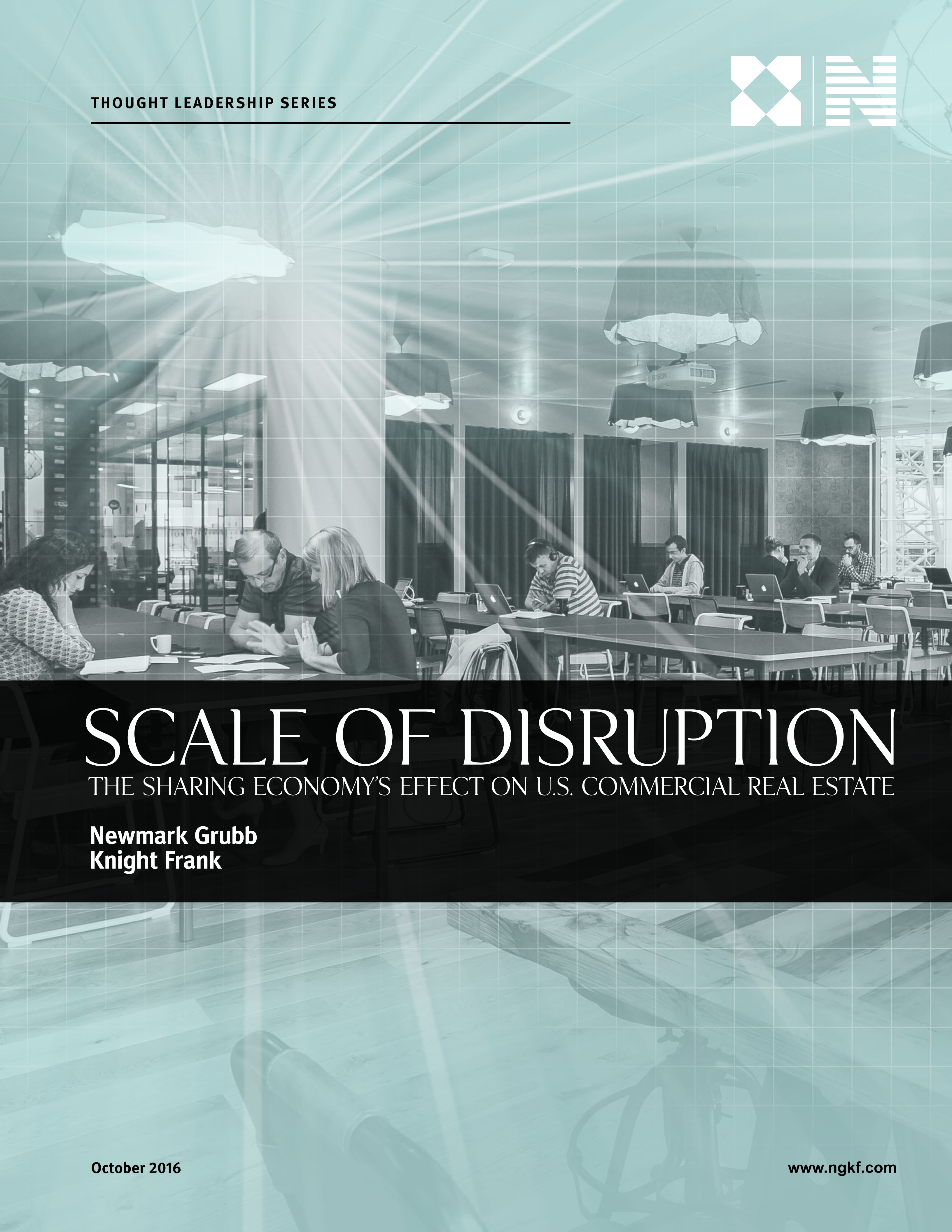
THOUGHT LEADERSHIP SERIES



SCALE OF DISRUPTION

THE SHARING ECONOMY'S EFFECT ON U.S. COMMERCIAL REAL ESTATE

Newmark Grubb
Knight Frank

October 2016

www.ngkf.com

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KEY FINDINGS

- The sharing economy is reshaping U.S. demand patterns for services and has initiated a declining emphasis on ownership of cars and homes.
- Of the major property sectors, office and hotels have been the most affected by the impact of the sharing economy; retail and multihousing have yet to see a large impact.
- On a four-point scale of disruption that was developed for this analysis (please see page 16 for details), the office sector scores three out of four and is considered to be very disrupted by the sharing economy. With the rise of coworking companies like WeWork, we are beginning to see a shift in the way people prefer to work, with even some large corporations embracing the coworking model.
- Multihousing scores only half a point out of four on our scale of disruption. So far, multihousing has been largely unaffected by changes from the sharing economy. However, with wage growth across the U.S. having lagged for the past several years, rental housing affordability has become more of an issue. A shared-common-area model for apartments could be the wave of the future, and developers should consider acting now to get ahead of the curve.
- Of all the major property types, the hotel industry likely has been the most affected by the sharing economy thus far. It scores three out of four on our four-point scale of disruption. The remarkable growth of Airbnb and other similar companies has caused hotel owners to take notice. However, due to a differing customer base, both Airbnb and traditional hotels have been able to thrive simultaneously during the current expansion cycle.
- The sharing economy has begun to infiltrate the retail industry but has not yet materially impacted retail as a real estate class. Retail scores only half a point out of four on the scale of disruption.

I.

WHAT IS THE SHARING ECONOMY?

