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Shared Office Feasibility Report

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Executive Summary

PrimeCo is seeking to diversify their portfolio. PrimeCo has sustained considerable growth and now requires more real estate to meet capacity demands. PrimeCo's corporate strategy is to create a new venture which will vertically integrate the portion of their supply chain which is their corporate headquarters. This vertical integration will diversify PrimeCo's business by not just housing PrimeCo; but by expanding into real estate and property management as the new entity serves as a cowork facility. The vision of this enterprise is to foster and develop the local community and the businesses, startups, and entrepreneurs within.

An industry analysis was performed using the Porter's Five Forces and SWOT frameworks to analyze the market and to assess the feasibility of such a strategy. Included in this report is the analysis for those frameworks.

The analysis supports PrimeCo's strategic vision. A key determinant of success will be PrimeCo's ability to remain cognizant of the rapidly evolving industry and to make timely and meaningful adjustments to maintain market relevance. The historical double-digit growth which has been recorded over the past decade is destined to slow. The shared office leasing industry is still in the growth stage of its life cycle. Analyst predictions are a good indication, but it is not a guarantee. PrimeCo must be cognizant of their timelines to enter and read the terrain of the industry to ensure that the chosen approach is successful. Primary and secondary research has demonstrated that this is an enticing industry to enter, both on a global and domestic scale. Areas of key strategic importance are: market entry strategy, market trends, product and service differentiation, and location.

Introduction

PrimeCo is Construction Company specializing in condominium exterior renovations and improvements operates from a corporate office located in Oceanside, California. They concentrate their operations in all exterior improvements for the units which they service. PrimeCo's offerings include exterior: paint, carpentry, molding, and siding. PrimeCo has chiseled out a niche servicing the condominium market as opposed to renovations for single family dwellings or apartment buildings due to its ability to leverage their economies of scale and their skilled laborers across relevant trades to satisfy the demands of homeowners' associations and to service large complexes.

PrimeCo has grown substantially over the years and now is in need of a larger corporate office to house its support staff and serve as a base of operations for its many employees. PrimeCo's founder and CEO, Brett Musgrove, is interested in making the new facility a multi-use building. Instead of finding a location which is sufficient for PrimeCo's expanded operations, PrimeCo is seeking to create a new business in the serviced office leasing industry which would serve as PrimeCo's lessor as well as leasing to an array of other local businesses. This new venture would serve as an additional revenue stream, diversify PrimeCo's services and industries, and supply local small businesses with affordable and unique office space and amenities.

Objectives

1. Methodology

   The methodology section discusses the research approach and the analytical tools which were applied. It explains the rationale for the approach used and the reasoning for why each analytical tool was selected and applied.

2. Industry Analysis

   The industry analysis identifies the overarching industry and the industry which most accurately represents coworking. The analysis of both industries allows for comparisons to be drawn and for coworking to be specifically targeted using a combination of both.

3. Market Research

   This section identifies the specific regional market and the existing competitors therein. The market research also illuminates the target consumer segment by region within San Diego. This information will allow executives to identify where the market isn't over saturated. Once the target location is selected, this information can then be leveraged to appeal to consumers and develop a competitive strategy.

Methodology

Research for the scope of this project can be categorized into two silos; contextual and conformational. These silos were applied to industry, market, and target demographic research. Methodology for PrimeCo's feasibility of a cowork venture in San Diego was a composite of primary and secondary data. Before insights could be gleaned, familiarity with the related industries had to be established. Secondary data was used to establish context and overarching themes to each respective research field. Primary data was then used to support the findings of secondary data and to develop specific predictive models.

Academic articles and professional journals were compiled and scoured so that the aggregate results could be formulated into a contextual background. The context which was gained was on a global and national scale. Research could not acquire the granularity of state or county level research for the cowork phenomena. It was concluded that this is likely due to the young and secretive nature of coworking. Findings were extracted and used as overall guidelines and litmus tests for primary research. The goal of the primary research was to tap into the local industry and local market to validate the implications of secondary research. Primary research methods included: site visits, personal interviews, and price estimates.

Site visits proved critical to gain understanding of the shared office leasing industry as well as the specific industry niche of coworking. Local San Diego coworking offices were identified and targeted for primary research. Locations were visited and toured. Special observations were recorded regarding: occupancy levels, amenities and services, target market, location, building design, and events. These observations were made passively. Afterwards active inquiries were rendered in the form of personal interviews. Site coordinators were questioned to develop deeper understanding of the observations. These sources of quantitative and qualitative primary data

served to confirm the findings of the secondary industry research. Discrepancies highlighted local trends and preferences.

Secondary research about San Diego's economy and workforce was compiled and examined. Specific attention was paid to the distribution of various industries around San Diego County. Industry research demonstrated what industries and demographics find co-working to be appealing; with that in mind, geographic industry clusters were identified to highlight areas of opportunity.

Industry and Market Analysis

Industry analysis was performed to create a contextual understanding. Several industries were identified and considered as the target industry. Ultimately, two industries stood out as the most applicable. Commercial leasing was identified as the overall industry for coworking ventures and was included in the analysis because it serves as the primary alternative to co-working venues. The serviced office leasing industry was identified as the most relevant industry to coworking. However, serviced office leasing does contain executive suite leasing in addition to coworking. Once the industries were identified and thoroughly explored, the local market for coworking became of prime importance. The local market is comprised of competitive rivals. To best understand the nature of the business, it is important to understand the nature of the industry and the nature of the market's reaction to local consumer's demand.

