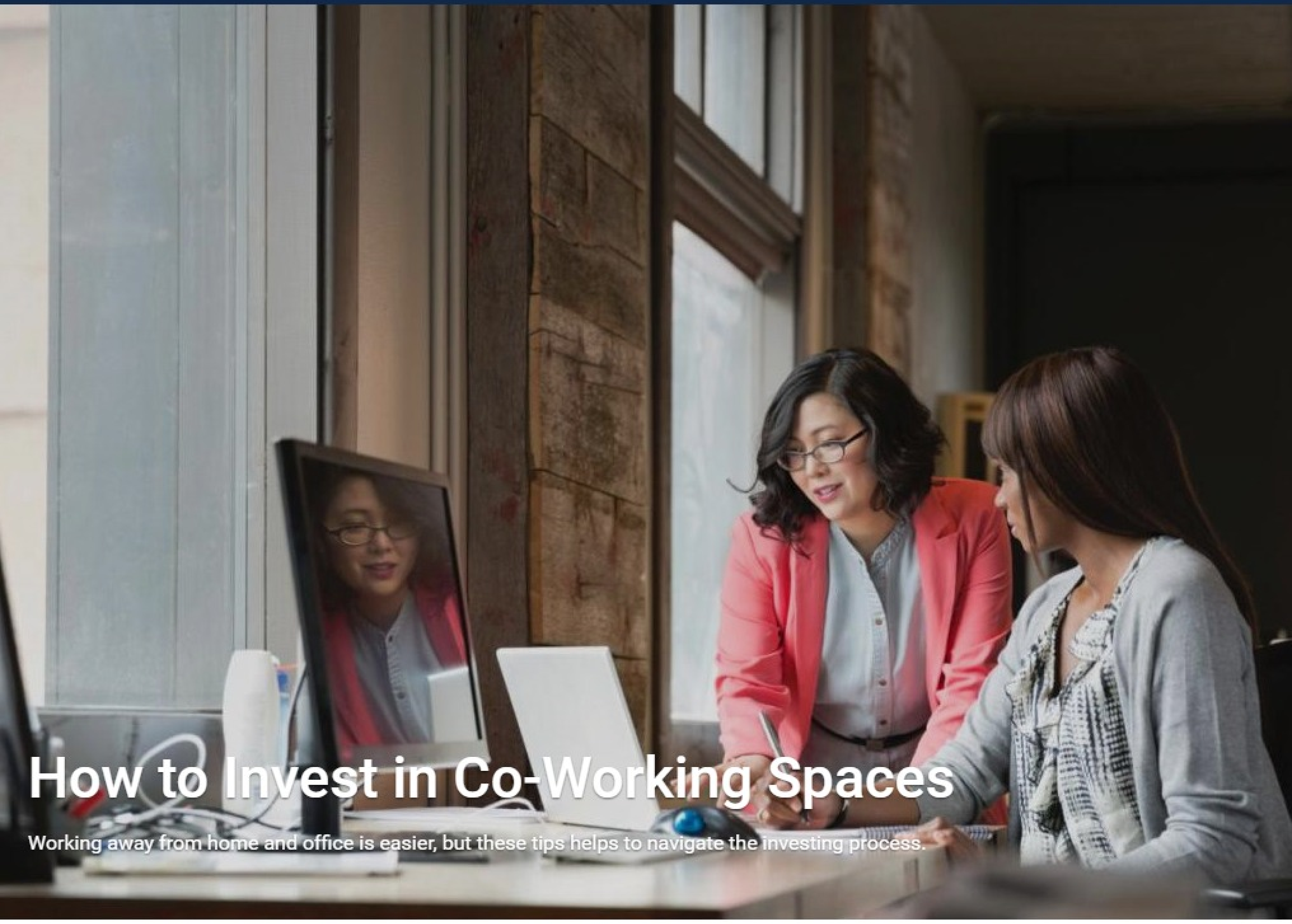

How to Invest in Co-Working Spaces

Working away from home and office is easier, but these tips helps to navigate the investing process.

