

Bankruptcy and Real Estate Client Alert |
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How Will the WeWork Bankruptcy Impact the Commercial Real Estate Market?



WeWork, the office-sharing and coworking office space company, filed for protection under Chapter 11 of the U.S. Bankruptcy Code this week in New Jersey. The company reportedly leases millions of square feet of office space in 777 locations worldwide, but the bankruptcy filing is limited to its locations in the United States and Canada.

In an initial filing, WeWork reported total debts of approximately \$18.5 billion and total assets of approximately \$15 billion. Shortly before its bankruptcy filing, WeWork reportedly had close to \$16 billion in long-term lease obligations, which account for approximately two-thirds of WeWork's operating costs.

The company reported that it has entered into a restructuring agreement with most of its stakeholders that will allow it to restructure successfully, largely by shedding leases to reduce operating expenses.

The Finances

WeWork was valued at approximately \$47 billion in 2019. The company was significantly devalued due to weaknesses in its original business plan and management, explosive growth, a failed attempt to go public in 2019, and the pandemic when people stopped working in offices. Ultimately, the company succeeded in going public in 2021. Post-pandemic, WeWork has continued to be plagued by difficulties, including the developing hybrid and work-from-home culture, increased competition in the coworking space, higher interest rates and macroeconomic uncertainty. As of last week, the company was valued at less than \$45 million, and its stock lost more than 97 percent of its value.

The Bankruptcy

Regarding the bankruptcy, WeWork's new CEO reported that the company intends to aggressively address its legacy leases and dramatically improve its balance sheet by seeking to reject the leases of certain locations, which are largely nonoperational.

The Impact on Commercial Lessors

WeWork's bankruptcy filing comes at a time of incredible tumult in the commercial real estate market. The pandemic, rising interest rates, and continued hybrid and work-from-home policies already have caused unprecedented vacancies in commercial real estate throughout the United States, particularly in major markets. Given the number of leases WeWork has and the large proportion of commercial real estate subject to those leases, WeWork's bankruptcy will significantly affect the owners of commercial

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real estate in the United States and their lenders. Indeed, prior to the commencement of WeWork's bankruptcy, many of WeWork's landlords had agreed to accept reduced rents, and now some of these landlords are struggling to make payments to their lenders.

Now that WeWork is in bankruptcy, it can employ Section 365 of the Bankruptcy Code to assume or reject unexpired leases. Although WeWork will have to make a motion to assume or reject its leases, the court generally will defer to the "business judgment" of a debtor to grant motions under Section 365. The assumption of a lease is essentially the retention of the lease. Unless agreed otherwise between the lease parties, assumption requires that all defaults under the lease be cured. Under the Bankruptcy Code, a debtor must assume a commercial real property lease within 120 days after the petition date or the lease is deemed rejected. Upon a showing of cause, the court may extend the 120-day period. If WeWork has any leases that are under market but no longer fit into WeWork's business plan, subject to an order of the Bankruptcy Court, WeWork can assume and assign them to a purchaser. If WeWork has a lease that it wishes to assume, but the lease contains unsatisfactory terms, subject to an order of the Bankruptcy Court, WeWork may modify and assume the lease so long as the counterparty consents.

Rejection of a lease is essentially the termination of a lease. A landlord whose lease is rejected pursuant to Section 365 is left with vacant space and a general unsecured claim composed of prepetition arrearages under the lease plus "rejection damages." The "rejection damages" portion of the claim is subject to a statutory cap equal to the greater of rents due for one year under the lease, or 15 percent of the rent due under the remaining lease term, not to exceed three years' worth of rent. There is some disparity among courts regarding the precise application of this formula, including whether claims relating to maintenance, cleanup costs, repair costs and costs to dispose of abandoned property are subject to the statutory cap. Regardless, this formula can result in tremendous losses for landlords, particularly in long-term leases. Notably, it is extremely unlikely that a claim will be paid in full, and any payment likely is at least a couple of years away.

While WeWork says it plans to remain in most of its current markets, and many believe the demand for coworking space will continue or even grow, it is unclear how many WeWork locations will remain open. It is clear, however, that many landlords will take a significant hit as a consequence of WeWork's bankruptcy, and it remains to be seen how many of their lenders will suffer as a consequence.

Whether you are a counterparty to a lease with WeWork, are interested in purchasing any leases or other assets WeWork may sell, or simply are seeking information regarding the case, Stradley Ronon's bankruptcy team is here to assist you.



[Deborah A. Reperowitz](#)

212.812.4138 | dreperowitz@stradley.com