Industry Analysis

Industry analysis was conducted on the commercial leasing and serviced office industries using Porter's 5 forces and SWOT frameworks. The commercial leasing industry was analyzed to give insight into the nature of office space leasing in a traditional setting and to establish a baseline for office space leasing. The next step in the research process was then to analyze the serviced office leasing industry. This approach was used because coworking is encompassed in both industries but comprises a relatively low percentage of each. This method allowed us to develop a composite industry analysis which would specifically target coworking as its focus. Coworking is in its infancy. Emerging in the 2010 in the wake of the financial turmoil caused by the 2007 recession. Coworking experienced double-digit growth through 2017. In the last year, the cowork phenomena has begun to slow to a growth rate of 5% and analysts predict this growth rate will continue for the next five years.

Commercial Leasing Industry

Commercial leasing is the overarching category for the niche industry of serviced office leasing. This industry includes: owner-lessor non-residential buildings, real estate rental firms, and companies which provide full-service office spaces. This industry notably excludes firms which offer warehousing, storage, and residential dwellings. The financial crisis of 2007-2008 heavily impacted this industry. This industry's recovery lagged behind that of the recovery of the overall economy. However, dwindling unemployment, increased consumer spending, and growing expendable consumer income has driven industry growth. Over the last 5 years, the commercial leasing industry has grown at a rate of 5.1% annually. Over the next 5 years, growth is expected to slow to an annual rate of 2.5% as demand for commercial real estate comes into balance with supply (Roth, 2018).

The commercial leasing industry faces high levels of competition. Barriers to entry are low. The largest barrier to entry for this industry is the high capital intensity requirements. The threat of substitutes is medium, as many individuals may opt out of traditional office spaces to work from home or the café. The bargaining power of suppliers is low to medium depending whether the companies operating in the space own or lease the buildings. The bargaining power of buyers fluctuates dependent upon the state of the economy. When inventory for real estate is high, the bargaining power of buyers is higher than it is when the inventory levels are low. This is further compounded by the fact that the inventory levels of real estate are often correlated to the overall health of the economy. Overall, this industry is in the mature life cycle stage and it is plagued with high levels of competition and volatility. Due to these factors, this is not the most attractive of industries to enter. The analysis of this industry and the rationale behind its performance will be addressed in greater detail below.

In the aftermath of the 2007-2008 financial crisis, surviving firms found that if they were to survive, they would have to keep overhead costs low and keep high levels of corporate agility. Economic recovery was astonishingly slow in the immediate 5-year period following the financial crisis. The next 5-year period saw increased growth and economic strength. However, specific to the commercial leasing industry, during the period 2012-2015 the industry's growth was slower than expected due to increased competition from e-commerce providers and online retailers. Due to the tenuous state of the economy, and specifically the commercial leasing industry, consumers of retail and office space are demanding more flexible lease terms. The flexible lease terms sought by firms ultimately allow these firms to maintain a higher level of corporate agility and to be able to respond much more quickly to industry and market changes. Increased demand for flexible lease terms has resulted in the commercial leasing industry to assume additional risk and serves to make the industry precarious. As nonresidential construction slows, the available inventory shrinks resulting in higher prices and lower bargaining power for buyers. As a result, many businesses have shifted to the rental market to maintain a competitive advantage and corporate agility.

Serviced Office Leasing Industry

Serviced office leasing is still a broad industry term which applies to companies such as "IWG/Regus" which procure space and offer furnished office suites, as well as coworking spaces such as "WeWork". The serviced office leasing industry is defined by IBISWorld as, "establishments in this industry rent or lease fully furnished office space to businesses on a part-time or as-needed basis to a myriad of businesses, ranging from startups to Fortune 500 companies. The industry also provides virtual office and conference room leasing options. Companies that provide conventional commercial leasing options are excluded from this

industry" (Rivera, 2017). While both of these models do accommodate emerging consumer trends, both companies approach these needs in a very different manner. Each major player in the serviced office leasing industry is seeking to differentiate itself to appeal to customers. Companies like IWG/Regus focus on offering individual executive suites. These are fully furnished offices which have a centralized secretary and complimentary services such as printers and fax machines. Companies such as WeWork take a starkly different approach by creating spaces which encourage coworking environments. Firms with coworking strategies offer a myriad of options and pricing strategies. Instead of offering only executive office suites, these firms provide offices, workstations, meeting rooms, conference rooms as well as support technologies and devices such as high-speed internet, printers, fax machines, and copiers. The benefit of cowork firms is twofold. The principal advantage is tiered pricing based upon individual demands. However, the second advantage offers the greatest opportunity for product differentiation. Firms in the coworking niche not only offer an array of spaces, but the true benefit is the ability to work next to interesting people across various industries. Effectively, these cowork spaces can provide networking opportunities and connections with new people with complimentary talents and services.

