Bankruptcy Law
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WeWork Holds Leverage Over Landlords in Threatened Bankruptcy

By James Nani

Deep Dive

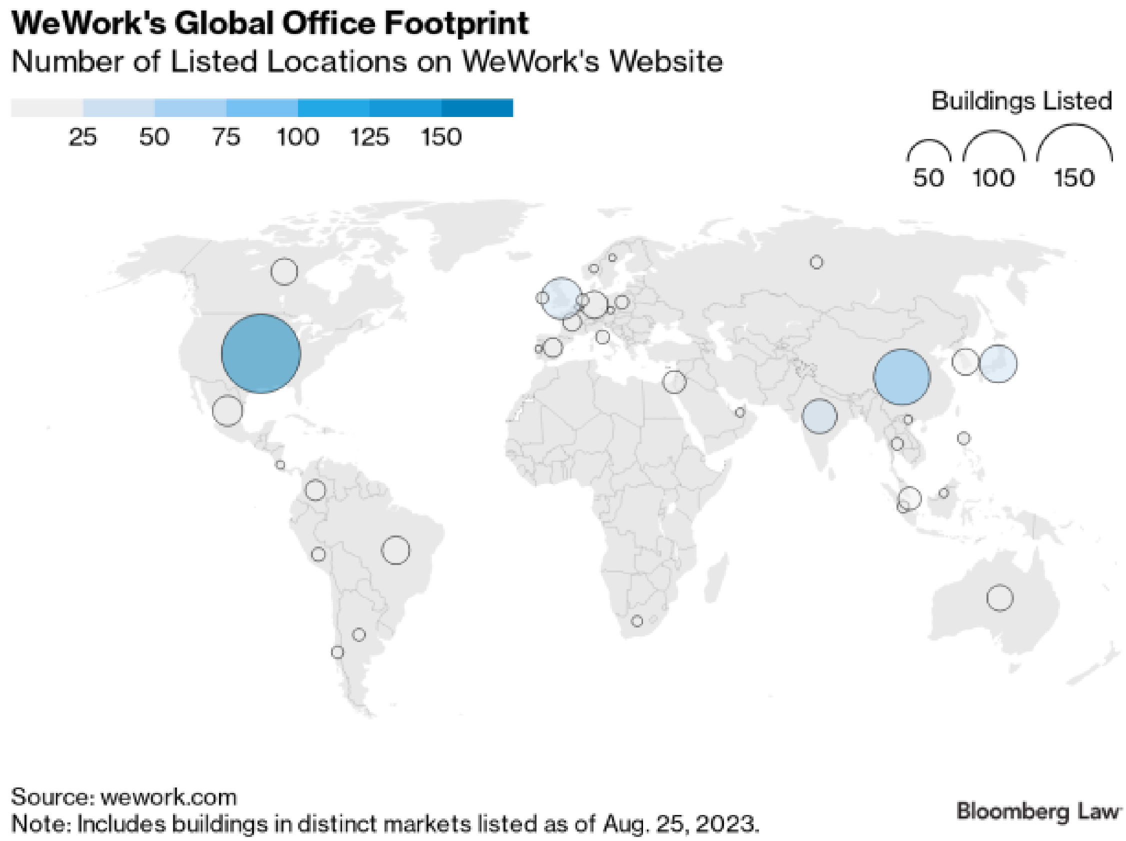
- WeWork undertaking major push to renegotiate its leases
- Bankruptcy rules cap landlord rent claims at three years

Coworking giant WeWork is flirting with bankruptcy, raising the prospect that its hundreds of landlords around the world could be forced to give it lease concessions.

With some $2.2 billion in rent obligations due next year, WeWork Cos. Inc.'s ability to recast or cancel its leases will be central to its survival. But the company's fortunes also reflect the changing nature of work and an increasingly hybrid workforce, adding to the "double whammy" facing commercial landlords who are also struggling with higher interest rates.

If the company opts for Chapter 11, its landlords will be forced to either accept deals on rent or be kicked to nearly the back of the repayment line, with claims for reduced rent obligations, bankruptcy and real estate specialists said.

The company recently began a process to renegotiate virtually all its landlord leases, which are spread among 777 locations in 39 countries as of June 30, according to a public filing. The result of that process may help determine whether the company will have to reorganize in bankruptcy.



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Chapter 11 would offer WeWork upsides, including the ability to escape onerous real estate leases. Faced with a debtor-friendly Chapter 11 scenario and a distressed commercial office market, landlords may be willing to cut rent or make other deals to keep WeWork as a tenant —in or out of bankruptcy, lawyers said. The threat of bankruptcy alone could force landlords to the table.

