one or with small groups – with candid, insightful and detailed commentary provided.

Most of the information was gathered on a non-attributable basis to allow transparency and objectivity in presentation, although some useful additional resources for further reading may be found in the References section.

This paper concludes that while existing RICS standards and guidance implicitly cover flexible workspace, it is certainly a fast growing and adapting sector that is changing investment in, lending for and the occupation of real estate. RICS is committed to monitoring, and where necessary expanding, its technical and thought leadership content on flexible workspace, but it will continue with principle-based rather than prescriptive standards for valuation approaches and methodologies.

1 Introduction

Flexible workspace has become a significant option for businesses seeking office premises of varying sizes. Flexible workspace is defined for the purpose of this insight paper as space in property provided for business or institutional purposes, often with flexibility around the duration, extent and type of occupation.

A consumer letting of flexible workspace usually includes all core ancillary charges, such as utilities, property taxes and maintenance. It is commonly occupied for shorter periods, with fewer obligations and simpler termination, than a traditional letting to an equivalent operator – sometimes only daily, or even hourly. In some cases, flexible workspace provides no physical barriers between other occupiers or corporate colleagues – a situation that may be referred to as ‘coworking’ or providing an ‘open plan’ office space.

Other common terms for flexible workspaces include ‘business centres’, ‘serviced offices’, ‘workspace as a service’ (‘WaaS’) and, in terms of corporate real estate, ‘hot-desking’ or ‘flexible working’ spaces. For the purposes of this insight paper, the corporate real estate function has not been explored in depth. Additionally, this paper does not include other flexible markets relating to retail, conferencing, residential, industrial or exclusively leisure operations or occupancies.

This insight paper has been written for a global audience, but the majority of the insights have been taken from UK and European stakeholders. Other markets have also been explored and commented on more broadly, including China and the United States of America.

1.1 Purpose and scope

A primary theme that shone through in the interviews and forums instigated to develop this insight paper is that the flexible workspace market can seem to blur the lines between the freehold valuation of real estate, the valuation of an interest in real estate such as a lease and the valuation of an ongoing or proposed business. Each of these is distinct and the distinctions form a key part of this paper.

This insight investigation focuses upon the valuation of properties providing flexible workspace, as opposed to reviewing corporate occupation and space efficiency.

This paper has been generated from detailed interviews and forums with parties from across the industry and the world. It does not reflect the views of any one interest or sector. It does contain some technical terminology, but only to the extent of terms common to the workings of the industry and its associates.

1.1.1 Valuation challenges

When undertaking a valuation in accordance with RICS standards, the critical questions of **what is being valued** and **the basis and purpose of the valuation** should be first and foremost in the valuer’s mind. Planning, zoning and licensing regimes across the world are usually focused on a property’s use (such as an office), but not necessarily on the specific format of the office’s use (for example, corporate headquarters, call centre or flexible workspace). This is important for the valuation of flexible workspace, because there is not

necessarily any regulatory, statutory or even physical difference between a flexible workspace and a regular office. Furthermore, building, fire safety and environmental regulations might also show no distinction between flexible workspace and a regular office. There are not necessarily any regulatory impediments to conversion.

In practical terms, a flexible workspace may need to contain an enhanced (or at least different) fit-out and configuration compared to a regular office. This may have cost implications but may not in and of itself have an effect on value.

Crucially, the use of the space as flexible workspace does not always have to pass with the property as part of a transaction, for example a sale or subletting. This fluidity between flexible workspace and regular office space means that investors, valuers and operators need to be crystal clear about the interest or entity that is being bought, sold or borrowed against. The investigations conducted in the preparation of this paper highlight the importance of valuation purpose. Real estate valuation is undertaken for a number of very different purposes, for example a purchase report, secured lending or financial reporting. These may be on the basis of something other than a value to a particular occupier, such as *market value*. A valuer needs to consider the intrinsic locational, physical, economic, social and contractual elements (if any) that mean an asset or assets is valued as flexible workspace or otherwise.

1.1.2 RICS standards and guidance considerations

Red Book Global Standards, which incorporates IVS, makes a clear difference between *market value* and value based on a calculation of worth to a particular occupier or owner – in other words *investment value*. A valuer can apply special assumptions to a valuation, but RICS standards require that these are agreed and understood with the parties involved and do not take away from the overall integrity of the valuation in terms of the purpose, bases or approach adopted. A valuer can look at alternative approaches to valuation to support their findings, but a valuation conclusion is necessary, and it requires an appropriate rationale.

While this insight paper refers to standards and guidance that inform valuations in the flexible workspace market, it is not to be viewed as guidance or a technical manual for the valuation of flexible workspace, or used as such. Red Book Global Standards require members and registered valuers to make appropriate choices about the bases of and approach to valuation, dependent on the terms of engagement, purpose and scope of a valuation. **RICS does not dictate the choice of valuation approach**, but it does regulate to ensure that appropriate reasoning and evidence have been recorded.

In some circumstances, statute, regulation and industry best practice may offer further guidance. Non-RICS members have the autonomy to make choices appropriate to the nature of their area of work, as long as these are in accordance with relevant statute and regulation.

Appendix A includes some further observations relating to RICS and wider industry standards that may be of interest to RICS members and consumers of valuation services.