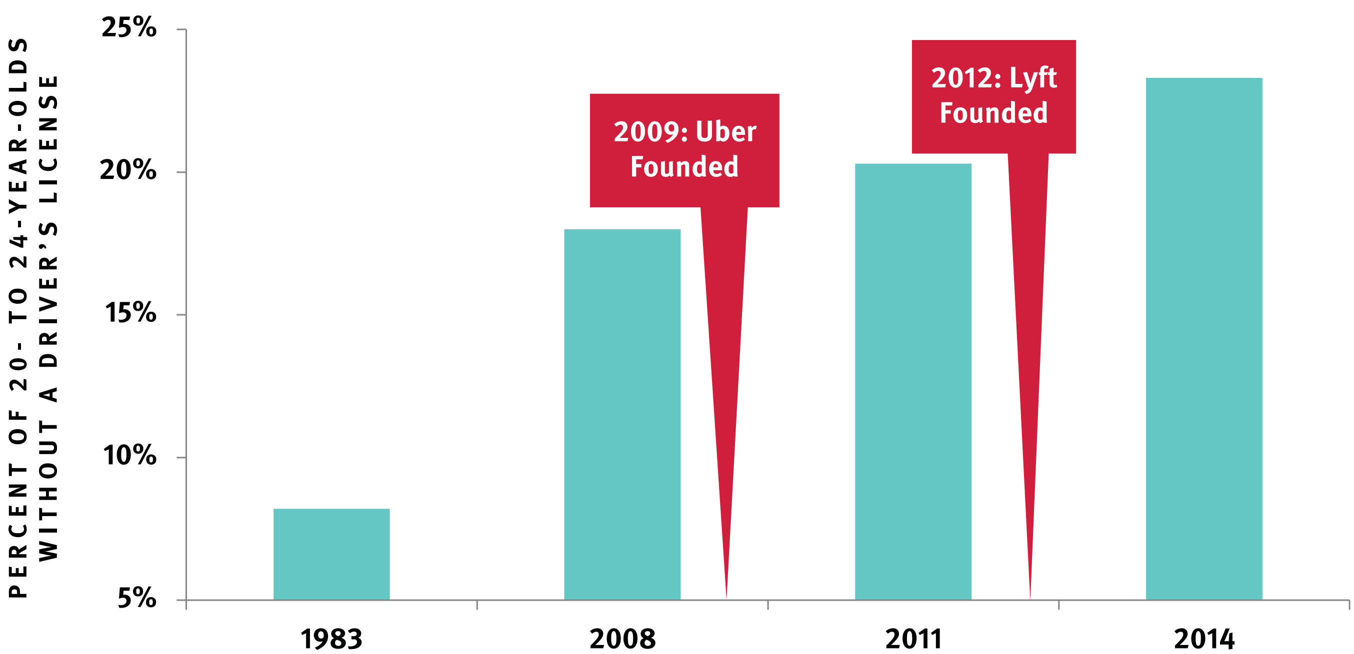
The sharing economy — also called the peer-to-peer network or collaborative consumption — is an economic model in which assets that are not used all the time are rented or shared with others. While not all consumers may be familiar with the term "sharing economy," many likely have heard of firms that utilize this model, like Uber, Airbnb, and WeWork. The extraordinary rise in popularity of these types of companies has largely been the result of the changing preferences of the millennial generation, which comprises 83.1 million people according to the U.S. Census Bureau — the largest generation in U.S. history.

51% OF U.S. INTERNET USERS POLLED PARTICIPATED IN A SHARING ECONOMY SERVICE IN 2015, **UP FROM 39% IN 2014**

Source: eMarketer/Vision Critical

High levels of debt, environmental consciousness, and a decreased emphasis on consumerism are all factors that have rendered the sharing economy particularly attractive to millennials. Many in this generation are eschewing car and home ownership, acts that had been rites of passage for prior generations. As shown in the adjacent chart, the number of 20- to 24-year-olds who did not have a driver's license rose from 18% in 2008 to over 23% in 2014. During this time period, major ride-sharing service companies Uber and Lyft were founded, making it easier for young people to get around without their own car and diminishing the need for a driver's license.

CHANGING DEMAND PATTERNS
PERCENT OF 20- TO 24-YEAR-OLDS WITHOUT A DRIVER'S LICENSE
UNITED STATES | 1983 – 2014



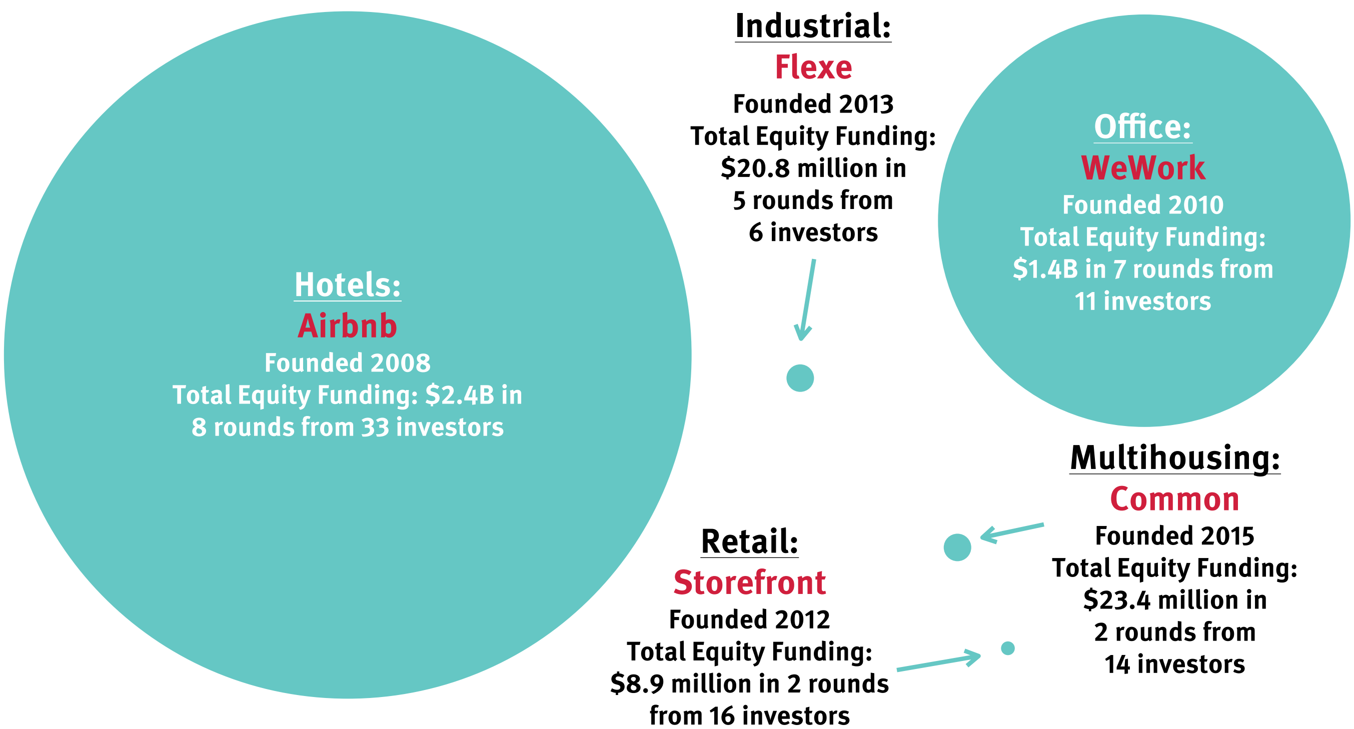
Source: Michael Sivak and Brandon Schoettle, University of Michigan, Federal Highway Administration, NGKF Research; September 2016

Another major change in demand patterns has been a significant decline in homeownership. The U.S. homeownership rate of 62.9% at second quarter 2016 is the lowest in 51 years. This decline has largely been attributed to rising property prices and stagnant wage growth. The decline in homeownership has been a boon to the multihousing rental market, but booming rental demand across the U.S. has led to rising rents. As a result, many young people cannot afford to live alone, as evidenced by the decline in renter-occupied single-person households. The rate of single-person rental households in the U.S. fell from 38.4% in 2006 to 36.3% in 2014, a 210-basis-point decline.

