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CHANGING RELATIONS: IMPLICATIONS OF NEW OCCUPATION PROFILES

How the rise of TMT occupiers and flexible workspace operators affects the relationship between tenants and property owners

Summary & Recommendations

Asian CBD areas have historically been dominated by finance. However, technology, media and telecoms (TMT) groups and flexible workspace operators were key drivers of demand over 2017–2018. TMT groups now occupy about 18% of prime office space in Asian CBDs, and flexible workspace 4-5%.

Growth in TMT and flexible workspace may slow, but is unlikely to reverse. Conversely, finance is generally flat or in slight decline.

In addition to changing occupation profiles, patterns of workplace organisation and design are evolving. Occupiers in general increasingly value flexibility, efficiency of space use and ambient experience.

We think that the new market situation has these key implications for the relationship between tenants and property owners:

- > Occupiers are better-placed to demand shorter leases and greater investment in amenities in or around buildings
- > Owners have an incentive to agree, since greater attention to ambient environment should encourage occupiers and their staff to stay
- > Flexible workspace groups can partner with developers and landlords, who need to include a flexible element in building design and management

22% TMT and flex

By Colliers' estimate, TMT groups and flexible workspace operators now represent about 22% of aggregate Grade A office space in the CBDs of major Asian cities

20% and 12%

Amount of Grade A office space occupied by TMT groups in Shenzhen and Beijing respectively, versus 26% in San Francisco and over 10% in the wider City of London

15% and 5%

Proportion of Grade A office space occupied by flexible workspace operators in prime office areas of Bangalore and Singapore, versus 5% in London and under 2% in most large US cities

75% and 16%

Proportion of prime grade office absorption represented by TMT and flexible workspace combined in, respectively, Singapore's CBDs and Hong Kong Island in 2018

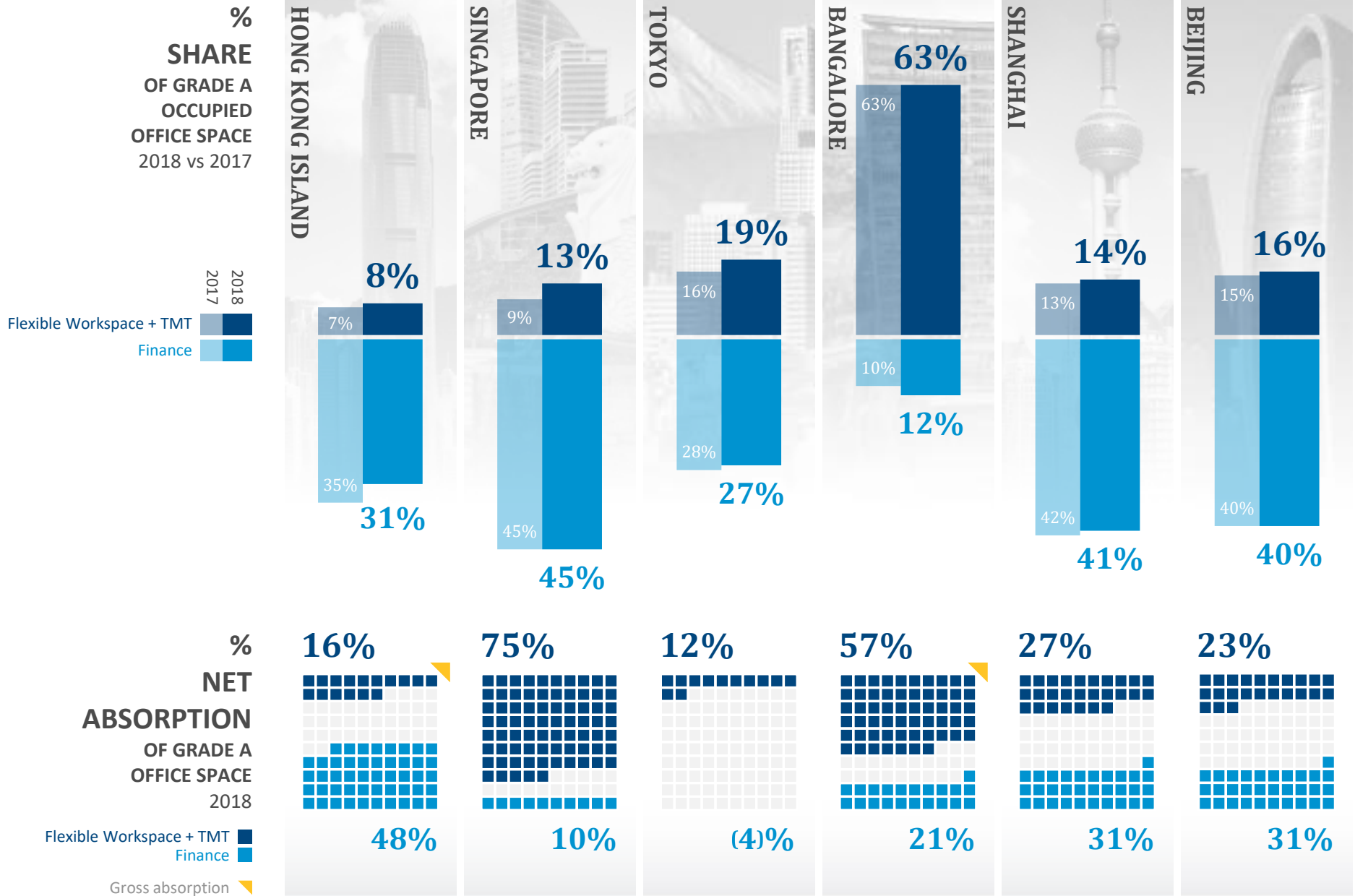
Asian CBDs have traditionally been dominated by finance, which represents 30–50% of total occupation of prime office space in most CBD areas outside India and the Philippines where technology is more important. However, patterns of occupation are changing, with the flexible workspace and TMT sectors the key drivers of new demand over 2017 and 2018. By our estimate, **TMT groups now occupy 18% of total prime office space across Asian CBDs, and flexible workspace a further 4-5%.**

