Research Report 2019

The Growth of Choice

Evaluating traditional space vs. flexible alternatives

Instant
RETHINKING WORKSPACE

FORA, CENTRAL STREET

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Introduction

Modern business moves fast. Change is inevitable. But having a flexible approach to real estate can hedge risk and boost business agility when expanding into new markets, creating project space or consolidating your portfolio.

In today's unpredictable business environment, real estate portfolios are becoming more agile and the choice of flexible workspace is enabling this change. By 2023, we predict that 35 percent of real estate will be in flexible workspace but today we are finding that companies are still struggling to determine which solution will work best for them.

Our report includes a step by step guide on how to evaluate flexible workspaces versus traditional real estate, the status of the flexible workspace industry today, and best practices in change management when choosing an agile approach to workplace.

Our Experts

MARIA GIESEMANN
DIRECTOR, THE INSTANT GROUP

Maria has more than 12 years' experience in real estate consulting, capital markets and corporate office portfolio management.

At The Instant Group, she advises corporate clients on leased and owned office portfolios, reducing capital and operating expenses and managing leasing risk. She also builds custom office solutions for clients seeking flexible office spaces.

Maria has a Bachelor of Arts in Urban Studies and a Masters in City Planning from the University of Pennsylvania and an MBA in finance from the University of Chicago Booth School of Business. She is a licensed Florida sales associate and a member of the American Planning Association.

ANGELA DETTORE
CEO, MOVEPLAN NORTH AMERICA

Angela Dettore leads the strategic direction of the business and works with the firm's leaders to develop new markets and product offerings.

Angela joined MovePlan in 2005 as the firm expanded its global footprint to the US and has worked in every role on the Delivery Team. Angela is an active member of CoreNet, CREW and IFMA. She earned her Project Manager Professional certification and CoreNet's MCR.w designation.

As the North American team lead, Angela ensures that the move and change management delivery is a valued service offering to clients. She has also been instrumental in MovePlan's expansion into laboratory relocation in the US as well as Space Utilization and Optimization Analysis.

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The Workforce Is Changing

A driving force behind the changes in the workplace is the demographics of employees. Their requirements and the necessity to retain talent have changed drastically, especially when it comes to amenities.

> **72 percent of CEOs believe that the next 3 years will be more critical for their industry than the last 50 years.**
>
> **PWC**

You don't need to look very far around office environments to see vivid examples. The amenities race has infiltrated office environments, so much so that it's now commonplace to see offices with perks ranging from refrigerated rooms for grocery delivery and hot-tubs, to onsite childcare facilities.

> **In just six short years millennials will represent 75 percent of the workplace - Deloitte**

In order to attract the best talent, flexibility is key. Employees are no longer expected to sit at their desks all day. Working hours and locations have become flexible and certain roles such as business development are expected to be out with clients during the day. Agile working can save a company on average a third of their total CRE costs.

Embracing Flexibility

Companies need to be ready and flexible to achieve targets. Change and growth go hand-in-hand with flexibility. The need to grow quickly and to change on demand, whether downsizing, moving locations or opening in a new market, will be hindered if CEOs do not embrace workspace flexibility.

Our proprietary, market data shows the changing dynamics offering choice to the sector:

- The global flexible office market is growing at **35%** plus year on year.
- Currently there are more than **31,000 flexible office spaces** available worldwide.
- New York City, the world's most expensive flexible office market, experienced **22% growth in the last 12 months.**
- Newer markets such as Mexico City and Hong Kong are seeing **19% and 17% growth**, respectively.
- We predict that by 2023, **35%** of office space will be flexible space.

WEWORK, WEIHAI LU, SHANGHAI

Flexible Office Space Defined

Flexible office space is an umbrella term that refers to coworking, serviced office and hybrid office spaces. The perception is that flexible space is working at a communal table with people from various firms - the way you see people working on laptops at local coffee shops. Yet perception is not reality.

> **While flexible office spaces may have an element of collaborative spaces, most operators have less than 10% of their space dedicated to this type of environment.**

Sole coworking spaces provide a shared environment in which individuals from different companies work side-by-side. These spaces charge a monthly membership fee.

