Savills World Research
Japan

Spotlight

Tokyo coworking: Separating fact from fad

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"After two years of explosive growth in APAC, premier coworking space is coming to Tokyo. We believe that changing work habits and other demand factors will drive the development of flexible office space."

Introduction

Coworking – a term that still evokes cartoonish images of trendy, latte-sipping millennials, graffiti-inspired décor, and colourful beanbag chairs – has once again become a hot topic of conversation in Tokyo.

WeWork, the U.S.-based, SoftBank-backed operator often credited with popularising shared offices for young entrepreneurs, is reportedly seeking to open an ambitious 10-20 locations in Tokyo by the end of 2018, which – if true – would make Tokyo the company's biggest presence in Asia. Mitsui Fudosan launched its new Workstyling brand of satellite offices in April with 10 locations, and intends to expand to 30 by the end of FY2017. Regus, the world's largest serviced office operator, already lists 50 "coworking" offices in Tokyo and opened its first standalone medium-scale coworking facility in May this year. A slew of other small, independent coworking studios offering monthly memberships have already appeared, but new premier options are likely to transform the market.

Market players have long been sceptical of whether the premier coworking model could truly take off in Japan, where the labour force has for decades favoured lifetime employment at large companies.

This time could be different for three reasons.

First, work styles in Tokyo – like in the rest of the world – are gradually changing to favour more flexible labour arrangements. Labour shortages are forcing companies to grow more creative in sourcing help. This will drive demand for both premier and affordable coworking space as well as other types of serviced and satellite offices.

Second, and more immediately, the coworking business has matured beyond its reliance on small startups and freelance contractors. Corporate tenants now make up a large and rapidly increasing share of international coworking revenues. Large, traditional Japanese companies are also showing interest.

TABLE 1
Key terminology

Term	Key features
Coworking space	Membership-based, casual, community-oriented
Serviced office	Contract-based, professional, emulates leased office space
Satellite office	Typically for company employees who would like to work remotely

Source: Savills Research & Consultancy

SUMMARY

- Tokyo's current coworking landscape mainly consists of a pool of small-scale, café-like studios, primarily in Shibuya and the central five wards.
- Premium-grade coworking space is now entering the market. Regus opened its first "Spaces" location in Otemachi in May, and WeWork is poised to commence operations in 2018.
- Large, established "enterprise" companies should drive initial demand for premium coworking in Tokyo more than they have in other markets.
- Japan's entrepreneurial infrastructure is steadily growing. Student-founded startups are increasing at near 5% a year and public and private organisations are working to promote new innovation.
- Changing workstyle preferences will also fuel long-term demand for new coworking options such as satellite offices.
- The number of registered freelancers in Japan has increased 23% since 2015, supporting a market especially for affordable coworking areas.
- A potential landlord may enjoy several benefits from incorporating premier coworking space into an asset. Coworking revenues per tsubo could fuel higher NOIs, and buildings could also benefit from trendy rebranding.
- Investors and occupiers can take this opportunity to examine the development of Tokyo coworking to see what sticks and what doesn't, and identify possible innovations that might be applied to the traditional Japanese office format.

Finally, attitudes toward entrepreneurship are also evolving in Japan. Although startups themselves are still relatively few, an increasing number of entrepreneurs are venturing out on their own. Public and private organisations are also working to institutionalise incubation and innovation.

Given these three trends, we believe that coworking space will continue to grow, and premier facilities will soon become a small but recognised segment of the Tokyo occupier market.

Demand: Three key factors

We believe there is immediate demand for large-scale coworking space in Tokyo, especially in the tech-heavy neighbourhoods of Shibuya and Minato. Tokyo's coworking market may not reach the relative volume of those in Shanghai or Beijing for some time – if ever – but the city's sheer size should absorb at least some large-scale space. SoftBank itself will likely fuel initial takeup, occupying a substantial number of desks at WeWork's initial locations.

As discussed, **three key factors** will drive absorption of coworking space in Tokyo.

