UK

FLEXIBLE WORKSPACE REVIEW // UK 2016

Instant

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THE OFFICE GROUP
Greville Street

// INTRODUCTION – A RECORD YEAR FOR SERVICED OFFICES

With media coverage of the co-working trend and collaborative workspaces capturing the imagination of business, the flexible workspace sector has enjoyed its highest profile year yet. The seemingly unstoppable rise of WeWork, strong performance of Regus and large take-up of space from brands such as The Office Group have dominated the headlines, and the data behind the news confirms that serviced offices are enjoying record demand from occupiers and a strong increase in workstation rates.

There was double digit growth in occupier enquiries for flexible workspace in 2015/16. The only area of the UK not to experience an increase in enquiries of more than 10 per cent was the capital itself, and London still enjoyed an increase of nine per cent. The South East had the highest level of enquiries in the past year with the South West not far behind as the flexible workspace boom spreads from London to the markets outside the UK’s major cities.

The South East of England – excluding London – has led the way with increases in workstation rates as growth in occupier demand has seen a rapid response in pricing; one which has been exacerbated by relatively constrained growth in the supply of space, compared to the rest of the UK. Workstation rates across the country are increasing above the rate of inflation as demand outpaces supply, with the South East showing the largest increase of 10 per cent.

A key trend in the capital has been the growth in enquiries and workstation rates in the outer fringe of London, namely the “Donut” that includes locations such as Kingston, Croydon and Ealing. These suburban locations have seen some of the UK’s most aggressive growth in terms of rates and enquiries despite a 12.5 per cent increase in supply as occupiers have chosen cheaper locations with good transport links over the highly competitive market in central London.

The total number of centres offering flexible workspace grew by 11 per cent across the UK in 2015/6. This represents solid growth in supply, especially from the larger operators such as i2, BE Offices, Regus, The Office Group and London Executive Offices (LEO). But with occupier demand remaining robust, the market seems set for further expansion.

The UK serviced office market has grown to include 2,939 centres, a year-on-year increase of 11 per cent. This compares to 3,168 centres (excluding co-working specific sites) in the whole of the US, and a more inhibited growth rate of 4.3 per cent across the Atlantic.

The record growth in workstation rates in the UK’s cities has been driven, in part, by increased take up of flexible space by corporate occupiers. Agile office solutions are now an established element of the corporate property mix for large occupiers with double digit growth for larger workspace requirements of 40 desks or more highlighting the increased take up of flexible space by corporates.

// WHAT DO OCCUPIERS WANT?

2015/6 has seen more variety to the types of space available in the UK driven by new entrants to the market and more varied occupier demand.

While co-working is the trend to have launched more than 1,000 news articles in the past 12 months, the number of specific co-working sites remains relatively limited in the UK, up just 14.3 per cent year-on-year. Far more prevalent are conventional serviced offices, which now offer co-working as part of the mixture of space to members across their portfolio. Such spaces have grown across the UK and seem set for further expansion in the coming months with an increase of 22.9 per cent in the last year.

Collaboration and agility have become bywords for the sector, attributes sought by occupiers and promoted by designers who are looking to the TMT (Technology, Media and Telecoms) sector as exemplars for office design. With many TMT firms from the West Coast of the US founded on the principle of **collaborative workspace**, this is a trend that the flexible workspace operators of the UK, and London in particular have embraced. The shared spaces available in flexible workspaces across London have become destinations for both start-ups and established corporates to network and socialise together; they are proving to be a hotbed of ideas and entrepreneurialism that are changing the wider perception of the sector.

Corporate take-up of flexible space has seen many operators evolve their offering to the market in innovative ways. The Quantum brand at LEO is a 6* office service - a boutique offering that allows clients to customise their space as they like within some of the groups' prestigious locations. The Office Group has continued to forge the way, acquiring more than 400,000 sq. ft. of space in the past year, while still retaining the unique personality of each of its locations fostered by innovations such as on-site Pilates studios, organic cafes, and screening rooms.

There are new entrants to the market such as Runway East, founded on creating a fertile environment for innovation and entrepreneurs. Founded by veterans of London's tech start-up scene, the Runway East site has a hardware testing and assembly mini-lab in addition to presentation rooms and event spaces. And the Headspace Group launched a similar offering with the goal of providing space to occupiers with "big ideas", and rapid growth plans that have captured the imagination of the market.

