

# Briefing note

## Flexible workspaces in Germany: where next?

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We believe flexible workspaces have the potential to fundamentally change office markets. Here, we outline why we believe this and how the office world of tomorrow might look via five theses.

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In our research "[Flexible workspaces in Germany: taking stock](#)", we examined the beginnings of the flexible office segment and outlined the current landscape for flexible workspaces in Germany. However, since momentum in the segment is so great that the landscape changes on practically a weekly basis, the other question that poses itself is: where is this leading? This is the precise question we aim to address here, using five theses to take a glimpse into the future. While we cannot predict the future, of course, our theses depict a scenario that we believe has a high probability of occurrence going forward. It is our aim to produce a contribution to the discussion that enriches the debate and can serve as a basis for the strategic decisions of office market participants. Our theses can only cast a spotlight on selected aspects of this landscape and many other elements remain beyond their scope. Nevertheless, the theses build upon each other and should dovetail to create an overall picture that could more or less become a reality.

### Thesis 1: Flexible workspaces are here to stay

While we consider this a low-risk thesis, it is not a consensus view. However, we believe flexible workspaces are more than a temporary phenomenon and are establishing

themselves as an integral part of the office market. Strictly speaking, they have long since achieved this as flexible office spaces have existed in various forms for at least thirty years. The current growth in the segment may also be a result of the healthy economy and many other temporary impulses (see Thesis 2), but it is not solely attributable to these factors. Structural changes are also lending impetus to flexible workspaces and, indeed, have facilitated their recent expansion.

The fact that more and more people can carry out their work wherever they wish from has played a pivotal role in the emergence of flexible workspaces. This has fundamentally impacted requirements for corporate offices. Previously, these were the only places where a company's personnel could carry out their desk-based work, essentially giving such offices a monopoly status. Today, however, personnel are asking themselves where they can work most effectively. Flexible workspaces are a possible solution for these and all other people who require a desk for work purposes. The evidence to date suggests, in our opinion, that such solutions may not appeal to everybody but do appeal to a large proportion of people.

Hence, technological advances have undermined the monopoly of traditional corporate offices and there is no going back. On the contrary, technological change will help flexible workspaces to achieve further growth

since technology is causing office space requirements to change faster than providers in the traditional office lettings market can respond. This is due, on the one hand, to the fact that their 'office space' product is limited in its adaptability. On the other hand, many owners of office properties have no direct contact whatsoever with their occupiers and are represented by intermediaries such as asset managers. Under these conditions, it is difficult to respond swiftly to changing occupier requirements. Consequently, the discrepancy between what the market is offering and the nature of the demand has grown wider and will only continue to widen for the foreseeable future. Providers of flexible workspaces fill precisely this growing chasm and will, therefore, secure a permanent position in the office market.

### Thesis 2: Supply and demand will continue their rapid growth for a few more years before the market has a shake-out

This thesis, too, is proposed with a high degree of confidence that it will become a reality. A glance at major cities in the USA or London suggests that the supply of flexible workspaces in Germany will continue its rapid growth. Flexible workspaces now account for 4% of London's total office stock and this percentage

is set to increase further. In the major German office markets, the corresponding figure is just 1%.

However, it is not only this numerical comparison that promises a growing supply but also fundamental features of this market. One such feature is the market's low barrier to entry. Besides appropriate space and a few desks, it does not take much to open a flexible workspace. That being the case, many additional new players are still likely to enter the market, including property investors and hotel or restaurant chains, all of whom already own space suitable for flexible workspaces and for whom, consequently, entering the market is even easier.

Another feature of the market for flexible workspaces is that larger providers have advantages over smaller rivals. Economies of scale play a part. However, even more important is the fact that, the larger a provider, the more benefits there are for its users. The more spaces a provider operates, for instance, the more attractive the provider is to users requiring workspace in more than one location. Furthermore, flexible workspaces are also social networks whose value increases with each additional member. Hence, size is an asset in itself and each additional space a provider opens enhances the value of all the existing spaces.

This combination of low barriers to entry and network effects guarantees further growth as well as a shake-out in the market. Since size is an asset in itself, growth is likely to take precedence over profitability for many providers, meaning that the supply is almost inevitably likely to grow until it exceeds demand. The risk of oversupply is further increased by the fact that demand is being driven not only by structural changes but also by temporary effects. It is evident, for instance, that many companies are experimenting with flexible workspaces and gathering experiences. Not all of these companies will use flexible workspaces for the long term. Hence, a portion of the demand attributable to such companies will cease sooner or later. Another factor spurring on demand for flexible workspaces is that co-working is cool. Companies wishing to benefit from this coolness factor are booking a few desks in a co-working space or at least holding their

next corporate event in such a space. However, the coolness factor will also disappear and with it some of the demand for flexible workspaces.

When the portion of demand attributable to these and other temporary effects fades away, providers with less resilient business models will cease to operate or will be acquired by competitors. The profitability of operators could also be threatened by players that offer their customers flexible workspaces as an additional service without wishing to directly profit from them. These include restaurant and hotel chains, for example.

### **Thesis 3: Flexible workspaces will go from the exception to the rule in the small office segment**

This thesis has its origin in a quite fundamental question: why do companies agree long-term leases for office space at all? From an economic perspective, it could be argued that they do this because transaction costs in the office market are very high. These include searching for suitable space, lease negotiations with the landlord, agent's commission, relocation and, where applicable, fit-out and furnishing of the space. With such high transaction costs, it would simply be uneconomical in most cases to agree a lease for only one year, for instance.