So with an understanding of what is driving the popularity of the sharing economy, let us take a look at how it has impacted U.S. commercial real estate. Across each major commercial real estate property type, at least one sharing economy company has cropped up, some much more well-known than others. The most recognized of these is Airbnb, a home-sharing service that is competing with hotels in many major cities. Lesser known are companies like Storefront, a service that allows owners of retail spaces to lease vacant space to short-term pop-up retail exhibits, or Flexe, a platform that allows companies with excess warehouse space to lease it to other companies with surplus inventory for a period of as little as a month. As illustrated in the adjacent chart, each of these companies has garnered interest from the investment community, but the scale of that investment varies significantly. Space-sharing powerhouses Airbnb and WeWork have received billions in equity funding, while Storefront, Flexe and Common (a multihousing community with shared living spaces) have received equity funding in the $8 million to $24 million range.

REAL ESTATE SHARING ECONOMY STARTUPS

EQUITY FUNDING FOR SPACE-SHARING COMPANIES



Note: Size of each bubble represents approximate scale of funding amount
Source: CrunchBase, NGKF Research; September 2016

We have assessed four major property types — office, multihousing, hotels and retail — to see how each has fared in the changing climate brought about by the sharing economy. Each property type was assessed on a four-point scale measuring how much it has been impacted by the sharing economy. Up to one full point was awarded for a "yes" answer to each of the following questions:

1. Have space-sharing companies captured significant market share?
2. Have traditional space providers been forced to adapt?
3. Has a significant portion of the customer base migrated from traditional to shared space?
4. Has at least one space-sharing startup in that property sector received significant equity funding?

II.

SCALE OF DISRUPTION FOR FOUR MAJOR PROPERTY TYPES

A OFFICE

The U.S. office market has experienced steady demand, with the vacancy rate at an eight-year low of 13.5% and asking rents steadily increasing over the past several years. Absorption through the first half of 2016 was positive in 46 of the 57 markets tracked by NGKF research. Let's examine how the office market is faring in the face of changes brought on by the sharing economy.

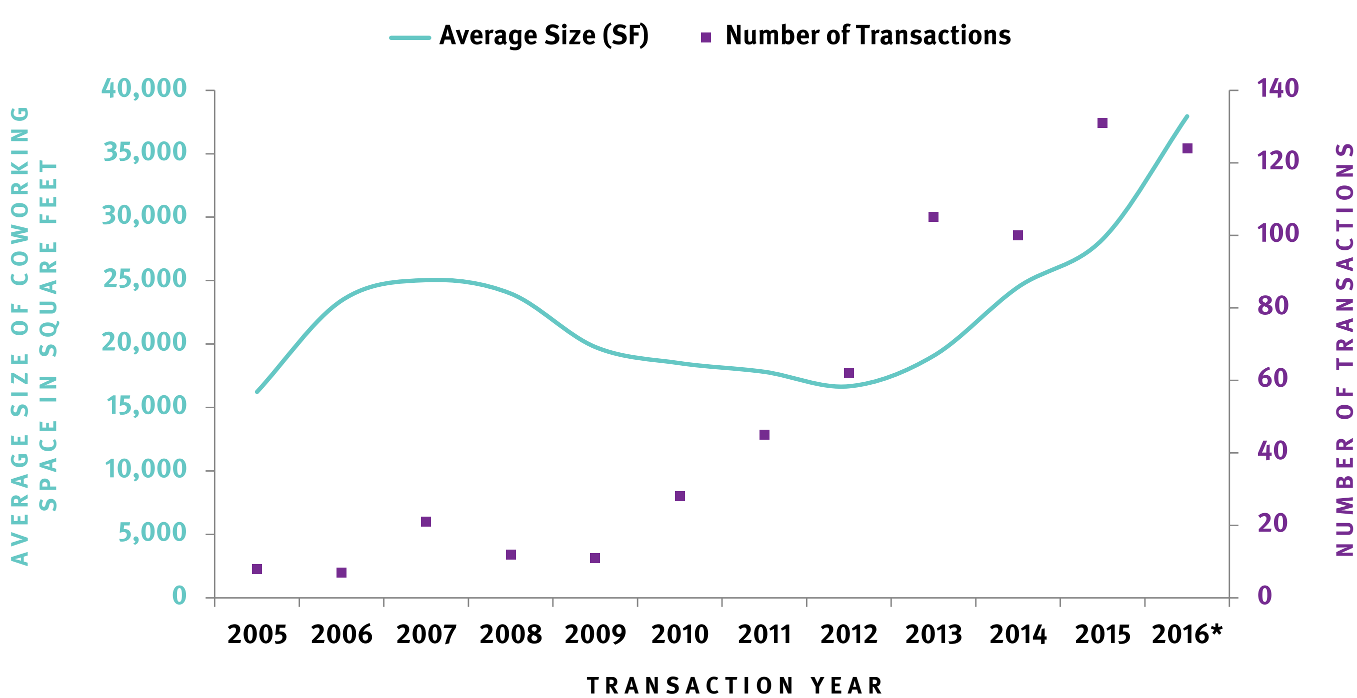
1. Have space-sharing companies captured significant market share? **Score: 0.5/1**

While office suite providers like Regus that offer fully-furnished executive suites have been around since the early 1990s, companies like WeWork and MakeOffices have been expanding steadily and have been successful in transforming the traditional corporate model into a collaborative coworking community. By offering funky creative space, weekly networking events, and amenities such as arcades and beer on tap, coworking companies have transitioned from occupying a niche segment of the market to carving out a sizable chunk of market share. As coworking has grown in popularity, coworking providers have expanded, both in number of locations and in the size of each coworking center. As illustrated in the adjacent chart, the number of coworking lease transactions and the average transaction size have both risen sharply since 2012. And according to a survey of coworking providers administered by Deskmag — an online magazine about coworking — 60% of U.S. coworking centers expect to expand in 2016.

OFFICE MARKET AND THE SHARING ECONOMY

GROWTH OF U.S. COWORKING: MORE LEASES SIGNED, LOCATIONS GETTING LARGER

AVERAGE SIZE AND NUMBER OF TRANSACTIONS: 2005 - 2016



*2016 through June, annualized. Note: Based on sample set of U.S. coworking transactions; not an exhaustive list. Source: CoStar, NGKF Research; September 2016

While coworking companies have seen tremendous growth over the past few years, they still occupy less than 1% of the total U.S. office market. They have further carved out the niche of furnished office offerings with short-term lease options, and have captured material market share in that segment, but do not yet have a significant share of the total office leasing market.

