Commercial real estate - Russia

CO-WORKING: THE SECRET OF SUCCESS

Research department Cushman & Wakefield

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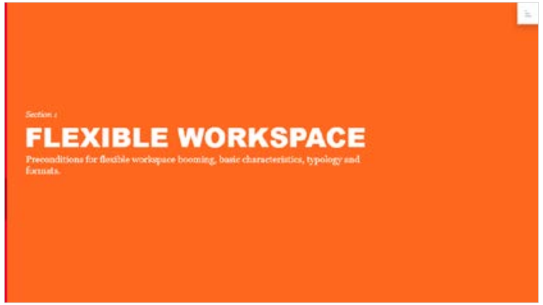
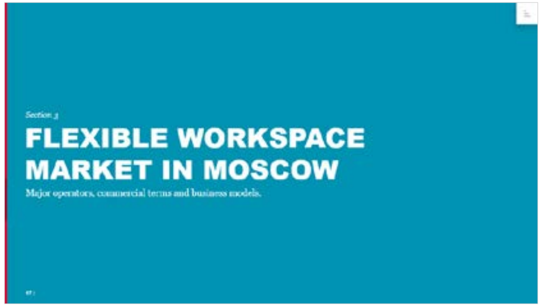
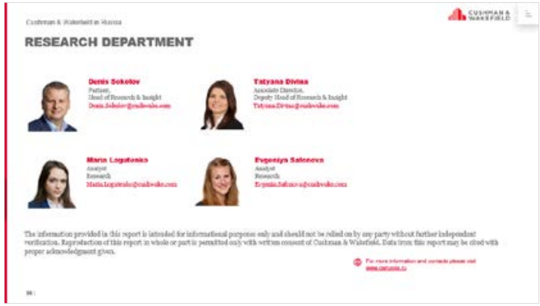






Section 1

FLEXIBLE WORKSPACE

Preconditions for flexible workspace booming, basic characteristics, typology and formats.

PRECONDITIONS FOR THE BOOMING OF FLEXIBLE WORKSPACE

TECHNOLOGIES	SOCIAL ASPECT	DEMAND	SUPPLY
• Opportunities for remote work - development of IT-technologies and cloud systems for collaboration.	• New generation of employees (generation Z); • Development of sharing economy; • Workplace is now more about life style and status.	• Increase of start-ups, freelancers, remote workers.	• Decline of rental rates; • Increase of vacancy in office buildings; • New favorable opportunities for tenants than before the crisis.

WHAT IS FLEXIBLE WORKSPACE?

Flexible workspace is a broad term that includes all types of **serviced** offices with equipped workstations which can be leased for a short-term by one person or a team.

Flexibility is:

- **Possibility of a short-term lease** (from 1 hour to several months);
- **Availability of different formats** (different types of workstations are available – unassigned (hot desking), assigned desk, mini-office).
- **Opportunity to choose any number of places** (from 1 workstation in co-working area to several mini-offices combined with additional workplaces in co-working, with an option of further expansion or reduction);

Workki

Cowork Station

ATMOSPHERE, DESIGN, NETWORKING

Flexible workspace and traditional office: what is different?

In the modern world, workplace becomes a characteristic of status. Working in a flexible workspace is attractive for the new generation of workers who value emotions and new experience. Design, atmosphere and “coolness” of the workplace are important for them.

The atmosphere of flexible workspace is different from a traditional office. There are many common areas with sofas and chairs where you can both relax and work.

Users have daily round-the-clock access, which allows flexibility in choosing a work schedule.

In some spaces different entertaining and educational events are held: lectures, master classes, workshops, etc., residents can participate in those.

Often, people with similar life philosophy work in one flexible workspace, residents can get inspiration and new ideas from communication with each other.

Here, people from different spheres work in one space, they can cooperate and help each other in professional and organizational issues. Sometimes, there are chat rooms in messengers for communication.

Even if atmosphere seems relaxing, residents’ perception is that they feel working environment. People mostly work for themselves and pay rent also by themselves.

“It is important that people want to make pictures in a co-working and share it with friends. When you come here, there must be a “wow-effect”. If people react, then everything is done right”.

Mikhail Komarov,
Founder of Cowork Station

TYPOLOGY OF FLEXIBLE WORKSPACE

There is no official, commonly used typology or classification of flexible workspaces either in Russia or in the world. Bellow we offer our version of the typology:

Flexible workspace

Dedicated	Non - dedicated	Specialized
Co-working	Café, time cafe	Workshops (craftsmen, repair shops, sewing and other)
Mini-office	Workplaces in public areas (e.g., in a shopping center)	IT co-working
Hybrid space	Other	Creative co-working

The **main business line** for dedicated flexible workspaces is serviced offices with **equipped workplaces**, while for non-dedicated workspaces this service is additional and **supportive** to another business line.