Flexible workspaces are changing this since certain aspects of the transaction costs can potentially be omitted (fit-out and furnishing costs and agent's commission) or at least reduced (costs of searching for space and agreeing a contract). And, as transaction costs fall, so the justification for agreeing long-term leases is diminished to the same degree. The smaller the requirement, the greater the effect in this regard since some transaction cost items are fixed or are not directly proportional to floor area. In other words, the transaction costs for an office measuring 200 sq m are relatively higher than those for 1,000 sq m of space. Hence, besides all their other advantages, flexible workspaces are financially attractive, especially for smaller occupiers. In this respect, we assume flexible workspaces will

absorb a large proportion of demand in the small office segment in particular. Very small office requirements for up to ten personnel will likely only find their way into the traditional office lettings market in exceptional cases. For freelancers, start-ups and other micro-companies with a large degree of uncertainty in terms of planning, besides the lower transaction costs, flexibility in terms of both time and space makes a strong argument for flexible workspaces.

### **Thesis 4: Flexible workspaces will become an integral part of the real estate strategies of large companies**

Transaction costs also play a part in our fourth thesis. Small offices are not exclusively sought after by small companies. Large corporates also need such offices in cities where they have only a small team, for example, or where they prefer to distribute their personnel across several smaller offices for strategic reasons. Owing to their lower transaction costs, flexible workspaces are also at an advantage here, as they are for such occupiers with time-restricted requirements for space for individual projects or as interim space, for instance. Certain requirements of large companies can, therefore, be better satisfied by flexible workspaces than by the traditional office lettings market. It is for these very requirements that corporates will use flexible workspaces.

However, yet further reasons can be deduced to support the thesis that flexible workspaces will become an integral part of the real estate strategies of large companies. One such reason originates from our explanations under Thesis 1. If there are people for whom flexible workspaces represent a better working environment than traditional company offices, then flexible workspaces will become a tool for attracting and retaining personnel. A further reason is that, by using flexible workspaces, companies gain access to the associated networks. Companies might seek access to such networks for various reasons, whether to co-operate with their members, to enter into exchanges that promote innovation or to sell their own products.

These few examples alone illustrate that flexible workspaces are far more than simply workspaces that lend themselves to flexible use. As such, they are likely to become an integral component in the strategic toolbox of large companies. The fact that they can also be used for other purposes, thus making them a Swiss Army knife of sorts in this toolbox, only increases the probability that our thesis will prove accurate.

### **Thesis 5: Office space will become a mass product with low margins**

This thesis is without doubt the boldest and, in its succinct formulation, does

not nearly do justice to the complexity behind it. However, the previous theses are likely to have made one thing clear. Providers of flexible workspaces satisfy far more requirements than “simple” office space. They use the basic office space merely as a vehicle. Unlike with owners of office property, however, it is not their product. Their products are office workspaces in the broadest sense as well as workspace-related services and access to networks. To use an analogy with the computer industry, it could be said that providers of flexible workspaces are delivering compatible software for the hardware that is office space. This extends the value chain and, since office space is then only part of the value creation process, it will become more replaceable. And, as the replaceability

of office space increases, the margins achievable on its sale or letting will decrease in direct proportion. In today’s world, where developers build office buildings, investors buy them and let them and flexible workspace providers operate them, income in the office market will be redirected in favour of the latter.

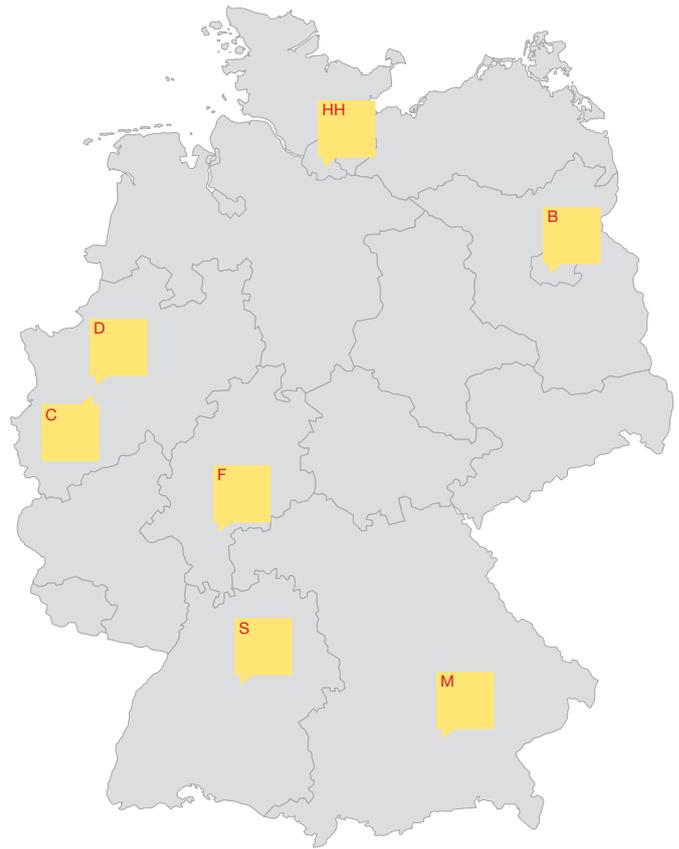
Some developers and landlords are responding to this by establishing their own flexible workspace platforms, acquiring an interest in existing providers or entering into co-operations with them. They have already recognised that flexible workspaces have the potential to fundamentally change office markets.

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