6 IN 10 U.S. COWORKING SPACES **PLANNED TO EXPAND IN 2016**

Source: *Deskmag 2016 Global Coworking Survey*

2. Have traditional space providers been forced to adapt? **Score: 1/1**

We can look at this in two ways: traditional office suite providers like Regus versus the office leasing market as a whole. Both have been forced to adapt. Regus has a strong following as a traditional corporate office suite but has not yet captured the tech and startup crowd. Regus responded to the unprecedented growth of WeWork by acquiring Spaces, a Netherlands-based company that caters more to the social side of the coworking movement. Spaces has locations in major U.S. cities including New York, Boston, Dallas and San Francisco, and it is coming soon to Washington, DC.

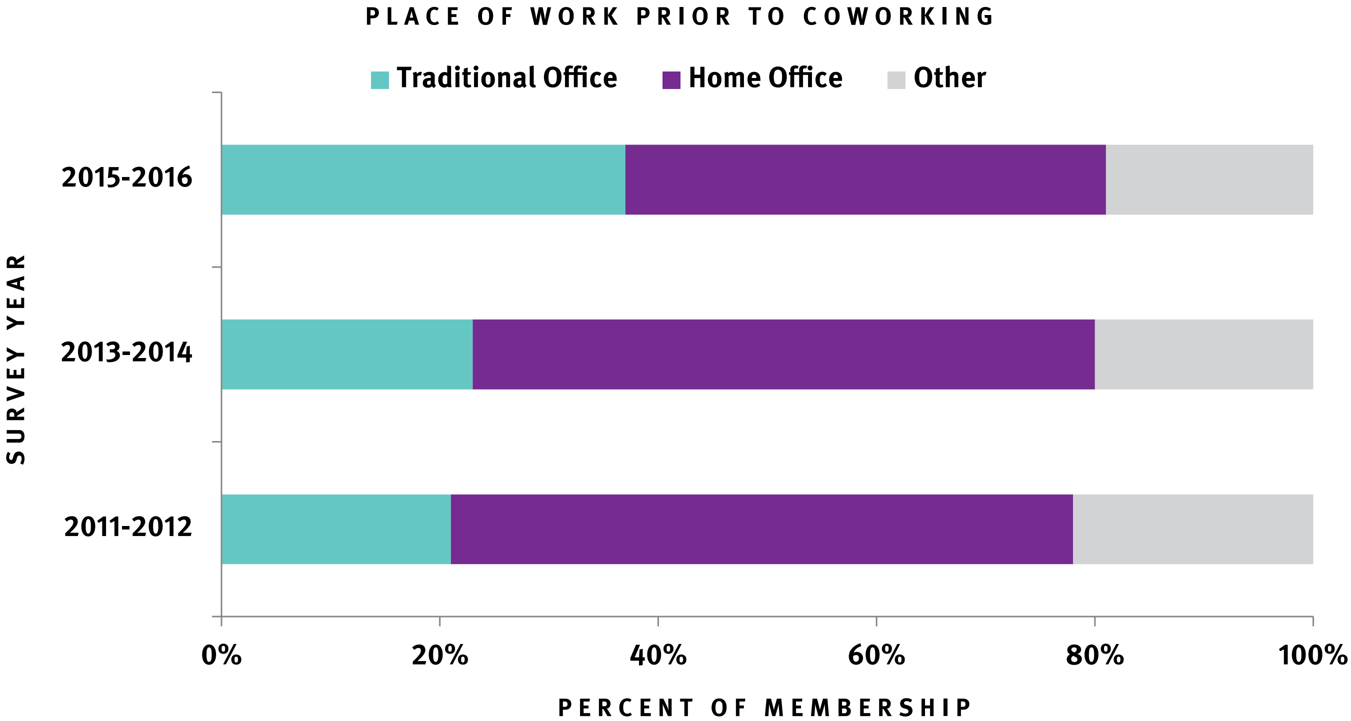
The office leasing market as a whole has also been forced to adapt, although to a lesser degree. Since coworking providers typically host smaller tenants, they have not yet posed a major competitive threat to owners of traditional office buildings, but they now are being more seriously considered as a new class of tenant type. This comes with its own risks since many of these companies are in their infancy and may not have the creditworthiness to make owners feel secure in leasing to them long-term. But while some owners of office buildings may view coworking as a fad, the sector has experienced tremendous growth and has disrupted how traditional office owners position their assets.

3. Has a significant portion of the customer base migrated from traditional to shared space? **Score: 0.5/1**

While coworking has always appealed to startups and young technology companies, its appeal has been broadening of late. As technological advances have led to teleworking becoming feasible for more workers, more are choosing that option. Many of these employees find coworking spaces to be a better alternative than working at home or in a coffee shop, where distractions abound. As a result, the clientele who utilize coworking space have become more diverse. As shown in the chart on page 8, the share of members who had worked in a traditional office prior to joining a coworking community increased from 21% to 37% over the past four years.

OFFICE MARKET AND THE SHARING ECONOMY

COWORKING MEMBERS INCREASINGLY COMING FROM TRADITIONAL OFFICE SPACE



Source: *Deskmag*, NGKF Research; September 2016

Even large corporations are starting to embrace coworking as part of their overall real estate strategy. Some major corporate entities looking to expand into a new market or working on temporary projects have placed employees in coworking suites rather than opening a temporary office. While it is more expensive on a per-square-foot basis, the flexibility provided makes coworking an attractive alternative. For corporations that provide business services to startups, placing sales employees in coworking locations allows ideal access to the tech crowd that represents a pool of potential customers.

45% OF MEMBERS OF COWORKING COMPANY SERENDIPITY LABS **ARE CORPORATE EMPLOYEES**

Source: Bloomberg

4. Has at least one space-sharing startup received significant equity funding? **Score: 1/1**

While perhaps not as well-known as Airbnb, WeWork has steadily become a success story among sharing economy companies. Founded in 2010 in New York City, WeWork has grown to over 100 office locations in 32 cities in North America, Europe and Asia as of mid-2016. The most recent funding round in March of 2016 valued WeWork at $16 billion. It has received $1.4 billion through seven rounds of equity funding. The company has ambitious growth plans to expand further into Asia. Some have questioned the sky-high valuation and brought up concerns that the level of growth is not sustainable for a real estate company. However, WeWork and its investors believe that its customer base will continue to expand as coworking continues to gain popularity across various office tenant types.

OFFICE: SCALE OF DISRUPTION
TOTAL SCORE: 3 OUT OF 4
VERY DISRUPTED

0	1	2	3	4
Not disrupted. Sharing economy has no effect.	**Modestly disrupted.** Sharing economy has had measurable but minor effects.	**Moderately disrupted.** Sharing economy is starting to modify behaviors.	**Very disrupted.** Sharing economy is forcing change.	**Completely disrupted.** Sharing economy is dominating decision-making within the industry.