In response to emerging consumer trends and behaviors, a new niche industry has arisen from the traditional commercial leasing industry. The emerging industry is that of serviced office leasing. Firms which compete in this new industry offer their customers the ability to rent or lease fully-furnished and equipped office space on a part-time or as-needed basis. Services and amenities for this industry include: work-stations, offices, virtual offices, conference rooms, and meeting rooms. Many firms which compete within this industry perform key tasks and activities which entice consumers. One of these key activities is that the serviced office leasing firm incurs the

high capital expense to procure the space then design, renovate, and furnish the space to meet the needs of customers. The other key activity is that these firms also offer flexible leasing and rental options. Both core activities capitalize on these emerging consumer trends and behaviors.

Industry Segments

The industry offerings can be compartmentalized into three major segments. These segments are: serviced office spaces, virtual office services, and conference room services. The overwhelming drivers to this niche industry are: corporate profits, number of businesses, number of office rental vacancies, demand for services, and prime rate. Gone are the days of safe and lush corporate careers. Prompted by corporate instability, individuals seek to start their own companies to become masters of their own destiny. This trend serves to increase the number of small businesses as well as the overall number of businesses. The increase in new business activity and the demand for space for these new endeavors then creates a shortage of real estate and rental vacancies. In turn, this trend sparks growth in the serviced office leasing industry. In 2017, the serviced office industry saw a continued increase in revenue and profits from previous years with over $4.6 billion in U.S revenues, which in turn represented roughly $510 million recorded profits.

Overall, the industry has exhibited consistent growth from 2012-2017 of over 12%, with double digit growth in revenues dating back to 2010. “Over the five years to 2017, industry demand has grown strongly, supported by slowly recovering business activity, particularly entrepreneurial activity” (Rivera, 2017). Serviced office leasing industry is estimated to grow at nearly 6%, totaling industry annual projected revenues of over $6.1 billion by 2022. This outpaces the generalized commercial leasing industry growth of 2.5% by 3.5%. IBISWorld states that for the next 5 years the “number of industry enterprises is expected to grow at a steady annualized rate

of 2.7%" (IBISWorld). In a recent CBRE report titled, Americas Occupier Survey 2017, it was reported by 51% of respondents that they anticipated utilizing a shared workplace model in the next year (Lesserd, 2018).

The shared office leasing industry offers opportunity in times of economic distress and economic prosperity. During times of prosperity, businesses use cowork spaces to lower operating costs and to allow for gradual expansion into new regions or as temporary space as new facilities are being constructed. The caveat to this growth during prosperity is that once businesses reach sufficient size and performance, there is a risk that they will seek conventional offices spaces as they outgrow their shared office space.

Interestingly, during times of economic distress, shared office leasing doubles the pace of the rest of the industry. This phenomenon can be partially explained by the need to minimize operating costs during economic hardship. Maintaining low overhead costs and corporate agility is a business necessity in times of business hardship. The implications are that while coworking businesses grow during times of economic prosperity, cowork businesses face greater opportunity as a hedge against uncertain economic conditions. This is reinforced by the FirstResearch industry report. The report states, "Weak consumer confidence and challenging business environment translates to lower occupancy levels in office buildings, retail outlets, and industrial space" (FirstResearch, 2018).

In a perfect economy, price is always the variable to which all consumers are most sensitive. Realistically, there are numerous variables from which customers derive value. The driving components of the serviced office leasing industry are: location, price, amenities, and services. In many ways price is dictated by the regional market competition as well as the price of the region's substitutes. In order to set premium prices and attract customers, firms in this industry

must carefully select their locations and must differentiate their offerings and amenities to appeal to the demands of their potential customer base. Customers select cowork facilities because of the convenience to their homes or places of business and because they provide an atmosphere and set of amenities which increase their value beyond that of a comparable amount of square feet in another building. In a highly competitive industry landscape, it is paramount that the firms differentiate themselves successfully to add value to their tenants. This can be achieved through a combination of techniques, all of which revolve around three variables which have the greatest impact: price, location, and amenities. First Research Industry report states, "Managers that are able to keep both owners and tenants happy are more likely to achieve low vacancy rates and produce steady rental income" (FirstResearch, 2018).

Coworking facilities tend to be clustered in metropolitan areas for many reasons. Key contributing factors are: metropolitan real estate prices, density of potential customers, metropolitan business centers, and the diverse nature of metropolitan commerce and industry. California is ranked among the most appealing states for coworking endeavors. As metropolitan regions become saturated with cowork businesses and the demand for office space is satisfied, expansion in other regions becomes necessary. According to the San Diego Business Journal, optimal new cowork regions in the United States are: Austin, New York, Denver, and San Diego. (SDBJ, 2018) The shared work space industry appeals to a plethora of businesses. Evidence suggests that this niche industry has broad appeal. Key sectors which are highly represented in cowork are; finance, insurance, real estate, start-ups, marketing, and web development.

The serviced office industry offers three major products and services: virtual office services, serviced office spaces, and conference and meeting room services. All these offerings vary

depending upon the specific company and the target market demographic. Service offerings are highly diversified, operating at hourly, daily, monthly rental rates, and short-term lease options.

Porter's Five Forces Analysis

The Porter's Five Forces framework is an analysis framework intended to be applied to industries to provide a comprehensive analysis of the industry landscape. The Five Force framework helps to identify the attractiveness and ultimate profitability of an industry. The Porter's Five Force model focuses on five distinct areas for analysis: competitive rivalry, the bargaining power of buyers, the bargaining power of suppliers, the threat of barriers to entry, and the threat of substitutes. This model allows for an overall industry to be analyzed and evaluated. Ultimately, this framework can help executives to determine the attractiveness of an industry.

