This report looks at the current market landscape of co-working spaces in Hong Kong , landlords' reaction towards the slowdown of the co-working industry, and the market opportunities amid considerable uncertainty.

Knight Frank

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Landlord-operated co-working spaces

An upcoming trend?

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THE CO-WORKING LANDSCAPE

Over the past decade, we have witnessed a massive rise in the number of co-working space operators in Hong Kong. International operators such as WeWork and Regus, and players from Mainland China such as the Beijing-based Ucommune and Kr Space have expanded rapidly in the market. Many took the opportunity to serve the growing market of start-ups, small businesses and freelancers, who appreciate more flexible commercial terms and require a smaller footprint. Over time, the belief that co-working space operators will disrupt the office space sector has encouraged an influx of capital investment to the co-working space sector, fuelling its growth in the past few years.

The asset-heavy business model, coupled with intense competition, was ultimately exacerbated by US-China trade tension, social unrest in Hong Kong, and the COVID-19 pandemic.

However, the proliferation of co-working operators quickly slowed down in recent years, resulting in a rising number of operators reported to be in financial trouble because of over expansion and, in some cases, mismanagement. The aggressive growth, typically driven by a chase for company valuation rather than actual demand, motivated many operators to sign long-term leases at unprecedented prices. For instance, Mainland co-working provider Kr Space signed a 10-year lease with Chinachem for an 83,000-sq ft-space at One Hennessy in Wan Chai in May 2018 for over HK$7 million per month, or HK$90 per sq ft. It was originally planned to be Kr Space's first flagship centre outside Mainland China. But the cash-strapped operator eventually surrendered the lease in April 2019, citing a tough operating environment in Hong Kong.

The asset-heavy business model, characterised by high initial capex requirements and long leases, coupled with intense competition in the crowded industry, was ultimately exacerbated by US-China trade tension, social unrest in Hong Kong, and the COVID-19 pandemic. In their struggle to stay afloat, some of the biggest co-working space operators scaled back their presence in Hong Kong. For instance, WeWork returned about 30% of its Hong Kong premises to their owners, surrendering up to 450,000 sq ft. Campfire contracted from 13 centres to two, returning approximately 115,000 sq ft. And WorkTech, embroiled in management controversies, and Kr Space retreated completely from the Hong Kong market.

Lease surrender cases of major co-working space operators (since 2019)

	Location	District	Size (sq ft)
WeWork	H Code	Central	100,000
	Generali Tower	Wan Chai	67,000
	Hopewell Centre	Wan Chai	60,000
	Hysan Place	Causeway Bay	32,000
	Sun Life Tower	Tsim Sha Tsui	150,000
	Octa Tower	Kowloon Bay	50,000
Kr Space	The Centre	Central	44,000
	One Hennessy	Wan Chai	83,000
	Times Square	Causeway Bay	54,000
	K11 Atelier	Tsim Sha Tsui	23,000
Campfire	V-Point	Causeway Bay	38,000
	Harbourfront Landmark	Hung Hom	77,000

Source: Knight Frank Research

LANDLORDS' REACTION

The debacle in the co-working space industry has left some landlords with a significant amount of surrendered space, typically in large floor plates, adding to the pressure from a leasing market that was already slowing down. However, this has allowed some opportunistic landlords to capitalising on the vacant space.

A number of landlords responded proactively by either operating the space themselves or forming joint ventures with established operators. For example, landlord of V-Point in Causeway Bay, established V-Co to self-operate the facility after Campfire walked away from a planned nine-floor centre in the building; China Resources has been operating the co-working space in China Resources Building in Wan Chai since its previous tenant, Regus, moved out; and recently, Henderson Land has transformed the abandoned space in H Code, Central that was surrendered by WeWorks to its own operated co-working space CodeWorks.

In these cases, the landlords not only save fitting-out costs for office space when the co-working operators moved out; they also received rental revenue rather than potentially leaving the space vacant. Inheriting this surrendered space may turn out to be a golden opportunity for landlords to experiment with a new offering to their tenants, putting them at the forefront of the co-working and flexible work space trend.

Though it is still uncommon in Hong Kong, we have seen landlords incorporating co-working space into their group business by forming partnerships with co-working space companies. These partnerships usually come in the form of joint ventures, in which both parties operate the co-working space together; or through revenue-sharing arrangements, in which the landlord outsources the operation of the flexible workspace to the operator and takes a share of the latter's income, while retaining control of the assets. An example of this is a joint venture formed by a local developer with a UK-based co-working space operator to run one of the spaces surrendered by WeWork.

In fact, landlords foray into the co-working sphere as operators is not something new in Hong Kong. A pioneer of this blueprint was a 30,000-sq ft co-working space in Taikoo Place, developed and operated by Swire Properties since 2017. Other examples include Mustard Seed, Emperor Group's first co-working space, launched in mid-2017; and Eaton Club, of Great Eagle Group, which now has several locations across Hong Kong in Central, Wan Chai and Kowloon. The aim of these real estate developers is to leverage their extensive network of corporate tenants to tap into the flexible workspace market.

AN OPPORTUNITY FOR LANDLORDS

Although minimizing short-term losses may be the obvious reason landlords are jumping into the co-working space game, there are several other strategic objectives for landlords that are worth considering.

The COVID-19 pandemic has proven some of the concepts that co-working operators have been preaching for years. To begin, it has shown that agility is a significant driver for co-working space users. Co-working space allows companies to react swiftly to changing markets by expanding, contracting or relocating their workforce as needed. These will be important factors when choosing office space in the future.

It is also evident that the number of start-ups is on the rise, in comparison to large enterprises. According to an annual survey done by InvestHK, there were over 3,184 start-ups in Hong Kong in 2019, up by 22% YoY, and up 42.8% over the 2017 figure. In 2019, start-ups in Hong Kong had 12,478 employees (+31% YoY) in 92 co-working spaces. This means that demand for smaller, agile workspace solutions will continue to rise too.

LANDLORD-OPERATED CO-WORKING SPACES: THE NEXT BIG THING?

For landlords, having their own co-working space brand and self-operating the space enables them to serve their tenants in a more bespoke way and provide a wider range of services to their tenants. Landlords can also offer the shared facilities in their co-working spaces to other tenants in their portfolio, creating a community and thus synergies among tenants. This combination can increase the appeal of, and demand for, their properties, which will eventually increase the value of their assets.

Although the concept of flexibility is not new to Hong Kong landlords, since most of them were already willing to lease smaller spaces with shorter terms, this presents landlords with an opportunity to innovate further.

Specifically, self-operating co-working space allows landlords to integrate other attractive concepts that businesses enjoy, such as full-suite offices and services, communal-focused design, and further contractual flexibility, all of which require a different approach to management, operations and governance. The ability of landlords to operate their own co-working brand will help them to not only differentiate themselves in this competitive market, but also prepare for the next wave of demand from flexible workspace operators.

The COVID-19 pandemic has prompted some companies to quit traditional office space and shift to co-working spaces as a substitute, boosting demand for co-working space. Many smaller companies and start-ups do not want to commit to long-term leases, especially amid the market downturn. Larger companies, as well, have started to include flex space as part of their holistic real estate strategy to reduce overhead, or are looking for satellite offices without large, upfront capital investment. Looking ahead, while the remote workforce is expected to grow in the post-pandemic era, demand for flexible workspace will inevitably increase. We expect traditional and institutional landlords turning into co-working space operators to be a continuing trend to watch.

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

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