This evolution mirrors global trends, **and in some cases is moving faster in Asia than in key centres in Europe and the US.** For example, TMT accounts for over 10% of office space in the wider City of London, and flexible workspace for 5% across London as a whole. In the US, flexible workspace accounts for under 2% of total office space in the major cities (though for one-third of new leasing over the past 18 months). The growth of flexible workspace and technology may slow in Asia, but is unlikely to reverse.

Not only are occupier profiles changing, but so too are patterns of workplace organisation and design. Offices are increasingly laid out on open-plan activity-based or agile working principles, while occupiers in general are demanding **flexibility, efficiency of space use and enhanced ambient experience as tools to staff retention** for a more mobile and typically younger workforce.

This new paradigm has important implications for the relationship between commercial occupiers and property owners in Asia. **Occupiers in general are now in a strong position to demand shorter leases and greater investment in amenities** in or around buildings. For owners, such investment ought to pay off, since greater attention to environment and experience should inspire tenants and staff to stay.

More specifically, flexible workspace groups are well-placed to partner with owners, who in our view need to include a flexible element in building design and management plans. Partnerships should help boost occupancy levels and rental income within buildings, which is in the interests of both sides.



Note. Figures for Tokyo are for the five central wards, figures for Bangalore are for prime office areas, other figures are for CBD areas. Source: Colliers International

NEW OCCUPIER SECTORS WELL ESTABLISHED IN ASIA

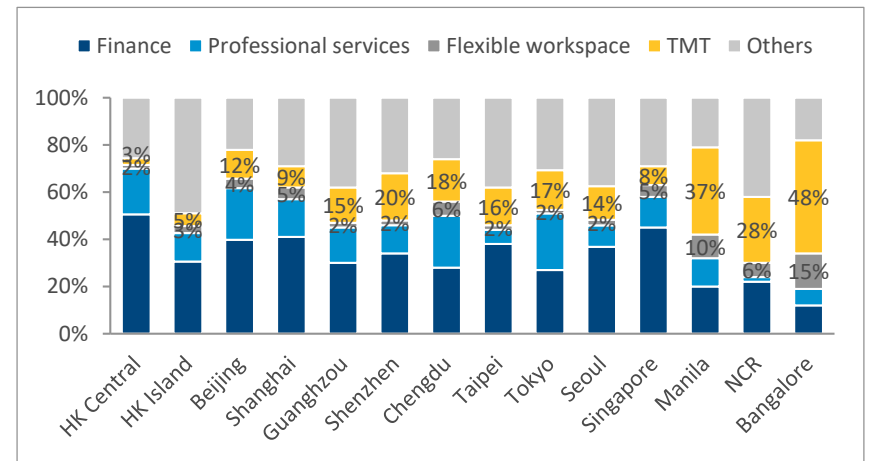
Tech and flexible workspace the key drivers of growth

Finance and professional services have traditionally been the dominant occupier sectors in the CBDs of major Asian cities. Finance alone still represents 30–50% of total occupation of prime office space in most Asian CBD areas outside India and the Philippines where technology is more important. However, patterns of space occupation are changing, with the technology, media and telecoms (TMT) and flexible workspace sectors the key drivers of new demand in many cities over 2017 and 2018. By our estimate, TMT groups now occupy 18% of total prime office space across Asian CBDs, and flexible workspace a further 4-5%.

