JLL Achieve Ambitions

Disruption or Distraction

Is flex space here for good, or just the latest real estate fashion?

Flex space: transforming real estate

We’re in a period of rapid transformation that has the potential to completely redefine the office market.

We’ve already seen how new business models that cater for people’s needs and preferences like never before have disrupted retail and hospitality. It was only a matter of time until office space had its own catalyst for change – one that addresses companies’ desire for more flexibility while putting the focus firmly on the human experience of the workplace, and brings with it profound implications for occupiers and investors.

Enter flex space.

At its core, its rapid growth is being driven by the evolving nature of work and the shifting structure of the economy, supported by rapidly advancing technology. On the surface, we’re seeing the rise of the gig economy and an explosion of start-ups. Corporate attitudes are also changing with an increased emphasis on flexibility and agility. Many larger companies now realise that, to compete in the digital age, they need to attract and retain skilled people who are unlikely to relish traditional office environments.

These drivers are challenging many aspects of the established office leasing model – and encouraging more companies to experiment with flexible space. While it still accounts for only a small proportion of overall office stock, our numbers show that it is growing fast.

In 2017 alone, the total amount of flexible space in the top 20 largest flex markets globally grew by 30% - equivalent to around 1 million square metres. Since 2014, the market has more than doubled, and in leading cities such as London, it now represents around one fifth of take-up.

Investors and developers are increasingly adapting to the rise of flexible space by introducing their own concepts or partnering with existing providers. Meanwhile, buildings with a high percentage of flexible space are increasingly seen as viable investment propositions.

The (hard) question to consider is

ADOPT *or* ADAPT

Flex space: Why, how and when to embrace or even avoid?

Our research indicates that the market in Europe is about to see even more rapid expansion.

Europe's stock of flexible space is set to grow by an average of 25%-30% per year over the next five years. Our interviews with many international companies highlight their appetite to expand their use and to experiment with different models, providers and working arrangements. Our latest research supports our 2015 prediction that flex space could represent as much as 30% of some corporate portfolios by 2030.

Yet there are risks. Most companies are, at present, in the experimental phase, as categorised by our new flex user profiling.

If they don't think these trial runs have met their needs, they may return to more conventional models. On the other hand, new operators are emerging, including those developed by landlords, which will offer more choice to corporates.

The model is already evolving as the market expands, and companies are developing their own visions of how to make flex fit. While some may only use such space for limited and specific purposes, the appetite among many businesses will undoubtedly test developers, investors, analysts and funders. With no one-size-fits-all approach, a laser-sharp focus on business needs and an understanding of strategy and priorities will be more important than ever.

Right now, the rise of flex space raises many questions among investors and occupiers about the longer-term future of the office market – around transparency, supply and demand and the nature of the future workplace. The long-term impact remains to be seen but in the shorter-term, the opportunities it creates will reward those who embrace innovation, risk and change.

A 'hybrid' model is driving growth

Over the past 20 years, serviced offices, and more recently co-working, have created new concepts for office space. Some of their best features have transformed the sector, particularly in areas such as workplace design. However, the impressive growth of the wider flexible space market in recent years has come from a novel hybrid offering, which caters not only to freelancers, start-ups and SMEs, but also, increasingly, larger organisations.

The rationale for targeting larger companies is clear. This sector has the potential to offer flex space operators more resilient revenue streams and a much larger and stable marketplace, particularly if they can secure relationships at regional or global scale. It's this approach that has the greatest potential to disrupt the office market as we know it.

A D P T

It’s not (all) about co-working

The terms business centres, serviced offices and co-working are often used indiscriminately. However, the various business models which have emerged over time and the current wave of innovative providers all have distinct features.

Serviced offices started in the 1980s with a host of local and international providers offering traditional office set-ups under a flexible lease. Co-working brands have been around for almost as long, although they really came to the fore after the Global Financial Crisis. Unlike more traditional serviced offices, co-working was initially pioneered by a new wave of start-ups and entrepreneurs looking for a fresh approach to the workplace. It offered a genuinely new approach: its design, amenities and culture would enhance collaboration, openness, knowledge sharing, innovation and the user experience.

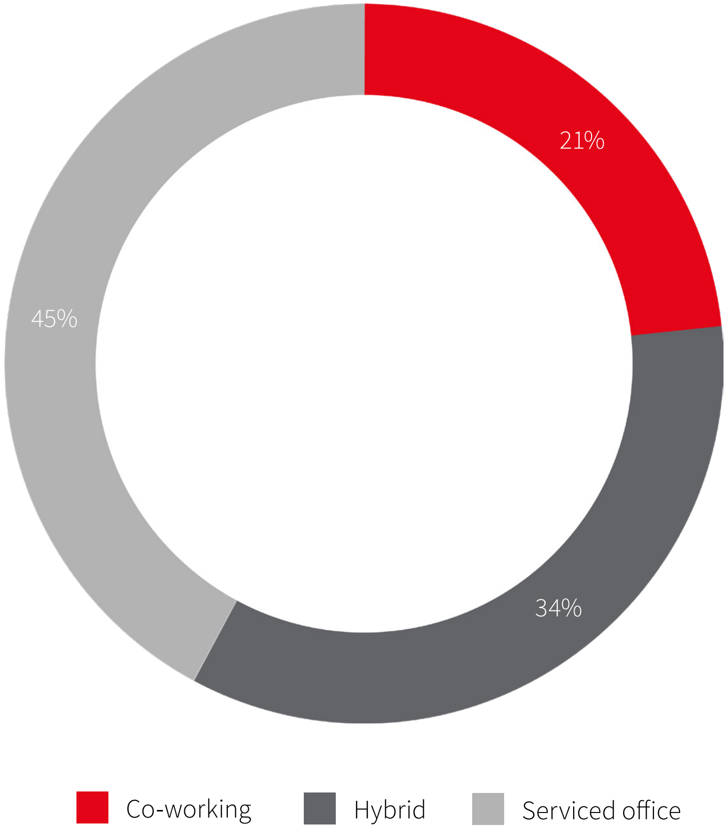
Many co-working brands have appeared in the last two decades but their quantitative effect on the office landscape has so far been modest, with many operating relatively small footprints. In Europe’s 20 largest flexible office markets, pure co-working brands account for just 21% of total flex space. However, continued demand for this space is underlined by a 21% growth in co-working space in 2017. The brands now recording strongest growth are often those which have either focused on specific local market nuances or those that offer a wider incubator/accelerator environment.