Specialized workspaces are focused on a certain type of activity. On contrary, people from different industries can be neighbors in dedicated and non-dedicated workspaces.

There are chain and non-chain **dedicated** flexible workspaces.

FLEXIBLE WORKSPACE AS A SERVICE

Dedicated flexible workspaces **provide the following required services**:

- Necessary office equipment (table, chair, storage box, table lamp, etc.)
- Common areas, kitchen with free drinks (tea, coffee, water)
- Cleaning
- Wi-fi
- Conference rooms
- Reception services (meeting guests, tea and coffee for guests)
- Telephony
- Office equipment (printer / scanner)
- Conference halls
- 24/7 access

Some spaces offer extra **unique** services. For example, a capsule hotel is located in Cowork Station Plaza and residents of this co-working are served with breakfast. In Tablica hybrid space there is an open roof with green zone and street bar.

VIRTUAL OFFICE

An extra service, provided in flexible workspaces.

Some flexible workspaces provide residents with a service of virtual office, which allows companies to have all necessary services without physical presence in the office.

Virtual office includes:

- Legal address (if necessary);
- Secretarial services (telephone, fax, correspondence distribution, incoming calls processing);
- Workplace in a co-working for a certain number of visits;
- Limited hours in meeting rooms.

CO-WORKING


Cowork Station Artplay


The Key Trekhgorka


Delovar


Flacon Coworking

Co-working is a workspace, equipped with workplaces available for lease for a short-time period (from 1 hour) at a fixed price (cheaper than in a mini office).

A resident may have an either assigned workplace or not (hot desking).

Often, co-workings have "quiet" and "loud" zones. People who make a lot of phone calls are not allowed to work in "quiet" zones.

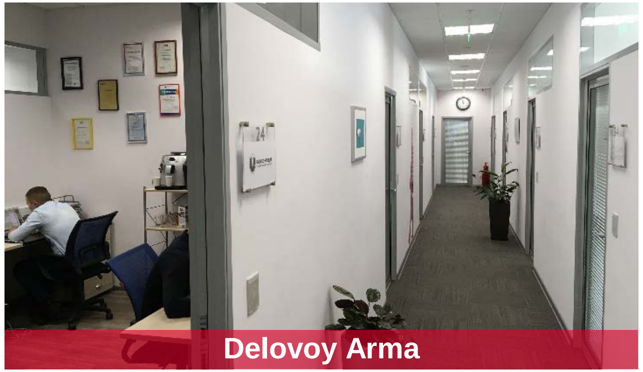
Formats of flexible workspaces

MINI-OFFICE


SOK Zemlyanoy Val


Meeting Point Okhotniy Ryad


Tablica


Delovoy Arma

Mini–offices are rooms for small teams. Here, the main difference from standard small offices in business centers is a set of services provided to residents.

There is more privacy and confidentiality in mini-offices than in co-working.

HYBRID SPACE

Workkki Neo Geo

CEO Rooms Empire

Workki Neo Geo

Deworkacy Red October

Hybrid space is a mix of mini-offices and co-working.

Mini-offices tend to occupy around 70-80% of work area due to the high demand from residents. Co-working areas are mostly needed to create atmosphere and stimulate additional demand from newly formed teams.

Section 2

DEMAND ON FLEXIBLE WORKSPACE

Demand evolution, target audience.

CO-WORKINGS STIMULATE GROWTH OF SMALL BUSINESS

Flexible workspaces provide opportunities for small companies to start, develop and grow.

Before co-workings became available, start-ups and freelancers did not have many opportunities to organize a comfortable workplace: they had to work either from home/cafe or to lease **low-quality offices**, which was problematic (long search, legal difficulties: registration of a legal entity to sign lease agreement, not always convenient location, low quality of interior design and non-friendly environment).

Flexible workspaces motivate self-employed entrepreneurs to open and develop their business offering an attractive and prestigious option for workplace location - modern workplaces with necessary infrastructure, short-term leases, friendly atmosphere and socializing with co-working fellows. Moreover, when having a workplace in a co-working, a person gets into creative and trendy working environment.

Flexible workspaces meet demand and, moreover, stimulate it.

Small offices in low-quality business centers

Flexible workspace

DEMAND EVOLUTION

Along with growing size of a company and a number of employees, needs for workspace change.

Home

Cafe, time cafe

Typical office

Workplace in co-working

Mini-office

Hybrid space (mini-office + workplaces in co-working)

TENANTS

The target audience depends on the location and price policy of a flexible workspace. There are several types of primary users:

1. Young professionals (mostly from IT and consulting), start-ups and small teams of 5-10 people. This group is the largest.
2. International companies, representative offices of foreign and Russian regional companies.
3. Corporate clients who need a temporary office (e.g., during office relocation, staff expansion or for project teams). Currently, the share of such clients is still small, but demand is gradually increasing.
4. Freelancers and remote employees are the smallest audience of flexible workspaces.

