

# REAL INSIGHT

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## The Evolution of Coworking in Mid-Sized Markets

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### The National Trend: Coworking Office Inventory Continues to Expand Rapidly

The concept of coworking, or flexible office space with shared amenities, has emerged in the last few years as an important part of office tenants' strategic real estate process. Companies that are seeking to expand, downsize, or move are increasingly looking at the coworking environment as an option. Coworking's evolution has gone from a model built around start-ups and entrepreneurs to one that also serves mid-sized companies and large corporations. These large tenants see the incorporation of coworking spaces into their businesses as a way of giving their workforce what it desires: opportunities to remote in from a secondary office setting; amenity-rich and community-centric spaces; and the ability to convene in unconventional settings (such as converted retail, restaurant, or industrial spaces). At the same time, these largest users have begun to experiment with the concept as a way to expand their footprints across several markets while potentially saving money through the flexible terms that coworking operators typically provide. Coworking currently comprises 1.5% of the office inventory in the 12 largest metropolitan areas; mid-sized markets trail only slightly, with coworking operators occupying 1.3% of inventory. Nationally, coworking and flexible space occupancy has increased 95.0% in the past two years, driven by established operators including

Knotel, Industrious, and WeWork. For more details on the differences among these firms' models, and on the state of coworking nationally—including projected growth rates in 24 U.S. markets—please download NKF's recent study [The Future of Coworking and Flexible Office Space: Five Potential Paths](#).

In this still-evolving industry, one coworking subplot to keep an eye on in the months ahead is smaller, independent coworking companies beginning to merge to better compete with WeWork and other large operators. This scenario could take hold as coworking options continue to multiply, making it harder for operators to differentiate themselves not only from direct competitors but also from traditional office offerings. Smaller coworking companies could merge to gain leverage, or larger operators could acquire smaller ones to build market share.

### Featured Market: Cleveland

Tenant preferences suggest a significant opportunity for coworking operators to expand throughout the Midwest in the coming years. Todd Goldstein, CEO and Co-Founder of LaunchHouse—a growing community that was one of the first coworking companies to come to market in Cleveland—noted in an interview with NKF that many Midwest markets are challenged by population density. Goldstein's observations reflect why Cleveland and comparably-sized markets are one step behind gateway cities with regard to the expansion of

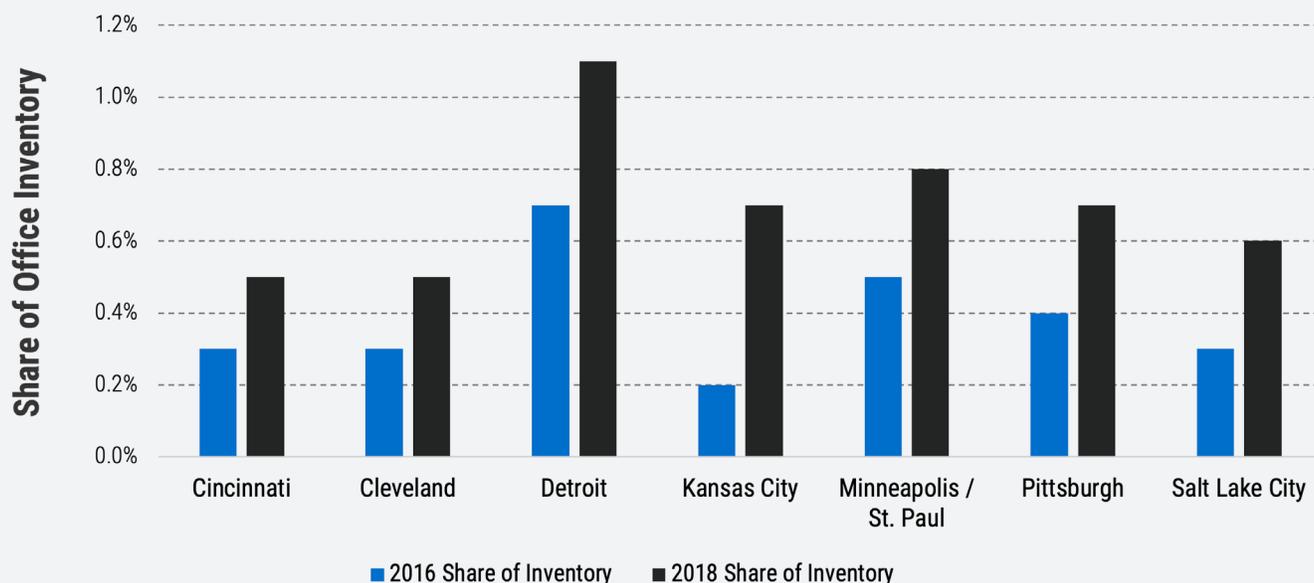
coworking—start-up founders and their employees are not in as close proximity as is typical in America’s larger markets. Notwithstanding a relatively modest 41.6% growth rate from 2016 to 2018, coworking and flexible office space concepts have generated a buzz throughout Greater Cleveland. Yet, national coworking leaders including WeWork and Industrious have yet to build a presence in Northeast Ohio—though it is widely believed that both of those firms are in the market for space. Some smaller, local operators—a group that includes Limelight, Midtown Tech Hive, and Beauty Shoppe—are gaining traction.