Many of the operators that initially marketed themselves as co-working companies have since adapted their space and services for a corporate audience, with a hybrid of private offices and some co-working space. This new model has driven unprecedented growth with around 850,000 square metres of hybrid space added in the top 20 European flex markets since the start of 2016, representing 51% of new flex space.

“First came serviced offices, which were very corporate. Now you’ve got the rise of co-working offering something different. The former realised it needs community, the latter now needs corporates. Both are coming to the middle and will continue to merge into one.”

Global FMCG company

Total flex space supply by model, across the top 20 European flex markets



Flex business models

Traditional serviced office

80% lettable office space

1,000-4,000 sq m

Single membership model

Hybrid

60-65% lettable office space

2,000-25,000 sq m

Multiple membership models

Co-working

80% co-working space

500-2,000 sq m

Multiple membership models

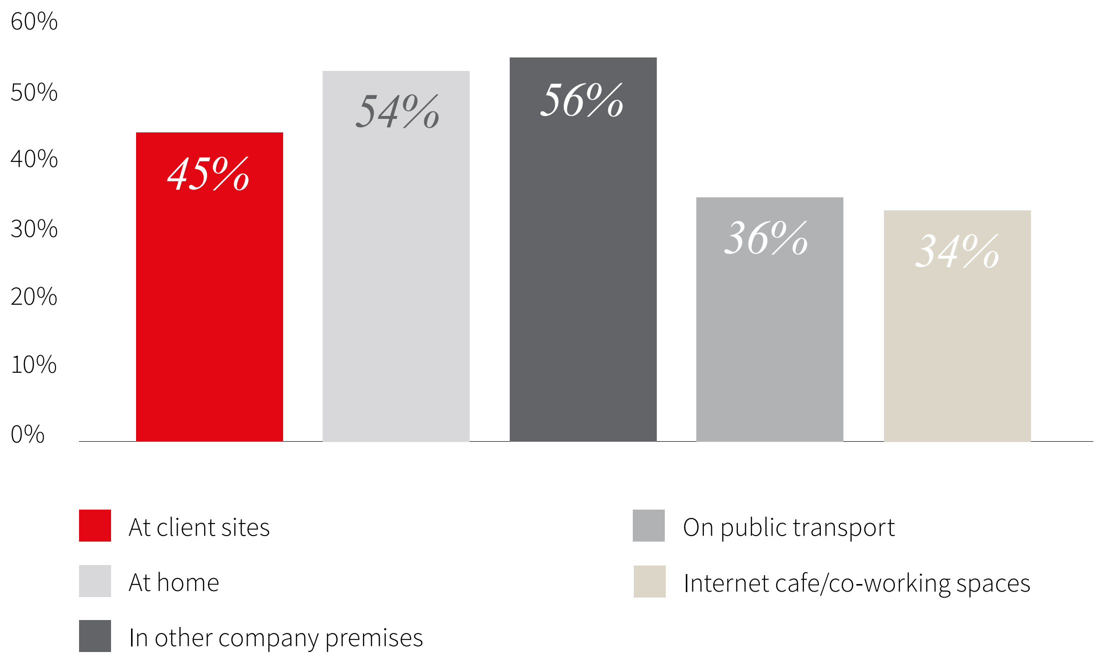
New entrants

Landlord initiatives

Managed and flexi-leases

How is the ‘Future of Work’ driving flex space growth?

Do you work in these places at least 1 day a month?



There are numerous drivers behind the rapid expansion of flexible office space, but ultimately it’s underpinned by evolutionary changes in how, when and where people work, alongside shifts in lifestyle. The proliferation of cloud computing, VPNs, super-fast Wi-Fi and 4G (soon 5G) connectivity means that office-type work can be carried out anywhere and at any time.

This increased mobility has resulted in a dramatic expansion in the range of spaces where ‘office’ work is conducted. Our research indicates that 56% of employees now work from other company premises at least once a month, followed by working from home (54%), on transport (36%) and in co-working spaces (34%). The reality is that the traditional office now actively competes with a range of alternative locations.

A more liquid and contingent workforce is also accelerating this change. Estimates suggest up to 30% of the working population is already working in the on-demand or gig economy. As the composition of the workforce becomes more fluid, the need for flexible space will continue to increase.

1 in 7 people are now self-employed in the EU.