"In 2018, the main tenant of a co-working is a small team of young people with a high level of education who are engaged in a high-margin business".

Pavel Fedorov,
Managing Partner, TheKey

Section 3

FLEXIBLE WORKSPACE MARKET IN MOSCOW

Major operators, commercial terms and business models.

MOSCOW IS THE LARGEST MARKET OF FLEXIBLE WORKSPACES IN RUSSIA

102,000

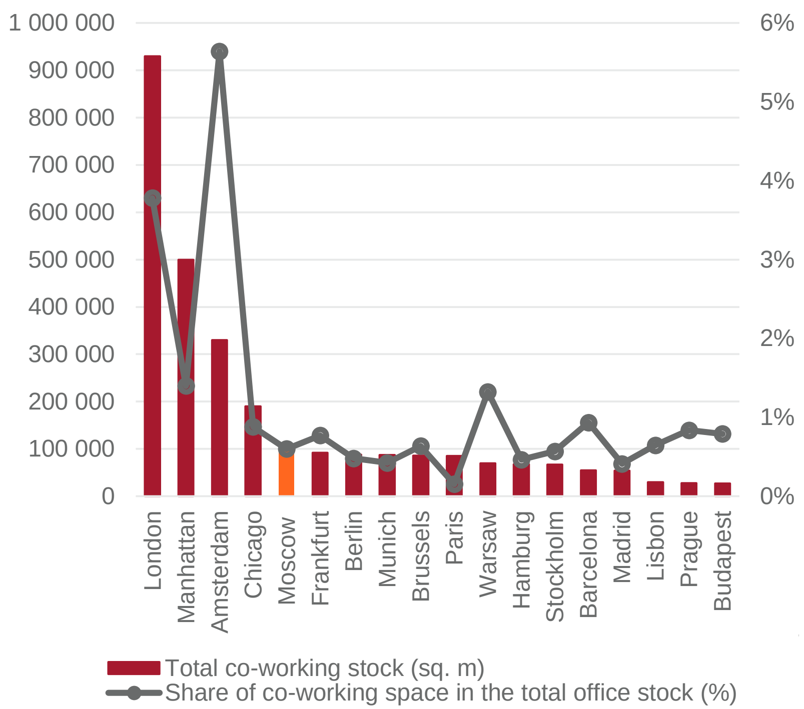
sq. m

Flexible workspace stock in Moscow, Q2 2018

<1%

The share of flexible workspace in the total office stock in Moscow, Q2 2018

Flexible workspace stock in the key European and US cities



- About 90% of flexible workspace in Russia is concentrated in Moscow. Several co-workings are also presented in other large cities, such as St. Petersburg, Ekaterinburg but their share is miserable.
- The share of flexible workspace in the Moscow office stock is comparable to European average - about 1%.
- Among European cities, the highest share of flexible workspace in the office stock is in Amsterdam. There is a large number of independent workers in the city.

INTERNATIONAL COMPARISON

The United States and UK account for more than a half of all flexible workspaces worldwide.

Flexible workspace from total office stock

4%

994,000 sq. m

London

1%

500,000 sq. m

Manhattan

1%

Average for the largest European markets

Source: Cushman & Wakefield

London

- London is the world's market leader by flexible workspace stock.
- The biggest share of UK flexible workspace is located in London. Currently, flexible workspace operators occupy 994,000 sq. m - about 4% of office stock in London.
- Co-workings are also represented in regional markets - about 353,000 sq. m of flexible workspace is located in other cities.
- **Major flexible workspace operators in UK:** WeWork, Regus / Spaces, The Office Group, i2 Offices, PureOffices, Bruntwood.

USA

- The US is another large global market of flexible workspaces. Flexible workspace operators occupy 2.5 mn sq. m in the largest cities of the US, which is 2% of the total office stock in the country.
- The biggest share of flexible workspace is located in New York, especially in Manhattan.
- In 2012-2017, the share of lease transactions with flexible workspace operators in Manhattan amounts to 2.9% in the total take-up.
- The flexible workspace market in the US is more consolidated than in UK. TOP-5 operators occupy 80% of the market, Regus and WeWork account for 72%.

FIRST FLEXIBLE WORKSPACES IN RUSSIA

The development of the flexible workspace market in Russia corresponds to global trends - the boom started about 3 years ago.