Hybrid spaces refer to operators that offer both coworking spaces and private offices throughout the building. WeWork is considered a hybrid space because they have both private offices and certain common shared elements.

Regus is an example of a serviced office space because they typically do not offer communal coworking space. A serviced office is fully equipped and managed by an operator. Companies rent individual offices or suites on a cost per desk basis.

> **Eighty-three percent of the market is made up of smaller, niche providers.**

The flexible market is therefore very diverse. WeWork, Regus and Servcorp make up 17 percent of the market. Flexible office operators have moved over into secondary and tertiary markets following the demand from corporates. Larger organizations are also moving into the flexible office space. No longer are two to four person offices standard in the industry.

> **64 percent of operators surveyed by Instant say they see a rise of requirements for 50 desks or more.**

Companies that are building out headquarters or can no longer contain their workforce in one location turn to flexible space as a solution.

Many companies see the benefit of moving into flexible space when they do not have a dedicated real estate team. By moving into flexible space, office managers and c-level executives save countless hours and budget by letting operators secure their furniture (even if they want a customize, branded space). Not only can companies get a turnkey, branded office suite but they then save on facility management costs.

TABLE 1. TOTAL COST OF OCCUPANCY COMPONENTS

US AND CANADA	OUTSIDE THE US
Gross Rent	Rent
	Service charge
	Property taxes
	Maintenance
	Cleaning (Janitorial Service)
Parking	Parking
Archive	Archive
Utilities	Utilities (electric)
Office consumables	Office consumables
Kitchen consumables	Kitchen consumables
Reception	Reception
Telephony	Telephony
Internet	Internet

TABLE 2. TOTAL COST OF OCCUPANCY TRADITIONAL VS. SERVICED OFFICES

TRADITIONAL	SERVICED	CASE STUDY – FINANCIAL SERVICES
Rent	Membership Fee	
Service charge		
Property taxes		
Maintenance		
Cleaning (Janitorial Service)		
Parking	Parking	
Archive	Archive	
Utilities (electric)		
Office consumables	Copies, scanning and printing	Office consumables
Kitchen consumables		
Reception		Reception
Telephony		Telephony
Internet		Internet

How to Evaluate Flexible Office Space Versus Traditional: A Case Study

When a financial services company needed to make their real estate footprint more efficient after being acquired by a private equity firm, they turned to The Instant Group to help evaluate their needs. The firm already had a portfolio of more than 130 offices globally. By going to flexible space in 30 to 40% of their offices, the company was able to reduce both capital expenses and ongoing operating expenses.

As leases started rolling over, Instant and the company looked at three scenarios:

- Renewal in the existing space
- A move to a traditional office space
- A move to flexible space.

This particular case study highlights a move in Latin America, so the costs are lower than what you would see in the US.

STEP ONE

The first step in evaluating a next move is detailing needs. Be as specific as possible. This financial services firm had very particular requirements-something flexible office providers have grown to expect from RFPs.

The firm was growing from 90 desks to 250 desks over five years, adding 60 desks in the first year and about 25 desks each year after. The firm needed two private offices, an archive room, and a dedicated server room. Security was tantamount, as most of the rooms needed access control, security cameras and wired ethernet with two data ports at every desk.

STEP TWO

An internal cost audit comparing total occupancy costs followed. This is crucial to truly compare flexible space to traditional space. There are significant differences in costs and considerations in traditional and flexible office environments. For example, reception is not usually considered a real estate cost; but in certain cases, moving to flexible space means being able to avoid that cost as the operator provides you with reception. In the U.S. and Canada, the gross rent includes your service charges, maintenance and cleaning fees, and property taxes. Outside of the U.S. and Canada, you need to add that to your audit. (See Table 1).

Table 2 shows what is included in a flexible office. While some operating costs such as printing and scanning are included in a flexible space, your pens, paper, coffee needs and other consumables vary by operator.

STEP 3

Step three is to compare the costs (see table 3 on page 13). Typically, companies would look at two different traditional spaces through a broker, and two different flexible spaces.