The (hard) question to consider is

x People

Sign here

or

P,ROF.IT$

What role can or should flex space play?

The consumerisation of real estate

Co-working has been the catalyst for the rise in flexible space and the growth of this phenomenon has been led 'bottom up' by people using the space. Our Human Experience research, which surveyed over 7,300 office users globally, found co-working spaces can support employee engagement more than other work environments. Employees also value more community space, and increasingly demand higher quality services and amenities, all of which feature heavily in the new generation of flexible space provided today.

Since the Global Financial Crisis, there has been a rapid increase in the number of startups, SMEs and microbusinesses, all of whom increasingly want flexibility. Crucially, flexible space operators are responding to this demand, but with high quality space and extensive amenities in prime locations which were previously out of their reach.

New generations entering the workforce also have different expectations of the office environment. Under 35s, in particular, are more mobile inside the office, more likely to work from a range of different locations and are more ready to embrace innovative workspace. The new generation of flex space has clearly embraced these changes with more open, amenity-rich workspaces coupled with fresh design concepts.

OUR HUMAN EXPERIENCE RESEARCH, WHICH SURVEYED OVER 7,300 OFFICE USERS GLOBALLY, FOUND CO-WORKING SPACES CAN SUPPORT EMPLOYEE ENGAGEMENT MORE THAN OTHER WORK ENVIRONMENTS.

7,300 OFFICE USERS

More companies turn to flex space

It's not just start-up and millennial demand driving the accelerated pace of flexible space growth; larger and more traditional companies are beginning to adopt flex space at scale. Businesses are responding to a raft of structural changes by optimising their portfolios, consolidating their office spaces and driving productivity.

Flexible space lets them respond to the needs of a more dynamic workforce and the requirements of specific teams in areas such as digital or product innovation. It can also attract specific talent pools, particularly among younger generations, which tend to favour a less traditional corporate office setting. For some companies, flexible office space enables them to act quickly if they need a temporary space, or to access a new market. For others, it's an opportunity to increase exposure to the zeitgeist in a particular industry or to help change their working culture.

In addition to the more traditional drivers of flexible office space – there are a number of other emerging drivers for corporate use. These range from improved innovation, collaboration and community, to business development and growth objectives. Improved space utilisation and portfolio flexibility, in addition to potential financial benefits, will also be powerful drivers of adoption - at scale.

"Accurately forecasting long-term real estate needs is next to impossible. The biggest benefit of flex space is it gives you options."

'Big Four' professional services company

The digital workplace

Digitisation and the rise of smart real estate have become key to corporate real estate strategy. The Internet of Things and Big Data now provide huge opportunities for managing portfolios and understanding how employees are working. A small number of flex space providers have begun to offer integrated technology solutions and digital interfaces for users and managers of space. For those companies still defining their digital real estate strategy, such platforms can offer the dual promise of improved user experience and more effective management of space needs. In other words, it can be perceived as a shortcut solution to what seems a challenging process of transition and digital adoption.

"WHAT FLEX $PACE REALLY DOE$ I$ INTRODUCE COMMUNITY. IN OUR LARGE CORPORATE LOCATION$, WE $TRUGGLE TO KNOW EACH OTHER"

INTERNATIONAL PHARMACEUTICAL COMPANY

People, community and culture

Many companies adopting flexible office space or co-working are impressed with the providers' abilities to create a sense of community, bolstered by services, events and social spaces. 'Community management' is something many companies struggle with in traditional office environments, and the potential for added vibrancy, energy and engagement within an organisational culture is seen as a major draw.

Ultimately flexibility in itself underpins much of the rapid and potential growth in this market. Companies have always found it hard to plan their space needs, and this has become more difficult in the fast and volatile operating environment of the present day.

The (hard) question to consider is

Unite or divide

Does flex space create communities or dilute company culture?

Obstacles to adoption

While demand is clearly growing for flexible space, there are obstacles to broad corporate adoption. Widely cited concerns include security, confidentiality and privacy in more open environments. Other companies are apprehensive about the potential impact on their branding and culture, particularly brand dilution. Lack of deep geographic coverage, concerns around the appropriateness of locations, excessive density and the quality of fit-out can also act as barriers to large-scale use for some.

On the flipside, there's also the risk of not adopting flexible space. Many firms are concerned about staff retention or attraction, and of being behind the curve. As increased mobility, superior connectivity, state of the art fit out and a range of leisure and hospitality services become the norm, no company wants to be perceived as stale.

"Branding is definitely a challenge. We don't want our brand to become secondary."

Global financial services company

Paying for flexibility, versus the cost of not riding the wave

The pricing dynamics of the flex space market and particularly the emerging enterprise segment is hotly debated, particularly as transactional evidence remains limited. With traditional serviced office space, flexibility has come at a premium.

However, with the new generation of flexible space, users tell us that, in some cases, it's cheaper to embrace flexible office space than commit to a conventional lease, along with all the operational and capital expenses it might incur. This often involves a reduction in space taken and an increase in occupational density alongside, for larger deals, the amortization of fit-out costs over the length of the lease (treating them as operational expenses not capital expenses). We also found evidence of corporates reverting back to traditional leasing structures from flex space, to avoid the premium paid for flexibility.

We believe both have a place in corporate portfolios of the future depending on individual cultures and requirements.

"We were paying a premium for flexibility... flexibility we didn't really need so we're reverting back to the original model."