Demand factor 1: Flexible work styles

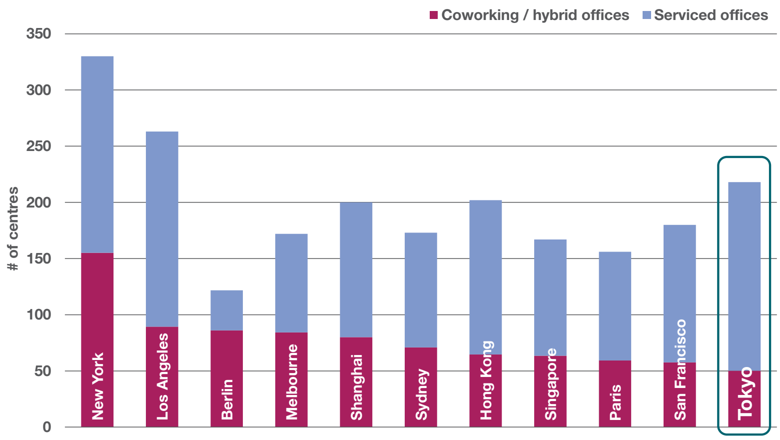
Japanese freelancing agency Lancers reports that entrepreneurs, freelancers, and other workers pursuing independent income now number 11.2 million people in Japan. This is up 23% from just two years earlier and totals 17% of the workforce. Freelancing is in fact growing faster in Japan than in the U.S., where the population of labourers seeking independent income grew just 2% from 2016 to 2017, although from a much higher base.

Freelancers make up almost a full 50% of Japan's existing coworking clientele [Graph 3]. Most coworking customers work in either IT or consulting. Japanese freelancers are still relatively low-paid, however, which is contributing to the development of affordable coworking space.

Increasing part-time labour participation by previously underemployed groups, such as workers over 60 or women returning

GRAPH 1

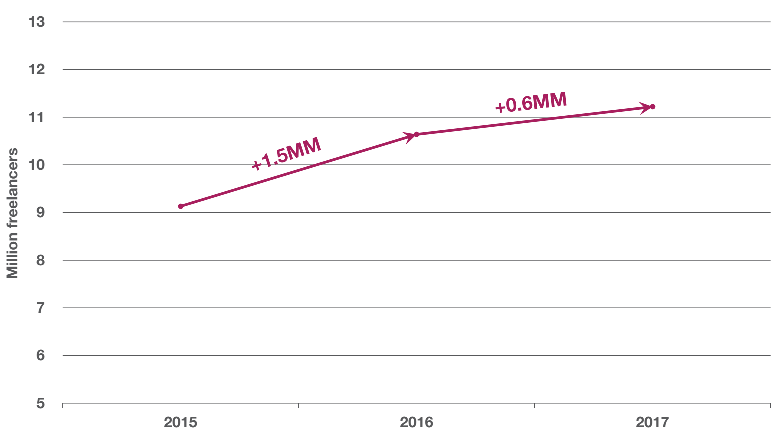
Shared office centres by type, 2016



Source: Instant Group, Savills Research & Consultancy

GRAPH 2

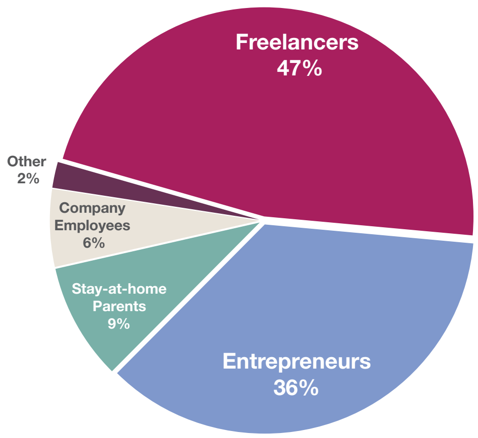
Growth in freelancers in Japan, 2015–2017