1.2 Market history and overview

From financiers located around central banks, insurance brokers based next to major underwriters and barristers' chambers operating in legal districts, the idea of pooling administrative resources for the cooperative benefit of a group has existed for many years (Worthington, 1983). A 'business suite' market developed in the United States in the mid-1960s, called Fegen Suites and named after Paul Fegen, an early innovator and operator

(Lindenberg, 2015). Once this early serviced office market was established, it extended to include firms seeking short-term space for the completion of a project and start-up companies looking for an 'off-the-shelf' package with less onerous costs around, for example, IT and communications provision (Evans, 1986). Since then, the service and administrative industries have grown around the world, and are still continuing to expand. This has been coupled with an increasing ability for businesses to operate outside large corporate structures.

The success of what was previously known as the serviced office or business centre market has often run counter to the market for standard office space and the wider economy. Large quantities of space that became vacant during a recession were only in demand when divided into small lots on short, flexible terms to suit the tenant (which included all fittings and services that tenants might not have had the resources or inclination to otherwise provide).

Although flexible workspace terms meant very limited short-term liability for a tenant, in the medium to long term the rent would generally be higher than in the open office market. However, in the open office market, terms may historically have meant lettings of 20 years or more, with substantial commitments towards fittings and repairs. Over time, a company would reach a point in the market cycle where the main office market became a more attractive proposition in terms of features such as office size, security of tenure, ability to adapt and long-term price.

Participants in RICS forums and interviews generally accepted that flexible workspace has gone from a niche market to a dominant sub-sector and that alternative letting models are becoming more mainstream in general. It is being increasingly posited that the market has seen a structural change, breaking away from the traditional serviced office market and cycle, and leading to a new flexible workspace market that is predicted to form a progressively more significant part of the wider office market, if not the dominant part. It has been suggested that this significantly expanded flexible workspace market will need to go through at least one full economic cycle to determine its resilience and continued impact.

1.3 Flexible workspace around the world: locations and logistics

Flexible workspace has penetrated the office market to some degree across the globe. In certain territories, basic flexible workspaces are actually more suitable and sustainable than land- and resource-intensive office blocks. Café-style hourly-rate flexible spaces and low-specification start-up units can be created with relatively little capital and suit the trend for being able to work from anywhere and on a more fluid basis than is seen in major financial centres. Generally, however, these represent a relatively small proportion of the office market as a whole – but this position is changing.

SIZE OF SUPPLY BY CITY

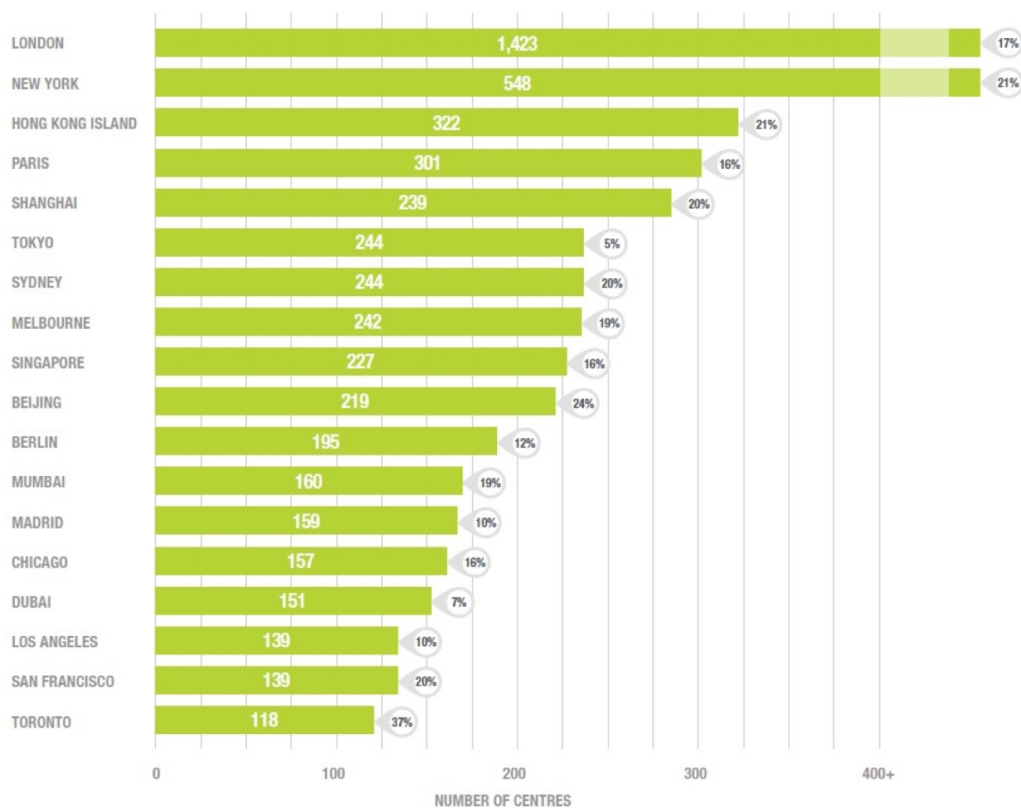


Figure 1: The top 18 markets for flexible workspace in 2019 (The Instant Group, 2019)

Figure 1 shows the top global markets for flexible workspace. In terms of the number of centres and desk spaces, flexible workspace markets as a substantial sub-sector are most highly concentrated (and the market is most mature) in those world cities and regions in which the regular office market is also substantial. Financial-, service- and technology-dominated economies tend to see a larger flexible workspace market. Major educational, research and graduate centres – as well as places where governments have invested in early start-ups – tend to have a fast-growing flexible workspace market. An overlap between well-being, quality and aesthetics means that cultural and artistic centres and localities within world regions also see a preference for more radical flexible workspace models, including those with communal, social and well-being features.