Global life sciences company

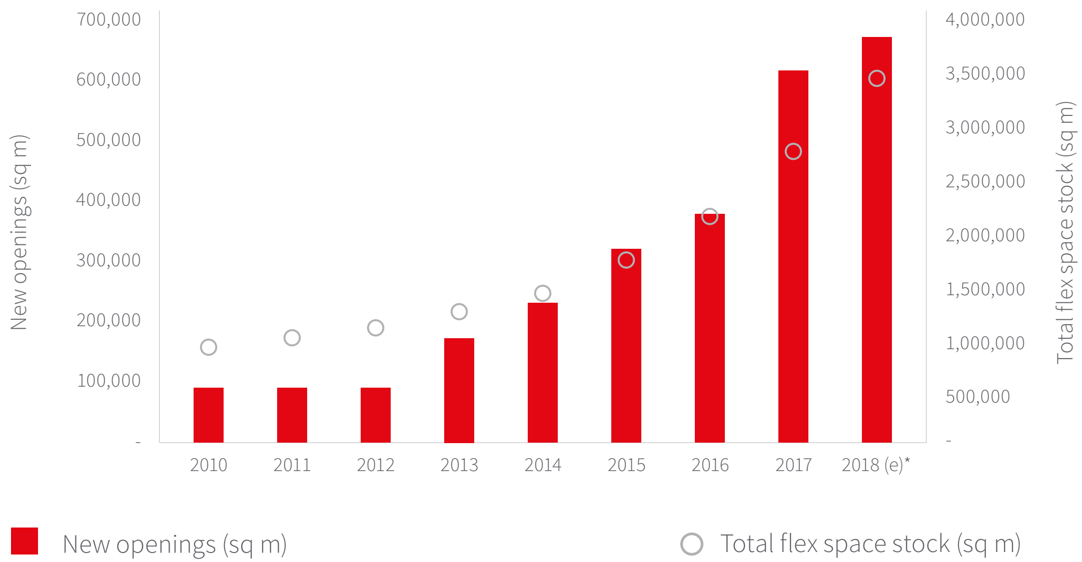
The value of real estate goes well beyond bricks and mortar. For a lot of companies, cost is not always the first consideration. They want to recruit from new talent pools, break silos within their own corporate culture and help different teams to come together and collaborate. They want more casual information sharing, more creativity, and new ways of thinking, and they believe flexible space and innovative environments can help with that. If all this can come alongside improvements in productivity and space utilisation that becomes a powerful combination.

Ultimately in real estate as in life, there is no such thing as a free lunch. Operational and capital expenses exist in all office properties and at some point the cost will have to be recouped, even in flexible or co-working offices. Some providers are offering innovative pricing and deal structures as they seek to boost demand, although the long term viability of these remain untested. Some occupiers are also worried about whether, in several years' time, there will be sufficient capital for operators to revitalise fit-outs as needed, given their often 'fashion first' approach, and the intensity of use.

How is Europe's flex space supply meeting demand?

We anticipate that flexible space will grow by an average of around 25-30% per annum over the next five years, although economic cycles may mean this will not be a linear process. This forecast suggests that flex space will move towards 5% of total office stock over the next five years, representing an additional 7 million square metres of stock in the 20 largest European flexible space markets. This would push the total market size to around 10 million square metres, equivalent in space terms to the combined market size of Dusseldorf and Frankfurt.

Flex space growth – 2010-2018

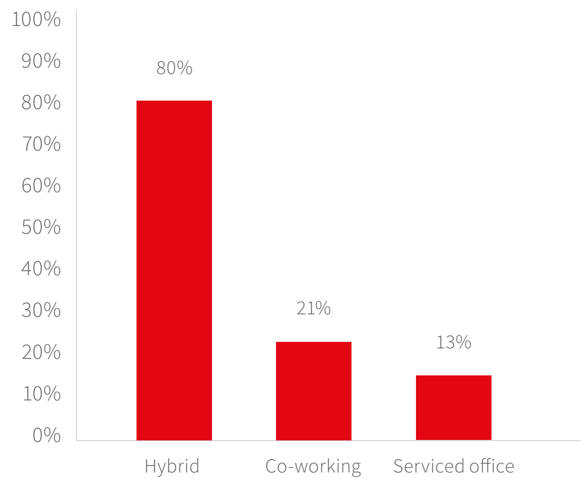


*Opened and known openings as at H1 2018

Europe in flex space take-off

The total flex space footprint in Europe grew by 29% in 2017. The 625,000 square metres of flex space added to the market over the year was the strongest increase on record and highlights the demand for flexible solutions. The amount of new flexible space provided in the first six months of the year suggests continued strong growth in 2018, in excess of 25%.