Source: Lancers, Savills Research & Consultancy

GRAPH 3

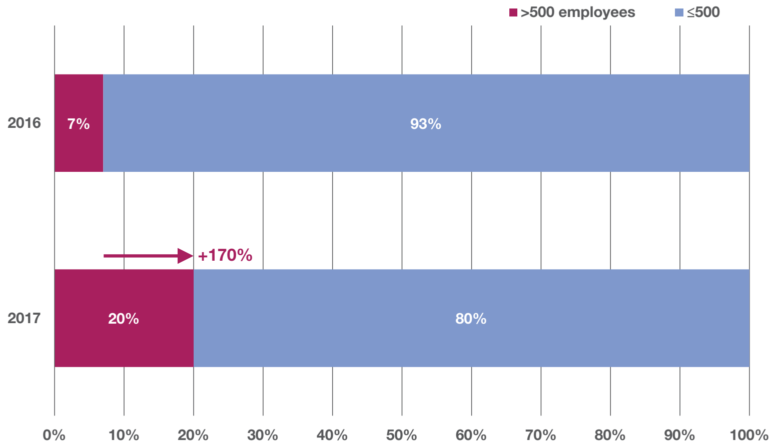
Typical occupiers of coworking space in Japan, 2016



Source: City Planning Institute of Japan, Savills Research & Consultancy

GRAPH 4

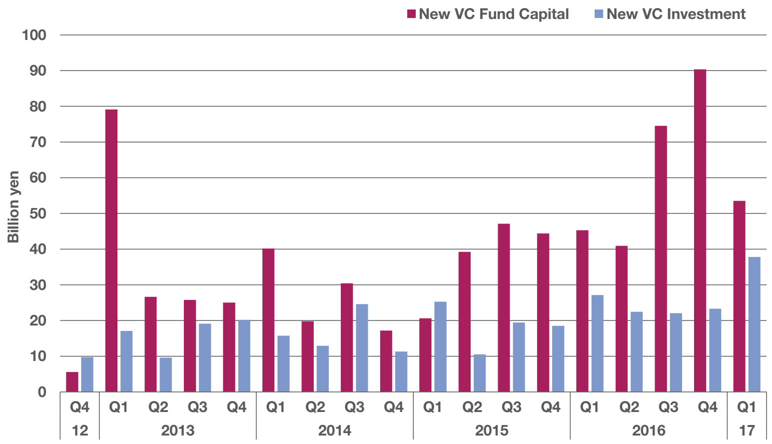
Global WeWork members by company size, 2016–2017



Source: Inc., Savills Research & Consultancy

GRAPH 5

VC fundraising and investment in Japan, Q4/2012–Q1/2017



Source: Venture Enterprise Center, Savills Research & Consultancy

from maternity leave, will also drive demand for alternative flexible office space. This is especially true for satellite offices. For example, Regus has launched three new "Regus Express" locations in residential areas of Osaka to cater to working parents who cannot leave home for long. The company reports that all three are operating at near full capacity.

Mitsui Fudosan also launched its Workstyling brand of office space in April with 10 Tokyo locations, and plans to add 20 more by the end of the fiscal year. Workstyling offices are small-scale studios that allow only corporate clients – not individuals – and as such cater to companies that employ a large number of flexible, part-time, or mobile employees. Workers swipe into a studio using a QR code; their employer is subsequently billed 300 yen for every 10 minutes of use. Notable users include Fuji Xerox, Cisco, Unisys, Unilever, and Mitsui Fudosan itself.

The median age in Japan is 47, 10 years higher than China's 37. This indicates that there may be less coworking demand from younger clients, although Japan's long healthy life expectancy may result in additional demand from retired freelancers.

Teleworking is also on the rise as the government attempts to relax working conditions and accommodate working parents. This may also drive demand for neighbourhood coworking and satellite office space.

Premier coworking operators as well as concepts like Regus Express and Workstyling should see success if these trends continue.