Flexible workspaces in their most concentrated form are commonly associated with major transport hubs and superior public transport links. There is a relationship between the often modern, dynamic and agile flexible workspace consumers (and their requirement for integrated logistics) and a range of transport options (such as local public transport, cycling, airport transfers and online taxi services). In secondary, tertiary and rural locations, small business centres, traditional serviced offices and some small coworking spaces do exist, but they are less common and substantially smaller in scope. However, a recent trend has seen major growth in regional centres throughout the UK, Europe and US, and flexible workspace is gaining market share in most cities.

2 Modes of flexible workspace

The flexible workspace market is diverse and innovative, and this has been the case for some time in mature markets, such as those detailed in a previous RICS research report, *Change and flexibility: the role of serviced office space in corporate property portfolios and office markets* (RICS, 2000).

There are broadly three modes of flexible workspace available to the consumer:

- traditional short letting of a small but defined space
- coworking, in which space is shared (see the next section for more information on coworking) and
- corporate spaces (or headquarters), where a much larger space is taken.

Many flexible workspace facilities offer hybrids of two or more of these modes. The degree to which the traditional letting and corporate spaces are self-contained varies between sites and operators. For each of these modes, there is usually the opportunity to add on shared or exclusive meeting, common and sometimes recreational facilities and services where not already part of the letting arrangement. Coworking spaces may also be part of a membership scheme (detailed further in the next section).



Figure 2: Examples of flexible workspace modes

The type and mix of flexible workspace provision, coupled with the features of the local market and the nature of the provider, dictate the relationship with the real estate in which the space is situated. Flexible workspace providers typically adopt the following ownership models:

- Freehold ownership: the flexible workspace is managed directly.
- Leasehold ownership: the flexible workspace provider takes a conventional office letting from a freeholder. The lease may include provisions (for example relating to income targets) that also give the freeholder an interest in the occupying business.
- Property company/operating company split: referred to colloquially in some territories as ‘propco/opco’, this is where the freehold owning property company (‘propco’) is held as a separate entity to the operating company (‘opco’) for a variety of administrative and financial reasons. Contributors to this insight paper emphasised the particular care needed in valuing these interests and the need to establish clarity around what is to be valued. The

exact company and ownership structure needs to be known by the valuer, as well as the terms of the opco letting or management agreement.

- **Management agreement:** alternatively, a freehold owner or leaseholder may decide to outsource the management of a flexible workspace entirely to an unrelated third-party company, which then returns the income from the space to the landlord (less a management fee). This model is often incentivised against the performance of the workspace.

Sometimes a hybrid scenario exists, blending or varying the above interests.

Increasingly landowners, investors and real estate service providers who were traditionally not specialists in this market are creating their own flexible workspace divisions, setting up standalone operations directly or factoring them into new developments.

Within each ownership structure there may be agreements between the landlord, lessees and management companies regarding who is responsible for the funding, design and installation of the fit-out and furnishings, as well as who is responsible for repairs and other constituent parts of a lease or licensing arrangement for real estate. In a market where price and take-up can be heavily reliant on aesthetics and quality, fit-outs can be expensive and onerous. In some cases, the party investing in the fit-out may take some time to realise a positive investment, and this then affects the nature of any valuation and the way in which it is viewed by the corresponding parties involved.



Figure 3: A heavily fitted-out flexible workspace

In common with the provision of any space, a flexible workspace may take time to reach a steady level of occupancy and income from additional services. This will be based on demand in the locality for the type of property and services offered. Demand in some areas can mean that occupancy levels start off very high and maintain that level based on latent demand, as well as the quality of the operation and its marketing. In other secondary or pioneering locations, and for certain property types or new types of services for a market, occupancy

and income may take longer to reach steady and sustainable levels. Operators will often seek to mitigate the need to allow time to reach a steady state by requesting incentives from the landlord, commonly in the form of rent-free periods but also premiums and contributions towards fitting out. Rent-free periods can range from a few months to a number of years, and contributions can be for very significant sums.

Some flexible operators may use their brand identity, covenant and business prospects to negotiate forward-funding for the fitting out of a flexible space (from a shell state) from the landlord or investor and significant rent-free periods to allow time to get the flexible space running and profitable. Consequently, the landlord is then in theory able to achieve a higher rent over the longer term, or benefit from the growth of a successful flexible workspace operation in which they may have a contracted stake. Here again our insight investigations noted the mixing of business and real estate investment, and the sharing of risk around the growth and success of a flexible workspace operation – particularly for those operations with a high degree or prominent marketing of coworking and service provision, and where they are reliant on corporate branding. The care that valuers, investors and operators take in making sure parties to a valuation, transaction or contract are clear as to the nature of the ownership and operating structure, and the entities being priced or valued, was once again highlighted.