Undoubtedly, there will be radical changes. Square footage will be much lower on the flexible options because operators will provide the square footage for private space without accounting for all the common space such as phone booths, conference rooms, and kitchen. The cost per square foot is thus not comparable. This is key in comparing the two different types of spaces.

> **In a flexible space option, capex expenses are avoided all together. Once you amortize the costs per month, including the capex expenses, it is clear that the flexible solution is much more cost effective.**

Dividing the operating costs and capex into two blocks, an audit will show what does and does not need to be included. In this example, we looked at a five-year term. On the traditional office example, there was a 3 percent increase in rent each year.

The Best Option

On the flexible side, the proposals from each operator varied depending on the finishes, amenities, and building clasification. Looking at the costs alone, the best option was the first flexible office space. However, the differences were not significant until considering capital expenses.

Where the difference is truly seen is in the capex portion. In a traditional office space, you could either be receiving a gray space, meaning you are receiving a cement box and you need to build out everything; or a white box, meaning the paint, carpet, and ceiling are complete but you need to build out the space with furniture. In this example, the capex expenses in either of the traditional office solutions was around $2 million.

The Real Difference

In addition to square footage not being comparable between space types, managers are often concerned about their employees being distracted by the additional amenities offered in a flexible space. Some even worry that their employees will be poached by another firm at the space. Instant has found that, more often than not, the opposite is true. Neighbors in the flexible space often become clients, and you in turn

end up using their services. Employee engagement and productivity also tends to increase in flexible spaces. In this case study, employees said they were 52 percent more productive in the flexible space.

Other concerns include noise and privacy. The noise will most likely increase in a flexible space but operators are willing to find a solution. Operators understand requests for additional noise abatement, sound insulation or special window treatments. Tenants must make sure to evaluate this early on and bring it up with operators during the RFP.

Impact on Company Culture

Company culture is another major consideration when moving to flexible space. In this case, the firm went from 16 private office spaces to two. The hierarchal structure changed. When evaluating your office move, it is critical to evaluate not only the cost, but also cultural needs and to create a change management plan early in the process.

> **“A co-working firm might charge $110 per square foot per year for space that a large landlord would lease directly to a tenant for only $50, said John Vazquez, Verizon’s head of real estate.**
>
> **Yet the costs come out about the same, he has found, because flexible space is more efficient and the co-working firm, not the tenant, spends the money to outfit and design the space.**
>
> **‘If I can use someone else’s capital and shorten my time commitment and my financial commitments, how is that not a win for me?’ Mr. Vazquez said.”**
>
> THE WALL STREET JOURNAL

TABLE 3. TRADITIONAL VS. SERVICED COMPARISON FOR A FINANCIAL SERVICES COMPANY

	TRADITIONAL			FLEX OFFICE		
	CURRENT SUITE 1104	FUTURE COSTS TRADITIONAL SPACE #1	FUTURE COSTS TRADITIONAL SPACE #2	FUTURE COSTS SERVICED OFFICE #1	FUTURE COSTS SERVICED OFFICE #2	NOTES
SPACE PLANNING						
Square feet	9028	22,316	24,995	N/A	8608	
Desk capacity	90	223	250	150	150	
Cost / month (rent + service charges) US$	**$ 22,456**	**$ 44,800**	**$ 45,049**	N/A	N/A	
Cost / square foot	$ 2.49	$ 2.71	$ 2.47	N/A	$ 8.47	Favourable market conditions for tenants gave us the opportunity to lease a brand new building for lower / foot square costs
Square Feet / Employee	100.0	100.0	100.0	N/A	57.4	Standard was 100 SF per employee
OPERATING COSTS						
Repairs, electricity, water, kitchen consumables & cleaning	3,700	7,887	8,715	included	included	
Parking	included	included	included	1,600	1, 600	
Internet, reception, telephony, office consumables & archiving	6,854	7,882	7,882	7,882	7,882	
Total cost of operating / month (Year 1)	**33,010**	**60,569**	**61,646**	**45,382**	**72,882**	
Total cost of operating / month (Year 2)		62,387	63,496	45,382	72,882	
Total cost of operating / month (Year 3)		64,258	65,400	67,882	72,882	
Total cost of operating / month (Year 4)		66,186	67,362	67,882	77,882	
Total cost of operating / month (Year 5)		68,171	69,383	82,882	77,882	
Total 5 year Operating Costs		3,858,859	3,927,457	**3,712,926**	4,492,926	
CAPITAL EXPENSES AND TERM						
Finish		Grey Space	White Box	Fully customized	Fully customized	
CAPEX / square foot US$		$ 93	$ 70	$ 0	$ 0	
Total CAPEX US$		**$ 2,074,000**	**$ 1,749,684**	$0	$0	
Average monthly cost with amortized CAPEX		**$ 102,738**	**$ 98,545**	N/A	N/A	
Term		5 years	5 years	2 years	3 years	
Expansion Options		In other floors	On this floor	On same floor	On same floor	
Yearly Escalation		3%	3%	On contract renewal	On contract renewal	
Free Rent		3 months	3 months	None	None	