The common theme of these centres, the new "Spaces" initiative launched by industry giant Regus and the phenomenal organic growth of WeWork is **collaboration**. The growth of the flexible workspace market is being driven by demand for agile space that facilitates collaboration among occupiers and accommodates rapid growth. The increase in the number of contingent workers such as consultants, part-timers and one-man bands is also a dominant theme but at the root of the shifting profile of the market is the view that flexible space is a growth enabler that allows start-ups to exchange ideas and work alongside established firms.

WEWORK
Soho London

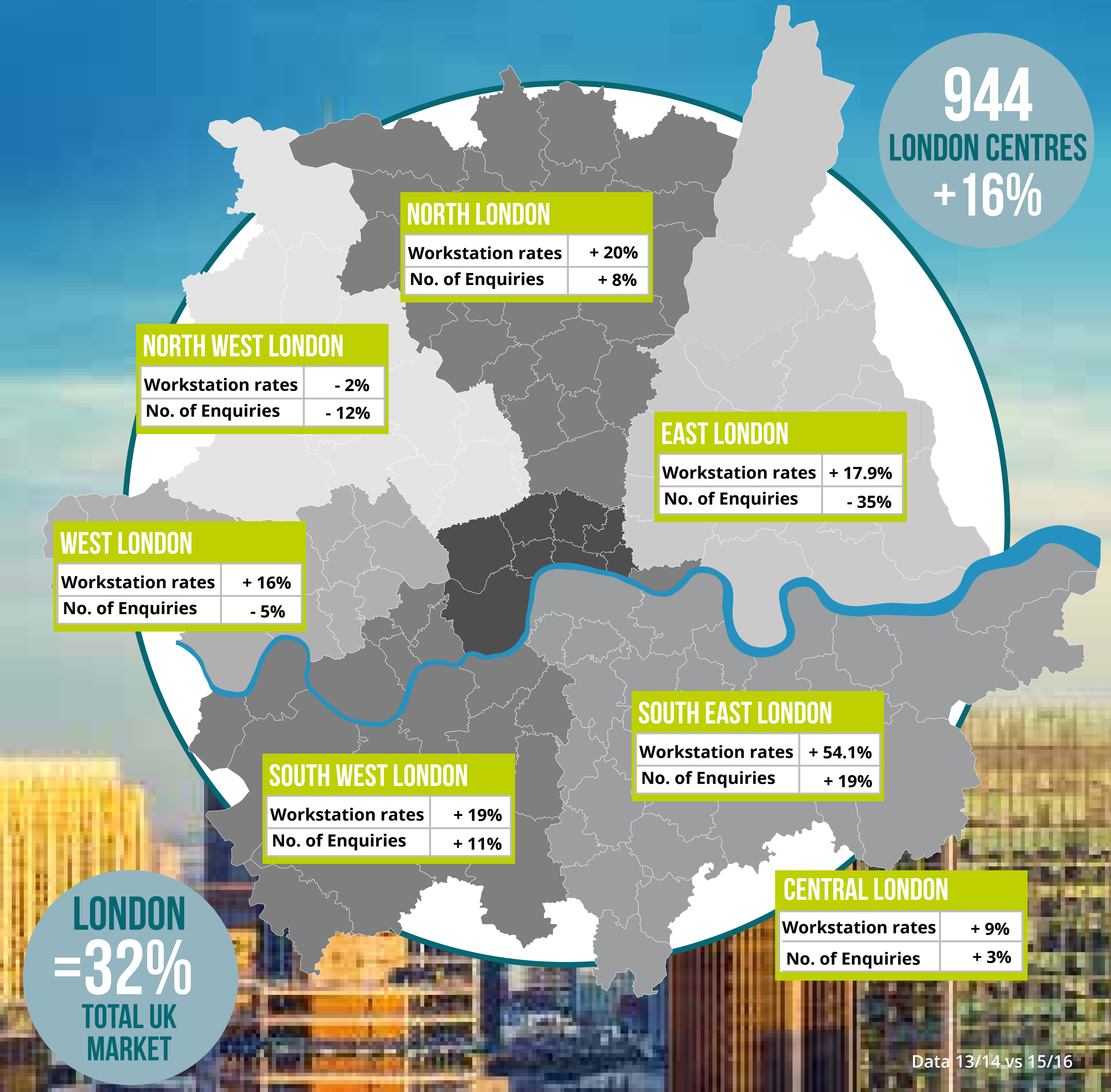
// CO-WORKING – WHAT IS IT AND WHERE IS IT HAPPENING?

Broadly speaking, co-working refers to a working practice, which involves a shared office environment for workers from different organisations.