Demand factor 2: Enterprise clients

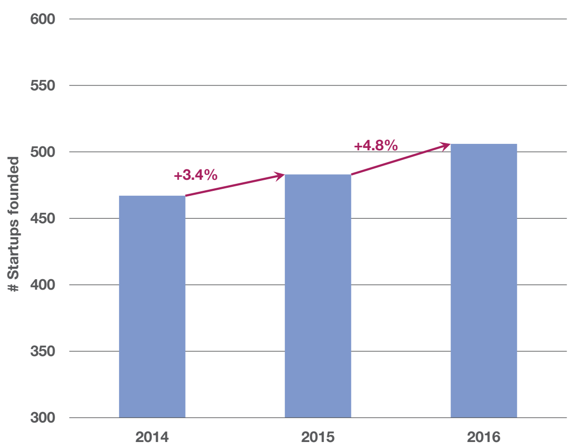
Premium coworking in Tokyo will likely be driven by large, established businesses more than it has in other markets. The coworking client base has matured rapidly over the past several years, and now includes the likes of Microsoft, KPMG, and HSBC. WeWork's global "Enterprise" segment, defined as members from companies that employ over 500 people, grew 170% from March 2016 to March 2017 and now includes 22,000 workers from 967 large companies. WeWork has rented out over 30 floors to single clients globally.

SoftBank has already signalled that it will be an anchor occupier of WeWork's facilities in Tokyo, and other companies are likely to follow suit. Operators report interest from large, traditional Japanese institutions such as railroad and real estate companies.

Takeup by enterprise clients will be fuelled by a number of factors, including a change in IFRS/USGAAP accounting standards that will require substantially all leases to be reported on balance sheet. Only 133 TSE-listed companies, or 4% of the exchange, have adopted IFRS as of February

GRAPH 6

New startups founded by university students in Tokyo, 2014–2016



Source: METI, Savills Research & Consultancy

2017 (and significantly fewer use USGAAP), but they are typically large multinationals and account for approximately 25% of the TSE's market cap. Such companies could seek premier coworking space as way to lighten balance sheets.

Demand factor 3:
Latent startup culture

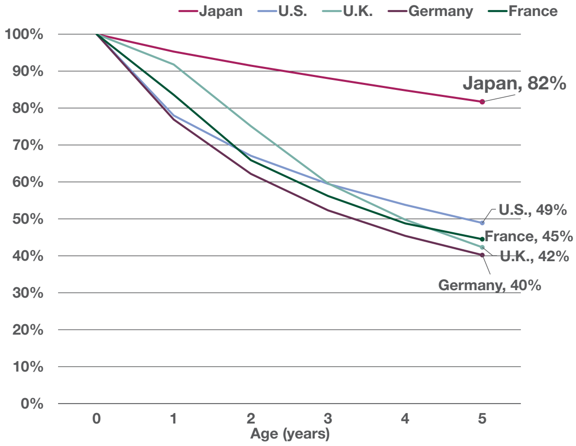
Domestic venture capital investment has increased by almost 50% in the past two years, and new committed capital has more than doubled. Though Japan's startup community is still tiny compared to those in the U.S. and China – approximately 1/50th and 1/20th the size, respectively, in terms of new investment in FY2015 – it is steadily growing.

Japanese startups are notable for their impressive survival rates. In a recent study of companies founded between 2007 and 2013, METI reports that 82% of Japanese startups are still in business in their fifth year; in the U.S., U.K., France, and Germany, over half fail [Graph 7]. This is partially because Japanese startups are more likely to be led by founders with prior business experience. Japan has seen over 80 companies newly listed in each of the last three years. The IC&T and service industries account for more than half. These growing companies could be good clients for premier coworking space.

