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Research

The impact of COVID-19 on flexible space

What the future holds in a fast-paced world affected by the pandemic

Introduction

Real estate around the world continues to evolve. As that happens, a spectrum of flexible space options has taken shape, ranging from on-demand workspaces and coworking memberships to short-term, flexible spaces and traditional space consumed flexibly. Businesses of all sizes need a variety of space options across this spectrum and will choose the right fit for each scenario throughout their portfolio. The need for an agile portfolio with a spectrum of flexible options has only increased due to the COVID-19 pandemic.

Flexible space is a spectrum

Workspace liquidity

Traditional space

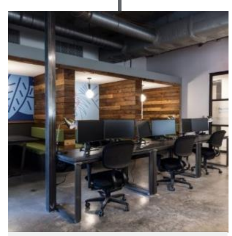
Long-term space with limited flexibility

Turnkey workspace

Move-in-ready flexible space customized to tenant needs, brand and culture

Short-term workspace

Dedicated team space for short terms (<2 years) and/or immediate needs

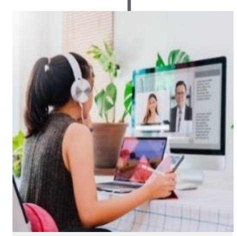


Coworking memberships

Ad hoc, individual access to single coworking locations or a coworking network

Workspace on demand

Individual desks or meeting rooms by the hour, day or week



Work from home

Workforce working from home, collaborating virtually with maximum flexibility

The impact of COVID-19 on the real estate and flexible space market is significant.

Not only has it dramatically changed the global real estate market, it also accelerated existing flexible space trends. The developments that initially drove the explosive growth of the flexible space market — including real estate portfolios becoming more agile, reductions in lease duration, the need for workplaces to support employee experience and engagement programs, health and well-being in the office and the amenity race within the workplace — will continue to drive demand for flexible space.

JLL Research predicts flexible space demand will continue to increase as a result of COVID-19, although in a different form than it took before the pandemic. In fact, we believe 30% of all office space will be consumed flexibly by 2030. While there are short, medium and long term implications of COVID-19 on the sector, the future of real estate is a spectrum of flexible spaces.

> *30% of all office space will be consumed flexibly by 2030*

The short term — (re)spond

Just as traditional corporate offices have been deserted, so too have flexible offices and coworking centers. As tenant priorities have shifted to employee health and well-being, the demand for short-term desks, shared offices and new memberships fell over the course of lockdowns around the world — ultimately testing the sustainability of some flexible space models.

Coworking companies will face the toughest test, as freelancers and start-ups opt to work from home. Simultaneously, large corporations are shedding memberships for quick cost-savings solutions.

While most flexible space operator offices remain open for business, they are forced to adhere to government guidelines. If 6-feet-apart social distancing is required, it considerably reduces the space allocated for individuals within the property. In practice, this means many flexible offices will record extremely low utilization rates and, in some cases, will remain nearly empty. Profitability in these types of coworking spaces is driven by high seating density and rental arbitrage. Flexible space operators with a 'hybrid' model that lean on long-term commitments of private office space in addition to coworking may withstand the storm. Those relying on a pure coworking model will likely suffer from the impact of COVID-19.

These challenges will expedite a long-predicted consolidation of the flexible space operator market. Investors will be significantly affected by flexible space operators closing their spaces, creating vacancies in their assets. COVID-19 will influence lease renegotiations, and those that cannot come to terms will likely close. In turn, cash-rich, opportunistic flexible space operators and/or investors could take advantage of this market consolidation.

> *Opportunistic flexible space operators and/or investors could take advantage of this market consolidation*

The medium term — (re)enter

As the workforce begins returning to the office, business continuity and operational resilience will come to the forefront for tenants. Flexible space operators that can withstand the challenge of the pandemic will look to support 'the next normal' in the workplace for all tenants — regardless of size or sector. In fact, some proactive flexible space companies are already attempting to drive brand loyalty through remote community services.

There will be an increase in workplace mobility programs emphasizing remote-working, creating a reduction in density in both traditional and flexible offices. Flexible space is quick and easy to acquire, and tenants will turn to it as a solution for smaller, satellite offices that reduce commute times and dependence on public transport. Furthermore, with expected economic uncertainty, portfolio reductions and cost-saving strategies will be employed. Short-term, flexible offices will support these enterprise goals.

Investors, significantly affected by the loss of flexible space operators and/or space closures, will look to repurpose their vacant spaces and potentially operate their own flex space. There will be more focus from flexible space operators on management agreement models as leasehold operators no longer have leverage.