Driven in part by the growth in the contingent workforce and start-ups, co-working has become a flexible alternative to taking conventional office space.

In many co-working spaces, there often operates forms of open collaboration between individuals from different organisations but with complimentary skill sets. Instant's research of the US market demonstrates that the co-working model differs radically across the country. In the more established flexible workspace markets – such as New York, Los Angeles and San Francisco – the model is driven by collaboration and shared workspace. While this form of co-working is growing elsewhere in the US and has started to grow in the UK, workspace operators are also using co-working to describe more conventional private office space with breakout areas for occupiers to meet, and work more flexibly if they choose. What we refer to as the hybrid model.

DESKLODGE
Bristol



// LONDON MARKET OVERVIEW - OCCUPIER DEMAND IN THE "DONUT"

The supply of flexible workspace in London has outpaced the UK, especially in the last years (growing at ~25%), and represents a third of the UK market. But for the first time in recent memory, ***the level of enquiries increased proportionately at a higher level elsewhere in the country than the capital.***

Occupier enquiries increased year-on-year by an average 20 per cent across the UK with the South East and South West leading the way while **London showed the lowest increase** at nine per cent. However, **workstation rates have increased in the capital by the largest amount in the UK**, by nine per cent, which suggests that there is still enough demand in the market to support the new space coming to market.

The supply of centres grew by 16 per cent in London during 2015/6 to total 944 of the UK's 2,939 centres and representing **32 per cent of the total flexible workspace** in the country. London's growth in supply outstrips the UK average by five per cent and seems certain to do so again in the coming year with aggressive expansion plans from WeWork and The Office Group.

Demand has spiked in the north east of the city and outer West London but also remains high in South London. Inner and West London demand has reduced from last year's high, due to high desk rates, which are deterring some occupiers.

High demand remains in the "Donut" around the capital including Kingston, Croydon, Richmond, Ealing and Harrow. We are seeing real drivers of growth in these areas including a large number of start-ups. The number of enquiries across these markets has increased by as much as 25 per cent in the past year but occupier demand has also been strong in the Southbank area growing at 16 per cent and South East London at 19 per cent from the previous 12 months.

The demand in these areas has arisen despite aggressive growth in workstation rates in these parts of the capital and hints at wider acceptance of the outer fringe markets among businesses seeking flexible space. Despite centre growth in inner London outstripping the fringe areas, outer London has shown higher growth in workstation rates and **almost double the percentage of enquiries**, as firms move to new locations with good travel links.

In contrast, areas such as Hammersmith, Camden and Tower Hamlets – zone 2 locations on the fringe of inner London - have experienced lower demand, on the back of higher pricing levels, which have acted as a deterrent to some occupiers. Hackney and Southwark have continued to show a transition to becoming more mainstream markets with strong occupier demand despite increases in workstation rates as high as 24 per cent in the latter, the largest proportional increase in central London.

Among the traditional office markets, the City, the West End and Kings Cross/Euston have all displayed double digit increases in occupier enquiries for space, and while flexible workspace supply increased by 20 per cent in the past year in the City, for example, workstations have continued to rise by twice the rate of inflation. In contrast, low demand areas include Midtown, Docklands, North West, East, and the West of the capital seemingly as a result of a large increase in supply to the market and relatively high workstation rates.

In summary, the key office markets of the City and West End showed healthy results in 2015/6 for operators but the real growth in the capital in terms of take-up of space, and therefore potential market growth in the future, would be London's outer fringe markets. Growth in enquiries for outer London was almost ten times that of inner London at 25.9 per cent and this comes despite workstation rates in the former rising by 21 per cent.

// THE REST OF THE UK - REGIONAL DEMAND ON THE RISE

The South East of England has shown a large percentage increase in demand for space from occupiers, which has driven up rates particularly as supply in the region is only just starting to increase versus last year's reduction.

The vast gravitational pull of London and the large supply of office space around the capital means that the South East market has always suffered by way of comparison. But there is now strong demand in key regional centres such as Brighton and Oxford because both offer a significantly different lifestyle from the capital and tend to attract a very different type of business.

Brighton has seen a large increase in demand and desk rates have gone up due to constrained supply in the city. In Oxford, desk rates decreased in the previous year and the reduction in price has encouraged occupier demand, but the lack of new space coming on to the market has seen rates to begin to recover steadily over the last year.