2008

First co-working in Russia

Bashnya, Ekaterinburg

2012

First dedicated chain flexible workspace in Russia

Cowork Station, Moscow

Bashnya, Ekaterinburg

- The format of providing equipped workplaces was first presented in Russia by Regus in 1998. Unlike modern flexible workspaces, at that time, the company was focused on mini-offices and had different target audience (representative offices of international companies).
- In 2008, the first co-working was opened in Ekaterinburg – it was Bashnya co-working with area of 80 sq. m (was closed in 2009).

Cowork Station, Neskuchny Sad

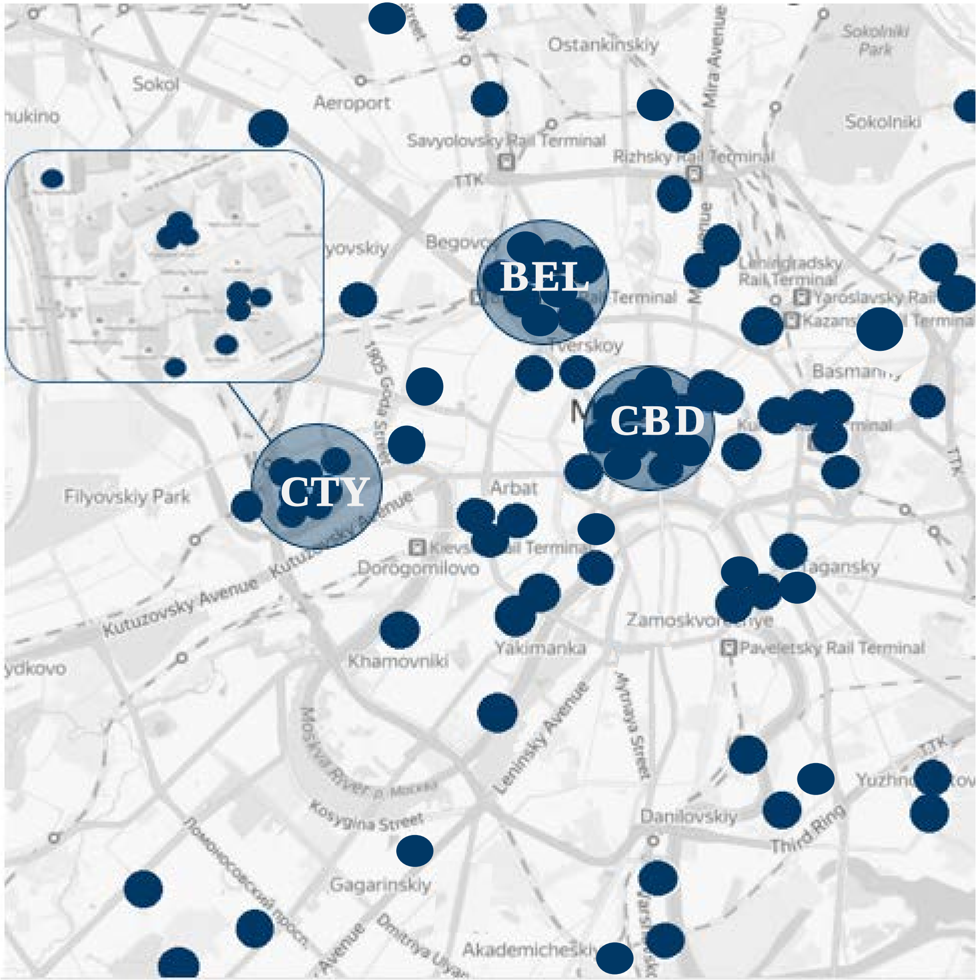
- In Moscow, the first co-working was Matrix Office in 2009, and then Flacon Co-working in 2011. In 2012 the first chain operator opened a dedicated flexible workspace - Cowork Station (Neskuchny Sad).
- Active development of the flexible workspace market started in the end of 2015, when the key players started developing – Meeting Point (the first location opened in December 2015), TheKey, Deworkacy, Workki, etc.

MAP OF FLEXIBLE WORKSPACES IN MOSCOW

The biggest share of flexible workspaces is located within the Third Transport Ring.

There are **86 dedicated flexible workspaces** in Moscow, 47 of which are locations of chain operators (55% of the total).
The majority of flexible workspaces is located in the city center and adjacent areas. Belorussky, Central and City submarkets are the most popular submarkets.

One of the key advantages of flexible workspaces for tenants is location in business districts within walking distance from metro. The highest demand and occupancy rate are in such locations.