ACTION STEPS FOR OWNERS OF OFFICE SPACE

- Owners of well-located but otherwise obsolete properties could attempt to court coworking providers as tenants, since most coworking companies seek non-traditional space at easily accessible locations and target below-market rents.
- There has been some concern about sustainability of the coworking business model and its ability to weather an economic downturn. Since it has not yet been tested, owners should be careful not to overweight their portfolio with coworking tenants.
- Having coworking providers in a building can be good for the owner's prospects for leasing the asset, as many startups are likely to want to stay in the same location when they outgrow their coworking space and can be funneled into direct space in the same building.

55% OF COWORKING LOCATIONS SIGNED LEASES FOR SPACE THAT HAD BEEN VACANT FOR **MORE THAN 6 MONTHS BEFORE MOVING IN**

Source: *Deskmag 2016 Global Coworking Survey*

ACTION STEPS FOR OFFICE TENANTS

- While it is not necessarily cheaper, startups or smaller companies may find that the shorter lease terms and supportive environment offered with coworking is a better initial solution than traditional office space. A move to traditional space can occur as the tenant matures.
- While coworking has largely been adopted by the startup and technology community, it is beginning to be adopted by the corporate world as well. For corporate employers, offering employees flexibility regarding where they work can be a good way to attract and retain top talent.

B MULTIHOUSING

With the sharp decline in the homeownership rate, the U.S. multihousing market has been booming. But has it been impacted by the sharing economy?

1. Have space-sharing companies captured significant market share? **Score: 0/1**

Multihousing is the most recent property type to try out the space-sharing model. Companies such as Common and WeLive have debuted co-living communities over the past year. Residents generally have private bedrooms but shared kitchens and common areas. The high-end finishes and upscale amenities take this living arrangement up a notch from college dorm living. These companies are in their infancy and are still experimenting with how to make their model work. While they have not yet captured significant market share, if co-living communities can provide an affordable alternative to renting a traditional apartment, more people may gravitate to this model.

19 NUMBER OF MEMBERS IN COMMON'S **FIRST EXPERIMENTAL CO-LIVING COMMUNITY IN NEW YORK**

Source: *Inc.*

2. Have traditional space providers been forced to adapt? **Score: 0/1**

Since the sharing economy for multihousing has not yet captured a significant share of the market, multihousing developers have not been forced to adapt. However, with the unprecedented amount of new supply coming online in the U.S. market, rent growth may be slowing. According to Axiometrics, 12-month rent growth in the national multihousing market averaged 3.7% in the second quarter of 2016, down from 5.1% at the second quarter of 2015. If rent growth idles, developers may be forced to change.

$875 **STARTING PRICE FOR A BED AT WELIVE IN CRYSTAL CITY, VA** VERSUS $1,413, THE AVERAGE ASKING RENT FOR A STUDIO IN THE WASHINGTON METRO AREA

Source: *Washington Business Journal*, CoStar

3. Has a significant portion of the customer base migrated from traditional to shared space? **Score: 0/1**

No, but fewer people are living alone. While U.S. wage growth has stagnated, rent costs have continued to increase. As illustrated in the chart on page 11, single-person renter households have declined significantly since 2008 as the share of income that is allocated to rent has risen. If this trend continues, co-living communities could be the next wave of affordable housing.

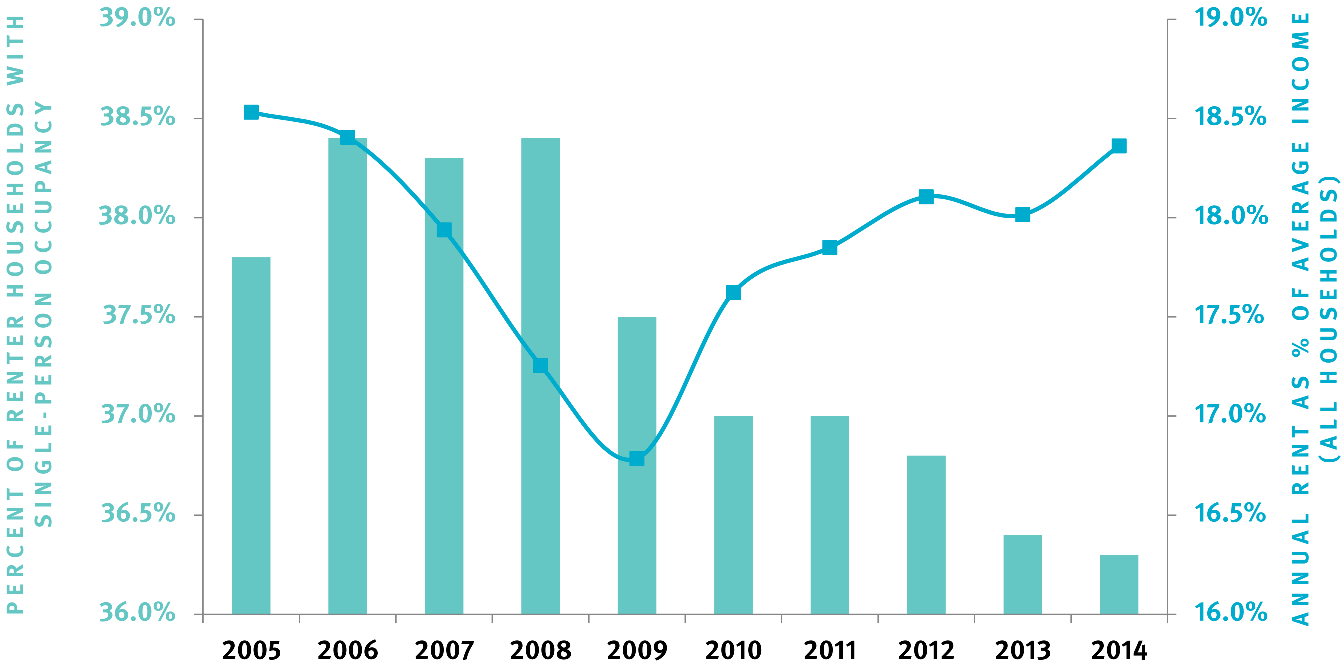
4. Has at least one space-sharing startup received significant equity funding? **Score: 0.5/1**

As illustrated in the chart on page 5, Common received $23.4 million in equity funding in two rounds. While this is not insignificant, it pales in comparison to the billions of dollars in equity funding received by Airbnb and WeWork. It should be noted that shared apartment community WeLive is a subsidiary of WeWork, which has raised significant funding. However, the bulk of that funding was likely geared toward expansion of the firm's highly successful office coworking business.