(HeroImages / Getty Images)

By Dawn Reiss | Contributor

May 11, 2016, at 9:00 a.m.

As the shared economy continues to evolve companies – both big and small – are managing their expense lines and testing new urban markets with co-working spaces.

In the past, many co-working companies were targeted toward freelancers and startups. According to the CBRE Group's 2015/2016 Americas Occupier Survey of 226 Americas-based corporate real estate organizations, more than 40 percent of respondents are using or considering shared workplaces.

Howard Tullman, CEO of 1871, a Chicago-based nonprofit startup that houses nearly 500 companies in 150,000 square feet, says that's not surprising. Many Fortune 500 corporations are "stuck in the suburbs and office parks" he says, and it takes large companies several years to create a downtown or central city location, which can be a nightmare in terms of how long the process may take.

"Instead, they are more likely to go out to a WeWork and rent a block of space," he says. "These aren't startups or freelance companies. These are large corporations that have to find 10 to 20,000 square feet and they would like to rent it for a year or two as an experiment before they go to their own facilities with their own people."

That's exactly right, says Dominic McMullan senior director of corporate communications for WeWork, a $16 billion privately-held New York-based company that opened in 2010 and has 100 locations in 28 cities. "We are seeing bigger companies trying to manage their companies with our real estate. We are seeing General Electric Co. (ticker: GE), Dell, Bank of America (BAC), and a lot of other blue-chip companies taking bets. They are able to expand and contract their space according to the demand they are seeing from their company."

[See: 8 of the Most Incredible Investments of the 21st Century.]

WeWork is growing rapidly. The company claims that it more than doubled the number of its business clients in 2015, to more than 9,000, and increased its membership from 16,000 members to more than 40,000. The co-working culture at shared workspaces gives entrepreneurs exposure to Fortune 500 companies – McMullan says corporations using WeWork include Lyft, Airbnb, Red Bull, Delta Airlines (DAL), Salesforce.com (CRM), Staples (SPLS) and Dropbox.

An increase in co-working spaces. One way to invest in the co-working space is via a real estate investment trust, which allows small and large investors to own real estate including commercial properties ranging from hotels to shopping malls and offices. Smaller co-working companies function similar to a small-capitalization stock in a regular fund says Jason Hamilton, president of KIS, a fee-only financial planning in southern California. Two of the large REIT options that include co-working in their portfolio are Vornado Realty Trust (VNO) and Boston Properties (BXP).

When making specific sector investments it's important to consider your whole portfolio and look at the time a company has been operating in a co-working space, Hamilton says. "It's a lot more risky if it's a brand-new company," he says. "Consider the investment in relations to the rest of your portfolio."

Based on its report published in January, CBRE says co-working in the U.S. is estimated to be experiencing a five-year compound average annual growth rate of 21 percent.

Kevin Richards, a registered financial consultant and CEO of KNR Consulting and Wealth Management in Laguna Niguel, California, says most REITs receive a 5 to 7 percent return rate. "Hospital and health care REITs are a bit on the safer side than alternative investing like co-working," Richards says, "which is very new and a riskier investment."

Before investing in a REIT, consider how much liquidity you have, your age and tolerance. For investors who can handle a "heart attack drop" quarter where the market drops 10 percent and may come back 20 percent, investing in co-working might be a good option, Richards says.

Other investing options include mutual funds like Fidelity's Contrafund (FCNTX), T. Rowe Price New Horizons Fund (PRNHX), which focuses on small-cap emerging growth companies, and Hartford Growth Opportunities Fund (HAGOX), which all include WeWork shares but have been a part of the mutual fund markdown of privately held tech investments as of late. Another option is looking for mutual funds with Regus, the largest operator of co-working space, globally, with more than 3,000 locations in 900 cities.