Michael Porter's Five Forces model of industry analysis was applied to the serviced office leasing niche industry to provide further insight into the nature of the industry and the firms which compete within that space. Porter's five force model serves as a comprehensive industry analysis tool which helps firms identify the attractiveness of a given industry. Each of the five forces are analyzed and rated as: low, medium, or high.

Competitive Rivalry: HIGH

Competition in this industry is high. Many firms compete within this industry to capture market share. Three main factors drive the competitive nature of the offerings of this industry: location, price, and amenities and services. These factors are leveraged by firms competing within the space to supply value to their customers and to differentiate their offerings from competitors and substitutes. The serviced office leasing industry is still in the growth stage of the industry life

cycle which results in ever increasing competition. Firms within this space have been racing to establish their companies through the development of multiple locations which offer the most value through appealing services and amenities. Ultimately growth has begun to slow as major competitors have emerged as dominant forces in the space. These leaders set the market expectation of offerings and value propositions which has increased competition and the difficulty of entering the industry. Industry growth is described by an IBISWorld industry report, "the Serviced Office Leasing industry experiences high and increasing levels of competition. Over the five years to 2017, the number of industry enterprises is expected to grow at a steady annualized rate of 2.7% to 6,757 companies" (Rivera, 2017).

The industry report shows a dominant market leader in IWG (Regus) with over 21% of market share. IWG is a major competitor in the serviced office leasing industry. However, the industry is segmented into two models: one which offers a traditional but temporary work environment, and the other that provides a more modern coworking environment. Firms such as IWG offer dedicated private offices which mimics a traditional executive office suite. A newer trend has emerged as the other modality which exists in this industry. This trend is that of "cowork" spaces. Firms such as WeWork offer a more diversified office experience, with services that range from: dedicated private office suites, dedicated desks in the common work space, hot desks in the common workspace, and use of facilities and amenities such as common spaces and conference rooms, as well various virtual office services.

The dominant force in the cowork space is WeWork Corporation which has emerged at the tip of the spear in this niche and sets the benchmark for competitors to follow. WeWork captures slightly over 4% of the serviced office leasing industry. IWG currently commands 5 times the market share within this industry. However, given the emergence of the cowork consumer trend

and its rapid growth, the division of market share is expected to shift. The outlook for WeWork and other cowork firms is positive as consumer awareness rises and as firms continue to open new locations and develop creative new amenities to entice consumers away from traditional office spaces and executive suites such as those offered by IWG.

IBISWorld industry report indicates that the selling point for consumers is the attractiveness of the ability to have a turn-key office compared to a traditional rent or buy office space which must then be set up and furnished. The IBISWorld industry report also states, "The location of a space is often equally important to customers interested in holding infrequent meetings in high-profile business districts and will likely accept a premium charge based on location and local property values". (IBISWorld) This iterates the importance of location for firms in the serviced office leasing industry. Not only does location determine convenience for consumers, it also creates value based upon the external environment of the location, and its proximity to workers and clients. It is expected that office space in a downtown metropolitan area will warrant premium pricing over an equivalent space in the suburbs where demand for space is lower. Factors which further add value to metropolitan locations go beyond the simple market price per square foot and extends into the intrinsic value of proximity to venues, points of interest, and proximity to workers and potential customers. Firms in this industry must diligently consider and design the amenities and services which it provides to differentiate themselves from competitors in the same general locations and to make their various locations more appealing to the markets it serves. This is how WeWork has become successful. Last year WeWork revenues totaled over $886 million yet reported loss of $933 million and still holds a valuation of approximately $20 billion with no shortage of investors willing to invest (WSJ).

Threat of New Entrants: MEDIUM

The threat of new entrants into the serviced office leasing industry is assessed at a medium level. The serviced office leasing industry is in the growth stage and increasing popularity has made this industry a very enticing one to enter. Many small companies are forming to try to enter this space in the market. Regulation around this industry is light which provides minimal legal and policy barriers to the industry. However, the model for shared office leasing is capital intensive. And the high capital requirements combined with a well-developed strategy for differentiation increases the difficulty to enter this industry. Firms trying to enter the industry find that developing a comprehensive strategy and then funding the venture proves to be capital intensive. Many small companies simply cannot afford to execute the necessary strategies which would serve to differentiate them from their rivals. The result is often a poor attempt to enter the market which leads to low rates of occupancy and struggling businesses. "IBISWorld estimates that depreciation costs account for 13.0% of the average company's revenue, indicating a high level of capital intensity. The costs of computers, video conferencing equipment, monitors and projectors, along with renovating floors, light fixtures and other amenities, can easily deter operators from entering the industry" (Rivera, 2017). The various factors create a composite rating of medium threat of new entrants to this industry.