21% OF WEWORK'S REVENUE **IS PROJECTED TO COME FROM WELIVE BY 2018**

Source: *Business Insider*

MULTIHOUSING MARKET AND THE SHARING ECONOMY
HIGHER RENT COSTS MEAN FEWER PEOPLE CAN AFFORD TO LIVE ALONE
UNITED STATES | 2005 - 2014



Source: U.S. Census Bureau, Axiometrics, NGKF Research; September 2016

MULTIHOUSING: SCALE OF DISRUPTION
TOTAL SCORE: 0.5 OUT OF 4
MODESTLY DISRUPTED

0
Not disrupted. Sharing economy has no effect.

1
Modestly disrupted. Sharing economy has had measurable but minor effects.

2
Moderately disrupted. Sharing economy is starting to modify behaviors.

3
Very disrupted. Sharing economy is forcing change.

4
Completely disrupted. Sharing economy is dominating decision-making within the industry.

ACTION STEPS FOR OWNERS OF MULTIHOUSING

- Since many multihousing developers have not yet adapted to the sharing economy, now is prime time to get ahead of the curve and start experimenting with roommate matching services, shared living communities, or renting by the individual room rather than the whole unit.
- Affordability is a continuing issue for many renters in the U.S., with annual rent as a percent of average income rising steadily since 2009. Utilizing a sharing economy model for apartments could be a good way to provide affordable housing that is still profitable for developers.

HOTELS

The U.S. hotel market has been performing well of late, with revenue per room and average daily rate up 4.3% and 3.6%, respectively, over the past 12 months, according to Smith Travel Research. At the same time, Airbnb has been a top performer among sharing economy companies. It's no secret that the hotel industry has felt threatened by Airbnb and in some situations considers its users illegal hoteliers. Let's assess the weight of that threat.

1. Have space-sharing companies captured significant market share? **Score: 1/1**

Yes. While Airbnb is the biggest example, other home-sharing companies have proliferated in the U.S. market and abroad including VRBO and HomeAway. Airbnb now has 60 million users and over 2 million listings and was valued at $30 billion in 2016.

$30 BILLION VALUATION OF AIRBNB IN MARCH OF 2016

Source: Bloomberg

2. Have traditional space providers been forced to adapt? **Score: 0.5/1**

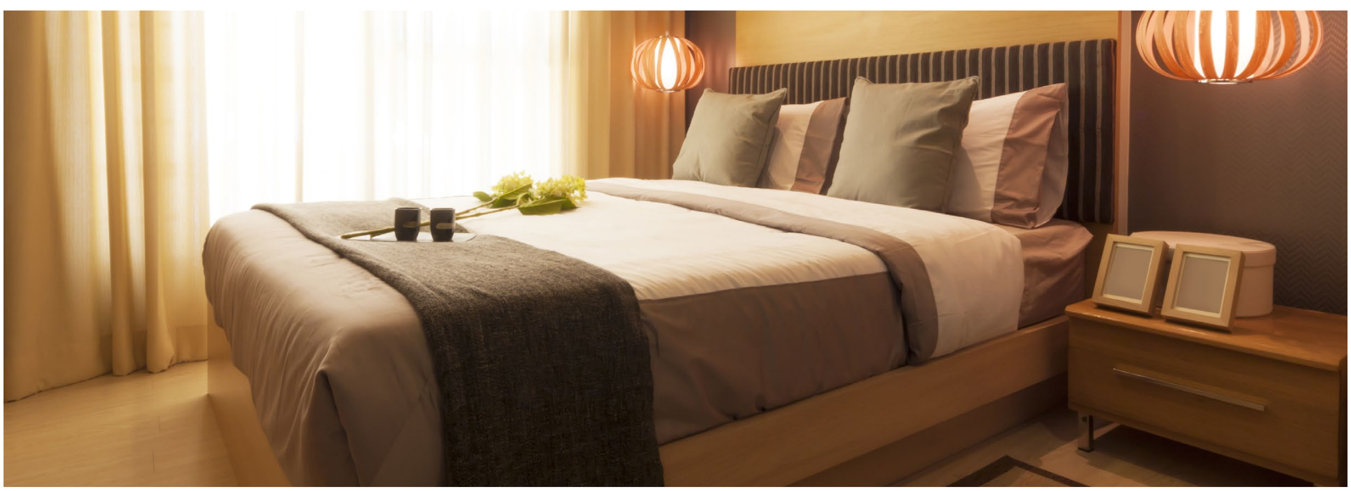
While U.S. hotels have still been performing quite well, with the huge success of Airbnb it is certain that some of that demand has come at the expense of traditional hotels. Some chains are taking tentative steps to ward off this threat by investing in Airbnb competitors. For example, in 2015 Hyatt Hotels invested in British home-sharing company Onefinestay.

3. Has a significant portion of the customer base migrated from traditional to shared space? **Score: 0.5/1**

Yes, but hotels are still thriving. There has been much talk about the hotel industry being completely disrupted by Airbnb, but it is largely still performing well, with occupancy, average daily rate, and revenue per room all on the rise. Airbnb caters to a niche market — particularly leisure travelers. As shown in the chart on page 13, cities with a higher cost of living have a greater disparity between hotel prices and the price for a one bedroom on Airbnb. However, hotel demand in these cities is already so great that Airbnb serves as a complement to the existing hotel base.

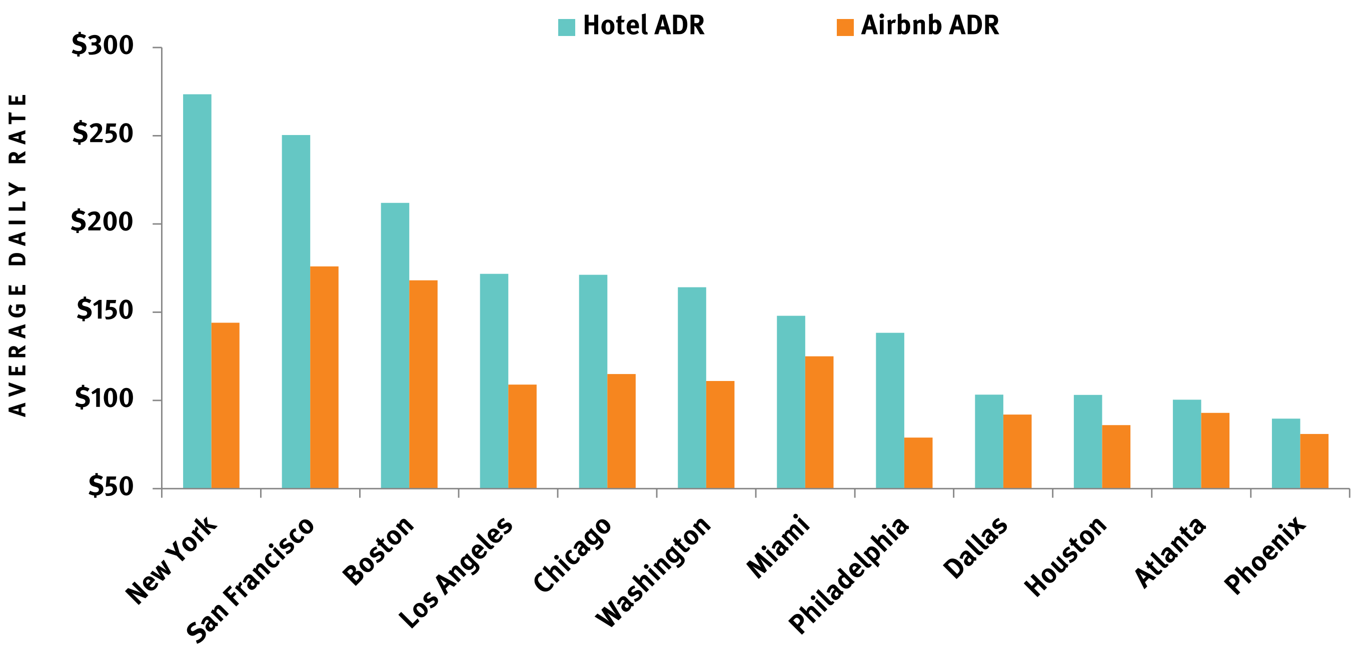
4. Has at least one space-sharing startup received significant equity funding? **Score: 1/1**