MAIN MARKET PLAYERS IN MOSCOW

The largest chain operators (2 and more locations):

Regus

13 locations

workki

2 locations, 2 more locations soon

CEO ROOMS COWORKING

2 locations

UNION PLACE

5 locations

Ключ

5 locations

DEWORKACY

3 locations

MEETING POINT

2 locations, 1 new location soon

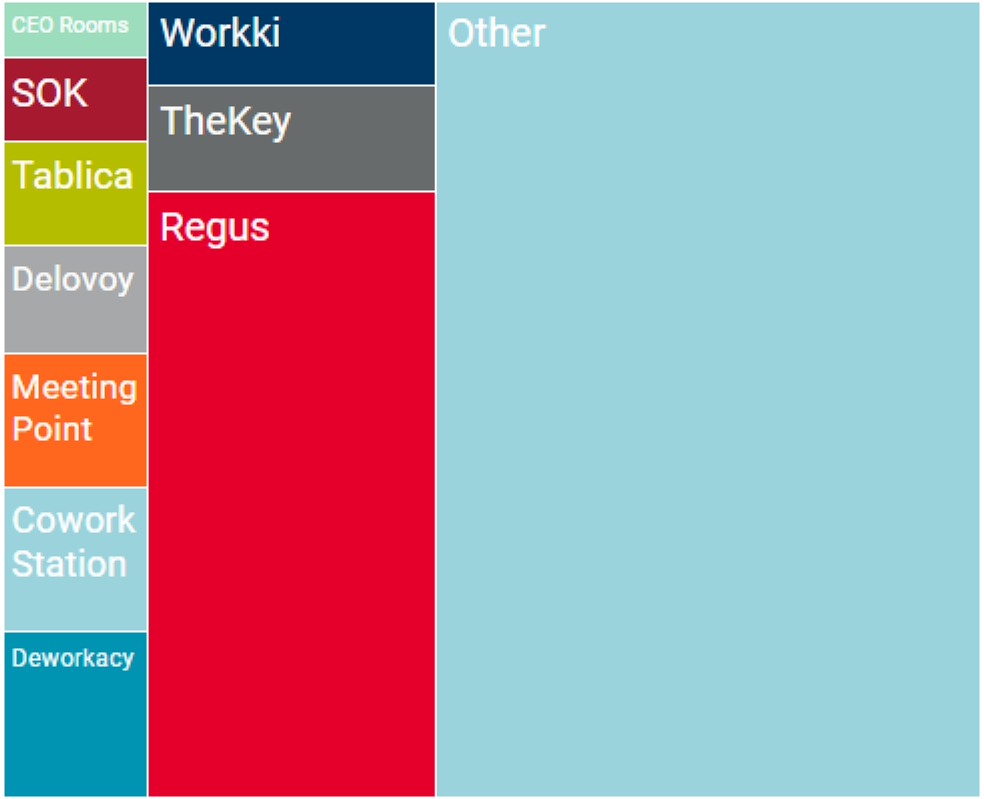
ДЕЛОВОЙ сеть офисных центров

4 locations

РАБОЧАЯ СТАНЦИЯ

3 locations

TOP-10 largest flexible workspace operators by area:



MAJOR OPERATORS ON THE MARKET

Chain and non-chain flexible workspaces with area of more than 1,000 sq. m

Name	Locatiom	Area (sq. m)	Unassigned desk (RUB)	Assigned desk (RUB)	Mini-office per 1 person (RUB)
HYBRID WORKSPACES					
CEO Rooms	1 Comcity	1,300	12,500	15,000	13,000
	2 Empire	400	35,000	40,000	30,000
Deworkacy	3 Izvestia	500	10,000	16,000	14,000
	4 Polyanka	2,554	10,000	19,000	27,500
	5 Red October	1,700	10,900	17,000	27,500
TheKey	6 Arma	1,320	16,000	21,000	from 70,000 for office
	7 Danilovskaya	1,070	14,000	17,000	from 39,000 for office
	8 Patriarshie	520	16,000	21,000	from 70,000 for office
	9 Shelk	1,730	14,000	17,000	from 60,000 for office
	10 Trekhgorka	1,820	14,000	17,000	from 60,000 for office
Cowork Station	13 Butyrskaya	2,700	14,900	16,900	17,000
	14 Artplay	700	14,900	16,900	23,000
	15 Neskuchniy garden	700	14,900	16,900	-
Workki	33 City	2,400	21,900	29,900	44,900
	35 NeoGeo	2,500	9,900	12,900	17,900
SREDA	31 Federation	2,400	-	30,000	25,000
Tablica	32 Mendeleevskaya	3,000	16,000	19,000	19,000
MINI-OFFICE (in some locations there are also co-working zones)					
Meeting Point	11 Okhotniy Ryad (BC Moskva)	1,577	28,000	от 32,000	from 80,000 for office
	12 Belorusskaya (BC White Gardens)	2,230			from 90,000 for office
Regus	16-28 13 locations				
SOK	30 Zemlyanoy Val	2,400	15,000	22,000	37,500

All rents are given per month.