Another element that moderates the threat of new entrants into the industry is the availability of land and building locations. Not only does real estate have high capital intensity, but there must be significant funding to float the business as the firm builds, remodels, and designs the work space. The construction process can be delayed for a myriad of reasons such as planning, permitting, political issues, or wildlife endangerment concerns. All these factors increase the risk for new entrants into the industry. Furthermore, once the new firm is operational, there is a time

delay between the firm's ability to function, and the firm's ability to acquire high occupancy levels to offset expenses. "Newcomers must compete with established existing players. IWG PLC, in particular, has managed to achieve a strong market share by quickly opening locations and absorbing the losses that these new spaces incur with income from more mature, profitable markets" (Rivera, 2017). Thus, incumbent firms have a significant advantage over emerging firms, even in new regions and markets. This is a major concern for new entrants to the industry, as industry incumbents such as WeWork, have the capacity, capital, and scalability to enter a new region in a meaningful way. These incumbents can bankroll the venture, often using financial means to expedite the various delays, and can afford to establish full strength offerings which provide services which are not diluted by financial strains. However, opportunity does still exist for small firms. "New companies may be able to cater to niche customers who only require a conference room or mobile workers who only need a small, one- or two-person suite." (IBISWorld) The opportunity which is greatest for new entrants to this industry is that of servicing niche consumers, and catering to a specific market demographic.

Threat of Substitutes: HIGH

The serviced office leasing industry is plagued by a high level of threat of substitutes. While there aren't many substitutes that offer a comprehensive blend of comparable services, there are still many alternatives which are cheaper and more easily achieved. These substitutes can include: traditional office space, home offices, or third-party spaces. Examples of third place spaces could be: libraries, cafes, and parks. Many of these substitutes are ostensibly less expensive, however they might not create the same value for the consumer. A true substitute is a good or service which satisfies the same consumer need and provides the same value for an equal or lesser price. Many traditional office suites are not of equal or lesser price to the offerings of

serviced office spaces and coworking business models. Furthermore, they often don't provide the comprehensive array of services and amenities which do provide value to the consumers. Even if a traditional office space has an equal or less expensive lease rate than a given shared office space, there are a myriad of associated costs which must also be considered. These costs include: furnishings, design, IT and technical services to establish infrastructure, and the downtime required to open a new office. Similarly, home offices are often much less expensive in the abstract. But practically speaking, a significant amount of capital would be required to derive the same value from a home office space.

Additional considerations would also be the cost associated with lack of productivity due to working from your home environment. Third place spaces do provide a very minimal set of requirements which can foster work; however, it is rarely possible to derive a high amount of value from a third place. To achieve the same value, one must often string together an array of third places along with several complementary businesses to mimic the value of a serviced office space. For example, if one were to work in a café, one would have access to internet and a chair. But if one needed to make a copy or to print, one would need to seek a separate business with print and copy services. In that example, if a call must be made, one must find a quiet and confidential place to hold such a call. And if one requires mail services, one must seek a P.O. Box at a post office or mail annex.

The economy is a key driver in the threat of substitution. As the economy underperforms, the demand for seemingly less expensive substitutes increases. As the economy flourishes, the need to save financial funding decreases. Over the last decade, the economy has transitioned out of a massive recession and is performing strongly. In the current economic state there is increased

business activity. This translates to an increase in entrepreneurship and lowering threat of substitutes as companies can afford office space.

Bargaining Power of Suppliers: LOW TO MEDIUM

The composite rating for the bargaining power of suppliers is low to medium. There are many supplier industries to the service office leasing industry. Suppliers to the serviced office leasing industry can be divided into two distinct categories, major suppliers and service suppliers. Major suppliers include: landowners, bankers and investors, furniture suppliers, electronics and technology suppliers, and office equipment suppliers. Service suppliers include: utility companies, commercial building contractors, software, and information technology companies. Landowners, bankers and investors, and utility providers have high levels of power over their products. However, land can be purchased which lowers supplier power of landowners. Other mitigating factors for the bargaining power of landowners is the array of building sites and the existing buildings which are candidates for renovations. Bankers and investors can often dictate the terms of the investment and loan that they provide the consumer. However, the larger the company and the more assets to borrow against, the lower the power of the finance suppliers.

The rest of the suppliers have a multitude of competing companies and compete heavily on price, so the various remaining suppliers are low to medium in their bargaining power. “Property management depends on the right team of vendors to perform various services, from landscaping and janitorial to systems engineering and renovations. A building manager may be required to coordinate the efforts of more than 35 separate vendors, according to global real estate company Colliers International. Having longstanding relationships with experienced, reliable, and cost-competitive vendors is vital to a successfully manage a commercial property (FirstResearch,

2018). Ultimately, the composite outlook for the bargaining power of suppliers ranges from low to medium, dependent upon a variety of variables.

Bargaining Power of Buyers: LOW TO MEDIUM

The composite rating for the bargaining power of buyers of the serviced office leasing industry is low to medium. There is a myriad of businesses which require office space and complimentary services offered by the serviced office industry. The prevalent sectors which consume the serviced office offerings tend to be: technology, creative (marketing, web development, and graphic designers), finance, insurance, and real estate. Due to the broad appeal to numerous sectors, the serviced office industry's buyers have low to medium bargaining power. Larger companies can leverage more power on firms in the serviced office industry due to their ability to purchase services and space in bulk. However, individuals and small companies have relatively little leverage to exert on this industry. Due to the broad appeal of this industry, there is no shortage of demand for services and space within the serviced office industry. Therefore, bargaining power of buyers is relatively low.