Currently, independent coworking operators are entering secondary markets by opening locations primarily in Central Business Districts while maintaining a small local or regional footprint. These smaller entities are generating buzz in Cleveland, perhaps serving as test cases for the larger coworking companies to consider. Cleveland’s coworking market has largely followed the national trend, in that most of the flexible spaces are in the CBD or the immediately adjacent and trendy neighborhoods, though the suburbs have been catching up. In fact, executive suite firm Regus—which does not focus on shared space but

often is grouped with flexible space providers—is Cleveland’s largest operator with 25.4% of the coworking market share. However, only 18.6% of Regus’s overall Greater Cleveland office footprint is located in the CBD. By contrast, local firm StartMart holds 17.7% of Cleveland’s coworking inventory, which is contained in one 35,000-square-foot CBD location. LaunchHouse comprises 4.4% of Cleveland’s coworking inventory through multiple small locations in Northeast Ohio. Overall, coworking encompasses just under 200,000 square feet of space across 31 locations within the Cleveland office market—0.5% of the total office inventory.

Comparatively, Salt Lake City, which has a population equal to 52% of Cleveland’s, has an office inventory that is nearly double that of Cleveland’s, and its coworking landscape is 0.6% of its overall inventory. (See the adjacent graph.) As in Cleveland, Regus currently is the largest operator in Salt Lake City, but WeWork likely will be a close second by the end of 2019. Other factors—such as share of millennials, strong venture funding, Silicon Slopes acting as an incubator for startup tech companies, and a relatively low cost of doing business compared to primary Western U.S. markets—all are indicators of a burgeoning coworking market.

## SHARE OF OFFICE INVENTORY IN MID-SIZED MARKETS THAT IS OCCUPIED BY COWORKING OPERATORS 2016 VS. 2018



Source: NKF Research; March 2019

## What Are the Implications for Our Clients?

LaunchHouse's Goldstein maintains that there are two main coworking lessons for the Midwest based on its experience thus far. First, coworking operators should temper their expectations when it comes to overall membership numbers, given market size. Second, they should expand their marketing to reach surrounding suburbs and rural areas, which may attract customers who are willing to drive to their coworking space. In fact, operators should consider monitoring the business goals of suburban municipalities' economic development departments, which have increasingly begun promoting coworking through entrepreneurial incentives as well as accelerator and incubator programs. Mixed-use developments in the suburbs also have created opportunities for coworking entities to gain traction in walkable and amenity-rich neighborhoods.

Some of Cleveland's large corporations are establishing satellite locations in traditional office settings as they test flexible space and their research and development

models. These companies also are expressing interest in coworking, which is encouraging traditional office asset owners to improve their amenities as a way to compete. Some of those asset owners also are developing their own flexible space programs. Tenants have spoken with their dollars that reduced overhead and flexible lease terms are important, and the market is responding in a variety of ways. Smaller markets may not have the population density of the gateway cities, but demand exists for flexible space. A similar transformation is occurring as in those gateway markets, albeit on a smaller scale. Nimble asset owners can take advantage of this evolution by arranging management agreements with coworking operators or creating their own in-house flexible space solutions.

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**Sources:** NKF Research, Newmark Grubb ACRES Research, *The Plain Dealer*, SIOR

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