The **North West** of the country has shown solid demand, with rates increasing in line with centre growth, and overall a stable market. Liverpool, in particular, has shown strong demand, which in conjunction with limited supply has led to a significant increase in rates although it still represents one of lowest cost cities in which to set up business. Growth in its great North West rival, Manchester, has been more settled due to slow occupier demand and stable supply to the market of new space, which if it continues might lead to a drop in workstation rates in the coming year as occupier enquiries fail to match centre growth.

Other strong performing areas include the **East of England** where a large surge in demand for space has been matched by continued supply meaning that rates are staying competitive. The West Midlands has also experienced increase in demand, but continued supply of new locations has cooled the large increase in rates from last year. Birmingham has produced a major recovery from last year - strong demand and office supply has yet to catch up, pushing up workstation rates. In Nottingham, a large increase in occupier demand, will lead to an expected increase in workstation rates next year if supply doesn't return to 2014 levels.

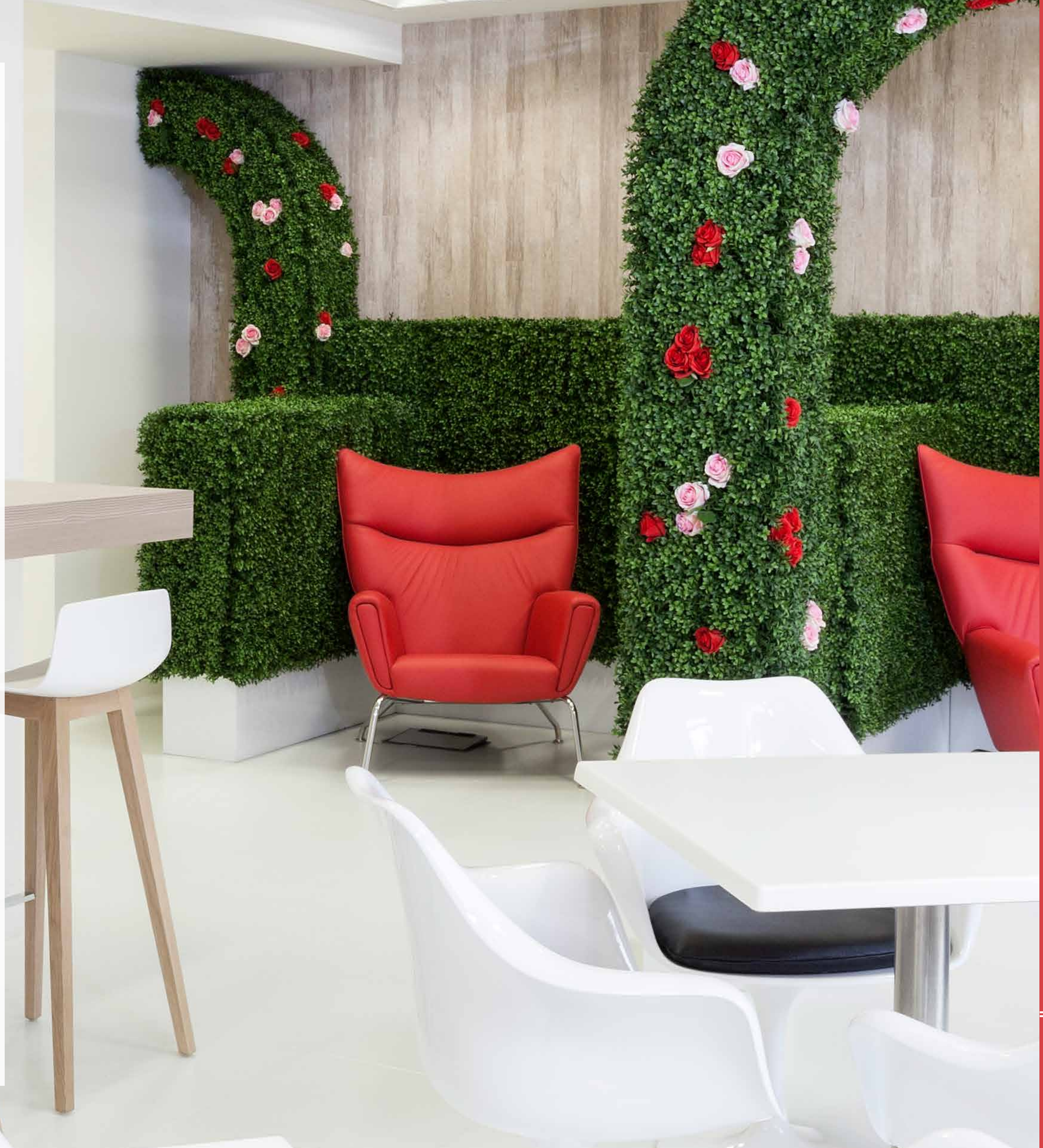
The **South West** has also seen a large surge in demand but continued supply of space in centres means that rates are staying competitive. In Bristol, a large increase in supply in 2014 has meant that demand from tech firms in the city during the past year has not pushed desk rates up.