This demand is further fueled by the growth of e-commerce. "Growth in e-commerce has affected investment in retail spaces. As online shopping increases, the demand for physical stores decreases and the demand for distribution centers increases. Web sales have grown by about 15% or more each year since 2010, according to the US Commerce Department" (FirstResearch, 2018). The implications of the trend of expanding e-commerce are far reaching. As e-commerce grows as a sector, the demand for retail space diminishes, ultimately freeing retail space inventory which can be potentially repurposed for office space. Furthermore, e-commerce firms do not require sales associates and store managers. Instead, e-commerce requires personnel in:

web development, finance, accounting, and operations and logistics. These personnel can best be served in office space as opposed to retail space.

Market Research

The workplace has evolved significantly in living memory. The most significant changes have taken place in the last two decades and are largely caused by exponential technological advancements. Technology has extinguished the necessity for large work forces; which is especially true among intellectual services. A single piece of technology has the capacity to replace several distinct paid office positions which were required only 60 years ago. A smartphone has the ability to replace a secretary, an operator, and a file clerk. Extrapolate that trend to all other commonplace technology and one can see how prolific technology is and how much it has changed how people work. The speed, the ease of use, and the raw power of these technological tools has forever changed the way that business functions. While businesses have evolved, the physical workplace has not. The result is a mismatch between what businesses demand and what the market currently offers.

The 2007 recession served as a catalyst which essentially created the serviced office leasing industry. During those dire times, the market was forced to adapt to demand and began to supply a new business model for office space. Coworking businesses were able to bundle a productive and stimulating workplace with a diverse community of businesses which allowed for networking and the opportunity to find complementary services. Coworking facilities provide turnkey spaces for companies to rent. These spaces are wired with the latest technology and allow for higher efficiency rates because many of the older types of business need are shared and are therefore spread among the firms in the facility. An example of this sort of modern efficiency

would be a conference room. Historically, conference rooms have rarely been used to capacity. In the modern workplace, conference rooms are even less needed due to telecommuting, video conferencing, and myriad other remote communication options. The need for the space still exists but the demand has shifted downward. To lower overhead costs, many businesses would rather share a conference room with other companies and simply reserve it when it is needed. It is this sort of efficiency that coworking fosters with respect to work space.

Coworking is appealing beyond the ease of the turnkey space and various operating efficiencies, but also because as the requirements for manpower has diminished, so too has the sense of belonging and community in the corporate world. The modern workplace has grown increasingly isolated. Coworking allows employees to mingle amongst themselves as well as with employees of other companies. This provides intellectual and social stimulation which ultimately boosts productivity. This model is especially appealing to small enterprises.

San Diego is overwhelmingly comprised of small companies, many of which are in knowledge-based sectors. For this reason, the San Diego market for serviced office space is booming. According to the WSJ it is the fourth most attractive region in the United States for coworking. The San Diego Business Journal continues to cover the growing industry over the last several years and its applicability in the region. Matt Carlson of Vice President of CBRE Commercial real estate said, “demand for coworking space is ‘across the board’ throughout the county.” (Huard, 2018) Primary research comprised of site visits and interviews confirmed the assertions found in secondary research.

Market Demographics

The greater San Diego area is an attractive metropolitan area; host to a population of over 3 million residents and an array of industries. According to the San Diego Economic Development Corporation, San Diego has "one of the most diverse and dynamic economies in the country." San Diego is home to "six universities and more than 80 research institutes which conduct groundbreaking research, train the region's workforce, and provide a workforce and technology infrastructure that enables the region to compete for investment and jobs on a global level" (San Diego Regional EDC, 2018). The region's economy is heavily knowledge based across a multitude of innovation-oriented industries. San Diego has leveraged this knowledge-based population, economy, and infrastructure to become one of the high-tech hubs in the nation.

The highly diversified nature of San Diego's economy has enabled the region to cultivate a conducive environment for San Diego to become a hub for a plethora of industries. This has attracted highly skilled, well educated, and technically proficient individuals to the region over the last few decades. As this pattern has propagated itself, the workforce and the region's population, has become more youthful. Older stodgy industries and their subsequent workforces have moved their operations to more affordable locations, ultimately leaving San Diego as a hotspot for youthful and knowledge-based workers.

Analysis of the 2016 U.S. Census data provides statistical evidence which validate the regions demographic trends. San Diego County ranks number one in the nation for population between the ages of 18 to 24. The 18 to 24 age bracket accounts for 27.1% of the overall population. The San Diego region's median age is ranked 5th overall lowest in the nation, with a median age of

35.7 years of age (San Diego Regional EDC, 2018). The San Diego region mean travel time is 26 minutes which ranks 2nd highest in the nation (US Census, 2016). Myriad factors contribute to the high commute times observed in San Diego. A combination of high cost of living, military presence, geographic dispersion, and population density all contribute to the high travel times observed within the region. The high cost of living often pushes residents to move far from their place of work to find affordable accommodations. This is especially true of the military whose pay is well below the region's standards. This ultimately causes members of the military to reside far from where they are posted. In many cases, military members live in bordering counties and commute into San Diego to compensate for the high cost of living. The greater San Diego region has seen the lowest unemployment rate in 17 years of 3.3% (San Diego Regional EDC, 2018).