Flex space model growth 2017



Hubs with high levels of start-ups, self-employment, SMEs lead flex space maturity curve

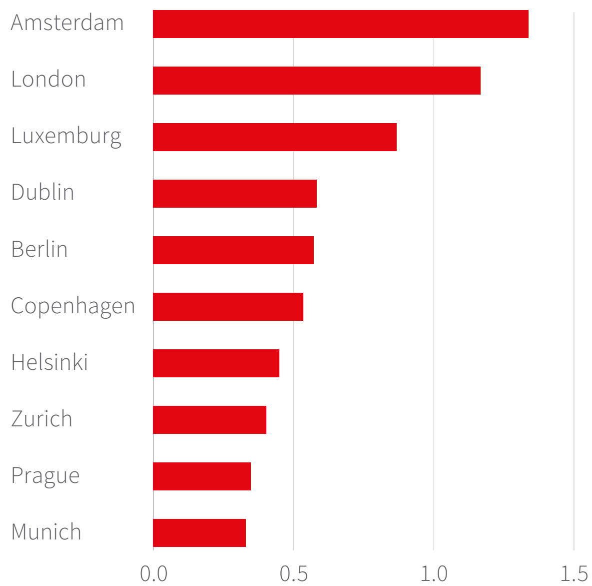
Europe's flexible space footprint has doubled since the start of 2015. This was initially driven by gateway cities and in particular clusters of start-ups, creative industries and SMEs. Pure co-working brands started to offer high quality space solutions, in quality locations, that were for some previously out of reach.

Fuelled by a rise in self-employment in the wake of the Global Financial Crisis, cities such as London, Amsterdam, Dublin, Berlin and Copenhagen were the real crucibles of the European flex space boom. They were not just the places where the market grew most rapidly, they also saw the greatest number of new operators and formats.

The cities central to the initial co-working boom have continued to dominate the market and now see the greatest range of operators. In the last three years the amount of flexible space in Amsterdam, Berlin and London increased by approximately 25% -35% per annum. At 5.6% of total office stock, Amsterdam now has the highest flex space concentration globally, ahead of even the most mature US office markets.

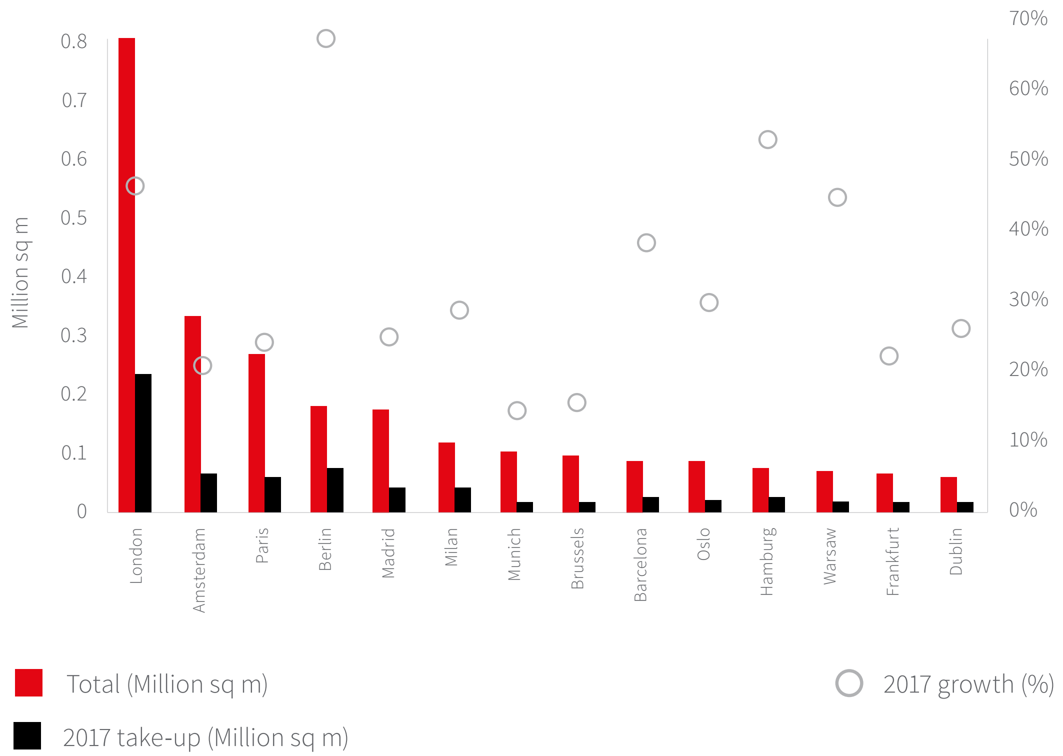
Central London accounts for 30% of total flex space in Europe, disproportional to its share of total European office space which stands at just 8%.

Start-ups per capita



Source: AngelList

Growth of flexible stock, key global cities



However, a host of other European cities are at the start of this process, with markets such as Hamburg, Warsaw and Barcelona all recording above 30% growth in flex space supply in 2017. They are in the 'take-off' phase and we expect to see strong growth in the year ahead.

The combination of leasing activity so far this year and the pipeline of the largest international brands indicate that the stock of flexible space will grow by 20-40% in most European cities in 2018.

The stock of flex space will grow by 20-40% in most European cities in 2018.

The (hard) question to consider is

or

#transitional

Flex space: Is one approach better than the other?
How far should you go?

In most continental European office markets, the majority of flexible office space (c.60%) is in the city centre and other key business districts, with the balance located in the often dynamic fringe markets.

Outside these locations, the market is dominated by more traditional serviced offices operators situated in or very near to transport hubs, as well as (often relatively old) discounted business centre brands. Suburban flexible space hubs, as seen in the US, are not a feature of the European market.

Since 2015, the five largest operators have accounted for 50% of all new flex space in Europe.

International operators and landlord-operated models will fuel growth.