We expect that independent entrepreneurs will generate less demand for coworking space in

GRAPH 7

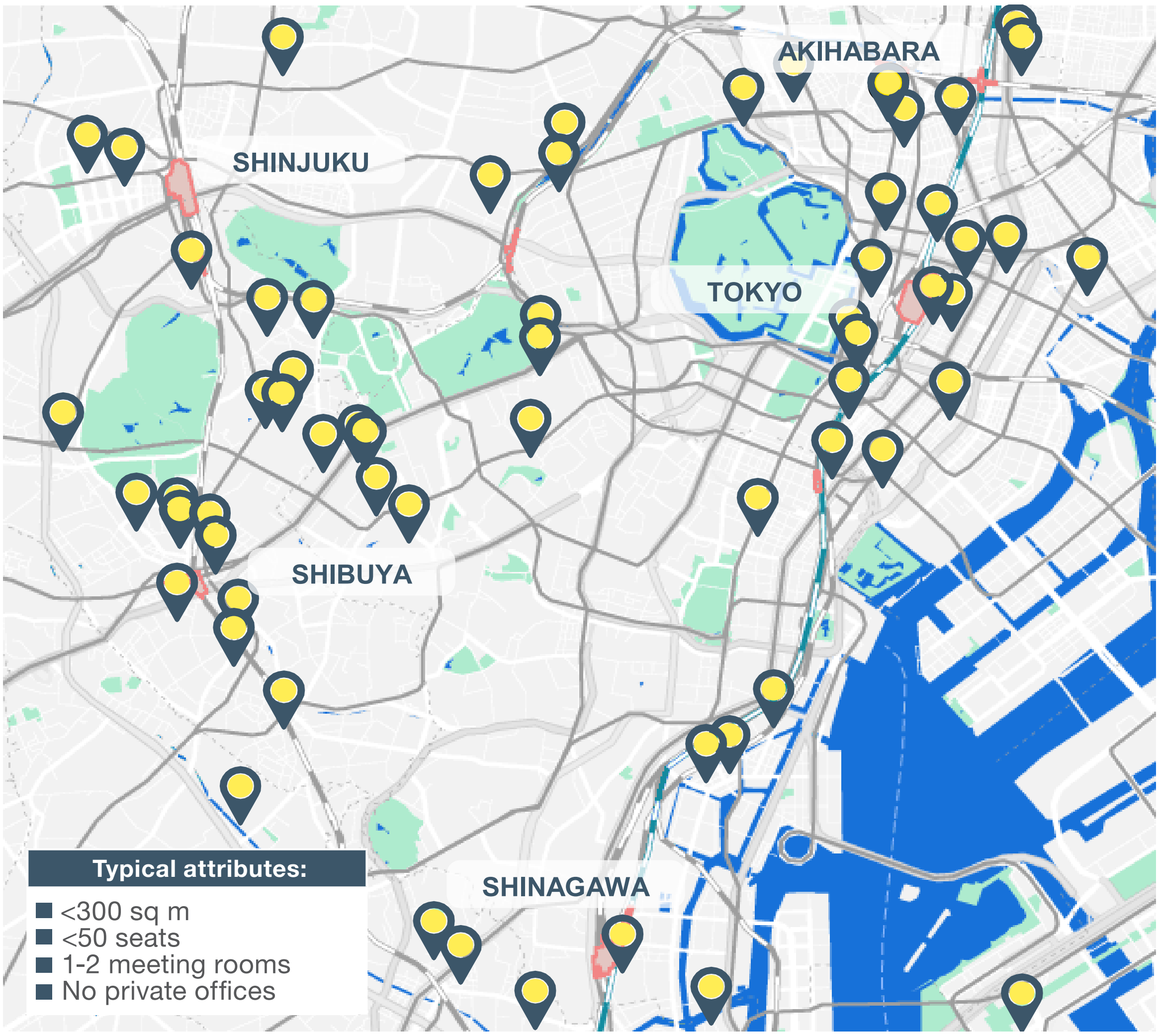
Startup survival rates by age and country, 2007–2013



Source: METI, Savills Research & Consultancy

MAP 1

Registered coworking studios in Tokyo, July 2017



Source: Coworking.com, Savills Research & Consultancy

Tokyo than they have in other global cities. That said, grass-roots innovation is now more widely regarded as both undeniably cool and an economic necessity, seeding future growth.

Supply: How much, and how fast?