The long term — (re)imagine

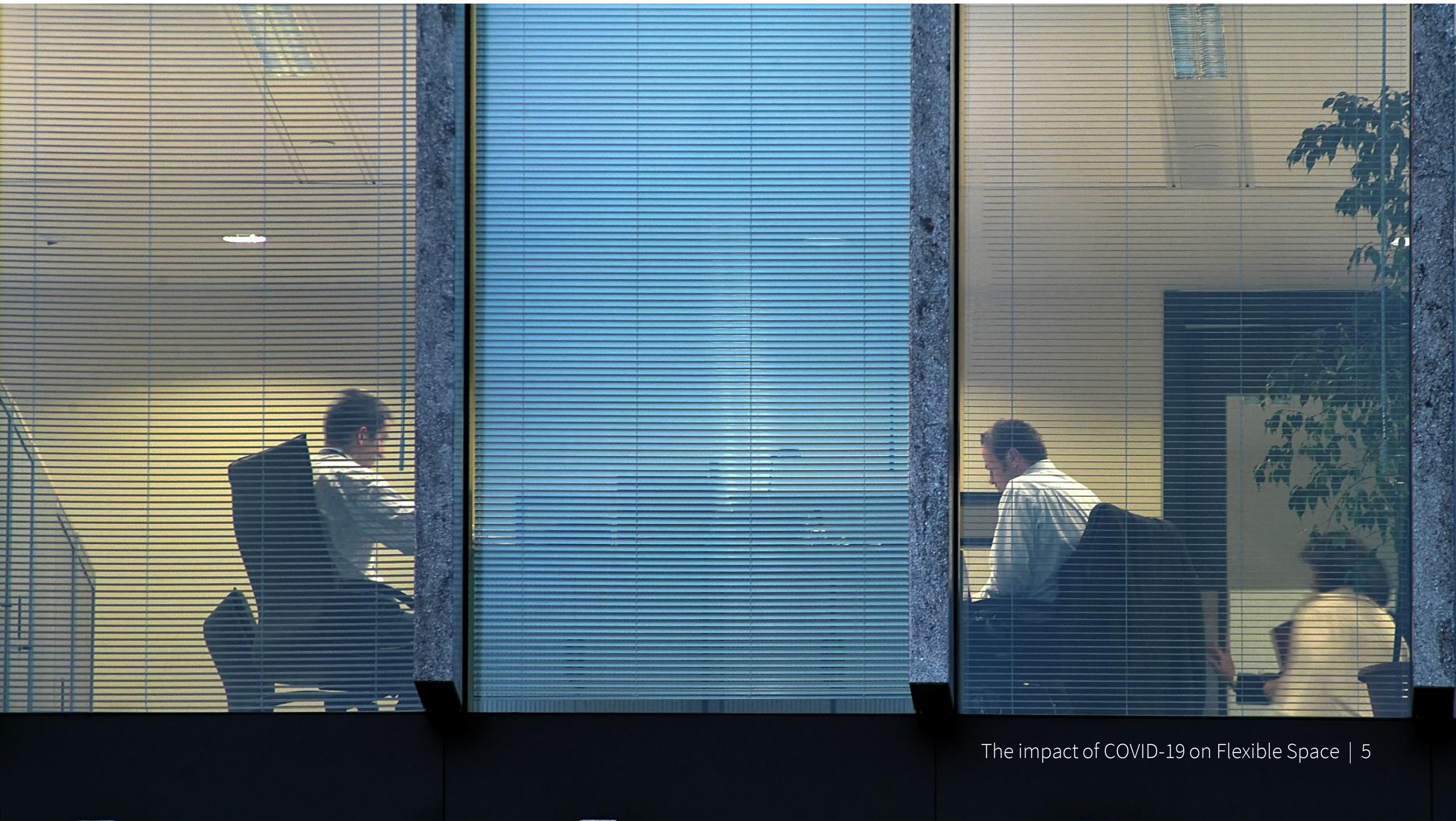
The role of the office has been challenged. The mass experiment in remote working has reinforced the need for the office to act as a communal space enabling collaboration, fostering innovation, emphasising company culture and supporting high-performing teams — rather than simply a place to work. This leads to an increased focus on technology-enabled, experiential workplaces that are best utilized for collaborative meetings and hosting clients/employees.