Northern Ireland and Wales have both seen limited supply and a consistent increase in demand, which has led to rates being driven up. Limited supply has pushed up rates in Belfast, but enquiries are not increasing in line with supply and the pricing of the market may start to limit demand.

Rates have fallen in **Scotland** because of significant cooling of demand for space, predominantly due to wider market pressure in the oil and gas economy of Aberdeen, and increased centre supply in Edinburgh and Glasgow, which has not been matched by enquiry numbers. Prices will continue to drop in Aberdeen until demand and supply match, but rates in Glasgow look like they might start to increase given a moderate improvement in demand.

Rates have also fallen in the **East Midlands and the North East of England**, where increased supply of space has contributed to the reduction. Over-supply of space in Newcastle this year and last has led to a significant drop in rates, and supply seems set to continue to outstrip demand. Similarly in Northampton, over-supply this year and last has led to reduced/level rates and demand is low; supply needs to tighten or rates will fall again.

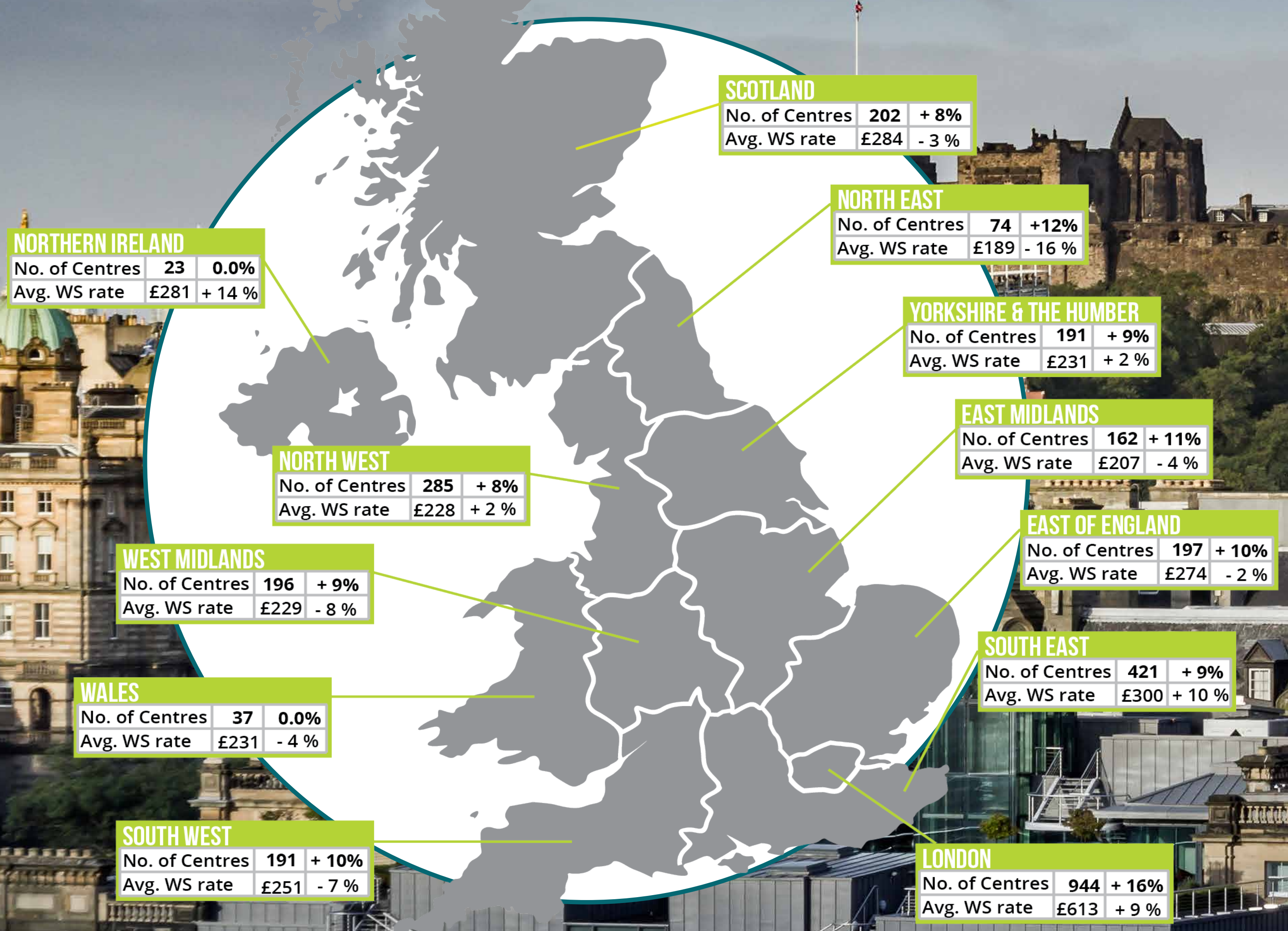
In the North, Leeds has experienced increasing desk rates but no accompanying increase in demand therefore we should anticipate a drop in rates in the second half of 2016. A lack of supply in Sheffield and moderate increase in demand has pushed prices up and if demand continues then supply will need to be increased in due course.