3 Coworking and membership schemes

Coworking presents some unique valuation challenges in comparison with other modes of flexible workspace. Space is shared between occupiers, and there is a lack of the physical boundaries found in most transactions relating to the occupation of real estate. Further confusion can be caused by the term ‘coworking’ being used as a generic term to describe all flexible workspaces or operations, which include coworking spaces as well as other modes.

Coworking is the most likely mode to be attached to membership schemes, and it usually operates on more flexible terms than more traditional modes of flexible workspace. Coworking is described by Baum et al (2018) as the ‘[...] latest incarnation of flexible workspaces, but one which is likely to have, in fact already is having a much more significant impact on previous models’, who develop this further by saying ‘Many believe it will be a major and significant disruptive influence upon the traditional office market and is a further good example of change that challenges traditional valuation methodologies.’

Table 1 shows large flexible workspace lettings, including coworking, in the USA in the second half of 2018, with a dominant market in the traditional office area of Manhattan, New York, but also substantial lettings elsewhere. The table demonstrates that coworking is expanding, from its roots providing small spaces or even single desks to individuals and start-ups, to form part of larger lettings for the benefit of some major corporations.

Coworking: Leases signed in H2 2018 of 25,000 SF+			
	Space leased MSF	% of total space leased	Number of leases
Manhattan	2.7	46.6%	37
Other top 10 markets	2.5	43.7%	42
Secondary markets [9]	0.6	9.7%	13
Total	5.8	100%	92

Table 1: Significant large flexible workspace lettings, include coworking, in the United States in the second half of 2018 (Colliers International, 2019)

3.1 Types of coworking operation

There are essentially two types of coworking operations:

- smaller café-style operations in all kinds of markets and environments, where coworking areas and meeting rooms make up the majority of the space, and
- larger flexible workspace operations, where coworking makes up a component part of the offering along with traditional lets and corporate lets.

In terms of the larger operations, direct input from the market received in compiling this insight paper has suggested that while coworking is a fashionable and fast-growing sector, its prominent location in a building, in marketing and in the ethos of flexible workspace in general can sometimes exaggerate the extent to which the space drives income. A significant number of operators, particularly in world regions with predominantly traditional labour markets, have suggested that coworking makes up only a small part of the overall space, income and ultimately business in a flexible workspace operation, although it is often essential in the marketing, branding and selling of space.

The ratio, earning potential and synergy of coworking areas with other flexible workspace in a property is likely to be a key aspect of the market going forward. Even the most progressive operators (in terms of coworking and additional service provision) are understood to seek and rely on significant levels of medium and large corporate holdings within their estates, on less liquid terms than coworking and smaller takes. The value of coworking space within a larger operation is still principally understood to be in its synergy with, and as a driver of, holdings on more substantial terms.

3.2 The evolution of coworking

Coworking steadily grew from a fashionable trend among technology, professional and other contemporary start-up companies in Australia, America and the UK in the late 1970s as these industries themselves flourished. It also existed in an earlier form in academic institutions, where graduates with fledgling companies would share or co-opt space from the institution itself or a nearby company or operator.

Improvements in technology and increasing worker autonomy (which arose from the reduced need for significant infrastructure) has seen a drastic growth in demand for coworking spaces, with forecasts suggesting the trend for this kind of space to be continuing upwards. Similar to many trends where growth has spiked, there is disagreement as to whether a tipping point has been reached and coworking is now set to become the majority or even dominant office model, or growth will plateau once the natural peak audience for this mode of flexible workspace has been reached.

The global economic trend towards growth in self-employment and consultancy, as well as a move away from corporate structures, remains for many economies. However, in mature and some planned economies this growth is either slowing or not seen. Conversely, some argue for the benefits of a traditional corporate real estate structure, such as economies of scale and the removal of impacts on productivity that shared space can allegedly cause. However, while the hubbub and energy of coworking is not suited to some corporate structures and job types, many people view the synergistic benefits of being in coworking spaces to be positive, as it enhances networking, support and mutual understanding. It has been suggested by some that the vibrancy even a small coworking space can provide may mean that it is worth including as a matter of course in any flexible workspace, even if the coworking space itself isn't particularly profitable. This echoes the roots of some of the technology companies from which coworking arrangements started, and it can be seen today from the modern working methods and innovative occupation strategies of such companies. Apple, Alibaba, Facebook, Microsoft and Samsung are reported to have taken significant space in modern flexible workspace operations, with coworking elements in locations such as Manhattan and Silicon Valley (Amador, 2018).

3.3 Membership schemes

A modern feature of coworking properties is the attached membership scheme, where a user can choose from a range of properties at a fixed membership rate or have a 'home' property but receive discounts for others. Membership schemes can extend nationally and even internationally, and may in some circumstances include multiple operators. When valuing a real estate interest, it takes great care and skill to attribute value from membership use.

Membership may be closely aligned with brand and business value, and provides a conundrum for the real estate valuer, investor and operator. Membership is at an embryonic stage in terms of overall office market or even flexible workspace share, but there is substantial growth. It is not clear whether this reflects a trend that will flatten or it forms part of the wider structural changes suggested by some contributors.

Analogies exist with membership in certain leisure environments such as members clubs, gymnasias and cinema schemes. In those markets, specialist valuers with the requisite skill and experience dominate.

