BROKERS ADAPT TO CORPORATE AMERICA'S NEW WAY OF WORKING

By John Salustri

We've heard the hype about collaboration, amenities, and shared office space—but how does that hype filter down to the transaction table, and how are brokers adjusting?

On the first score, it's clear from those in the field that it ain't just hype. On the second, SIORs are not only living the age of collaboration, they're acting as advocates for it, helping their clients enhance recruitment and retention through their physical environments.

And here's a two-for-one spoiler alert: FASB (Financial Accounting Standards Board) rule changes have little to do with the choice to add more flexible space agreements. For those brokers who think space-on-demand doesn't pay, well, think again.

The On-Demand Revolution

"Every client we work with is taking a serious look at their space, how they've been working, how they'll be working in the future and what their employees want," says Bo Hargrove, SIOR, principal at Rich Commercial Realty in Raleigh, N.C. What those tenants want, according to the tenant rep, is "collaborative space, more amenities and more opportunity to enjoy the workplace."

Daniel Levison agrees. Levison is chairman of CRE Holdings in Atlanta, which owns a coworking business along the WeWork model (SharedSpace is the name of the firm), along with CRE investments, and a brokerage firm, so his view of change comes from a variety of angles.

"WeWork has identified Atlanta as a market where they want 20 locations," he reports. "I saw data recently that said 63% of all coworking was in seven major, densely populated cities, and 45% of all coworking was in New York City alone.

"In Atlanta," he continues, "75-80% of our office space is suburban product, so we're seeing more activity from big companies in the suburbs." Clearly, even in a fragmented market such as Atlanta, space-on-demand is big and getting bigger. In fact, according to WeWork statistics, the "WeWork economy . . . supports $122.3 billion of GDP worldwide."

And, as those numbers imply, it's not just for startups anymore. "It may have begun with startups," says Levison, "but only 10% of our firm's membership is startups. In our three locations, 38% of our members have 28 to 40 people, and 28% have more than 50." He says that, as a rule, his membership profile consists of firms with one to four people, with projected growth upwards from about $125,000 annually. "We're starting to see more interest from larger, established companies."

It should be noted that this interest in short-term space seems due more to operational considerations than to new accounting rules from the Financial Accounting Standards Board. FASB has changed its leasing standards so that tenants now face more stress of leases on the balance sheet.

"We've been debating for a couple of years about what impact new FASB rules would have on our business," says Adam Kaduce, SIOR, a senior vice president at R&R Realty Group in West Des Moines, IA. "Frankly, we've seen very little FASB-related influence on how people are looking at real estate. It's more about talent-retention. Everyone has more important drivers for their real estate decisions than FASB. If they can take advantage of it, great, but it's not the lead driver." Neither Levison nor Hargrove see little movement driven by the standards change either.

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Mother of Invention

The WeWork story is impressive, especially given that the firm launched less than a decade ago (Regus, of course has been around even longer, since the 1980s), and the changing nature of work has fueled an explosion of providers. While market reach is expanding daily, certain locales are still under the radar; markets such as Des Moines, says Kaduce, where entrepreneurial landlords and tenants are making it up as they go along.

"If something happens on the coasts, it's a couple of years before we see the ripple effect in this smaller market," he reports. "WeWork has looked around this market, but we don't have a lot of the national players providing coworking space. So customers are redesigning their offices with similar furniture, areas, and spaces, with collaboration spaces and break rooms that look like cafes."

Without the plethora of options open to major markets, "customers in our market are willing to sign longer-term leases to free up more TI dollars and build out more expensive spaces with those touches," Kaduce says. Since the Great Recession, tenants have increased their lease terms from an average three-to-five-year hold up to as much as 10.

Brokers as Advocates

No matter the provider, be it a global concern like WeWork, an entrepreneurial landlord, or the tenants themselves, the brokers we talked with are reading the tea leaves and pointing their clients toward the future.

"Absolutely," says Levison, "especially if I'm asking the right questions: If you're eight people now, where do you see yourself in two, three, or five years? If they're in a growth mode, I'm going to encourage them to consider an office-on-demand environment.

