

The Increasing Importance of Serviced Offices as a Competing Land Use in Global Cities

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Abstract:

Once considered a relatively low key land use in central business districts, the number of serviced offices has increased dramatically in recent years. The factors driving the demand for serviced offices have changed, and the suppliers of this service have reacted quickly to meet these needs. This trend has been assisted by the expansion of a select number of multi-national companies that specialise in the provision of serviced offices, available in a flexible range of office types and costs.

This paper considers the reasons behind the rapid growth in the serviced office market, and examines the role of both the user and the provider. Attention is focused on the global marketplace and how these changes have been transformed into the Australian central business districts. The information will be of benefit to property analysts, developers and investors, especially when seeking an alternative use of existing traditional office accommodation.

Introduction

The serviced office market has experienced rapid growth and sustained high level of demand in recent years, which has caught many in the property market by surprise. But more importantly, this trend appears likely to continue into the future. Recruitment, technology and business service companies are some of the drivers fuelling this increased demand, and have now replaced dot.coms as the driving force in the serviced office boom (Wright, 2002). Furthermore, this demand has also been pushed along by the flexibility of new age companies, which are seeking a flexible workplace and often prefer to outsource their property requirements. New start-up companies as well as established organisations appreciate the gains made from using a flexible property provider.

There appears to be other drivers behind the increased demand for serviced offices. For example, the impact of the 'D Generation' types may result in more part time and casual or contract workers in the future, as well as flexible working conditions. Popular in the 1990's, the concept of 'hot-desking' means that more flexibility from work space will be required. Thus, there are changes in the workplace that have moved somewhat away from the traditional 40 hour week in a standard office environment, and towards the need for a flexible office product.

The increased level of demand for serviced offices may have implications for the wider property market, since serviced offices usually compete in the same marketplace as alternative land uses, such as commercial offices and inner-city residential housing. This creates new challenges for property analysts, who are placed under increasing pressure to identify changes in the real estate market before or as they are occurring. Therefore, the challenge is to recognise changes in today's market as they occur, and anticipating the implications of these trends for the broader office market.

The paper considers what a serviced office actually is, and how it differentiates from other land uses in the central business district. Consideration is given to the changing trends in serviced offices, and implications for the future are also discussed. Suggestions for research into this property sector are canvassed, which has received little attention due to its relatively short life span. The background information was provided via the experience of one of the co-authors, Kay Stewart, who has managed serviced offices throughout the world including

Russia, Eastern Europe and Australia. This included setting up a new business centre from scratch for a major international player in St Petersburg, and then progressing to Regional Operations Management role in Eastern Europe. In Australia, this included setting up an entire serviced office network nationally for a new local operator. Through these roles, a wealth of hands-on experience with all aspects of the operation of serviced offices has been gained, including IT&T, sales, finance, human resources and daily operational management.

The Concept of a Serviced Office

A serviced office is essentially an office that is fully operational in all respects and suitable for immediate occupation. Typically, a serviced office operation is configured to allow for a range of office sizes, ranging from as few as one person and up to 10 persons in one room. It is common for a number of adjoining offices to be taken together to accommodate a higher number of persons. However, they usually consist primarily of offices that accommodate one to three people, as these are the most popular sizes and can be added together in small multiples to accommodate expansion. Serviced offices are often utilised by new small businesses and established businesses expanding into new areas or organisations who wish to maintain a CBD or interstate presence, with head office elsewhere.

As opposed to vacant office space that requires a fit-out by the incoming tenant, the serviced office provides varying levels of facilities. Most offices are equipped with furniture, decoration, telephone system, internet connection, and a computer in some instances. Common facilities to be shared among all tenants include local area network printer, photocopier, fax machine, fully equipped kitchen facilities, videoconferencing and meeting room facilities. A common reception area is provided along with receptionist and telephone answering service. In addition, there is an associated management and customer service team consisting of at least four staff to service the common facilities and provide 'pay as you use' administrative and secretarial services. Additionally services offered usually include mail and fax service, courier services, catering and room service, stationary supplies, travel services, meeting co-ordination services, IT support services and generally any other outsourcing requirement of the client, such as assistance in recruitment of secretarial or administration staff. In reality, there is a broad spectrum of serviced offices in the market that range from providing the bare basics, up to offering high end technology and equipment, along with a complete management team and highly personalised service.