Interactive map by link

* blue color on the map is existing space, red - planned to open

LEASE TERMS

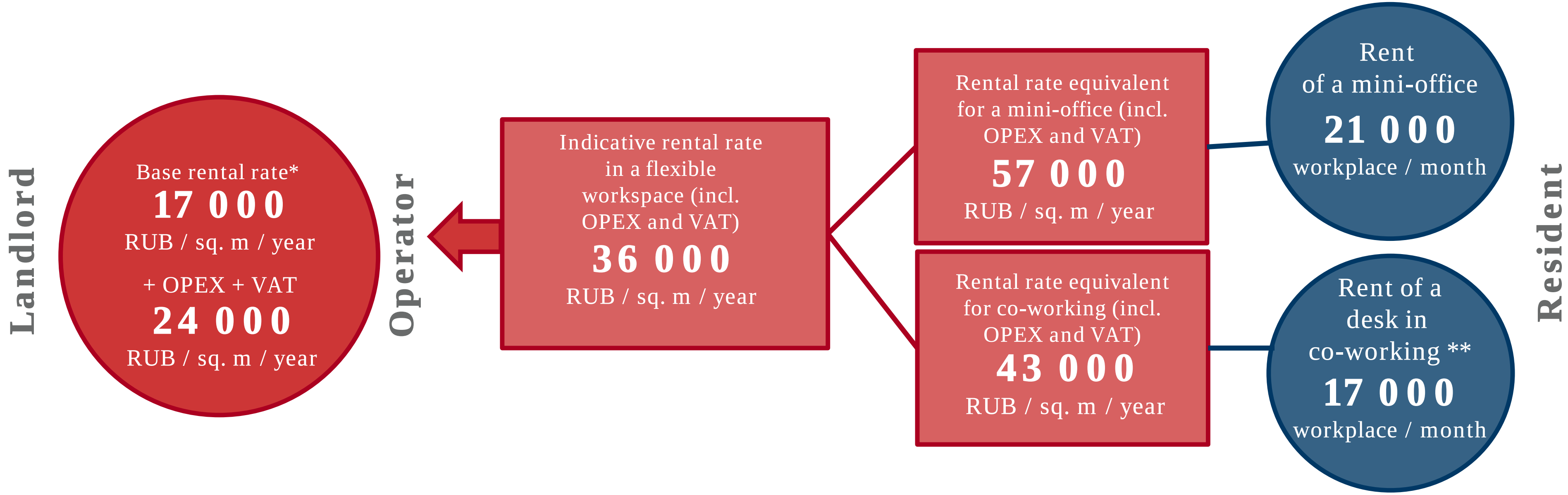
Residents of hybrid workspaces has several options to lease a workplace:

Type of workplace	Standard minimum lease period	Average rental rate, a workplace per month
Unassigned	1 hour	15,300 RUB (~ 240 USD)
Assigned desk	1 month	19,000 RUB (~ 300 USD)
Mini-office	11 months	21,200 RUB (~ 335 USD)

- All rental rates include **operational expenses and VAT**. Rental rates are calculated for chain hybrid workspaces.
- Often rental rates include several hours in meeting rooms. Sometimes, when residents lease a workplace for a long-term period, they receive discounts.
- There are flexible workspaces offering passes to co-working for several visits per week / month.
- Some operators provide residents with opportunity to work in all locations of a co-working chain.

** Rental Rates in US Dollars are calculated according to the current Russian Central Bank exchange rate (as of 08/07/2018): 1 USD = 63,5 RUB*

INDICATIVE RENTAL RATES



* Average rental rate for buildings, where flexible workspaces are located
** Average rental rate for unassigned and assigned desk

Apart from rental income, flexible workspace operators make profit from additional services – leasing meeting rooms, organizing events, etc. Depending on a model that operators use, an additional income amounts to 10 - 40% of the total income.

EVENTS

Leasing space for events as a source of additional income.

There are event halls in some flexible workspaces. They have several functions: they are a part of infrastructure, additional source of income, and attraction for new clients.

For instance, the event hall in Meeting Point, which is located at Okhotny Ryad brings about 40% of revenue.

Not all operators promote their event halls because an additional service line demands additional administrative resources.

Some flexible workspaces are focused on leasing of workplaces only. Conversion of new clients/residents from events is insignificant.

BUSINESS MODELS OF OPERATORS

Model 1. Leasing premises

- Operator of a flexible workspace leases a big office block, makes capital investment (fit out, furniture and equipment purchase), pays operational expenses and then leases small blocks or workplaces for a short-term to the end user.

Model 2. Purchasing premises

- Operator owns the premises, covers capital and operational expenses and leases small blocks or workplaces for a short-term to the end user.

Model 3. Partnership with a landlord

- Operator leases a space at a discount rental rate. Landlord/investor covers capital expenses (sometimes split between landlord and operator). Operator is in charge of operational management. Income is shared between landlord and operator.