We, as a society, are assessing if it's necessary to work in a fixed, permanent position daily. Even prior to the outbreak of COVID-19, 4 out of every 5 employees reported that given two similar job offers, they would turn down the one that didn't offer flexible working, according to the 2019 IWG Global Workspace Survey. Therefore, remote and flexible working practices are now expected and no longer seen as just a perk. This could further push enterprises to more agile real estate solutions, and perhaps lead to less demand for long-term leases and/or owned assets.

A mix of traditional and flexible space will be even more important in CRE portfolio strategies in the future, especially as employees will now expect the ability to work at home and be closer to home. Businesses will have a greater need for flexible space to accommodate portfolio expansion and contraction along with crisis support to flex their space needs as necessary. Enterprises will increasingly expect landlords to offer the ability to flex as an amenity as their business changes.

The focus on health and well-being will only increase in the future. The densification trend that had been happening over the last decade will likely reverse. Enterprises will lean on flexible office space as a way to map out how to relax this density.

Investors will be much more focused on security of covenant and will be more analytical in working with flexible space operators in future. This will translate into an increased need and demand for high-quality flexible space from trusted providers. Locally, this could result in smaller, more efficient markets consisting of a handful of well-financed, profitable regional operators.



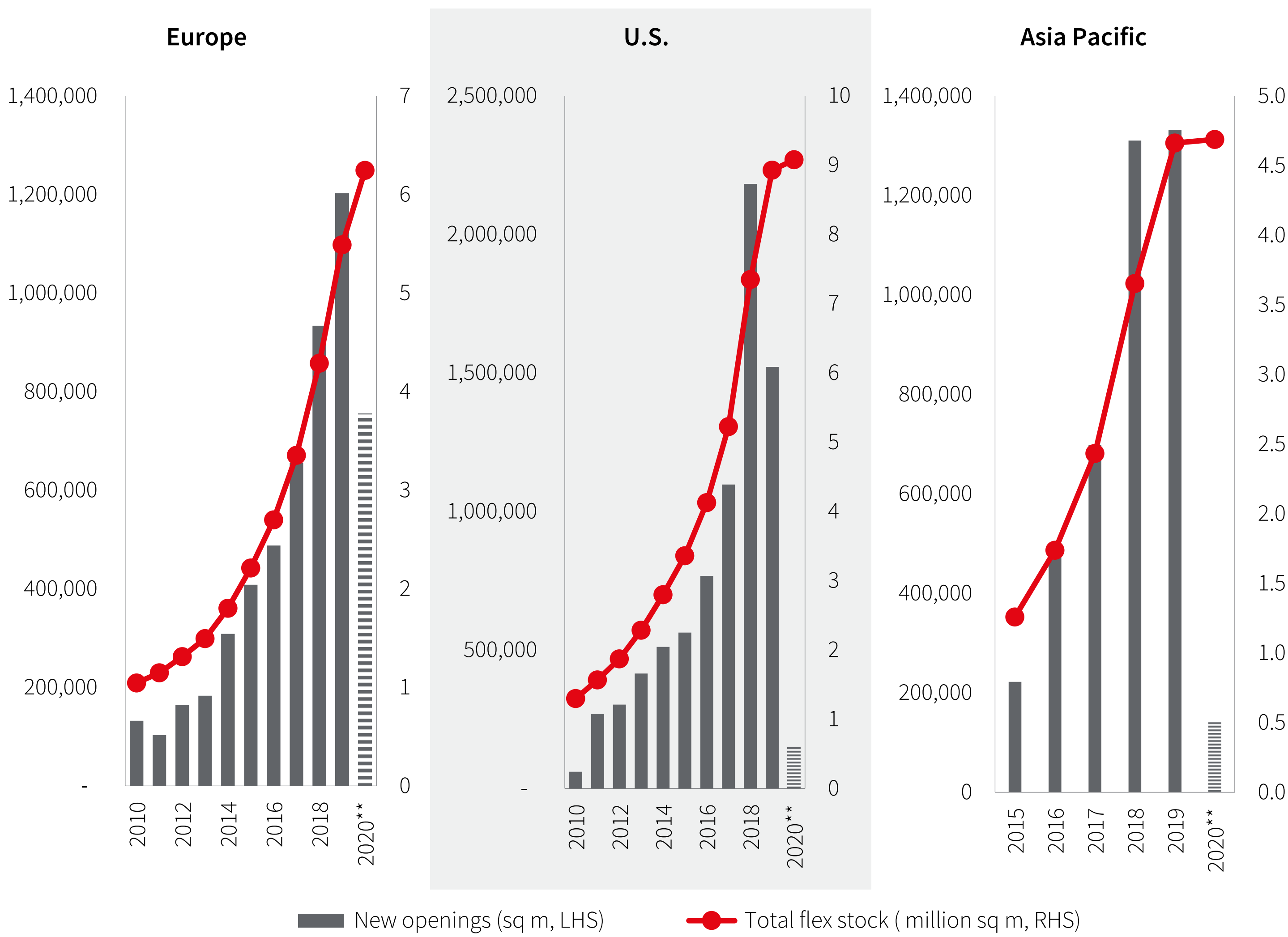
Flexible space markets

Global uncertainty puts strong flex market growth trajectory temporarily on hold

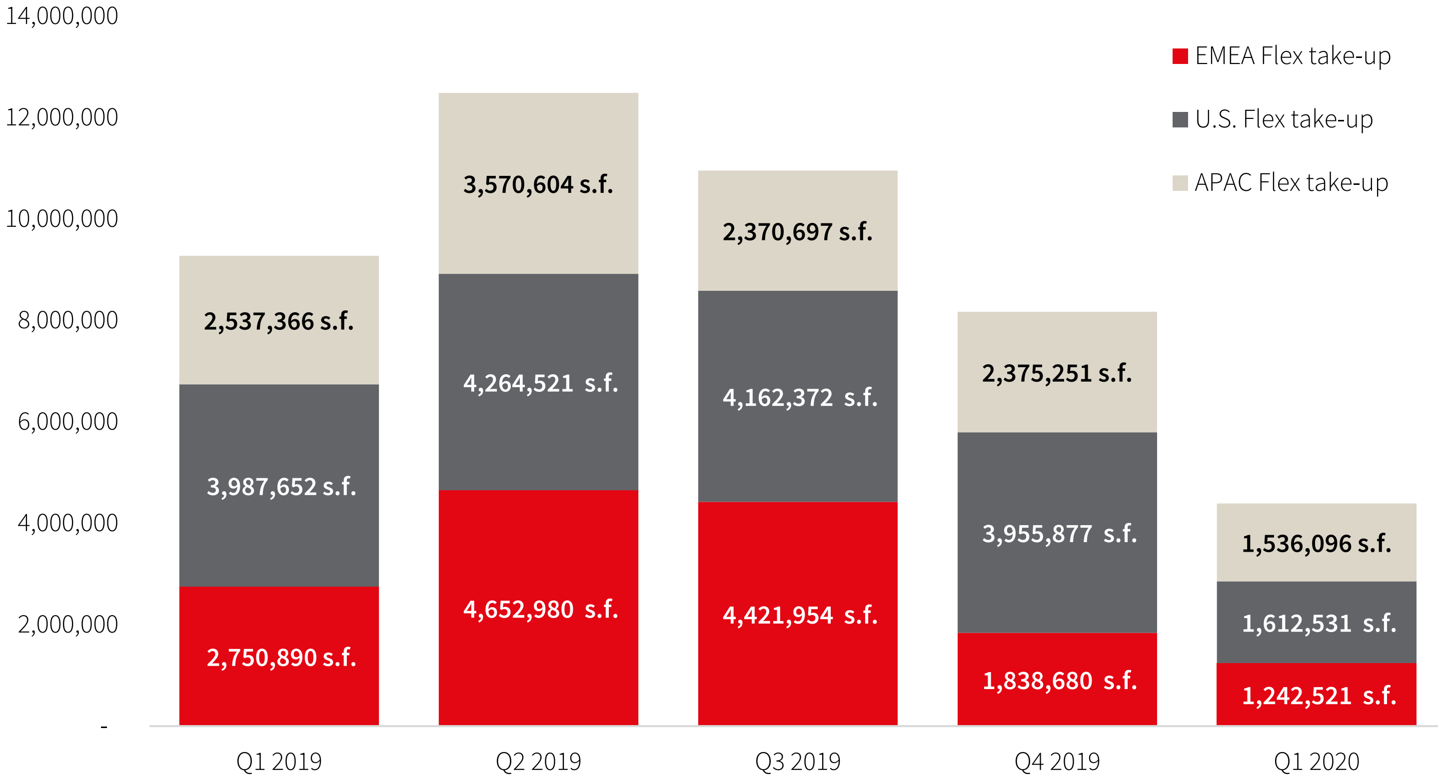
The global flexible space market has grown by an average of 25% since 2014, with the top 20 markets across the three regions recording a combined flex inventory of around 204 million square feet. Accounting for over 10-20% of leasing activity in many markets in 2019, flexible space has grown from a marginal business sector to a key pillar of growth in most global gateway cities over the last decade.