Technology and media has thus emerged as a major occupier sector. This was already true in the major Indian cities, where the TMT sector accounted for between about 19% of Grade A office space in Mumbai and 48% in Bangalore at end-2018, and in Manila, where the proportion was 37%. However, by our estimate this sector now accounts for 20% of total Grade A space in Shenzhen, 12% in Beijing, and 17% in Tokyo. In Shenzhen, we calculate that the technology sector accounted for 67% of net absorption of Grade A space in 2018.

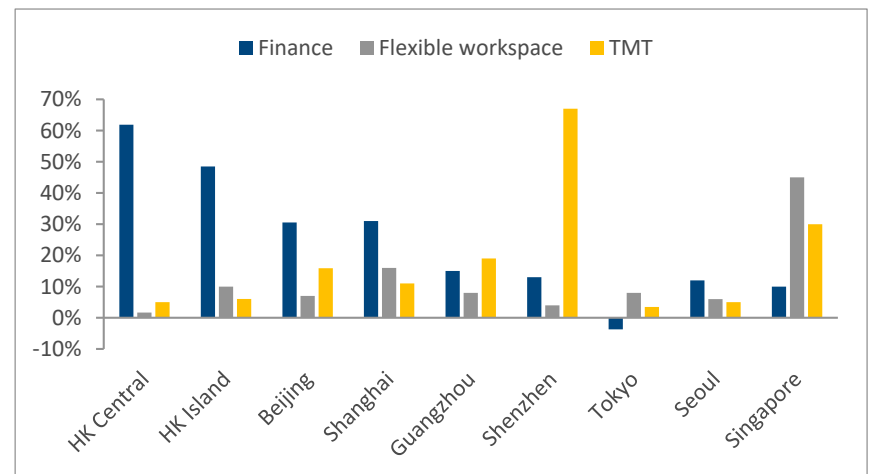
Technology and media is less important in Singapore and Hong Kong, where the sector accounts for 8% of total office space in Singapore’s CBD districts and about 5% of space on Hong Kong Island. However, it is noteworthy that the technology and media sector represented, respectively, 30% and 6% of net absorption of Grade A space in Singapore’s CBD districts and Hong Kong Island in 2018. We believe that this growth reflects continued significant investment in fintech (the area overlap between finance and technology) in both cases.

Figure 1: TMT and flexible workspace as proportions of prime grade office space across Asian cities (end-2018)



Source: Colliers International

Figure 2: Proportion of net absorption from finance, TMT and flexible workspace in Asian gateway cities in 2018



Note. Figures for Hong Kong Island refer to gross absorption.
Source: Colliers International

Flexible workspace accounts for 4-5% of Grade A office space across large Asian cities by our estimate, with the greatest concentration in Indian cities

We have seen that flexible workspace (referring to coworking and serviced offices) still represents only 4-5% of aggregate occupancy of Grade A office space in Asia. However, the proportion would probably be higher if Grade B space were included, since flexible workspace has proven a valuable tool for revitalising Grade B office buildings in Hong Kong among other markets. Overall, flexible workspace continues to expand across Asia. While classic coworking spaces served freelancers, entrepreneurs, remote workers and start-up companies, increasingly flexible workspace groups are providing an additional temporary space solution to large corporate enterprises.

Flexible workspace operators have made particular inroads into Indian urban markets: by our estimate, the sector accounts for 15% of total Grade A office space in prime areas of Bangalore, and for at least 6% in the NCR agglomeration. The proportion of space occupied by flexible workspace operators is high in other emerging cities too, e.g. Manila on about 10%.