4 Data collection and analysis: challenges, risks and opportunities

The collection, sharing and analysis of data is a major issue in almost all areas of business and institutional administration. Data is a particular issue in relation to flexible workspace, as part of the attraction is the range of rates, services and conditions on offer. Furthermore, whereas many real estate transactions are either statutorily or commercially reported, or made available in some format, flexible workspace data is harder to both gather and interpret due to its often more transient and multifaceted nature. It may also be transacted through third-party brokerage.

RICS insight investigations in this area suggest that better data will help improve valuation accuracy and contribute to a sustainable market. Flexible workspace is, however, a highly competitive and fluid market. The agility with which transactions can take place means that they can instantaneously reflect peaks in demand, trends for additional services and customer expectations on terms. Analogies have been drawn with online hotel rates and even taxi services, with similarly accessible phone and online applications used to broker flexible workspace services. This fluidity of data makes analysis difficult, unless that too becomes live and based on contemporary transactions.

Access to this live and active data is an aspiration that some in the market suggest is an inevitability, albeit perhaps only available as a resource internally to the firm producing it. However, some argue that the fluid part of the market represents only a small section and that many transactions instead follow steady cycles over periods that can be more easily tracked and published. Furthermore, the case has been put that even the fluid parts of the market do not deviate far from a steady trend, and therefore indicative data can still be informative and provide a benchmark.

Some data providers publish proxy 'desk rates' for flexible workspace modes and locations, and these are understood to have been used to inform the valuation of traditional serviced offices for some time. Desk rates may be reflective of 'core' services that the occupier cannot do without (such as electricity), but these may not include all additional services. They will often be an average or index, and it has been suggested that the underlying data may need further investigation if used for formal valuation, primarily in terms of what is included and how it was derived.

The flexible workspace market is a substantial and growing sub-sector but – in line with most commercial markets – there are fewer capital than letting transactions and, given its overall size, there may be very few capital transactions from which to make direct valuation comparisons. The insight included in this document also demonstrates the focus of operators on an income-driven model, the consequence of which means that, for them, the resultant capital value of the real estate may not be their primary focus. In the eyes of some operators and investors, when capital value comes to be considered there can be a lack of available data that accurately measures the value of income when real estate operates as a flexible workspace.

5 Valuation implications: overage, premiums and returns

One of the main issues facing valuers, investors and operators is the assumption that can be made around the level and consistency of net income into a flexible workspace, particularly in comparison to a viable alternative use such as a standard office. The unique selling point of flexible workspace in the eyes of investors and operators is the ability to achieve greater net income levels than the space otherwise would – a ‘premium’ or ‘overage’. The valuer cannot assume that a premium or overage is intrinsically linked to the real estate; they must make a professional judgement based on the evidence. This is of particular concern when viewed in terms of the transferability of any premium in the event of sale or transfer.

Going forward (and assuming the sector continues to grow as expected) this question may evolve into a more straightforward one: whether an investment made in flexible workspace can provide a secure return over time, above that of appropriate alternative office uses and arrangements for a given property. The question of differences between the real estate asset, interest and business value also comes into sharp focus, i.e. what are the effects on any overage, premium or return if one or more of the many factors implicit in flexible workspace valuation changes? For example, an operator may be lavish with its staffing and added extras, meaning a premium is negated. Another operator could command a certain level of demand due to its brand alone, irrespective of the relative location or quality of a property. A landlord may have spent so much on fitting out for the benefit of a flexible workspace operator that they need to be certain of growth over time, without default. Given the few, if any, regulatory barriers to market entry, the extent and proximity of competition is also a vital consideration.

RICS insight investigations suggest that a premium above the market office rate (or to cover initial investment), or conversely a negative adjustment to yields, cannot be assumed purely because a property is to be used as flexible workspace. There is a danger that the modernity, dynamism and unknown potential in this popular sub-sector could lead valuers, investors and operators into making decisions without the required objectivity, rationale and evidence. Where finding *market value*, our insight investigations suggest paying particular attention to the factors that make the property different from an ordinary office and establishing whether these factors can be assumed for any reasonable occupier or operator, as well as upon transfer of the real estate interest.

Investors involved with this RICS insight paper made it clear that they will look at the structure of interests, the history of an operating company and the prospects for the future when evaluating decisions around flexible workspace. Investors also stated that they may assume vacant possession value (as offices) as a ‘backstop’. Operators and their partners vehemently advocated for their ability to clearly demonstrate premiums and a reliable indication of returns through good records, examples of other properties under their ownership, the strength of the market and reliable comparable data. Valuers applying RICS standards are required to take an objective view of these sometimes diverging perspectives. Where finding *market value* or *market rent* as defined in Red Book Global Standards, actual accounts data and the covenant of a particular operator (business) may not give a definitive picture. A valuer often needs to rely on a judgement of the position of a generic occupier for that property and market, rather

than a specific existing occupier, and therefore it may be helpful to refer to a clear analysis of relevant transactional detail (where available) and perhaps triangulate valuations using alternative methodologies (see section 6.7).

6 Consistent evaluation of flexible workspace income: potential methodologies and approaches

The techniques discussed in this section have not been set down or specifically endorsed by RICS; instead, they were discussed as part of the investigations for this insight paper in order to identify the value of a flexible workspace property and its related interests, or the business value, for various purposes. The approaches included are not exhaustive or exclusive. This document does not offer suggestions as to the circumstances in which a particular approach would be used, or make any recommendations of preferred approaches.