"I think this is a story about leverage," said Harold Bordwin, a principal in New York at Keen-Summit Capital Partners LLC who specializes in renegotiating distressed real estate.

WeWork interim CEO and Director David M. Tolley on Sept. 6 announced in an open letter that the company will try to exit "unfit and underperforming locations" but remain in the majority of its buildings and markets. The announcement came after the company warned last month that it had "substantial doubt" about its ability to continue operating.

Landlords at Disadvantage

One of the primary tools for debtors in Chapter 11 is the ability to assume or reject a lease. Leases would be by far the most critical issue if WeWork were to file for bankruptcy, said Jim Van Horn, a partner at Barnes & Thornburg and global president of the Turnaround Management Association.

“Landlords are very much at a disadvantage in situations like this because there are very limited options for landlords in this market in particular,” Van Horn said.

A reorganization would give the company an opportunity to get new space and a lower price, he said.

A WeWork coworking space in the Arts District of downtown Los Angeles, Calif., in 2021. Photographer: Bing Guan/Bloomberg via Getty Images

A bankrupt WeWork could also try to find a company to purchase its leases. But right now, that may be difficult with the amount of availability on the market, Van Horn said.

A WeWork bankruptcy that rejects leases would contribute to landlords’ existing troubles by leaving them with big blocks of empty space, said Eric Haber, counsel at brokerage Wharton

Property Advisors.

“They’ve already been hit with the double whammy of remote work and higher interest rates,” Haber said.

The company has since late 2019 exited or modified 590 leases, reducing its lease payments by an estimated $12.7 billion, Tolley has said.

Though a WeWork bankruptcy poses problems for many landlords, some in the real estate market have been preparing.

“When underwriting properties with WeWork as a tenant, real estate lenders have been baking-in a potential bankruptcy to their underwriting assumptions to account for this added risk,” said Ran Eliasaf, founder and managing partner of real estate private equity firm Northwind Group.

‘Unsatisfactory Result’

The ability to scrap leases is a huge benefit for companies that have a glut of them, said David Skeel, a law professor at the University of Pennsylvania Law School.

“Being able to reject undesirable leases and pay ‘bankruptcy dollars’ rather than real dollars is a big advantage of filing for bankruptcy when such a company is struggling,” Skeel said.

Rejecting a lease in Chapter 11 essentially counts as a contract breach, which means the contract terminates and the landlord is left in similar position as it would be outside of bankruptcy, according to Bordwin.

However, under the bankruptcy code, that pre-bankruptcy lease claim is capped and can never exceed three years of rent, Bordwin said. That’s a significant difference from how rent obligations would be treated outside of bankruptcy, he said.

“Not only is it capped at three years, but then it gets paid at the end of the case in ‘bankruptcy dollars,’ with other unsecured creditors,” Bordwin said. “It’s typically paid out cents on the dollar. So it’s a pretty unsatisfactory result for landlords.”

WeWork had a weighted average of 11 years left in its leases and future minimum lease payment obligations of about $25 billion as of June 30, the company said in an August filing.

Rent that’s due after a bankruptcy filing and before a rejection has a higher payment priority compared to pre-bankruptcy rent, and needs to be paid when a Chapter 11 plan goes into effect. That often means debtors make those lease decisions relatively quickly after filing for bankruptcy to keep costs down.

As landlords weigh their options, they typically have to consider the interest of their mortgage lenders.

“Can the landlord make decisions without talking to its its mortgage lender? Will its mortgage lender agree to that kind of rent reduction? So it’s not such a simple negotiation where the landlord is making that decision on his own,” Bordwin said. “More likely than not, it’s got to get consent from the lender.”