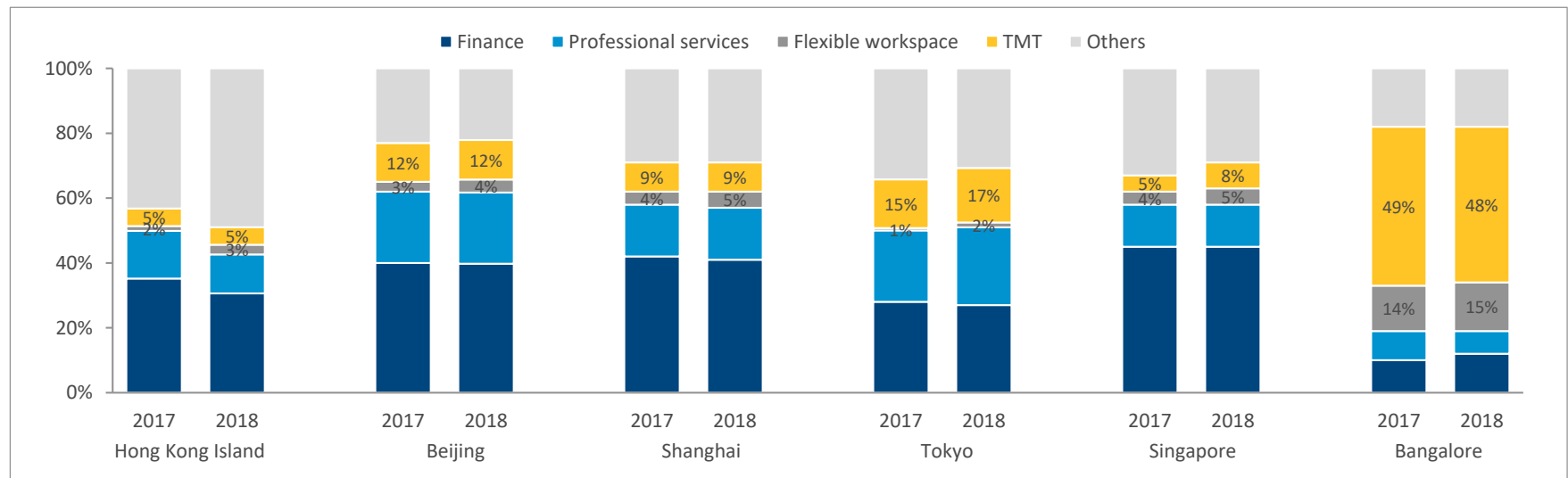
However, flexible workspace operators have also been expanding rapidly in developed markets. For example, we estimate that the sector now accounts

for 5% of prime grade office space in Singapore and Shanghai. For Hong Kong Island, we believe the proportion is 3%, although this falls to 2% for Central. For several other major cities, e.g. Seoul, Guangzhou, Shenzhen and Tokyo's five central wards, the proportion appears to be about 2% or below.

Our estimates for net absorption in 2018 point to a trend of continuing expansion in the flexible workspace sector. We believe flexible workspace accounted for 16% of prime grade net absorption in Shanghai, 10% on Hong Kong Island and 8% in the five central wards of Tokyo. Most remarkable was Singapore, where we estimate that the sector accounted for 45% of net absorption last year.

We believe that flexible workspace is now fully established as an occupier sector, serving an important market niche. While growth rates in the sector may slow from now on, we do not expect the trends to go into reverse. We see particular growth potential at the premium end of the flexible workspace market, especially for those operators focusing on provision of amenities and hospitality-related services.

Figure 3: Change in proportion of prime grade office space represented by TMT and flexible workspace: end-2018 versus end-2017 in key investment centres



Note. Figures for Tokyo are for the five central wards, figures for Bangalore are for prime office areas, other figures are for CBD areas. Source: Colliers International

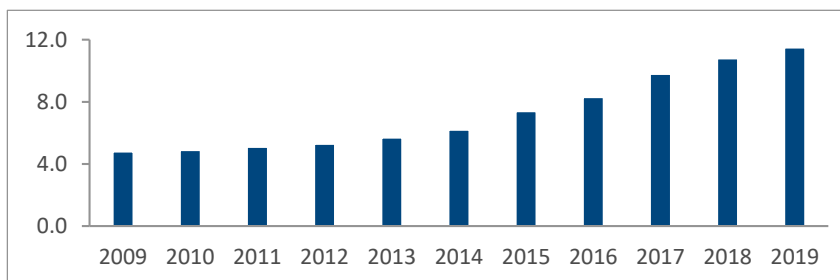
CHANGING OCCUPATION PROFILES IN LONDON AND THE U.S.

Tech expansion in London an example for Hong Kong

The expansion of the technology and flexible workspace sectors in Asia mirrors global trends, and in some respects Asia is moving faster than major urban markets in Europe and the US. According to Colliers UK, active flexible office space centres totalled 11.5 million sq feet (1.1 million sq metres) in London as a whole at end-2018, with a particular concentration in the West End. This represents 5% of total London office stock. A further 3.0 million sq feet is due to be launched between now and 2020. The flexible workspace sector has grown rapidly in London (see Figure 4), and will grow further. However, on this basis the proportion of total office stock represented by flexible workspace is lower in London than in many Asian emerging cities, and no greater than in Asian developed cities like Singapore and Shanghai.