It is hoped that publishing these insights on methodologies and approaches will lead to further discussion and engagement, with the long-term goal of improving valuation consistency. Investors, operators and valuers may need to question whether due diligence and a suitable rationale have been used in a valuation, or whether the simplest, most traditional or most convenient method has been used rather than the most appropriate. That is for parties to judge themselves at this stage; however, by engaging with this subject and promoting material on potential techniques, it is hoped that parties will have greater ability and confidence when it comes to making such a judgement.

These investigations suggest that – given the different modes of flexible workspace and the commonplace mixing of types within a single property – the methodology and valuation approach are to be selected prudently and appropriately. Current and proposed ratios of space type available to the consumer (e.g. coworking, traditional or corporate) may affect the way income is considered, particularly where membership schemes and assumptions around additional services come into play. The operator's set-up – be it freehold ownership, leasehold, propco/opco, management agreement or hybrid – may also affect the way that income is considered and what that income is attached to (discussed further in sections 6.2 to 6.4).

6.1 The purpose and basis of a valuation

Valuers, investors and operators are reminded of the need to clearly establish the **purpose** of the valuation and therefore the subsequent **basis**. Where that basis is for *market value*, the worth of a property to a particular operator or the business values of that operator should be excluded where the two differ. A consideration of what defines the property as a flexible workspace and whether that is transferable on letting or sale is necessary.

Although some professional and academic voices have suggested for some time that 'serviced offices are valued using the profits method or investment method depending on whether or not the assets are owned by the operator' (Wyatt, 2013), there is no consensus that the profits method is suitable for valuing all flexible workspace, and it is not considered appropriate for a valuer without experience in the market.

6.2 Investment versus discounted cash flow valuation approaches

Depending on the circumstances, a traditional investment valuation or discounted cash flow is considered more appropriate by the valuer. The traditional approach takes an actual or hypothetical letting value and, where finding freehold value, capitalises this with an appropriate yield. A variant of this approach used for the valuation of flexible workspace uses a split yield: one is applied to the regular office value, and one is applied to the 'premium' value above that. Put another way, a yield is applied to the core net income related to the basic provision of the office space, and a second yield to the more variable income related to additional service provision. A traditional approach is seen by valuers to have greater simplicity and fewer assumptions, and makes it easier to compare transactional data from the regular office market with data from the flexible workspace market.

The discounted cash flow approach sets out hypothetical net income in much greater detail over time. The approach is capable of explicitly considering more variables, but each of these requires assumptions that cannot be derived from contemporary evidence as they relate to future events. Contributors to this insight recognised both approaches. There was no consensus over which is the more attractive approach, with both criticism and endorsement of each. Some prefer to triangulate different approaches, which is described further in section 6.7.

6.3 Freehold valuation

Where the property is held as a freehold, numerous valuation techniques are being adopted in the market. The simplest of these is a valuation of the property as an office based on a comparable method, applying an appropriate yield to a *market rent* derived from transactional evidence. This has been heavily criticised by some as not being reflective of the factors discussed in section 5. A development of this is a simple capitalisation of an assumed sustainable net income, again with reference to an appropriate market yield. This has the danger of effectively being either a business valuation or wholly inaccurate, and valuers have been keen to stress the expertise required to make any judgements around net income, specifically knowledge of Earnings Before Interest Taxation Depreciation and Amortisation (EBITDA). An alternative to this method is to apply a dual-yield approach: one to the equivalent market office rate for the locality and property, and the other to the difference between this and the net rate for the corresponding flexible workspace. Beyond this, many investors, operators and valuers are using increasingly sophisticated discounted cash flows to look at incomes, costs and returns.

6.4 Freehold valuation with a conventional lease

Input into this insight suggested that a property with a conventional lease arrangement can be valued with an appropriate market approach, with no need for complexity. However, it was pointed out that a lease to a flexible workspace operator may not always be straightforward – it could, for example, contain clauses around rent reviews that effectively share the risk of the business between the letting parties. Letting arrangements may also make provisions for the fitting out of a property, and therefore a net effective rent might not be obvious from this and may change depending on the period over which it is analysed. The rent may be to a Special Purpose Vehicle (SPV). Given these factors, the rent paid by a flexible workspace operator may not be the *market rent* for the property. A flexible workspace operator may be paying a rent based on their medium-to-long-term income projections, which are not necessarily

attributable to a typical occupation of the same property. Lease interests may form part of a wider development or existing office scheme, and this could have specific synergistic value or liability as a result. RICS insight discussions noted that yields applied to capitalise lease interests need to be carefully considered, seen to derive from appropriate and comparable sources, and produced by valuers with appropriate levels of experience and expertise.

6.5 Valuation considering management agreements, shared income and other joint venture models

A joint venture may arise through the creation of a legal interest in the property, such as a lease, or it may solely be a management agreement and therefore there is no legal interest in the property. In both approaches, the landlord and flexible operator agree to share varying proportions of the income and liabilities of an operation over a fixed term or throughout its life. This has the benefit of sharing the operational and investment risks and, for the landlord, it may increase potential income. The agreement may be similar to one that operates on a retail basis, where a minimum amount is paid by the occupant and the income-related portion starts at a fixed point. Alternatively, a purely income-sharing model may be adopted, or the landlord could keep the majority of the income, with the operator taking a fixed management fee – perhaps with incentives around income.