Model 4. Operator's model

- Landlord provides operator with a fitted-out premises with equipment and furniture. Operator is in charge of operational management and receives a fee from landlord.

REAL ESTATE IS CONVERTED INTO SERVICE

Leasing business model is the most widely presented in Russia. This model is the most acceptable and understandable for landlords as it is the least risky for them – this is a standard long-term lease agreement. For operators, the risks are at the maximum level – operator has a long-term lease commitment with a landlord and makes all the capital investment, while having a short-term service contract with residents. Operator always has a risk of insufficient occupancy rate to cover expenses.

Operator's or partnership models are more preferable for operators as they allow to split the risks with a landlord. If the flexible workspace is successful, both sides win and the landlord gets higher income from partnership/operator's model than from lease of the space.

However, due to demand recovery on the office market, landlords are not ready to accept the risks of operator's model.

"The legal relationship between co-working operator and developer is based on a lease agreement (though with a specific pricing). The landlord needs to be confident that the tenant will stay for a long period. The tenant also needs to be sure that he won't be thrown away if tomorrow some other tenant who is ready to pay more comes.

The legal relationship between co-working operator and resident is a service contract. In a service contract, either side may withdraw from this agreement at any time. Operator can throw away a resident, a resident can say good bye to the lessor and move to another place. Thus, co-working operator takes the risks if residents leave".

Konstantine Kouzine,
Partner, Baker & McKenzie

SPACE REQUIREMENT PER ONE EMPLOYEE

Flexible workspaces sell the feeling of comfort.

FLEXIBLE WORKSPACE

6 sq. m

Feels like **8 sq. m**

TRADITIONAL OFFICE

8 sq. m

Feels like **6 sq. m**

On average, one workplace in a flexible workspace accounts for **6 sq. m**, including common areas, while in a traditional office the common norm is 8-10 sq. m. Flexible workspace operators use space more efficient – with a higher price of a square meter more workplaces are organized compared to the same area in a classic office.

However, in a flexible workspace an end-user has a feeling of having more space than in a standard office. This impression is formed due to common areas, atmosphere and flexible working hours (not all residents are in the office at the same time).

FLEXIBLE WORKSPACE: KEY TO SUCCESS

LOCATION

- Flexible workspace should be located within walking distance from metro (not more than 10 minutes) or in points of attraction of the target audience (cultural, art, business clusters).

SPACE DISTRIBUTION

- The most affective area of a flexible workspace is 1000 sq. m and more – the loss factor is less and space planning is effective which means a balance of co-working areas, mini-offices and common areas. Mini-offices are of the highest demand due to the specifics of the Russian mentality – people want to work in their “own” separate space. However, co-working zones are also needed to follow the concept and atmosphere of a hybrid space.
- Space of a smaller area is worth doing only as supporting infrastructure – in a hotel, café, restaurant.

OCCUPANCY RATE

- Depending on a model, occupancy rate should be 70% or more for the breakeven.

CHAIN DEVELOPMENT

- Developing a chain of flexible workspaces provides the highest efficiency due to the economy of scale.

“Occupancy rate should not be less than 70%”.

Tatyana Sharaeva,
Managing partner, Meeting Point

Section 5

CONCLUSIONS

WORKING IN A FLEXIBLE WORKSPACE: THE POINT OF VIEW OF A RESIDENT

Advantages	Disadvantages
• No need to invest in fit out, furniture and equipment; • Possibility to lease a small block/workplace in the office building of class A or B with services included in the rental payment; • Possibility of a short-term lease and renting additional workplaces if the number of employees increases; • There are many people from different spheres in one space, which allows to get new business contacts; • Comfortable working climate; • Opportunity to take part in events organized in a flexible workspace;	• Noise – a lot of people in one space can be bothering while working; • In co-working areas confidentiality is not strong enough; • Some people consider flexible workspaces unpresentable to invite clients and partners; • Higher rental rate compared to a traditional office.