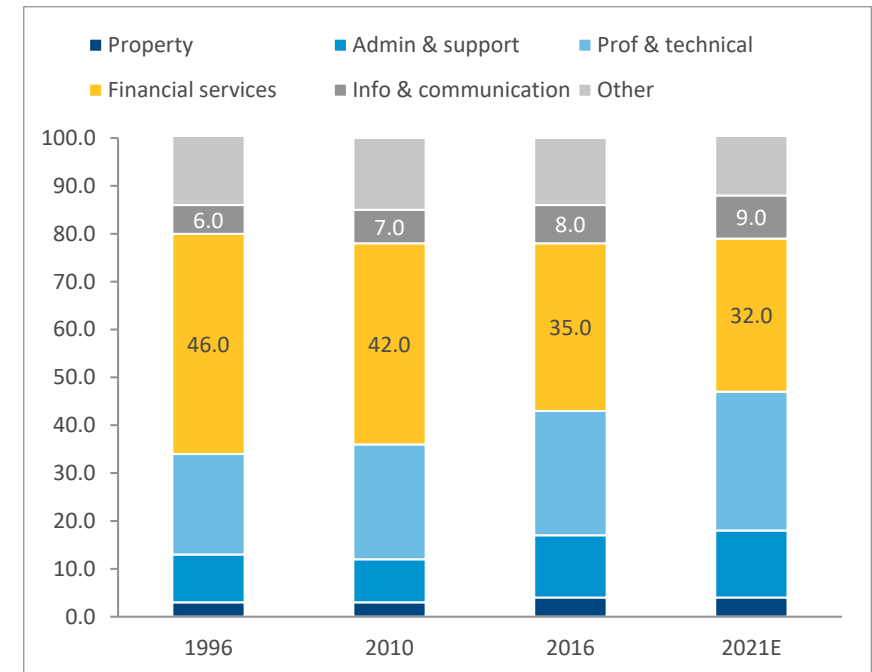
The TMT sector has likewise been a key driver of growth in London's office market. Across London, take-up of space has been driven by expansion by four large technology and social media groups: Google, Facebook, Amazon and Apple. This expansion has included the City, the traditional financial centre of London; and occupation of office stock in the City by technology and media stood at 4.7 million sq feet (0.44 million sq metres) at end-2018, equal to 6% of total stock and up by 30% in five years. In the wider London City, including the City Fringe of Farringdon, Shoreditch and Old Street (Silicon Roundabout), TMT represented over 10% of total stock at end-2018.

Figure 4: London's flexible workspace 2009–2018 (millions of sq ft)



Source: Colliers International. Figures as of the start of each year.

Figure 5: Rebalancing of City of London offices: sectors as % of stock



Source: Colliers International

The expansion of London's technology and media sector might appear almost prosaic if compared to Bangalore or Shenzhen, for which, as we have seen, technology and media accounts for 48% and 20% of total office occupation respectively. However, we believe that the example of London is especially relevant to another traditional financial centre in Asia, Hong Kong.

In our report "Top Locations in Asia – Technology Sector" (19 September 2018), we highlighted Hong Kong as a "wild card" location for technology occupiers and mentioned that the city is becoming more exciting as a tech centre for several reasons. These include proximity to Shenzhen and South China; recent expansion in the city by social media leaders like Facebook and Alibaba; and accelerating investment in fintech, including planned expansion by major banks like JP Morgan.

Rapid recent expansion by tech occupiers in London illustrates Hong Kong's potential in this sector



Occupiers in general increasingly value flexibility, efficiency of space use, and experience

Fig. 6: Flexible workspace share of office stock in 19 US markets

	Q2 2018
All Metros	1.6%
Tech Markets	2.0%
Professional Services Markets	1.8%
Other Markets	1.1%
High Wage Markets	1.9%

Source: Colliers International

US example suggests property owners are responding to the challenge from flexible workspace operators

At first sight, many Asian cities have significantly higher penetration of flexible workspace than their US counterparts. However, we believe the example of the growth of flexible workspace in the US carries several messages for Asia. As noted in Colliers' report "U.S. Flexible Workspace and Coworking: Established, Expanding and Evolving" (February 2019):