Change is Inevitable - Plan for It

The three highest costs to companies are: people, technology and real estate, but the investment in people outweighs the other two significantly.

Of a company's total annual spend, 82 percent is on employees. Making an investment in change management is truly making an investment in your employees.

High quality change management programs are six times as likely to meet project benchmarks. A change management plan is also key to finishing a project on time, therefore minimizing the costs with a project going long.

A key aspect to change management is understanding that the change is happening to every employee in the organization on every level. It is affecting those who support the change and those that do not.

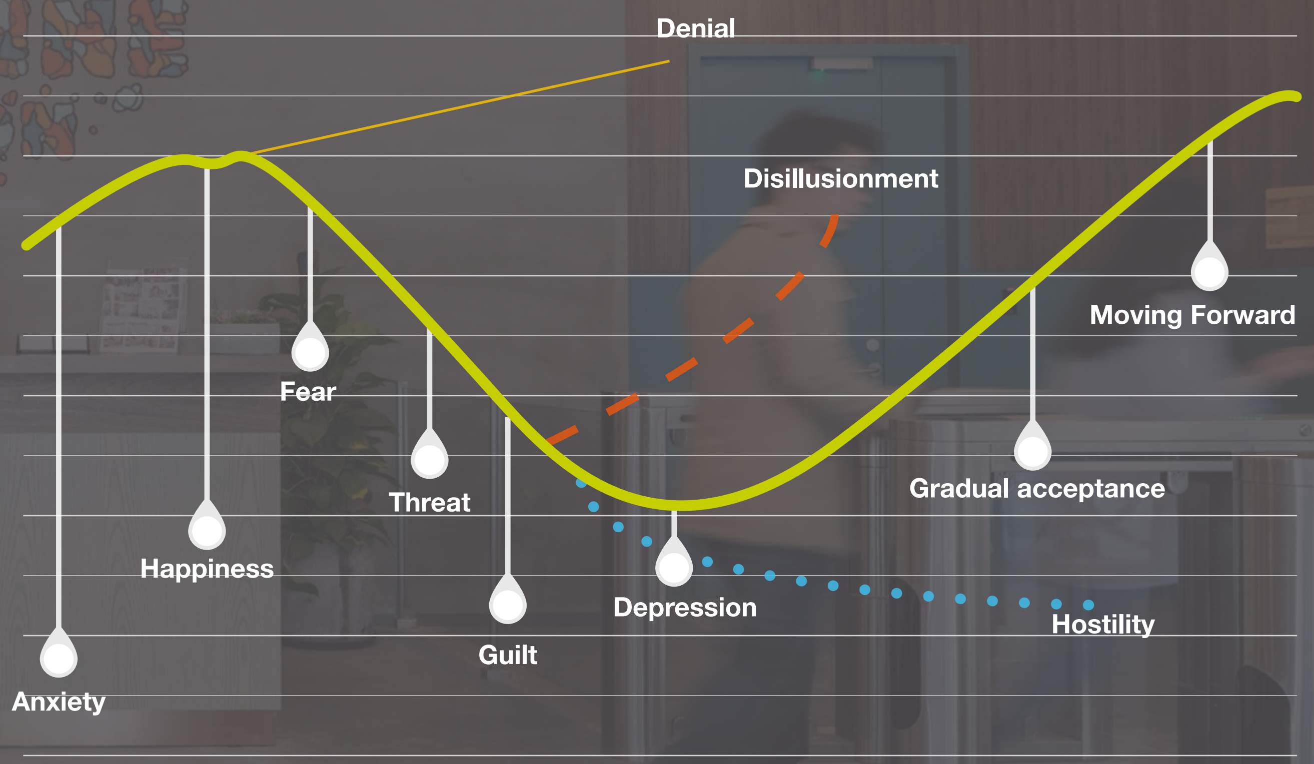
Change management programs often focus on the people showing resistance to the change but it is just as important to remember those who are for the change. Even if an employee is agreeable, they may still be fearful or feel threatened by the change.