Yes. Airbnb is the darling of successful startup companies. As of mid-2016, it ranks third on *Fortune*'s list of "unicorns" — private companies valued at $1 billion or more — behind only Uber and Chinese electronics company Xiaomi.



HOTEL MARKET AND THE SHARING ECONOMY

HIGHER-COST CITIES HAVE GREATER PRICING DISPARITY BETWEEN HOTELS AND AIRBNB



Note: Data as of June 2016; Airbnb average daily rate is for one bedroom. Source: Airdna, Smith Travel Research, NGKF Research; September 2016

HOTELS: SCALE OF DISRUPTION
TOTAL SCORE: 3 OUT OF 4
VERY DISRUPTED

0	1	2	3	4
Not disrupted. Sharing economy has no effect.	**Modestly disrupted.** Sharing economy has had measurable but minor effects.	**Moderately disrupted.** Sharing economy is starting to modify behaviors.	**Very disrupted.** Sharing economy is forcing change.	**Completely disrupted.** Sharing economy is dominating decision-making within the industry.

ACTION STEPS FOR OWNERS OF HOTELS

- While Airbnb has been very popular with leisure travelers, it is not necessarily a practical option for business travelers who seek consistency and predictability in accommodations. Focus investment on hotel classes that cater to business travel, as this is less likely to be disrupted by the sharing economy.
- Consider following the lead of some major chains and partnering with or investing in home-sharing companies while the concept is still evolving.

D RETAIL

The U.S. retail market has been performing well, with shopping center vacancy steadily declining for the past few years, despite a marked shakeup of the brick-and-mortar retail market imposed by e-commerce. Is the sharing economy having a similar effect on retail?

1. Have space-sharing companies captured significant market share? **Score: 0/1**

While there are several examples of retailers that utilize the sharing economy model — like Rent the Runway, for example — space-sharing for retail as a real estate class has not yet taken off. One company in this space is Storefront, which utilizes a model similar to Airbnb's but adapted for retail. Founded in 2012, Storefront pairs owners of vacant retail space with retailers who wish to set up temporary "pop up" exhibits, shops or event spaces.

$2,000 **THE AVERAGE COST TO OPEN A POP-UP ON STOREFRONT** VS $98,000 TO OPEN A TRADITIONAL BRICK-AND-MORTAR STORE

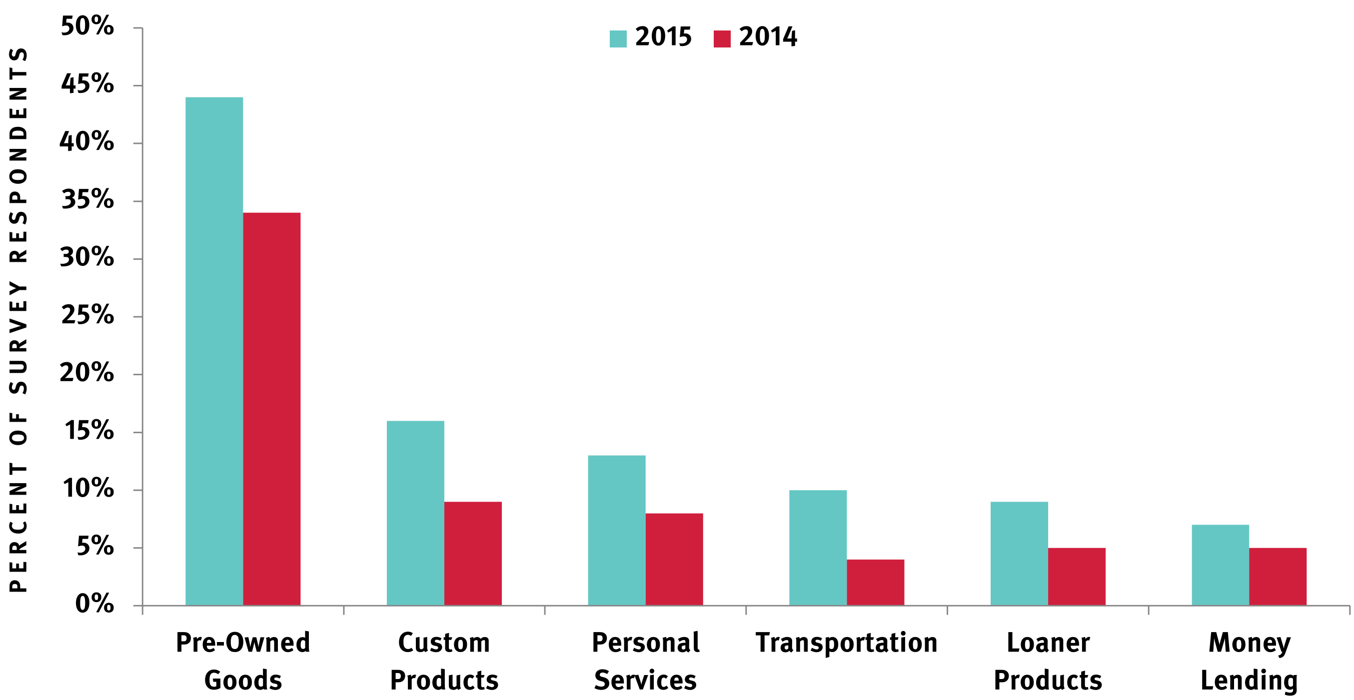
Source: Storefront

2. Have traditional space providers been forced to adapt? **Score: 0/1**

The largest change that has taken place in retail over the past several years has been the huge disruption to brick-and-mortar retail stores as e-commerce has become an increasingly larger segment of the market. In contrast, the sharing economy has had little effect on the retail real estate market so far.