A major product of most serviced offices are 'Virtual Offices', which are often sold as a lead in product to a fully serviced office. Serviced offices require high-end telephone systems that are capable of dealing with hundreds of extensions and 'virtual numbers', hence the term 'Virtual Office'. This product name is commonly used in the industry but has limited understanding by the public. A 'Virtual Office' is simply a dedicated phone number and telephone answering service, as well as fax number and business address. It is 'virtual' because it gives an impression of the company having an office and staff at that particular location. On any given day an organisation can occupy an office, as large as would be required, by simply renting an office for a day from the serviced office operator. Furthermore, a Virtual Office package may be accompanied by various options, such as a monthly quota that includes a set number of hours of meeting room or office usage per month.

Most serviced office operations offer a range of products, including:

- virtual offices;
- serviced offices;
- single day stay offices.
- meeting, training and conference rooms; and
- videoconferencing.

As well as offering the tenant a high degree of flexibility, the serviced office operator can also benefit from the variable accommodation needs. This capability gives the operator the ability to move rents with market prices as they are occurring, rather than waiting for review clauses to come up in leases as with traditional office accommodation.

Nevertheless, there are negative aspects of providing serviced office accommodation. For example, tenants retain the option to move out easily and with relatively little notice. However, if the serviced office is managed correctly there are many other ways to tie the tenants to the building. One scenario may be to develop the loyalty of the tenant, or providing services and facilities that are much superior to the other alternative options available to the tenant. In this example, the tenant would find it extremely difficult to go elsewhere and set up the same services, or find the same services with another operator at a competitive rate.

The Global Serviced Office Market

The suppliers of serviced office accommodation compete in a unique marketplace. These suppliers can be divided into four main groups based on geographical segmentation, namely:

- (a) multi-national global organisations;
- (b) regional organisations in a regional area such as south-east Asia;
- (c) national organisations in one country only; or
- (d) local serviced office organisations in one location only.

Even though the serviced office market is a specialised niche sector, global players are continually increasing their market share. This section considers the reasons behind the success of a major global service office provider, namely Regus Business Centres.

Regus Business Centres was established by Mark Dixon, with the company setting up its first centre in Brussels, Belgium. Dixon, an English national, struck upon the idea whilst travelling in the late 1980s after finding it difficult to find an office to conduct business in foreign countries. Dixon soon moved the head office to the UK and established numerous operations there, following by an expansion into major Western European centres, Eastern Europe and finally Asia Pacific and the United States. There was a huge gap in the serviced office market, particularly in the UK, due to the very archaic and conservative property market with leases for commercial offices commonly offered on minimum terms of 10 to 20 years. At that stage, it would have been considered outlandish to even offer lease terms for as little as 3 years, let alone 3 months. Yet, Regus initially offered the shortest agreement available for serviced offices. Another substantial barrier that was removed from traditional processes was the long and protracted process of negotiating and preparing the traditional lease agreement. To overcome this, Regus adopted a simple two page service agreement that was written in plain English. Hence, the process for tenants to find and sign up new office accommodation was reduced from months to days. The benefit of a simple agreement is that they can be entered into quickly, giving instant access to a fully operating and functional office within timeframes of 1-2 days if required by the tenant. The serviced office market is clearly a demand-led product with a high degree of flexibility to suit the changing needs of the tenants, which is the foundation of this company's success. Recently, Regus is placing the emphasis on marketing via the internet, and has also introduced a frequent user's card and has a range of benefits and discounts for this target market group.

Drivers behind increased demand for serviced offices

There are a numbers of separate factors that have contributed to the demand for serviced offices. However, the benefits vary in importance to individual tenants and this summary represents the overall market demand factors.