OFFICE SPACE IN TOWN

Waterloo

REGIONS Y-O-Y



Data 13/14 vs 15/16

CITIES Y-O-Y

City	No. of centres	Centre growth	Avg Workstation rate (£)	Workstation rate growth
London	944	16%	£613	9%
Leeds	61	2%	£264	12%
Birmingham (City)	59	13%	£252	12%
Edinburgh	53	13%	£300	7%
Manchester (City)	51	11%	£271	9%
Bristol	47	12%	£266	-18%
Glasgow	44	2%	£238	-12%
Nottingham	33	3%	£218	6%
Sheffield	33	-3%	£199	7%
Milton Keynes	26	4%	£260	13%
Belfast	22	0%	£282	14%
Aberdeen	21	5%	£405	-15%
Newcastle	21	17%	£223	- 21%
Liverpool	20	11%	£247	76%
Brighton	17	6%	£432	16%
Northampton	16	23%	£251	11%
Cardiff	13	0%	£256	-1%
Oxford	12	0%	£295	11%

Data 13/14 vs 15/16

// GLOBAL OVERVIEW

HOW DOES THE UK MARKET COMPARE?

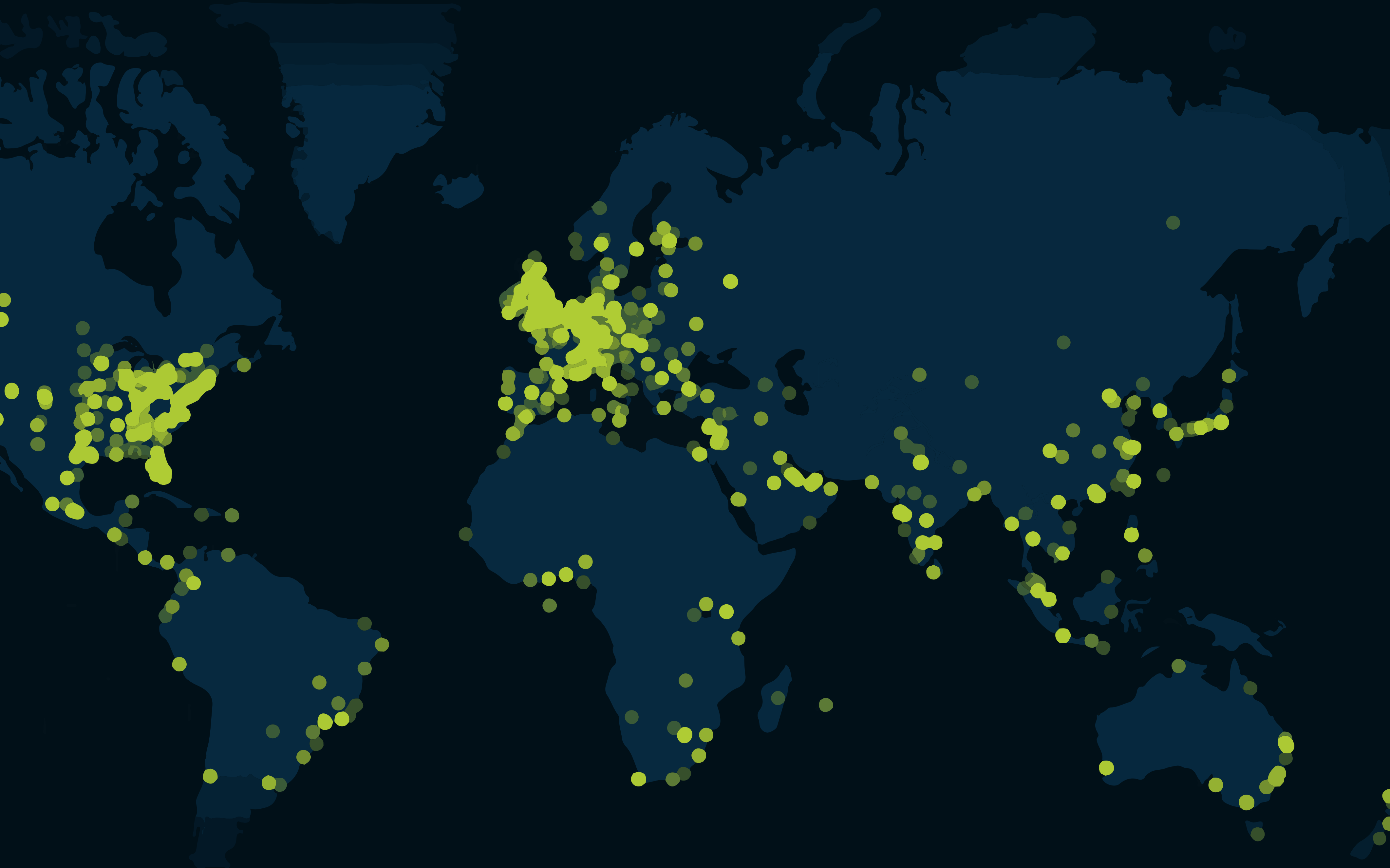
In the past decade, the global market has averaged 13 per cent growth and has tripled in size overall.