- > **Fast growth** – Flexible workspace continues to grow at a rapid pace, now accounting for one-third of urban office leasing in the last 18 months.
- > **Focus on enterprise** – As in Asia, flexible workspace providers in the US are shifting focus to target larger corporations and enterprise clients.
- > **Rare bright spot** – Flexible workspace is one of the few growing sources of office demand, although it still makes up only a fraction of the market, with 1.6% of all stock in 19 leading US office markets at end-H1 2018.
- > **Owners are responding** – Flexible workspace is impacting traditional leasing models and firms' occupational portfolios, together with the nature of how office space is designed and utilised. **Traditional property owners are responding with their own flexible space and lease options.**
- > **Tech and high-wage markets** – **The concentration of coworking space is almost twice as great in tech-driven markets as in other markets** (notably New York's Manhattan). Coworking is also clustered in high-wage cities and markets with a high concentration of professional services firms.

CHANGING TRENDS IN WORKPLACE AND BUILDING DESIGN

Activity-based and agile working encapsulate the new patterns

The changing profiles of occupation are leading to new approaches to workspace organisation and building design. Some of these affect fit-out of office space, while others have more impact on building design. In the opinion and experience of Colliers Asia, **occupiers in general increasingly value three things**:

- > **Flexibility** – although this means different things. It can mean total flexibility of location, i.e. freedom for staff to work 100% at home or 100% at the office. It can also mean flexibility of hours, i.e. freedom to work at any time
- > **Efficiency of space use** – which does not necessarily mean smaller. With workforces increasingly mobile, some technology companies only require enough office space for half their staff
- > **Experience** – i.e. a comfortable and pleasant environment in the office and surrounding area. However, features like collaborative spaces, wellness rooms and F&B facilities are usually of little use unless firms actively encourage their staff to use them

In practice, there seem to be two main forms of new, more flexible workplace layout. One approach is **activity-based working (ABW)**, which has the aim of facilitating the various activities in which employees engage during the day, and of maximising the output from those activities. ABW has a strong emphasis on promotion of collaborative space where staff can mingle and work together, as well as leisure space and quiet zones where staff can concentrate by themselves when necessary.

Agile working is a concept whose roots lie in the IT sector, where many firms employ an iterative approach to software delivery that builds a product incrementally instead of delivering a completed product in one go. Typical of the agile organisation is a structure involving "squads", i.e. multidisciplinary teams of no more than eight or nine people which are intended to be nimble and hence capable of reacting fast to changing client demands.

“
New building designs call for a greater mix of amenities and an opened-up podium

Advantages of ABW and agile workplace design are claimed to be as follows:

- > Reduced property costs and workspace savings
- > Better space utilisation and ability to match staff to fluctuating demands
- > Increased productivity and efficiency
- > Enhanced ability to attract and retain talent
- > Wider and more effective communications and information sharing
- > A more dynamic and lively workplace
- > Decreased energy consumption and lower environmental impact by reduced commuting where remote working is incorporated

New building designs

In addition to changes in workplace layout, the new breed of office occupiers appear to be driving certain changes to building design. These include:

- > **Easy access to experience and entertainment** – more mobile and younger workforces demand access to F&B and entertainment facilities in retail podiums and/or nearby malls
- > **Dual or multiple entrances** – one entrance for finance tenants and others with high-security needs, other entrances for flexible workspace members and other tenants with lower security needs
- > **Reduced needs for large, temperature-controlled IT spaces within a building** – reflecting the spread of cloud computing and offsite data storage¹, as well as retrenchment in financial tenants’ trading operations
- > **Generous provision of horizontal plenum spaces for relaxation**, but also sub-division of certain open spaces into smaller suites to reduce noise

It is not always easy to adapt older or smaller office buildings to meet these new requirements. The needs of the new breed of occupiers may compound an existing problem in Japan, where many buildings are very old and not compliant with the country’s strict anti-seismic standards. (This applies especially to Osaka, where 31% of buildings are non-compliant, based on data from the Japan Real Estate Institute.) For many developers in Japan, we think that demolition and redevelopment of older office stock is cheaper than other options, and more likely to attract new tenants at higher rents.

¹ Colliers International (2018): “Flex, Core and the Cloud: A Blueprint for the Future Asia Pacific Workplace”

NEW OCCUPATION PROFILES: IMPLICATIONS

New property environment

We may summarise the key points from the earlier sections of this report as follows:

- > **The technology and media sector and flexible workspace operators** have become increasingly important as occupier sectors in Asian cities
- > **This development mirrors global trends**, and in many cases is moving faster in Asia. The expansion of these sectors may slow, but is unlikely to reverse
- > **Flexibility, efficiency of space use and experience are key attributes of the modern workplace**. Occupiers in general, not solely flexible workspace operators, increasingly value these qualities

In our opinion, the chief implications of the new environment for the relationship between commercial property occupiers and owners are as follows:

- > **Occupiers in general are now in a strong position to demand shorter leases and greater investment in amenities in or around buildings**
- > **Flexible workspace groups are well-placed to partner with owners, who need to include a flexible element in building design and management plans**

We discuss these points in turn.