WeWork has boasted that it is expanding by half a million square feet (roughly 45,000 sq m) a month globally. Major operators active in Shanghai and Beijing now number in the double digits, from a base of almost zero just three years ago. The two Chinese cities combined now easily offer over 200,000 sq m GFA of coworking space, enough to fill the Shin Marunouchi Building.

Tokyo already has a plethora of established coworking spaces, but most are small-scale, independent studios of just a few hundred sq m GFA. These coworking studios tend to be modest, offering at most one or two meeting rooms, a copy machine, reception, wifi, and beverages – they are essentially private, membership-based coffee shops. Memberships typically start around JPY10-30,000 per month, suitable for low-to-middle income freelancers.

Portentously, however, this Tokyo landscape resembles the fragmented, small-scale shared office landscape of other Asian cities just three years ago. Almost all large-scale development in the Asian coworking market has occurred in the last two years. Coworking periodical Deskmag notes that the average number of desks per establishment grew from 78.5 to 167 from 2016 to 2017 in Asia, and the average facility size grew from 857 sq m to 1,540 sq m. These are single-year increases of 113% and 80% respectively, pulled up by the opening of several large-scale facilities. Establishments with 150+ desks made up 12% of the market in 2016; this share grew to 20% in 2017.

This growth has until now largely occurred without Japan. Why, then, has Tokyo been left behind?

One barrier is simply baked into the local lease structure. In Japan, traditional corporate leases are only two to three years with automatic renewal and allow a break with six months' notice. This is already far more flexible than the fixed-term leases that prevail in other markets, making the added flexibility of coworking space somewhat less valuable by comparison.

Additionally, large Japanese developers have generally spurned third-party coworking operators, making it difficult for those operators to establish a local foundation. SoftBank's over $4 billion vote of confidence in WeWork, however, has demonstrated at least some local traction for the concept, and the two companies formed a 50-50 JV in mid July to manage WeWork's upcoming operations in Japan. It could be significant that SoftBank is a telecom company and not a developer, though, indicating that WeWork may still be working to secure support from local real estate companies.

Though WeWork remains the trendy posterchild for coworking space, other market players will have a perhaps greater impact on the occupier market in the coming years. Regus already has 150 traditional serviced office locations in Japan; it plans to reach 500 by 2020. Its holding company also opened a 582-desk standalone coworking facility under its Spaces brand in May 2017 on the ground floor of the Otemachi Building. Memberships start at JPY64,800 per month, which is an impressive 46% premium over per-tsubo Grade A office rent and CAM in the area – and the Otemachi Building, at 60 years old, is not even a Grade A building. It should be noted, however, that traditional leases have costs not included in the up-front fees and space-per-desk ratios can vary, so comparisons must be taken with a grain of salt.

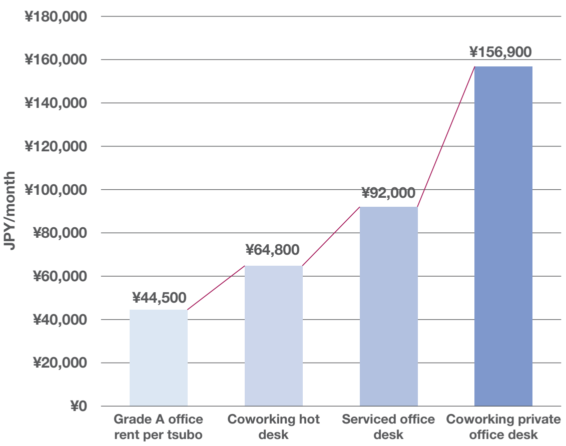
Spaces has seen its membership grow 10% from May to June and 11% from June to July. The brand has also just opened a 488-desk location in Japan Post's brand-new JP Tower Nagoya.

Implications for landlords

A premium coworking operator could make a unique and beneficial tenant for certain types of buildings. Operators have traditionally sought to convert large floorplates in older, low-quality assets in gentrifying neighbourhoods; however, this has started to change as they seek enterprise clients and expand overseas.