Management agreements and other shared income models can make the interface between business valuation and real estate valuation particularly complicated.

Investigations for this insight paper suggested that the valuation of flexible workspace property occupied in this way needs to be undertaken with full knowledge of the operational model, including the terms of any management agreement or other shared income approach and a record of how these terms have been reflected (where relevant). Issues with certainty and transferability of income are heightened in the case of management agreements, because the link to the underlying real estate is indirect.

Insight investigations concluded that the valuation of a management agreement (as opposed to the property in which it operates) is commonly the valuation of a business, and this needs to be carefully considered by the parties involved.

6.6 Development appraisal

It has been noted that – in common with other real estate interests where an income-based approach is used in valuation – prospective valuation or development appraisal of flexible workspace is particularly difficult. This is because there is no actual data from the property in question from which to derive assumptions on turnover and costs. In these circumstances, specific attention may be paid to who the owning and operating parties are, what their history is, and the link to and security of their wider business interests. When looking at *market value*, it has been suggested that even more care is taken and justification provided for valuing the space above office value on proposed developments – in other words, identifying what makes the property or proposed property a flexible workspace if that market is yet to be established.

6.7 Triangulating techniques

Some operators and valuers have suggested the best and most accurate way of determining value is to look at the valuation outcomes from several techniques and approaches, comparing and evaluating each, standing back and concluding an appropriate answer.

The theory is that the triangulation of various techniques and evidence bases gives greater confidence in the resulting valuation. Appropriate benchmarking and sensitivity testing of assumed costs and rates may also provide confidence to the parties involved.

6.8 Vacant possession plus a period of income

There was consensus criticism from operators, valuers and investors of a simplified valuation methodology that assumed regular office value in vacant possession, plus a single period of hypothetical income, as a crude proxy for a premium for flexible workspace use. Anecdotal evidence was given during the insight-gathering process of some operators, valuers and investors adopting a vacant possession office value and adding six months' or a year's income as an assumption of additional income above office value over time. Evidence for this approach was seen where valuers had little experience of the flexible workspace market, or where the market was underdeveloped in a location. It was referred to by some as a 'method of last resort'.

7 Valuation basis: business value versus real estate value

RICS has established standards and guidance for business valuation, including VPGA 3 of Red Book Global Standards. This section incorporates IVS 200, which relates to businesses and business interests. However, this insight paper is focused primarily on the valuation of real estate interests containing flexible workspace operations and not the value of those operations per se. That said, there is an increasing interface between business and real estate valuation, and a resultant risk of inaccurate outcomes if the boundaries and terms of each are not understood, particularly in a market where brand and goodwill can be important factors, which is discussed further in section 7.2. Of great importance are clear terms of agreement with respect to the valuation to be undertaken, stating what exactly is to be valued and therefore whether the value of any business attached to a property is relevant (and whether the worth of a property to a particular business is being considered or not).

7.1 Separating assets

The relationship between business value and real estate value in the context of flexible workspace has been known and commented upon for some time. McAllister (2001) concluded that ‘serviced offices owner occupiers have two main assets – the tangible property asset and intangible business asset(s) – which are symbiotically linked but separable’. The traditional role of a valuer is often to find either the *market value* (assuming vacant possession) or the *investment value* (to a particular interested party) of a piece of real estate. The structure and nature of the flexible workspace market can make this more complicated through factors such as joint ventures between operators and owners or management agreements, where brand identity and goodwill may be significant.

Some commentators have suggested that valuers are able to sufficiently estimate the hypothetical net earnings (EBITDA) of a flexible workspace where they have enough relevant data, experience and knowledge of the market. Some investors, however, will only have regard to the value of a flexible workspace, in addition to its value as office space in vacant possession, in circumstances where they have trust and confidence in the underlying business venture and security that only that business or an equivalent will operate from the property. In other words, where finding *market value*, valuers may have regard to a typical business structure and lease or licensing arrangements likely to operate out of a property, whereas investors in some circumstances may not want to risk separating business value from that of the real estate.

7.2 Goodwill and brand

Some flexible workspace brands are household names and are often put forward as exemplars of the industry, its dynamics and its history. Certain operators also build reputations at a local level. Reviews and commentary about the industry are commonplace, giving transparency to the market’s operation and attaching qualities to certain operators. All of this causes both positive and negative value for the brand, and the operational reputation of flexible workspace providers and resultant goodwill.

The valuation methodologies described in section 6 consider the value of a flexible workspace property based on comparable evidence from the flexible workspace and regular office market, estimations of hypothetical income, or a combination of the two. In reality, a driver for actual leasehold value or net income may relate to the goodwill a particular operator attracts or the attractiveness of a particular operational brand in the market. Neither of these can be assumed upon the transfer of a property interest. The need to carefully identify the entity being valued and the purpose and basis of valuation are reiterated.