During this time rapid expansion in the emerging markets of EMEA and APAC with growth rates of around 20 per cent have outstripped those in the more mature markets of the UK and the US, where expansion has still been a very respectable 10 per cent on average. Tellingly, global recession and economic uncertainty has done little to stymy this growth and the profile of the sector, driven by media attention and more aggressive marketing within the sector, has never been as high. The rapid growth seen in the emerging markets will stabilise at a lower level in due course but occupier demand has reached record levels in these less established centres for the flexible workspace market.

The UK and US are still the largest global markets for flexible workspace. The UK market has grown now to include 3,290 centres (including co-working space), a year-on-year increase of 11 per cent. This compares to approximately 3,562 centres in the whole of the US (including co-working space), and a more inhibited growth rate of 4.3 per cent across the Atlantic.

In terms of serviced offices specifically, the UK's 2,939 is 32 per cent of the global total, while the US market has 27 per cent, EMEA has a 22 per cent share, APAC 15 per cent and Latin America just four per cent. And while APAC represents a relatively small part of the total, we are seeing strong signs of growth in that region. For example, the Hong Kong market has increased by 50 per cent in just two years; there are now 174 flexible spaces available – driven in part by the global trend towards co-working – which is only slightly behind New York's 214 centres.

The three largest operators in the market – Regus, Premier and Servcorp - now make up 36 per cent of the total market. However, if WeWork's anticipated level of growth continues then it will enter this select group, with the US company forecasting 1.5m square feet in London alone by 2016.



// OCCUPIER DEMAND - WHAT IS DRIVING ENQUIRY NUMBERS?

Corporate occupiers are increasingly pursuing flexible workspace and utilising it as a key part of their real estate strategy. Take up of serviced office space by the corporate market has been rising steadily, as has the size of requirements being satisfied — regularly taking hundreds of desks for project space in the UK's major cities.

UK
4.6 MILLION
CONTINGENT WORKERS

Longer initial terms are also evident with some operators reporting average increases from nine to 15 months. Instant's recent review of the US flexible office market — conducted in Q3 and Q4 2015 — shows that take up of flexible workspace by corporate occupiers has driven growth in the American market over the past year and flexible workspace operators have been behind significant property deals in the country's key city markets. This trend for corporate occupation of such space is borne out by a 29.27% increase in global enquiries from Fortune 500 companies for 25+ desks 2015/16 vs 2014/15.

29.27%
INCREASE ENQUIRIES
FORTUNE 500 COMPANIES
25+ DESKS

The data also suggests there is a wider range of solutions being provided by serviced office operators (from day offices and lounge facilities, co-working space and high-end luxury space to bespoke office configurations).