The European flex space landscape is increasingly diverse with a large number of local brands operating across the market. We identified around 700 unique operators in the 20 largest European office markets, 20% of which opened their first centre within the last two years. Just a handful of brands are truly international, with more than 10 locations in total. However, these companies are growing strongly, with the top five European operators accounting for 50% of new flex space since 2015. We believe this pattern will continue as these international operators increase their footprint in established markets and expand beyond 'gateway' locations to second-tier cities.

The other source of growth will be landlord-created platforms, although local adoption varies greatly. In Amsterdam the landlord offering already accounts for around 25% of total flex space, while in Paris some of the largest landlords such as Gecina, Icade, Foncière des Regions and Nexity have all recently launched their own brands. In Germany, a key growth market for flex space operators, the landlord response has been very limited. Alstria's (REIT) flex space platform is one of the few existing landlord-operated responses in Germany so far.

The 7m sq m of new flexible space is a gross figure – it does not correspond to a net increase in office supply. In many cases new flexible space is provided in repurposed legacy supply, breathing life into old and tired office stock and catering for demand from corporates, SMEs and freelancers.

2k 53

What does the future look like for flex space?

Not all businesses will require flexible space, but the vast majority will significantly increase their usage over the next five years. In particular, increased flex space use by corporate or enterprise users has the potential to have a significant effect on the total office market.

We have interviewed a wide range of senior-decision makers at a range of diverse businesses globally to understand their needs. Most of these large corporates have been using serviced offices for a number of years to enter new markets, set up small satellite offices or cater for short term space needs. However, this has always been a small part of the portfolio, almost exclusively below 5% for companies of substantial scale. This flexibility has traditionally come at a premium, and the space has not been seen as particularly different from conventional space, which has prevented penetration into the wider portfolio. However, there are signs that the new generation of flex space providers are now changing that.

We asked larger corporates to forecast their use of flex space in the next three to five years. While a number of more conservative companies anticipate that their use will remain at under 5%, a significant minority across a range of industries see their use increasing to 5%-10%. A further group anticipates the increase to be as much as 20%-35% with some suggesting further still.

This type of growth would represent a dramatic recasting of corporate real estate portfolios and even under a super-conservative base case, a minimum 5% of corporate portfolios represents a significant requirement in overall space terms, with dramatic implications for the market.

"Our adoption rate is still very much lease-event driven."

- Global investment bank

2k 53

"JLL's estimate of 30% flex space [of total corporate portfolios] is fair, but likely underestimated."

Global professional services company

Typologies of corporate flex space use

Based on our extensive engagement with corporate occupiers, we have segmented the market into three different flex user categories, which feature companies of varying sizes and industries. Companies tend to fall into one of these groups below:

The 'visionary' end of the spectrum is of particular interest. We have interviewed a number of companies across industries that are committed to aggressively expanding their adoption of flexible office space within the portfolio. It's likely that, as we see larger and more 'traditional' companies deploying these concepts at scale, we will see a swift shift along the adoption curve for more conservative adopters.

The largest proportion of the businesses we interviewed are in the experimental phase, actively testing how and how far they can integrate flex space within the wider portfolio. We therefore believe that the enterprise flex space market in Europe is in the take-off phase, although the trajectories of individual companies will differ widely.

Conservative

- Low percentage of flexible space in the current portfolio
- Zero or limited expansion anticipated in the future
- Key obstacles to widespread adoption: Culture, coverage, security and compliance concerns, specialised space needs

Experimental

- Low to moderate percentage of flexible space in the current portfolio
- Forecast to reach up to 10% and beyond in the next 3-5 years
- Experimental expansion; pilot and trail phase; analysis of use cases and different providers' solutions
- Open to benefits and ideas of innovation, but also focused on challenges and limitations

Visionary

- Significant usage can be observed
- Clear and ambitious plans for a widespread adoption of flexible space, reaching upwards of 20% of the portfolio
- Innovative and bold approach and scale of use
- Focused on benefits and value of flexible space, with a vision to mitigate any risks

Future demand - case studies

The Conservative Case Study:

This global software & gaming company does not expect to embrace the use of flexible offices because of the nature of its industry. No flexible model has been able to provide the necessary technical infrastructure that the development of its products require. The company has used flexible space in the past, but primarily for overflows and relocations and only uses it now for supplementary space. It does see some benefits, stating "co-working has brought a fresh and innovative approach" and acknowledges the community element as a benefit for smaller enterprises.

The company has no expected expansion until the technical requirements can be solved, although its back office and publishing staff could possibly move into a flexible office. However, there is a hesitation to locate in a shared space so not to lose employees to other companies and/or direct competitors.

The Experimental Case Study:

This global investment bank is currently reviewing its internal innovation strategy and trying to determine how flexible office space can support it. The company is currently reviewing RFPs and propositions from providers of all types. Ultimately the bank believes flex space could comprise up to 10% of its portfolio, but "we'll likely max out at 5%".

The company likes the short-term options the concept provides stating that "the ability to turn the tap on and off is great". However, there are also reservations about the speed of market development and it considers some providers to be moving too quickly. The bank also questions how the offer will remain fresh in the long-term, specifically addressing the need to keep the fit-outs up-to-date. Therefore, the company is unlikely to partner with a single provider. Branding is another concern as it has a certain identity to maintain.

The Visionary Case Study:

This professional services company with more than 20,000 employees worldwide is a "huge believer" in the benefits of flexible space. Ultimately it expects greater than 20% of its portfolio to be in flexible space within 5 years.