The region outperforms both the national and California unemployment rates which are at 4.5% and 4.4% respectively (San Diego Regional EDC, 2018). This has catapulted the region to the top 10 metropolitan areas ranked in the nation for the lowest unemployment rate. San Diego holds the 7th place position in rankings of unemployment. This is a sign that existing businesses are growing as well as a good indication for new business growth and development. Another key indicator is the 12-month average for monthly newly established businesses which is currently at 3,274 across 473 industries. This is reinforced through San Diego's Economic Development Council's February 2018 Economic Snapshot that shows consistent job growth and an overall increase of 1.5% from 2017. San Diego's median household income is $70,800 annually; ranked 9th in the United States. These income figures are higher than the national average due to the cost of living in San Diego, as well as, the higher education levels of its population. 37.4% of

San Diegans have at least a bachelor's degree, 14 percent have a graduate degree, and 2% have a PhD. The college graduates in San Diego are overwhelming graduates in engineering and science fields with a combined total of 42%. San Diego's percentage of scientists and engineers rank 4th in the United States further substantiating the assertions that the region's population is well educated, and the region's economy is knowledge based and technical (San Diego Regional EDC, 2018).

San Diego's economy has demonstrated significant progress in the last year, as the unemployment rate fell 0.7% to a 17-year low of 3.3%. In the last month, the unemployment rate of the greater San Diego region grew .01% to 3.5% overall. The north county 78 freeway corridor cities demonstrate slightly above the regional average in terms of unemployment. The cities along the 78 corridor demonstrate unemployment rates as follows: Oceanside is 3.6%, Vista's is 3.8%, Escondido is 3.4%, and Carlsbad is 3.3%. Unemployment rates fluctuate frequently and are highly reliant upon the driving industries for the region. Discrepancies in the unemployment rate among those cities could reflect the various industry activities within each city, especially as many industries seem concentrated to cities in the north county region (San Diego Regional EDC, 2018).

Office Space Leasing Performance

Office and industrial space in the region have demonstrated post-recession records. Lower vacancy rates and increased new construction are indicators of a growing economy, stimulated by low unemployment and increased job growth. There is a strong correlation between jobs growth and low unemployment, and increased demand for workspace. The most recent figures

from the SDEDC show that the vacancy rate in the office market is at 11.3%, which could appear high. However, with so much new construction, 349k sq. /ft. in the last quarter alone, ultimately, the new construction could be biasing the statistics for office space occupancy. (SDEDC). Projections for new construction predict an upward trajectory regarding office space. This is an indication that business growth will continue as businesses are established within the region. The SDEDC also reported that the region's average price per square foot for office space is $2.90 FSG (Full Sale Gross). However, highly desirable regions and locations see significant fluctuations as the office space moves towards the ocean, downtown, or business hubs (Carlsbad, Rancho Bernardo, Poway, etc.). Industrial space is a different market which is not applicable for this study; however, it is worth mentioning that this market has seen post-recession records. The SDEDC reported that the vacancy rate is a mere 4.9% and there has been over 3.5 million square feet of new construction in the industrial sector. These numbers are signals that reinforce economic, business, and job growth throughout the region. The office space market and the industrial space market have both experienced a dip in lease rates from $1.43 per square foot for a high-finish lease and as low as $0.90 per square foot for a low-finish lease (San Diego Regional EDC, 2018).

Key economic metrics demonstrate that San Diego's economy has grown steadily in recent years. The economic growth has stimulated the region's business activity; resulting in new ventures and existing companies to seek out operations within San Diego. The increased business activity has driven demand for workspaces. Workspace can be divided into three major categories: retail, office, and industrial. Currently vacancy rates in the region are much lower for industrial and retail spaces, with office vacancy rates nearly tripling the vacancy rates of the

other categories. This statistic, taken out of context, could be quite alarming. However, there are many contributing factors which have caused this to be the case. The largest factor that has contributed to the high office space vacancy rates is the evolving workplace. Primary and secondary research has indicated that the modern business has evolved but that many office spaces have not.

The surge of highly technical millennials into the workplace has changed the way that business is conducted; thus, changing the requirements of an office space. Gone are the needs of physical document storage, or row after row of secretary. The modern worker has replaced manual labor and physical infrastructure with technology. This shift has increased efficiency and reduced the need for large offices. This shift has been happening for the last two decades. However, new cloud-based technologies combined with a new workforce has accelerated the speed of this shift. In San Diego the shift from traditional office space to modern office space is more pronounced because of the youthful and technically oriented nature of the region's workforce.

Office Space Leasing Demand

Demand for traditional office space has declined, yet the need for offices has not. This is especially true in San Diego. If traditional office space does not satisfy the consumer's needs, what will? One of the industry's answers to that question is serviced office space. Serviced office space is ideal for many small and medium sized firms. It allows companies to share the risk and overhead of the space with their neighbors, ultimately increasing profit margins and corporate agility. Serviced office spaces can range from modernized executive suites to coworking environments. Coworking environments have proven to be particularly attractive to the modern

worker. The rationale behind this trend is that because the modern worker is more efficient than ever, the need for a large workforce has been diminished. Many services have been outsourced or simply replaced by software. Ultimately, this leaves behind a skeletal crew of employees within smaller firms. While this meets the needs of the corporation, it does not foster a robust community at the office. People spend more time at work than they do at home with friends or family, so the need for social engagement is high. Coworking allows several companies to operate under the same roof, and to share communal spaces. This allows corporations to reduce overhead, and still provides social interaction opportunities for the workforce. Furthermore, it allows firms to collaborate and network with companies in other industries which ultimately stimulates the business and the employees.