This astonishing growth slowed in Q4 2019 as WeWork scaled back its expansionary drive, focusing on optimizing its existing portfolio after cancelling its IPO in September of that same year. In addition, the entrance of new flexible space operators slowed, as financing of new ventures became more challenging. Meanwhile, some landlords looked to cap long leases with flexible space operators within their portfolios.

Flexible space leasing activity in Q4 2019 was down 50% compared to 2018. In Q1 2020, the start to the global COVID-19 pandemic pushed flexible space activity down even further, with most cities recording just a handful of new transactions representing either overflow from Q4 or landlords continuing their own formats. In New York, flexible space leasing was down 84% year-over-year. Meanwhile, Central London and Paris activity was down 83% and 52% respectively compared to Q1 2019. In Asia, Hong Kong saw a decrease in flexible space leasing by 44%, while no new flexible office space was signed in Shanghai during Q1 2020.



Global flexible space take-up (square feet)



Flexible space positioned for strong growth following COVID-19

Looking ahead, the global flexible space market is likely to see limited growth in 2020 as the office leasing market remains heavily influenced by the pandemic. Unsurprisingly, most new office deals are lease expiration-driven transactions, as companies attempt to preserve cash and cut discretionary spending.

However, following these uncertain times, demand for flexible space is likely to be resilient. Large occupiers have rapidly adopted agile space strategies. Although freelancers are more likely to shed coworking space as the COVID-19 outbreak stalls business, 67% of CRE decision-makers are increasing workplace mobility programs and incorporating flexible space as a central element of their agile work strategies.

After the initial wave of uncertainty has passed, some of the larger, well-capitalized flexible space operators will restart their expansion drive, picking up assets and market share from those unable to weather the storm. This is likely to be boosted by large organizations' unwillingness to commit to large capex projects and therefore opting for pre-built space and lease flexibility. Market consolidation will yield a heathier marketplace, with strong flexible space operators remaining. At the same time, we will expect growth to shift from leases to fee-based management agreements, white-labeling and/or self-perform concepts by landlords.

In a revived post-pandemic market where flexibility is high on the corporate agenda and the purpose of the office centered around collaboration, flexible space should emerge stronger than ever and growth could quickly return to its impressive pre-COVID rates.

Implications

Tenant implications

As tenants start to return to their offices, business continuity and operational resilience will come to the forefront. There will be an increase in workplace mobility programs emphasizing remote-working and a reduction in densities within traditional offices. Since flexible space is fast and easy to acquire, we anticipate companies often turning to flexible space solutions to support portfolio reductions and cost-saving strategies during this time of economic uncertainty. In the longer-term, a portfolio mix of traditional and flexible spaces will be even more important. This is especially true as employee demands now include shorter commutes and less-dense workplaces that prioritize health and well-being.

Investor implications

We expect a significant shift in flexible space operating models, with investors leading the charge principally by self-performing the space with management structures, rather than riskier, traditional sublease models. This model allows investors to take advantage of pre-built flexible space and its tenants already in their assets to create an additional revenue stream that meets tenant demand for flexible space while driving immediate and long-term value for their asset.

Conclusion: the future is flexible

Flexible space has been significantly impacted in the short-term by the COVID-19 crisis. Flexible space operators with high exposure to freelancers, start-ups and in-person events will be the most challenged. We expect a significant shift in flexible space operating models, with landlords self-performing their own flexible space or signing management agreements with flexible space operators. However, in the medium- and long-term, demand for flexible space will not only return, but increase as occupiers embrace core and flexible models more widely.

> *Flexible space is here to stay, but it has evolved into a spectrum of options that provide various levels of real estate flexibility, experience and choice for tenants and landlords alike.*

Take the next step

There will be a myriad of options coming out of COVID-19 that provide various levels of real estate flexibility and choices for tenants and landlords alike. Contact us to learn how we can help you navigate the right agile solution to fit your unique needs.

About JLL

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JLL's research team delivers intelligence, analysis and insight through market-leading reports and services that illuminate today's commercial real estate dynamics and identify tomorrow's challenges and opportunities. Our more than 400 global research professionals track and analyze economic and property trends and forecast future conditions in over 60 countries, producing unrivalled local and global perspectives. Our research and expertise, fueled by real-time information and innovative thinking around the world, creates a competitive advantage for our clients and drives successful strategies and optimal real estate decisions.