Brand and goodwill are by no means exclusive to the flexible workspace market and are commonly dealt with in the valuation of, for example, hotels and restaurants. However, given the difference between factors such as levels of available data, valuer experience and market progress, the methodologies and assumptions for one market are not necessarily true for the flexible workspace market. Investigations for this insight paper suggested that appropriate levels of experience and the need to look at a range of data, plus the triangulation of techniques, all assisted with ensuring that the value of brand and goodwill is not inappropriately included in the value of property.

7.3 Portfolio valuation

Some participants in the insight-gathering process argued that the risk of overlapping business valuation with real estate valuation is overstated and, furthermore, that the hotel analogy suggested as a proxy for flexible workspace is incorrect, as the variability in occupancy and risk associated with a hotel may be higher. The case has been put that flexible workspace valuation is more analogous with portfolio valuation, essentially wrapping up the valuation of interests and appropriately considering the net value. An example would be the valuation of a shopping centre, which would combine various rental and other income streams and find an equated value. However, even in a modern retail environment, the terms of a retail lease are likely to be longer and more predictable than the considerably more liquid terms in a flexible workspace operation.

8 Conclusions: future applications, support and guidance

This insight paper is the first significant publication following the convening of an RICS steering group to explore the subject of flexible workspace in 2017. Further articles, research and professional development have been commissioned and will continue to explore this topic moving forward. The limitations of this paper have been stated in the introduction, but it is accepted that greater flexibility around the terms and operation of real estate is a common feature across many asset classes. This paper fits into that bigger picture, which RICS will continue to define and explore.

RICS is committed to monitoring and supporting developments in this arena through our website, digital communication channels, journals and other content. It is a key topic on the RICS radar and one we will come back to. In common with all insights, this paper can only reflect a snapshot in time.

This paper makes no mandatory or best practice suggestions. It has raised issues that RICS will explore further, such as the interface of business and real estate valuation, analysis of lease transactions, collection and analysis of data, and the future of work and indeed of valuation practice.

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Appendix A: Relation to wider RICS and industry standards

This section links the detail of this insight paper to current RICS standards, in particular Red Book Global Standards, and is included as a reminder and point of reference for members of RICS to show what standards and guidance already apply. It is also a useful reference for end users of valuation services, so that they too are aware of the expectations of RICS members.

It is not the intention of this document or section to provide a comprehensive list of valuer expectations (which would mean effectively recreating Red Book Global Standards). Instead, this paper includes a synopsis overview, with an expectation of further detailed referencing by valuers to the source material.

During investigations for this insight paper, it has been mentioned that Red Book Global Standards does not ‘cover’ flexible workspace, which has led to some confusion. RICS standards adopt a principles-based approach across all asset classes and not a sector-by-sector guide, so they ‘cover’ flexible workspace in that they provide a framework for a valuer to provide to an end user, to allow them to understand valuations of any type of asset, including flexible workspace. Furthermore, IVS are created and maintained by the IVSC, and are fully incorporated into and followed by RICS standards. Beyond the core standards in Red Book Global Standards, RICS also provides national supplements and guidance notes, which are again usually based on wider principles rather than particular sectors or sub-sectors such as flexible workspace.

Under VPS 1, the terms of engagement and scope of work must be agreed and clearly recorded. The variety of work and the overlapping of interests in the flexible workspace arena place much importance on the terms of engagement, including, for example, the **purpose** (3.1(f)), the **basis or bases** (3.1(g)), the **nature and extent of the work** (3.1(i)), and **any assumptions** (3.1(k)). Clarity is required in terms of the identification of the asset(s) or liability(ies) being valued. VPS 3 determines the way in which the matters addressed by VPS 1 should be reported, including any assumptions and limitations.

Attention is drawn to VPS 2, which details a valuer’s required inspection and investigations, noting paragraph 1.10, which states that ‘A valuer [...] will be familiar with, if not expert on, many of the matters affecting either the type of asset, including where applicable, the locality’.

Bases of value, assumptions and special assumptions are detailed in VPS 4. Valuers are reminded to pay particular care and attention to understanding the correct bases, as defined in IVS. These include *market value*, *market rent*, *investment value*, *equitable value*, synergistic value and liquidation value. There must always be a clear distinction as to whether what is being valued represents the value to a particular operator (or with a particular operator in place), or it is a value that might assume no particular operator. The three main valuation approaches are detailed in VPS 5: the market, income and cost approaches.

The remaining sections of Red Book Global Standards are for guidance purposes only, but they are considered best practice in the eyes of regulators and the courts, and enable a

framework for clear and consistent reporting to end users of valuation services. They include but are not limited to:

- VPGA 1: Valuation for inclusion in financial statements
- VPGA 2: Valuation of interests for secured lending
- VPGA 3: Valuation of businesses and business interests
- VPGA 5: Valuation of plant and equipment
- VPGA 6: Valuation of intangible assets
- VPGA 8: Valuation of real property interests.

Reference to the contents and guidance contained in VPGA 4, which covers the valuation of individual trade-related properties, has been made by parties involved in gathering insights for this paper. VPGA 4 is specifically worded to highlight its use for single assets and where there is an element of restricted flexibility in the design or adaptation. VPGA 4 is therefore only to be used in limited circumstances and with some caution, though exact circumstances are not prescribed, given the overall principles-based nature of Red Book Global Standards. Paragraph 1.4 of VPGA 4 recognises that it may later be applicable to a wider group of assets as markets evolve, within the limitations included here.



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