"Every time we show space at our Dunwoody location, we start at the top floor," he continues. "Coworking business occupies the entire floor. Often, a tenant says they need 2,500 square feet with X number of offices and this many conference rooms. Our traditional available space might be a little small. But we see each of our buildings as a community and provide credits for conference rooms upstairs and access to the coworking. So, many times we can get deals done when, without SharedSpace on the top floor, the traditional space wouldn't work."

"Our job changes every year as more changes happen in the market," adds Hargrove. "A lot of clients know about the changes taking place in how people want to work, but we still need to have those conversations. In fact, we recently toured six spaces with one client in the legal field. The purpose was to show them how work today is different than it was a decade ago, when they last redid their space. All of that puts us in the role of advocate. We're helping to drive that ship."

R&R does much of the same thing. "It's nice to have clients willing to showcase their spaces," notes Kaduce, adding that existing tenants are not their only resources. "We have two design professionals on staff who have been incredibly helpful in taking clients through the steps of re-envisioning their spaces."

The Broker-Fee Issue

Some brokers cautiously approach the idea of space-on-demand. Rightfully so. After all, the concept totally disrupts the classic 10-year-lease mold. Not to worry, say our experts.

"The co-working concept can be a place for companies to incubate and develop before they're ready to take on a traditional lease option," says Kaduce, "and it provides brokers an opportunity to locate those companies in a real estate space rather than someone's home or garage. For more developed companies, coworking provides additional services beyond space alone, and those services can push up rental rates and commissions. I'm not of the opinion that coworking is going to kill the brokerage industry. Rather, it provides an additional opportunity to better tailor a solution for our clients."

Speaking of which, "we're always driven to find the right solution for our clients," adds Hargrove, "and the solution can vary dramatically depending on who the user is. Space-on-demand does really well given current market conditions because most traditional landlords aren't willing to do a lease with flexibility to it. That gives a huge advantage to the on-demand providers of the world that can take a long-term lease and give occupants the flexibility they need." (In addition, WeWork claims an occupancy-cost savings of $24,000 annually for a four-person company.)

Service aside, "some broker concerns are valid," he says. "What if the economy changes?" And what if a company runs into bankruptcy, as Regus did back in 2003? "What would it mean to tenants and landlords if that should happen again?" Valid points all, he says, but "for now, for us, it's about what's the best situation for the tenant, and that presents a great opportunity."

"The one with the money drives the bus," says Levison. "But most brokers don't want to show coworking space because they perceive it as a loss of income—but that's totally inaccurate. The reality is that it can cause a loss of short-term income," but longer term, it's actually more profitable.

He explains that brokers can either cash-out or earn more over the length of the lease. "Every coworking space I've ever come across—including our own—offers a 10% commission. So, if someone is signing for a month or three years, brokers are paid 10%, but it's in a monthly annuity, and that's the rub for brokers: we want all our money now."

Atlanta, he says, is one of a few markets where brokers get paid based on monthly annuities. In other words, as the tenant pays, the owner pays.

"With a cash-out in Atlanta, the broker collects the first month rent, called a 'profee,' and 4% of the value of the lease," he continues. "Over the term, we still get that first month's rent and 5% every month the landlord gets payment from the tenant."

"The real kicker is at renewal," he says. "In a cash-out, you can get a 2% fee and in the annuity the agent keeps getting the 5%. Coworking continues paying 10% throughout the entire term." He adds that, based on coworking trade-association statistics, the average coworking stay is in excess of 40 months.

"But agents are getting paid monthly, so they can actually make more money putting tenants into coworking than they can in traditional leasing," he explains. "We spend a significant effort trying to educate the Atlanta brokerage community about this, but I wouldn't tell you the message is getting across."

Big paydays or no, space-on-demand is here to stay, and, if nothing else, it all comes back to the service aspect of brokerage. "Business owners now have to ask themselves if coworking space will help them hire and keep the best talent," says Levison. "So we're tasked with providing these environments to help enhance productivity if we want to lease out our buildings. That's what coworking is all about." ▽

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