Occupiers can now make greater demands

A key factor behind the expansion of flexible workspace has been growing uncertainty about the future on the part of traditional tenants. Headcount needs have become increasingly difficult to predict in the financial sector in particular, where automation and artificial intelligence threaten to remove many jobs in back and middle office functions such as settlements, customer relationship management, accounting and compliance. However, similar circumstances apply to many other occupier sectors.



Occupiers are now in a position to request shorter lease lengths, greater investment in space fit-out, and longer rent-free periods

With headcount needs increasingly difficult to predict, it is no surprise that **lease lengths have fallen globally**. In the London office market, for example, according to Colliers data, the average lease length has fallen from 11.4 years in 1997 to 5.9 years in 2018, while the average time to the initial lease break has fallen from 6.8 years to 3.0 years over the same period. In both cases, Colliers expects the figures to fall further over the next few years.

Leases in Asia are typically shorter than in Europe or the US, at around three years. Nevertheless, big Asian cities face similar challenges to big western cities, so we see no reason for a period of three years to represent a floor.

Against this background, we believe that for occupiers are now better-placed than before to request:

- > **Shorter lease lengths**, since owners know that occupiers uncertain about their future space needs may not commit themselves otherwise
- > **Greater investment in space fit-out**, in order to offer a workplace to tenants that offers the appropriate level of experience. We consider this point further below
- > **Longer-rent free periods** as technology start-up and flexible workspace operator tenants build up their operations

As a consequence of the recent trends, we have concluded already¹ that **more active involvement is required in building management on the part of commercial property owners**, with largely passive investment strategies likely to prove less successful from now on. We expect that this situation will provide further impetus to value-added investment strategies.

Property owners have an incentive to agree

The new profiles of office occupation are likely to impose higher financial burdens on commercial property owners. We have seen that the expansion of the flexible workspace partly reflects success in creating experience, which is vital to staff retention for occupiers and tenant retention for landlords. Experience involves provision of, or access to, collaborative spaces, F&B facilities, and entertainment.

In certain markets, property owners are becoming expected to offer such amenities, increasing the cost of total project development. In Australia, for instance, landlords today are increasingly likely to provide event spaces, a suite of meeting rooms, wellness and F&B facilities in their buildings.

Australia is an example of a market where commercial landlords have traditionally provided high financial incentives to occupiers. In Asia, South Korea and Japan are similar: landlords here have historically preferred to increase rent-free periods in difficult times than to cut face rents.

In other markets, such as Hong Kong, property owners have traditionally been very unwilling to offer financial incentives to their tenants. Even in Hong Kong, however, we believe that forward-looking landlords will realise that times are changing, and that greater flexibility in dealing with their tenants is advisable.

We suspect that commercial owners in general will become more willing to offer open, collaborative event spaces, wellness and F&B facilities in their buildings. This concept can extend almost to the creation of a miniature village around large buildings. In this regard, we note that Mitsubishi Estate, backed by the largest land bank in the Marunouchi district, has created a network of multiple buildings in central Tokyo connected via underground streets complete with shops, cafes and izakaya-style bars. This business model ensures that the company can provide very high quality of service to its tenants and has helped drive progressive rent increases.

We think that such investment is necessary and likely to pay off. In the past, in most Asian cities, the dominant occupiers were large financial groups which were most concerned with proximity to clients, security concerns and specific building features such as large spaces for trading operations. They paid less attention to the ambient experience offered to their employees. However, in a world where the fastest-growing occupier sectors feature a high proportion of staff working in flexible locations with flexible hours, it is vital to create an environment which makes them want to stay.

¹ See our related report "Changing Dynamics: Implications of New Occupier Profiles for Property Owners" (7 March 2019).

Flexible workspace groups are well-placed to partner with owners

The expansion of flexible workspace operators has reflected both an increasing desire on the part of employees for a more collaborative and less formal workplace environment, and increasing use of flexible workspace by large occupier sectors, including both large financial groups and technology companies (in Asia as in the US).