GRAPH 8

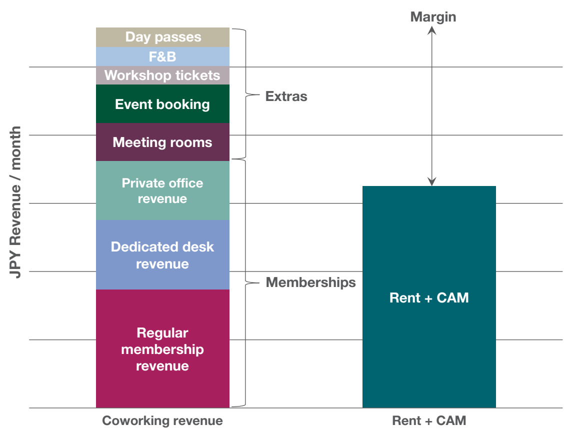
Monthly office cost in Marunouchi, Q2/2017



Source: Spaces Otemachi, Servcorp, Savills Research & Consultancy

GRAPH 9

Conceptual illustration of coworking revenue margin over surrounding rents



Source: Savills Research & Consultancy estimates based on Deskmag, market data
Revenue is an estimate for conceptual purposes only; does not necessarily indicate achievable market values

Now, companies such as WeWork and Naked Hub are actively hunting for prime office property in central business districts. One rumour purportedly had WeWork in talks to occupy an office floor of a specific brand-new, high-grade building in a posh prime area, until it became clear to the landlord that WeWork was hoping to use the space to host occasional large social events.

Though WeWork is likely to select already-popular areas for its first Tokyo locations, trendy retail and good access are often more important than proximity to other offices. Grade B office property, the upper floors of shopping malls, and even refurbished warehouses are all natural fits. In this way, a coworking operator could help a landlord rebrand or repurpose an otherwise struggling asset. Large blocks of vacant space in such buildings are rare in Tokyo, but opportunities may arise, especially during downturns.

Key risks

Though coworking could fill a useful market gap in Tokyo, there are several key risks. Most can be mitigated through skilful operation and the establishment of best practices.

Security remains a major concern, especially for enterprise clients. Coworking facilities are not well-suited to managing sensitive or classified information, which could limit the types of functions they may house. The flexible membership structure also makes it more difficult for an operator to control the types of tenants it accepts, and could expose it to reputational risk.

Competition from new operators and facilities is also a concern. Other facilities such as libraries and hotels are experimenting with coworking space, and companies are incorporating lessons learned into their own office designs. This competition could squeeze the margins of dedicated operators.

Additionally, the model remains untested in an economic downturn. It is still unclear how membership numbers will move in the event of a recession, and flexible office space and labour may be the first to go when companies tighten their belts.

OUTLOOK

The prospects for the market

After enjoying explosive growth in other Asian cities, premier coworking operators are poised to enter Tokyo. Regus' Spaces Otemachi opened in May, and global workspace darling WeWork intends to open its first facility in 2018.

Three demand factors should drive the development of coworking in Tokyo.

First, work habits and demographics are trending gradually toward more flexible and freelance labour. This will create demand for new types of office space as both workers and employers seek alternatives to traditional environments. Affordable coworking space and satellite offices are especially poised to benefit.

Second, large, established companies now comprise a significant and rapidly growing share of premier coworking memberships globally; this trend will likely ease entry into the Japan market. We expect initial supply to be largely absorbed by these companies.

Finally, the Japanese startup community is growing steadily. An interest in IT, engineering, and entrepreneurship among youth, as well as new public- and private-sector recognition of the economic importance of startups, is spurring gradual institutionalisation and investment.

Landlords and occupiers would do well to learn from the successes and failures of coworking operators when creating their own space. Coworking's entry into the Tokyo market will provide a good opportunity to see what sticks and what doesn't and identify possible innovations that might be applied to the traditional Japanese office format.

Coworking's immediate market footprint may be too small to attract the attention of most investors, but it could grow much bigger in ten years' time. It is not too early to keep a close eye on this emerging trend.

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