Coworking has been identified as highly attractive to the San Diego region. The reasoning behind this assertion is because of the nature of San Diego's economy. The local economy has a basis of technology, creative work, and innovative industries. The workforce which supplies these industries is highly educated, technologically savvy, youthful, and creative. The major industries which exist within San Diego are mostly innovation based, and benefit from the coworking model. Many of these firms are small and comprised of highly skilled individuals who have little need for large corporate complexes. Instead, there is a high demand for workspace close to the worker's homes which promotes productivity and community. Primary research has reinforced that the young modern worker has expectations about quality of life that traditional workers were not concerned about. These expectations include work life balance, sense of community, and engagement. As larger corporate operations dwindle, coworking offices

allow modern companies to foster the sense of community and engagement that millennial workers view as intangible job benefits.

According Brett Ward, an executive managing director at Cushman & Wakefield, cowork office space is projected to cap at 5% of the total office space in the region (Lessard, 2018). The total accessible market of office space in San Diego is approximately 77 million square feet. Applying the 5% projected office space cap for cowork to the total region's 77 million square feet gives a theoretical cowork market cap of 3.85 million square feet. Currently the SDBJ reports that coworking accounts for 1.2 million square feet of office space which is 1.56% of the total accessible market. The greater San Diego region bears an average fully serviced gross (FSG) per square foot price of $2.90. The total accessible market of all office space in the region calculates to an average of $223,300,000 monthly revenue. The coworking office space monthly revenue is estimated at $3,480,000 monthly averaged across all of San Diego County. The projected growth potential for cowork office space in San Diego is 3.44% of the total accessible market which equates to another 2.65 million square feet. The projected revenue based upon this growth would be an additional 7,681,000 monthly. A CoWorker.com survey reported that, "57 percent of coworking space owners plan to open new locations within the next year." This figure is in line with primary research conducted within the San Diego region. This demonstrates that the serviced office space industry has recognized the potential in San Diego and efforts are being made to capitalize on the prime market.

Office Space Outlook

A potential outcome of the cowork office space movement is that companies which started in cowork environments might soon achieve significant size and require private office spaces to accommodate their changing demands. This is an element of risk for the serviced office space industry. The predicting factors which determines whether new businesses will occupy the newly available cowork space is the state of the economy, and the desirability of each cowork firm to potential clients.

The market entry strategy is a critical component to the success of cowork companies. Cowork spaces must compete with a variety of substitutes which range from traditional office spaces, serviced office executive suites, and home offices. To attract consumers to the firm's operations, cowork companies must differentiate themselves from their substitutes and their rivals to maximize the values that they can provide. To successfully develop a market entry strategy, the firm must select a location and then identify the needs of the consumers in that region. To best identify the needs of the consumers, the cowork venture must look at the demographics of the workers who live in the area as well as the industries which are prevalent in the immediate community to ensure maximum applicability to local workers and businesses. If there are several desirable demographics or industries, then the coworking space should perform a cost benefit analysis to determine which market to target. It is critically important to recognize the market demographics of the immediate area to the facility and to maximize the appeal based upon these findings. As cowork firms expand operations in the area, the market becomes more saturated and the task of differentiated products, services, and offerings becomes harder and harder to achieve. A timely market entry within the next year will ensure that a new venture will be fully

operational while serviced office industry and cowork office spaces are in the growth phase of their life cycle allowing for a strong market entry. Due to the lack of barriers to entry, failure to act quickly could jeopardize the outlook of such a venture because new locations and companies within the market can materialize within a matter of months.

Many of the competitors within the cowork market space are attracted to opening locations in metropolitan areas. This is due to the population and business densities. According to Cushman and Wakefield executive Matt Carlson, "The hottest spot is downtown. It's more urban and dense. You're more likely to set up a coworking spot close to where people can walk to their homes" (Lessard, 2018). Carlson goes on to say that currently, demand is across the board in the San Diego region, but that downtown can support larger and more numerous operations. Primary research underscores this assertion. For example, Common Grounds coworking enterprise is expanding into downtown San Diego, San Jose, Denver, and Long Beach within the year. Union Cowork recently opened their operation in Encinitas in addition to their existing locations in East Village, Glendora, and their two existing locations in North Park. The Block is a new cowork venture currently under construction and is scheduled to open this year in Carlsbad. Currently, there is a void of cowork businesses in Oceanside. This is likely due to the distinctive demographics of Oceanside and the distinctive differentiation strategy required to be successful in the area.

The city of Oceanside and their economic development department identifies manufacturing, distribution, tourism, and agriculture as the major economic drivers of its economy. However, in recent years biotech has been the fastest growing industry in Oceanside. There is a scarcity of

cowork business in Oceanside. This may be due to the types of industries and businesses which are prevalent in the city. There is a possibility of capturing the relatively small percentage of Oceanside businesses which are traditionally attracted to cowork establishments such as: finance, insurance, real estate, web development, marketing, or other creative businesses. However, that is a small piece of Oceanside's economy. A stronger strategy would be to target and market to a larger segment of Oceanside's economy. Examples might include, marketing to the office space needs of Oceanside's tourism sector.

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