Traditionally, the company relied on flexible space for M&A and swing space, but has been running cost-benefit analyses for its smaller offices with many options now being cheaper than their traditional leases. Ultimately, it even sees traditional leases in its core portfolio being able to incorporate flex space. "If a landlord were to attach an offer of co-working space on the back of a lease, we'd be very interested. Especially if we're there long-term."

Disruption

The (hard) question to consider is

or

Distraction

Is flex space here for good,
or just the latest real estate fashion?

What does flex space mean for the wider market?

The European flex space footprint is set to grow by an average of 25%-30% per annum over the next five years, accompanied by a sharp uptick in large-scale corporate use of these facilities. This will be a genuinely disruptive force in European office markets and will provide a number of challenges for non-responsive, conventional development and investment models.

Transparency

It will become harder for any single actor – developer, investor, operator or occupier – to gauge the supply and demand dynamics in the wider office market. As flex take-up continues to increase and the stock begins to compete with 'conventional' office space for large requirements, it becomes harder to take a clear view on 'real take-up'. Space which is listed as let can still, in reality, be on the market. Clearly, some larger corporate deals will be well documented but the plethora of smaller, short-term deals are almost impossible to track. This means that real vacancy rates and supply levels become more opaque. Vacancy rates calculated according to conventional methods could become prone to underestimation. The rents paid by end users, and the incentive packages, are also opaque. This will make it harder to underwrite development or investment decisions, based on current and forecast pricing and supply levels.

Predictability

Historically the relationship between (net effective) rents and supply has informed views on future market movements. As the flexible segment grows, it will take away some of this transparency. Also, rental levels, supply and vacancy levels in flex space could potentially move very quickly, given the short-term nature of commitments. Even if it were possible to accurately gauge fundamentals in the market, the situation could change rapidly within months. This could be problematic during either a sharp boom or a downturn. It will also make it more difficult for developers or investors to understand potential competition when deciding whether to move ahead with a deal or a project.

Lease terms

The rise of flex space is likely to accelerate the decline in average lease lengths, particularly in traditionally "long-lease" markets such as the UK and in the sub-500 square metres sector. However, this needs to be set against other trends in the office sector, which suggest there will be greater investment in branding, experience and technology in HQ locations, which will require long-term commitments. In reality, the market will provide a broader spectrum of choice, from fully flexible to longer-term solutions, to suit a broad set of changing wants and needs.

Yields

Limited exposure to flexible space has not had a noticeable impact on yields. Indeed, developers and investors may benefit from diversification and the operator's ability to energise communal spaces. Lack of tenant track record and underlying tenancy risk, however, typically increases an asset's perceived income risk profile. Buildings where flexible space represents greater than 50% of Rentable Building Area (RBA) have so far traded at a discount. Recent deals on the continent have shown a decreasing yield differential, although the current cycle and the absence of quality investment product will have to be taken into account.

As the industry becomes more mainstream, lenders and investors are becoming more accepting of moderate exposure to the flexible office segment and its diversification benefits, as part of a well-diversified tenant roster. Indeed, valuations may move towards a cash flow model rather than a more traditional approach. However, it should be noted that the scale of the sector is unprecedented and values could see different trajectories to the mainstream market at various points in the cycle.

The (hard) question to consider is

FUN

or

→| Does·flex·space·work·for·people,¶
or·help·people·work?

Flex space in the market cycle

At the end of the last two cycles, downturns triggered a reduction in demand for office space, with take-up reducing by 20%-25% on average across Europe. Flexible space providers will experience the same headwinds in the next downturn. While the underlying drivers of the expansion of the flexible space sector will persist in the long run, demand could be volatile, and given the short-term commitments involved, this can lead to equally volatile occupancy levels and income streams.

Like many new industries, the flexible space market is fragmented. Currently there are at least 25 individual operators in most major European cities; less than 15% of European brands operate in more than three locations. Flex space operators must be able to absorb demand shocks across a broad geographical platform to survive in a downturn. Providers that lack geographical diversification may struggle to absorb such shocks, although some niche players will survive and thrive through sector specialisms, tenant loyalty and price discounting for the well-capitalised.

Differentiated, well-funded and platform flexible space operators with income diversification, quality of product and service offering will be best placed to drive occupancy rates. They will also double-down in a downturn, taking the opportunity to acquire businesses or space. Consolidation is inevitable, and a downturn would accelerate this process. It's therefore the well-capitalised and experienced flex space providers who are most likely to succeed, although innovative and niche operators providing a next generation or differentiated offer will also flourish.

Flex space operators must be able to absorb demand shocks across a broad geographical platform to survive in a downturn.

What does a flexible future look like?

The flex space market is at an inflection point. It has moved well beyond the traditional model of co-working and has the potential to offer deeper and more integrated real estate solutions to large enterprises at a wide geographic level. Companies are beginning to explore the potential of flex space as an end-to-end solution, across the real estate lifecycle. Perhaps most importantly, the rapid growth of flexible and managed space solutions is driving real and tangible change in the wider market.

Consumers of space

Thanks to the proliferation of technology, and the changing expectations of the workforce, occupier demand for flexible space will continue to rise. Meanwhile, innovation in the flexible space sector is accelerating. Many of the amenity rich, user-focused concepts found in co-working or flex space are also being applied to re-energise existing portfolios. Experience-led real estate, high quality service provision and active community management are just some of the benefits being deployed well beyond the flexible space operators.