For landlords and developers, this situation suggests the following:

- > In designs for office buildings, **some floors should be reserved for flexible workspace use**
- > Landlords can **either manage these floors themselves, or manage them in partnership** with flexible workspace operator tenants

Colliers refers to this sort of approach as the **“flex and core”** model. Under this model, an occupier signs up to office space on a long-term lease for its core business, together with flexible workspace to handle volatility in staff numbers. Variations revolve around how the core space is accommodated, either with an operator or directly with a traditional landlord. Cost savings can be achieved when a flexible workspace operator takes up a large floor space and passes a portion of the discount to the underlying tenant.

There is nothing to stop a property owner from adopting this model itself, without cooperation with a flexible workspace operator. Some landlords already host their own flexible workspace operations, for example Blueprint by Swire Properties in Hong Kong, and Ascendas-Singbridge in Singapore (due to be acquired by CapitaLand). Indeed, we think traditional landlords are well-placed to challenge flexible workspace operators on their own turf.

That said, other landlords will prefer to set up partnerships with flexible workspace operators to meet the needs of large tenants. This is partly because flexible workspace operators have more direct experience of the market, and partly because they are often more widely spread. In this regard, it is important for landlords to select the right flexible workspace operator partner. Certain buildings may require a premium flexible workspace operator, while for other buildings a basic operator may suffice.

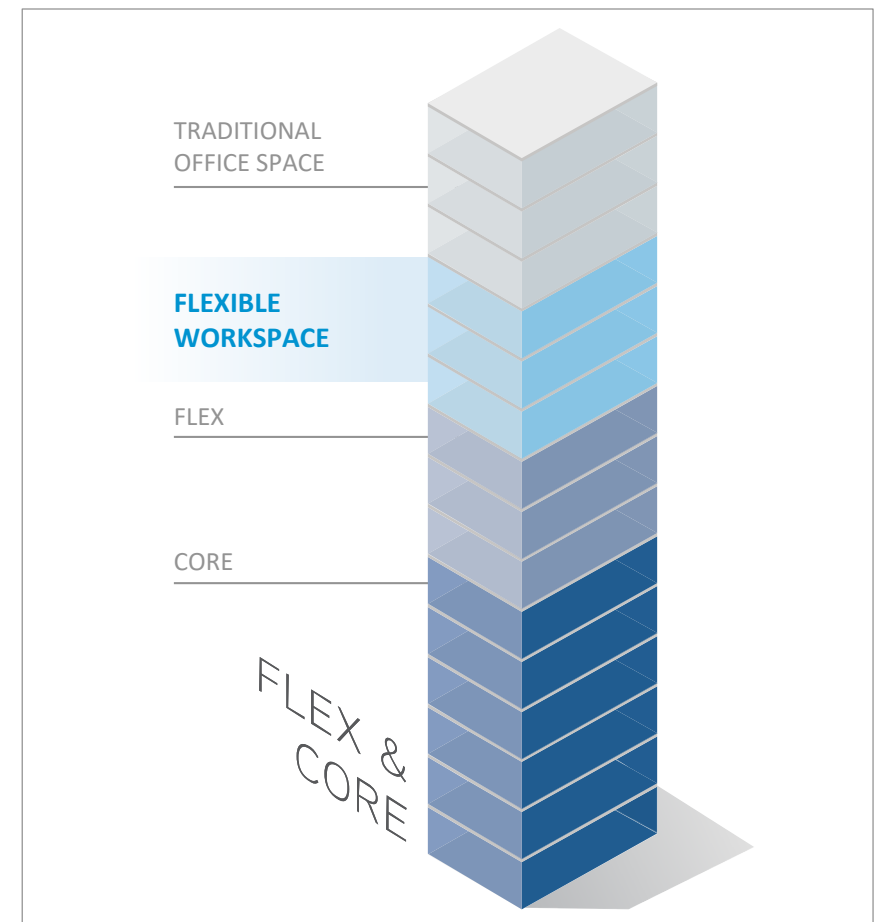
We encourage flexible workspace operators to pursue partnerships with landlords, and think they have a high chance of success. To generalise, flexible workspace operators are often more skilled at creating an ambience

or experience, while owners often have longer and deeper relations with specific tenant classes. Partnerships should help boost occupancy levels and rental income within buildings, which is in the interests of both sides. In recent discussions in the conservative Hong Kong market, we have been encouraged by the willingness of flexible workspace operators to seek to partner with property owners, and by owners’ willingness to reciprocate.



We encourage flexible workspace operators to seek partnerships with landlords, and think they have a high chance of success

Figure 7: The “flex and core” model



Source: Colliers International “The Flexible Workspace Outlook Report 2018 – APAC”

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