Instantaneous availability

The typical serviced office is available at short notice, meeting the demands of business with limited time constraints. In a similar manner to the ‘just in time’ supply of goods to the manufacturing industry, a serviced office can provide a fully functional office with only a matter of hours or days needed for lead time.

Short term agreements

In direct contrast to a typical office lease structure over multiple years, an agreement for serviced office accommodation can be over much shorter periods. Although three to six monthly agreements are common, it is increasingly popular for serviced office leases to be structured over weeks or even days.

No complicated leases

Rather than dealing with complex and intricate lease documents, often involving legal assistance, a typical service office agreement is written in a plain English format. It is designed to be ‘user friendly’ and avoid unnecessary terms and clauses typically found in a commercial office lease.

Flexibility to grow and contract

Providers of serviced office accommodation attract many new start-up businesses, and the potential for ‘overnight’ expansion without relocating is a priority for these growing businesses. At times, this may require expansion into gradually increasing floor areas, rather than taking up entire or partial floor areas that may also require a fit out. This is an attractive aspect of serviced offices, that cannot be easily matched by providers of traditional commercial office accommodation.

Outsourcing to focus more on core business

If a separate provider takes care of the tasks involved with office accommodation, this will allow the business to focus on *running the business*.

Personal service

In a typical office accommodation agreement, the lessee negotiates with an independent marketing agent, who acts as the ‘middle man’ and negotiates with the lessor. In addition, the lessor may be an institutional investor whom the lessee may never meet, with a complete absence of personal service. However, in a serviced office arrangement the tenant negotiates directly with the accommodation provider, allowing a higher level of personal service and permitting an overall swifter process.

Higher degree of affordability and low establishment costs

A serviced office tenant may be restricted in the financial resources available, especially in the infancy of a relatively new business. There are distinct advantages for these tenants to be gained from sharing high value infrastructure for an affordable price. In other words, these tenants on their own may not be able to afford access to the quality of functionality of equipment provided by the serviced office i.e. phone systems, printers, copiers, broadband internet.

Additionally, a conventional office agreement usually requires a substantial ‘up front’ payment prior to accessing the accommodation due to the long term commitment of the lease. Serviced offices only require a number of months rent as a deposit and generally do not require bank or personal guarantees.

‘Pay as you use’ system

A serviced office tenant only pays for services and personnel when required, rather than supporting the ongoing permanent cost of these items.

These services include:

- answering the telephone with the company greeting;
- greeting visitors at reception and facilitating a meeting;
- conference and meeting room facilities;
- full office support including mail and fax services, secretarial support, computers, photocopying.

Tenant may benefit from the bulk buying power of the Serviced Office provider

Each tenant has the option of purchasing goods and services, items such as travel, stationary, catering, recruitment services, technology services at a cheaper rate than what they would otherwise be able to negotiate on their own.

Other associated drivers:

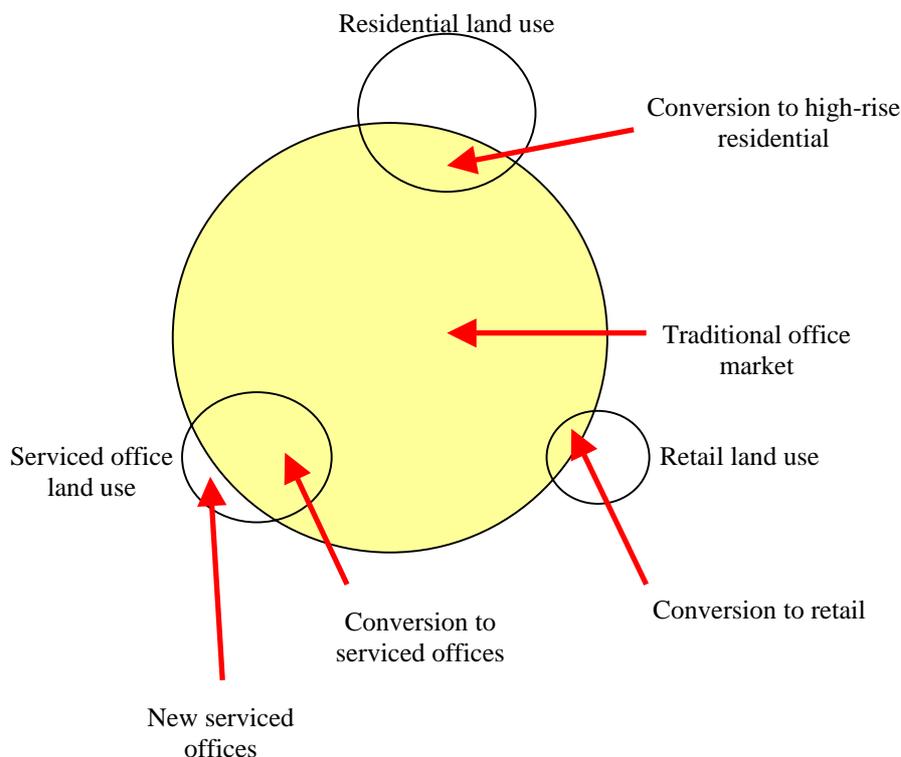
- Set up an office instantly anywhere around the world, serviced offices are normally located in prestigious CBD buildings;
- It may be more practical and cost effective for tenant to have majority of the operation out of the CBD and only have a minimal office presence in the city. As a result, the rental cost savings could be astronomical;
- Supports new business set ups, as new business can set up very easily and cheaply by starting with a virtual office and can expand to a permanent office as they grow. This also allows access to a huge number of resources in both equipment and personnel that they can use on a user pays basis.

Implications for conventional office markets

Providers of serviced office accommodation are competing in the same marketplace as commercial office accommodation, as shown in Figure 1. There are other competing land uses with varying levels of demand, including residential and retail property, which involve either the conversion of office property or construction of new property. The effect on the supply side can be shown in Figure 2, where the supply for serviced office accommodation (S^1) has evolved out of the market for traditional office space (S^0). However, the new supply curve (S^0) is substantially steeper, being a niche area that appeals to a relatively small area. Simply explained, the price of serviced office accommodation is represented by P^1 , as opposed to P^0 for conventional office space.

Caution should be exercised if additional suppliers of serviced office space enter the market, which would result in an oversupply situation and a sharp decrease in pricing structures. This, in turn, may cause a conversion of serviced offices back into traditional office accommodation, and it is envisaged that non-dedicated providers of serviced offices would react first. This scenario highlights the flexibility of this marketplace, where serviced offices have the ability to quickly adjust to market demand.

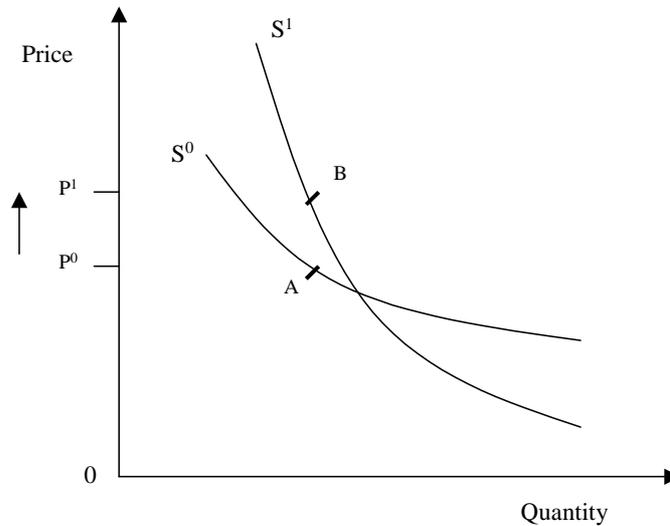
Figure 1. CBD Property Market.