There are more options for firms than at any time previously. It is clear that there is now wider acceptance of the flexible workspace market from traditional and institutional landlords as well as the commercial agents in the conventional sector. And the trends outlined above — the move towards a contingent workforce that now numbers 48 million in the US and 4.6 million in the UK, as well as large corporates seeking more flexibility in their workspace — has made this acceptance inevitable.

NET.WORKS
Highbury & Islington

// THE FUTURE - WHAT NEXT FOR THE MARKET?

Unsurprisingly, London and New York still remain the costliest locations for flexible workspace. Prices are relatively comparable in both of these global cities with £740 in New York and £745 in London with Hong Kong, for example, just £480 in comparison.

And, despite rapid expansion in the UK capital and the US's East Coast hub, **we believe that these markets still have a lot of growth left in them.** The past year has seen huge expansion from WeWork in New York and London, and from the likes of The Office Group in the UK, while Regus continues to expand globally. But consumer demand continues to soak up increased desk rates and strong competition remains for the best sites.

The introduction of exciting new brands into the market - such as Soho House taking 44,000 square feet in key global locations under its Soho Work brand - and the marketing phenomenon behind the growth in co-working suggest that 2016 will be another busy year.

The key trend for the UK – and globally - will be the **ongoing corporate uptake of flexible workspace.** In 2015 we saw 40+ desk deals increase by 25 per cent in London alone – this statistic is indicative of larger corporate activity, driven by the increase in project work and the expansion in contingent workers. Corporate occupiers are now taking a long look at their space utilisation and are becoming increasingly aware of the option of using flexible office solutions in their portfolios.

While enquiries for flexible space were up 21 per cent for the UK in total and 39 per cent in the regions, the growth in non-flexible office enquiries was up only 15 per cent (according to data from Estates Gazette), suggesting that many of these firms want space to grow but are not ready to commit to leased offices as yet.

We would anticipate that ongoing economic uncertainty – fuelled by speculation on the future of the European Union and concern about foreign markets – **will ensure that demand for flexible space will continue into 2016/7.**

Growth in what might be considered secondary locations in the fringe and outer fringe of London have been driven by occupiers seeking more competitive workstation rates in a booming market. This trend will continue through 2016 to 2017 with new locations such as Camden, Hackney, Clapham, Waterloo, SoHo, Stratford, Marylebone and Vauxhall coming to the fore. There is still high demand in traditionally popular areas with some strong transport links such as Kings Cross, Euston, London Bridge, and Oxford Circus but operators are struggling to acquire the right floor plates at competitive rates that would facilitate increased supply.

In the rest of the UK, the growth in enquiries in the Midlands shows that the draw of the HS2 scheme and a very competitive office market in Birmingham will lead to growth in the city's flexible workspace market. Similarly, the markets that will benefit from Crossrail such as Reading, are already receiving interest from operators and occupiers alike as the commute time to central London will radically decrease. And cities, such as Bristol, Brighton, Oxford and Cambridge will all see strong performance in the coming year as they become alternative locations for tech start-ups. Another key challenge for the market is whether established flexible workspace operators **can successfully integrate the co-working model** into their centres. With demand for co-working sky rocketing, and also driving the media interest in the sector, the existing market is understandably trying to introduce the membership model for co-working space into existing space. However, the tight margins in procuring space in London, in particular, make this easier said than done and will pose a significant challenge for operators who benefit the most from tenants who sign up for serviced space for the medium term.

Lastly, corporate take up of flexible space continues to expand in no little part because of **the change to lease liabilities that will launch in the US in 2018** and the UK shortly after 2019. These new accounting standards will demand that liabilities and assets associated with lease operation to be accounted for on a company's balance sheet. Currently, off-balance sheet leases are a key element of companies' financial reporting strategy and debt structure. With all this set to change in the short to medium term, there will be a new raft of corporate occupiers looking to flexible workspace solutions within their property portfolios while the uncertainty around lease liabilities remains.

The Instant Group is the independent global flexible workspace specialist.

Underpinned by unrivalled expertise we tailor unique workspace solutions to help businesses of all sizes to grow, drive efficiency or gain invaluable insights.

Partnering with 99% of the world's flexible office providers, The Instant Group's workspace procurement platform Instant Offices lists over 8,500 flexible office options, across 115 countries and over 1,500 cities.

From small businesses to mid-caps, corporates to project-led businesses, it's the go to partner for more than 7,000 organisations globally - making it the largest buyer of flexible office space in the world.

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Note: All figures in this report were collated using The Instant Group's proprietary transactional data and market research surveys as at September 2015.