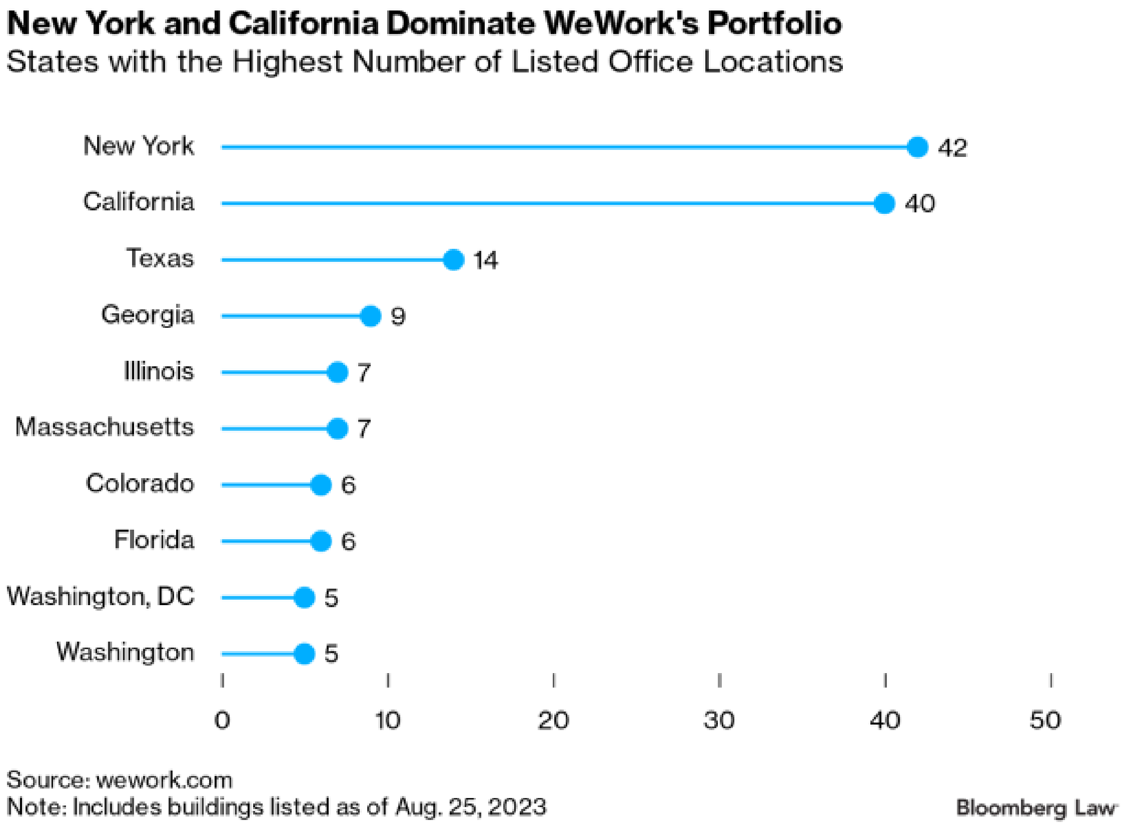
Office Distress

Decisions by landlords over how to address WeWork’s situation may be compounded by the difficult task of trying to find similar tenants, said Ann K. Chandler, a Denver-based real estate attorney with Hall Estill.

“There’s all these services that WeWork offered to provide to their members who were using their spaces,” Chandler said. “It’s not an easy thing for a landlord to take back that kind of space.”

Chandler noted that renegotiating leases may be challenging because of growing competition in the coworking industry.

WeWork public filings offer a glimpse into the layout of its coworking empire. The company had 43.9 million rentable square feet of space globally as of the end of 2022. Of that, 18.3 million was in the US and Canada. The company has more than 600 landlord relationships globally, according to the filings.



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By the end of June, 41% of WeWork's revenue was earned in the US and a majority of the company's 2022 revenue from US locations came from the greater New York City, San Francisco, and Boston markets, according to public filings.

While those area leases offer possible lease savings, they also bring in significant income. As of the end of 2022, WeWork said it represented about 1% of the total commercial office stock in New York City.

WeWork has struggled in recent years, but other coworking companies have seen gains. Regus and Spaces brands owner IWG PLC, which says it's the largest provider of hybrid workspace globally, announced in August the "highest-ever revenue" in its 30-year history.

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Past Coworking Bankruptcies

WeWork wouldn't be the first shared workspace entity to go bankrupt.

Knotel Inc. filed for Chapter 11 in January 2021 following losses stemming from the pandemic and a worldwide shift to working from home. The New York City-based company—which employed about 110 people, had about 300 customers, and had more than 4 million square feet of leased workspace—eventually wound down after it sold its business to lender Digiatech LLC, an affiliate of commercial real estate firm Newmark Group Inc.

Coworking space provider RGN-Group Holdings LLC and affiliates—subsidiaries of Regus Corp.—won court approval in August 2021 for their bankruptcy plan which allowed them to keep operating in most of their roughly 1,000 North American locations.

The bankrupt Regus subsidiaries were able to reorganize by renegotiating a substantial number of their leases.

But while bankruptcy offers some advantages, it's also costly and risky.

"They're trying to avoid bankruptcy because then they're in play. They can be bought," Wharton Property Advisors' Haber said. "They could end up liquidated if the reorganization doesn't work. They lose control."

Andrew Wallender contributed to this story.

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