There are other considerations that may affect the level of stock in both serviced office market and for traditional office accommodation. Firstly, serviced offices are usually run by an operator who leases space from a landlord. In this case, there may be limited benefits to a landlord having a serviced office tenant as opposed to a normal tenant, although this does prevent the landlord from losing smaller tenants to other buildings. Those smaller tenants may expand and later want to expand, moving out of the serviced offices and into larger spaces in the building, which saves changing business address and is more convenient than moving to another building.

A serviced office may also be considered a resource to other tenants in the building, as they can also use the business services that the serviced operator provides on a 'pay as you use' basis. Secondly, there are building owners who set up serviced offices in their own buildings. In this case there will be considerable benefits to the landowner, as they can produce a higher overall return from a fixed asset, at the same time offering higher levels of personalised service and facilities to the tenants of the building.

Figure 2. Supply of Serviced Office Accommodation.



Implications for the Property Market

The depth of the serviced office market is yet to be determined, which questions what proportion of the CBD office market will be converted to meet the demands for serviced office accommodation. Nevertheless, the serviced office market is not mature and demand has not levelled out yet, primarily due to the infancy of this product and a general lack of market awareness. As supply has increased substantially in recent years in certain locations, demand must slow eventually and the serviced office market would enter into a series of supply and demand cycles.

As with traditional offices there are different qualities of serviced offices. These range from the very high end high quality executive style, through to fairly poorly run and poorly fitted out suburban operators. However, generally the larger operators are generally in prime locations in either prime or Grade A space.

The implications are not so much that serviced offices will absorb a lot of the office space, or compete with other uses such as residential, but it is more that building owners may have to move toward the 'serviced building' model to stay competitive in the marketplace. Simply explained, tenants may demand more services in the future and will tend to go towards serviced orientated buildings, rather than conventional office accommodation without services. If future trends move this way and building owners are slow to react to this, they

may be left behind with higher vacancy rates. Furthermore, new serviced offices are now including shared technological infrastructure, so all tenants can benefit from these additional services. This may mean that in the future developers and owner will have to look at how the building is designed from the outset to develop buildings which have a high level of integration between intelligent facilities management systems, shared internet and telecom infrastructure and additional business services which are managed by an in-house team, ie. the focus will be no longer just on the physical appearance of the office but more importantly the “invisible” infrastructure that will provide all of the services to make operating an office an easier task for the tenant.

Conclusion

The profile of the serviced office market has evolved rapidly from its humble beginnings, although it has been recognised as a stand-alone property type in today's marketplace. It is distinctly different from other land uses in the CBD, and it has the versatility to rapidly adjust to changing needs. Most of the attention in the future will be placed on the depth of the serviced office market, and what are the implications from traditional office space. Whilst it is unlikely that serviced offices will ever entirely replace traditional office accommodation, the growth of this new product has been dramatic and deserves more recognition than it has received.

It seems that the option of converting existing office accommodation into serviced offices is not an effective process, and consideration should be given to designing and constructing purpose-built accommodation for services offices from the ground up. This would result in lower overall construction costs, and a superior product for the serviced office tenant. Thus, if a building was designed and constructed from day one to be ‘serviced’ it would have a higher construction cost but would also have the potential to generate higher revenues.

Even though the serviced office operators appear to operate independently, there would be additional benefits if the providers combined their market knowledge for the betterment of this new industry. For example, a substantial amount of resources are expended in market research and advertising, which could be better allocated if directed at the aggregate serviced office industry.

There is no doubt that serviced office accommodation is here for the long term, and the market has additional growth left. It appears that building owners may want to give further consideration to complimenting their building with other value-added services, such as the provision of fibre optic computer cabling, broadband internet connectivity, business services and in-house management teams to ensure that they continue to attract and retain quality tenants. No longer is the physical appearance of an office the only important aspect, as increasingly the ‘invisible’ infrastructure is becoming a key consideration for office users.

In conclusion, further research needs to be undertaken to ascertain the depth of the serviced office market. This can only be conducted with the consent of serviced office operators, who have much to gain from raising the profile of this industry with its impressive growth history.

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