RETAIL MARKET AND THE SHARING ECONOMY

PERCENTAGE OF SURVEY RESPONDENTS WHO HAVE USED A SHARING ECONOMY SERVICE IN THE PAST 12 MONTHS FOR...



Note: Based on demographically representative sample of 51,078 survey respondents from the U.S. and Canada ages 18 and over
Source: Vision Critical, NGKF Research; September 2016

3. Has a significant portion of the customer base migrated from traditional to shared space? **Score: 0/1**

The sharing economy is beginning to take off for retailers. As shown in the chart on page 14, the percentage of survey respondents who used a sharing economy service for various retail goods and services increased significantly from 2014 to 2015. For now, pop-up shops that would utilize a service like Storefront are similar to the startup companies that utilize office coworking. They are smaller, sometimes temporary retail businesses that probably would not be target tenants for owners of retail space. The sharing economy is certainly infiltrating retail as a business but has not yet materially affected retail as a real estate class.

4. Has at least one space-sharing startup received significant equity funding? **Score: 0.5/1**

A startup has received funding, but not a major commitment. Storefront received $8.9 million in equity funding in two rounds. Similar to Common for multihousing, this is not a small sum of money, but it is small in comparison to the billions of dollars in equity funding received by Airbnb and WeWork. In fairness, those companies were founded in 2008 and 2010, respectively, while Storefront was founded in 2012. It remains to be seen whether Storefront will receive additional funding and become a bigger player in the space-sharing business.

RETAIL: SCALE OF DISRUPTION
TOTAL SCORE: 0.5 OUT OF 4
MODESTLY DISRUPTED

0	1	2	3	4
Not disrupted. Sharing economy has no effect.	**Modestly disrupted.** Sharing economy has had measurable but minor effects.	**Moderately disrupted.** Sharing economy is starting to modify behaviors.	**Very disrupted.** Sharing economy is forcing change.	**Completely disrupted.** Sharing economy is dominating decision-making within the industry.

ACTION STEPS FOR OWNERS OF RETAIL SPACE

- For well-located retail space that is currently vacant, leasing it short-term for a pop-up shop can be a productive way to generate income and foot traffic while courting a longer-term tenant.
- Hosting pop-up shops can be a good way to gain access to potential long-term tenants, since many startup retailers will eventually expand and require more space or additional locations.

FREE COST TO **LIST VACANT RETAIL SPACE ON STOREFRONT**

Source: Storefront

ACTION STEPS FOR RETAIL TENANTS

- For retailers that are just starting out or that are looking to build a customer base, starting a pop-up shop is a cost-effective way to gain brand exposure.
- On average, opening a pop-up shop is much faster and less expensive than opening a permanent retail store, so pop-ups can be a good way to get a retail business started while seeking a permanent location.

SUMMARY: SCALE OF DISRUPTION TABLE

Scoring: Up to one full point for a “yes” answer to each question.

CRITERIA	OFFICE	MULTIHOUSING	HOTELS	RETAIL
1. Have space-sharing companies captured significant market share?	0.5	0	1	0
2. Have traditional space providers been forced to adapt?	1	0	0.5	0
3. Has a significant portion of the customer base migrated from traditional to shared space?	0.5	0	0.5	0
4. Has at least one space-sharing startup received significant equity funding?	1	0.5	1	0.5
Total Score	***3***	***0.5***	***3***	***0.5***

0
Not disrupted. Sharing economy has no effect.

1
Modestly disrupted. Sharing economy has had measurable but minor effects.

2
Moderately disrupted. Sharing economy is starting to modify behaviors.

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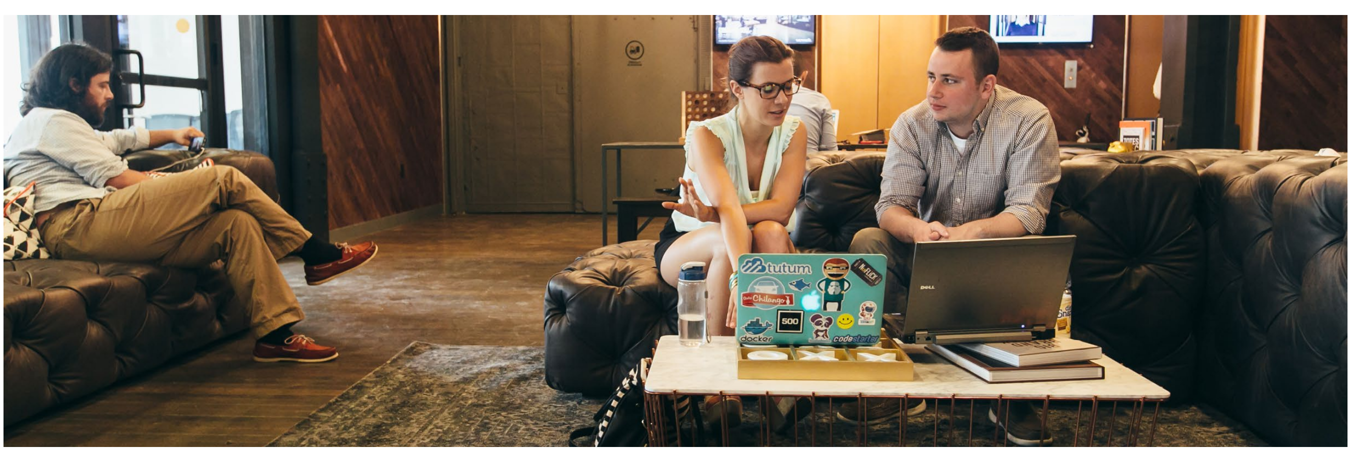

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Smith Travel Research

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United States Census Bureau

WeWork.com

Images provided by WeWork.com


DETOUR
AHEAD
#WWSEA


TRON
FRAGILE


POP
UP
SHOP

Gregory H. Leisch, CRE
Senior Managing Director
Market Research
gleisch@ngkf.com

Alexander (Sandy) Paul, CRE
Managing Director
National Market Research
apaul@ngkf.com

Bethany Schneider
Research Manager
bschneider@ngkf.com

Alex Shirokow-Louden
Research Analyst
alex.shirokow-louden@ngkf.com

Washington, DC
1899 Pennsylvania Avenue, NW
Suite 300
Washington, DC 20006
202.331.7000

Tysons
1410 Spring Hill Road
Suite 600
McLean, VA 22102
703.448.2000

Baltimore
One East Pratt Street
Suite 805
Baltimore, MD 21202
410.625.4200

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