In addition, integrated technology, workplace data analytics and space utilisation improvements could also significantly drive demand. If flex space or co-working providers can demonstrate sustained evidence of improvements in occupier space utilisation, which can be scaled, we will see an acceleration in enterprise adoption.

While we believe that the drivers behind the growth of flexible space are here to stay, there are risks to the rate of adoption, notably the rate of current expansion, the ability of providers to manage services and cash flow against this background and the quality of the experiences of some of the most adventurous adopters.

Furthermore, the strength of the fundamentals does not necessarily mean that individual providers will continue to thrive. Other models, perhaps led by existing investors or landlords, may – or may not – prove more resilient over time.

In 2015, we predicted that up to 30% of corporate portfolios could be co-working or flexible space by 2030. Recent data suggests that bolder enterprises are exploring such levels of growth, albeit many will experience more moderate growth in the next three to five years. While take-up and impact in the medium term will fluctuate with market cycles, longer term adoption and wider implications for occupiers and the office real estate sector look certain.

Many companies are now experimenting and reviewing existing portfolio and workplace strategy in light of this shift in the market. There is no-one-size-fits-all solution and we see a range of strategies emerging based on the needs of individual businesses and even teams. While experimentation continues, and provision remains embryonic in some areas, the appetite for flexible space from SMEs to multinationals is increasingly clear cut.

Companies are beginning to explore the potential of flex space as an end-to-end solution, across the real estate lifecycle.

Developers and investors: Fail to plan or plan to fail

Flex space growth rates – and its impact on the office market - cannot be ignored. The vibrancy and amenities provided by flex space operators can energise spaces, helping to drive occupancy and values elsewhere in buildings or developments. They can also allow investors to diversify income streams into the SME space.

The appetite for flexible space offers opportunities to fuel demand in prime locations and decrease vacancy in some weaker portfolios, especially as the need for innovative environments and unconventional design is likely to unlock opportunities for Grade B and C properties. Flex solutions will therefore reduce obsolescence; if an office can be anywhere, then anywhere can be an office.

The focus on flexibility and service and the adoption of a more consumer-centric approach will disrupt the traditional marketplace and challenge some existing practices and norms. Average lease-lengths will shorten and the sub 500 square metres segment will become much harder to let on traditional terms. Lease lengths on 'platinum' prime may remain unchanged, but such commitments will be achieved through bespoke environments for HQ buildings, such as heavily invested and branded layouts or smart building technologies. Indeed, the assets most in demand in the future may combine the two, with amenities like green space and a holistic approach to health and well-being. Furthermore, tenants will come to expect a range of ancillary services and a more vibrant fit-out. This will provide investors with opportunities for differentiation and additional income streams, but will also force developers to adapt to compete.

Modular fit-outs and quick turnaround space that is easy to let for one to 24 months can play into this while currently under-utilised common areas can serve as on-demand flex space. We anticipate greater competition and a profusion of new models, with new participants moving into the space. Investors and developers will consider establishing a flexible space concept, collaborating with existing operators and looking at M&A. At the same time, some of the new wave of operators are already beginning to invest directly in real estate, looking to control assets wholesale or sometimes in joint ventures with funds or other sources of capital.

The appetite for flexible space offers opportunities to fuel demand in prime locations and decrease vacancy in some weaker portfolios.

Preparing for tomorrow

In our 2016 research into the future of the workplace, 'Workspace, reworked', we suggested that changes in the structure of the workforce would polarise the nature of office assets. The tendency for companies to concentrate on lean, core functions and outsource more activities would lead to the rise of a 'contingent workforce' which would use digital connectivity to access a range of shifting opportunities, potentially worldwide. As a result, companies would consolidate their core functions and invest heavily in smart, experiential, heavily branded HQ facilities. These would need to be supplemented by a range of flexible spaces for the contingent workforce – and in particular for project teams involving a mix of staff.

This suggests that the market may increasingly be split between:

- Prime, HQ-type assets with long leases, valued according to conventional methodologies and having bond-like investment characteristics
- Flexible space, potentially offering higher investment returns, but valued according to the cash flow characteristics of the operator – i.e. having more equity -like characteristics

The combination of these two asset classes within a single location may prove very attractive to occupiers – particularly if they have preferential options on the flexible space, and there are additional benefits such as strong place making, a high-quality food & beverage offering, and green space. This combination of income streams will also prove highly attractive to investors.

Meeting today's challenges while preparing for tomorrow

The rise of flex space is a structural shift with lasting impact. Along with wider workplace trends, it will further fuel polarisation in the office market.

In many ways, we are seeing a new way of looking at office space, taking inspiration from retail and hospitality, where a customer centric approach has been driving the agenda for decades. Indeed, all real estate is increasingly being driven by the end user. Today's employees want spaces that better meet their needs; tomorrow's employees will expect it. Providing flexibility and creating environments that inspire, stimulate and respond to change is non-negotiable to attract the next generation of talent that companies need to succeed in a fast-paced, global marketplace.

The future will favour entrepreneurs, intrapreneurs and experimentation. While we can't guarantee the future end game, we can plan, be prepared to fail, learn, fix fast and succeed. The alternative is to fail to plan, fail to respond, to remain static and where underperformance or failure is almost guaranteed.

The rise of flex space is a structural shift with lasting impact. Along with wider workplace trends, it will further fuel polarisation in the office market.

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