> **When a change management program is put in place, 71 percent of projects are completed on time.**

The change curve (chart 1) is a way of understanding an individual's confidence in the change- where the morale sits and how confident people feel in their role throughout the change. It is normal for there to be a dip in moral throughout the process; but the role of the change management program is to ensure that the dip is as shallow and narrow as possible.

WEWORK, YUNNAN LU, SHANGHAI

CHART 1. CHANGE CURVE



Need for Change Management

The Prosci ADKAR framework in change management focuses on awareness of the need for change- what is the change and why is it important to the organization. After vocalizing the need for the change, it is important to create a desire for the change. This stems from understanding what people's personal motivations are and appealing to those factors.

Providing Knowledge

Next, you have to provide knowledge, giving people the skills and support to feel comfortable with the change. Once you create a desire and teach your audience how to support the change, you must give them the ability. Although people may understand the tactics, actually delivering those skills may be difficult.

Change Management Framework

An effective change management framework helps remove the barriers to change, such as change fatigue, people not feeling heard or people feeling excluded from the process. One top tactic in removing the barriers is to appeal to the brain, meaning engaging both the analytical and emotional communications. For example, using statistics to highlight the 'what's in it for me' message.

Pace Over Time

Another tactic is called 'pace over time' in which a company needs to be very wary not to overwhelm people with messages. Messaging needs to be at a steady pace at which employees feel that they are being communicated to without

being bombarded with messages. Most companies are dealing with a lot of changes at the same time so understanding where workplace announcements fit best in the realm of all the other changes is key. Prioritizing the announcements allows firms to avoid change fatigue.

Story Telling

Story telling is one of the most effective 'why' tactics in change management. Focusing on why the change is important in the overall business objectives will help establish trust. Most resistance to change stems from lack of trust, not the change itself. Employees are fighting the unknown that may stem from the change. Planning is another tactic companies should consider. This means identifying the points of resistance up front and planning support for these items.

Once you've removed as much resistance as you can and implement the physical relocation, you must continue the change management plan through reinforcement. Put in long-term support for the change and use incentives and rewards. Change happens over long periods of times so you may have to go back to prior steps throughout and reinforce certain objectives or build more desire.

Pro Tips for Change Management

1. Ensure there is enough time for the change initiative to happen. Make sure the time frame of the change includes not only the announcement, but also the time it takes for employees to absorb and process the change. Change management professionals tend to say you need to attack the message in seven different times in seven different ways. You need enough time to do that.

2. Make sure the right information is presented at the right time. Present a timeline for when information is distributed to avoid both information scarcity and information overload.

3. Bring people along the journey with you. Understand that the people who the change is most affecting tend to get the information in small drips over a longer period of time. During absence of information, people will create their own truth. Try to avoid this by sharing as much detail as early as possible – even if this information may change. People are more accepting of change when they feel in the loop even when you explain that the process may change.

4. Change management needs to be for all levels of the organization. Ensure your program has strong leadership support but also make sure that support for admins and mid-level managers are planned for. Mid-level managers tend to be the biggest resistors to change.

5. Regardless of the group, make sure employees understand their role and that you provide supporting documentation.

6. Make sure you are measuring engagement throughout the change and evolve your plan. Your plan will change. Flexibility is key to reevaluate the needs based on what you are seeing from employees and stakeholders.

Rethinking Workspace.

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

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

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Contact:
For enquiries about this report please email contact.us@theinstantgroup.com

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

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