Rather than trying to find individual co-working investments, Todd Saxton, associate professor of strategy and entrepreneurship at the Indiana University Kelley School of Business, suggests investing in a syndicate where individuals can co-invest, on a site like angel.co, with angel investors or venture capitalists. "Don't expect extravagant returns," Saxton says. "But you have a better chance when you're working with seasoned investors."

Other things to consider. If you are considering investing directly into a co-working space, most experts say much of the business' success depends on ownership and leadership behind the facility.

Morris Levy, co-founder of The Yard, a New York-based co-working space that has six locations, says any investor should consider the demographics of the market and the competition and the proximity to public transportation of a co-working space.

[Read: 3 Reasons Not to Try Shorting Stocks.]

"When I opened my first location, we looked for where people wanted to spend their time," Levy says. "People with laptop and cell (phones) can work from anywhere, but a lot of people want to go to co-working spaces so they can be inspired by other people in other businesses."

That's why investors should make sure ownership is committed to providing an atmosphere where people can come in and rely on a company. "Nobody wants any nonsense if they are paying to come in to work," Levy says.

Unlike a "dog-eat-dog" environment that sometimes permeates an office space, people using a co-working space typically want a sense of community in a collaborative environment known for congenial sharing, says Jamie Hodari, co-founder and co-CEO of Industrious, a co-working company that has 12 locations in 11 cities. "Every single year, salary matters a little less and workplace engagement matters more," he says.

Much of the opportunity for individual investors to invest directly in a project comes early on as a cash-flow investment where investors own a portion of the individual project and earn income if it is a success, says Hodari, who worked with small investors until they had expanded into eight cities. After that, he suggests investors consider investing during the initial public offering.

Many experts, including Hodari, also point to a potential leveling off this year as the market matures. "We've already seen the first wave of co-working places shutting down," he says. "Two or three years ago it didn't matter the quality of the space, there was so little supply you'd be full."

Investors should research the market to gauge if a co-working space is legitimately viable.

"You don't want to invest in co-working space that's doing fine today only because it's a constrained supply, and once there's enough co-working space to meet demand it can't compete," Hodari says. "It's hard to know today who is going to be the winners and losers. We are year or two away from that."

Another factor is a potential economic slowdown. Marty Caverly, senior vice president at Resource Real Estate in California, says any investor should ask a co-working company, "When we go through an economic downturn, how are you going to maintain? It all comes down to operating margin, and if they aren't over 40 to 45 percent in this market they are doing something wrong. This is the top of the market, we are in the sweet spot right now."

Although co-working spaces haven't weathered as well in the past, with Regus filing for Chapter 11 bankruptcy in 2003 after the dot-com bubble, Caverly says technology today allows companies to be efficient and effective even from a remote location. Still, there isn't the extensive 100 years of data that some industries have for that type of economic climate.

"Because this is a very new product category you don't have that correlation," Hodari says. "That's the single biggest risk when you are investing in an industry like this, no one knows what it will look like in the next recession. It might be better or a lot of co-working spaces might end up in a lot of trouble."

Mind the GAAP. Many investors are also paying close attention to the pending Financial Accounting Standards Board and International Accounting Standards Boards update to the general accepted accounting principles (GAAP) that will affect commercial real estate leases. For public companies, the update will begin in late 2018.

"Companies will have to start treating leases for office or retail spaces as liabilities on the balance sheet, not as public expenses," says Alex Cohen, lead commercial specialist for CORE, a real estate brokerage firm in New York City. "Tenants will have to take a net present value of their remaining lease obligation as a liability."

This will have a major impact on reducing earnings before interest, taxes, depreciation and amortization (also referred to as EBITDA) in leased office spaces, Cohen says. "It's going to encourage companies to take shorter-term leases," he says. "So there is less of a liability they have to apply against their earnings."

[Read: The Incredible Shrinking World of Investments.]

If the lease obligation is less than 12 months, companies won't have to treat it as a liability, Cohen says, "and that makes co-working with a six- or nine-month commitment much more attractive."

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