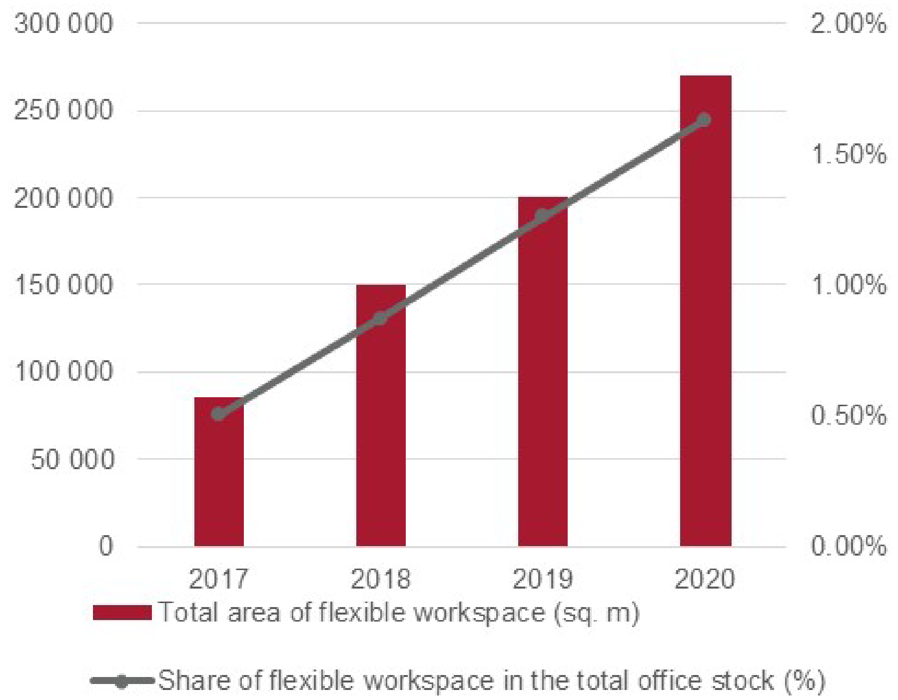
“There are confidential clients, confidential files. The idea itself, that these files can be seen by someone else or viewed from a computer screen of a neighbor, means for me multimillion-dollar lawsuits and loss of business”.

Konstantine Kouzine,
Partner, Baker & McKenzie

LEASING SPACE TO A CO-WORKING OPERATOR: THE POINT OF VIEW OF A LANDLORD

Advantages	Disadvantages
• Improvement of the building’s infrastructure –flexible workspace makes a building more attractive both for new tenants and for existing companies which have the opportunity to allocate there a part of the employees and project teams; • Decrease of vacancy rate in the building; • Quality fit out of space by the operator; • Increase of the building’s popularity due to different events organized in the premises; • There is no need in parking slots for non-corporate residents of a flexible workspace.	• There is a risk that people working in a flexible workspace won’t correlate with the main audience of the office building.

Flexible workspace supply, Moscow, 2018-2020



DEVELOPMENT FORECAST

Considering current growth rate of flexible workspaces and unsaturated market, the format has a great potential of further development. Often, demand exceeds supply, especially for allocation of relatively big teams (20-30 employees).

In the nearest future we expect:

- The rapid increase of a number of operators and entry of new international players that will cause competition growth. By the end of 2018, the market volume will almost double, in 2019-2020, the average annual growth will be 35%;
- Increase of average size of a flexible workspace;
- Large corporations to show more interest to flexible workspaces;
- Domination of chain operators;
- Operator's model to be developing.

"Chain business models are always ahead of non-chain operators because of distribution of costs among locations (for marketing, maintenance of back office, attracting new clients, etc.). Moreover, due to the possibility of redistribution of costs and revenues, chains will be more resistant to possible market changes. Small non-chain co-working spaces are able to compete with chains, however they will be less efficient and more exposed to the risks".

Evgeniy Ovchinnikov,
Director, Workki

KEY CONCLUSIONS

Flexible workspaces convert real estate into service

- While entering into a long-term lease commitment, operator provides the end user with a service of short-term lease.

Availability of flexible workspaces generates demand

- With growing availability of flexible workspaces, start-up entrepreneurs get an additional incentive to open and develop the business.

The demand for flexible workspaces is high, the market is not saturated

- The market has a great potential for development –the flexible workspace supply will increase by more than 2 times by 2020.

There is no single business model, operators are trying to find the most effective one

- Currently, the classic long-term lease agreement between operator and landlord is the most popular business model. However, flexible workspace operators are experimenting with models and trying to work with landlords on a partnership basis.

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About the company

CUSHMAN & WAKEFIELD IN RUSSIA

Cushman & Wakefield has been successfully operating in Russia since 1995, with employees more than 150 experienced and highly qualified experts. The Moscow office implements projects in all major cities in Russia and the CIS, forming transnational teams for solving complex tasks when necessary. There are 12 key areas of company activity, covering all the sectors of commercial real estate: offices, retail, warehouses, hospitality and tourism, land. The range of services provided includes the leasing of spaces, asset management, investment consulting, real estate operation, services for corporate clients, project management, development consultancy, representing tenant's interests, valuation, hospitality and tourism. Cushman & Wakefield is one of the largest companies in the global commercial real estate market, with a turnover of $6.9 billion and a team of more than 48,000 specialists in more than 400 offices in 70 different countries. For more information, visit our websites – www.cwrussia.ru and www.cushmanwakefield.ru