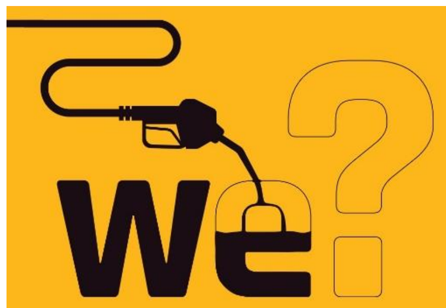
Real Estate Capital

Will lenders keep faith with a refuelled WeWork?

Plenty of Europe's real estate debt providers have lent against buildings occupied by the co-working operator. Real Estate Capital examines whether the company's $9.5bn rescue by SoftBank will alleviate concerns caused by its recent troubles.

Publication Date: 2nd December 2019 | By Daniel Cunningham and Rhiannon Curry



It once promised to "elevate the world's consciousness". But WeWork's failed attempt at a stock market flotation in September most likely elevated a few heart rates among Europe's real estate lenders.

Ever since the New York-headquartered poster child of co-working brought its breakneck expansion to Europe in 2014, its landlords have been able to count on sourcing finance. Indeed, for those lending against office properties, WeWork became a difficult tenant to avoid. Data published in Q1 by consultancy Colliers International show the company absorbed around 6.5 million square feet (603,865 square metres) across Europe within four years.

However, for a time, it looked as though the WeWork bubble might burst. The company had been dogged by questions over whether its business model – taking long-term leases and sub-letting on a short-term basis – could survive a recession, and many deemed its January valuation at $47 billion to be massively overinflated.

Questions of governance were also raised by some of WeWork's practices, including co-founder Adam Neumann personally acquiring stakes in buildings that are leased to the company. All this came to a head when lacklustre investor demand led to an initial public offering being pulled on 30 September. Reports in October, including by US news service CNBC, said WeWork would run out of cash by mid-November.

A lifeline came on 22 October in the form of a $9.5 billion refinancing by its largest investor, Japanese firm SoftBank. A new management team was put in place and Neumann was sidelined. A turnaround plan was outlined in early November.

Bloomberg reported that the company was conducting a sweeping review of its plans to expand in London, its largest European hub. WeWork declined to comment for this article.

Will WeWork's near implosion and subsequent rescue affect real estate lenders' appetite to finance the buildings it occupies?

Michael Shields, EMEA head of real estate at ING – one of Europe's largest lenders to prime office property – says the Dutch bank's position on WeWork has not changed "at all", notwithstanding the recent events. However, he is quick to add that ING has always taken a cautious approach, and has typically only financed assets in which WeWork, or other co-working providers, account for less than 20 percent of the income. In March, one of the bank's sponsors was considering leasing its entire building to WeWork, something ING declined to back.

"We've been consistent," says Shields. "We've always said we would not finance any building in which a co-working tenant is 100 percent of the space. In general, we don't like financing standalone, non-investment grade, single-tenant buildings. It's just not our cup of tea." In Shields' view, SoftBank's refinancing of WeWork's parent, The We Company, will somewhat mitigate the damage to the company's reputation in the eyes of lenders: "Lenders and landlords are now basically dealing with SoftBank, and that should be a more attractive tenant to have in your building."

Rescue We

A non-bank lender, who did not wish to be named, described their organisation's "underwriting rule of thumb" on WeWork: "We're OK with it being in less than 30 percent of a building. It would be difficult to find lenders for 100 percent-occupied buildings. Buildings housing WeWork tend to be valued at a wider yield, a premium of 25-50 basis points."

Market sources say they do not know of any financing deals involving WeWork-occupied buildings that have fallen through since the failed IPO and subsequent rescue. However, the Financial Times reported on 27 September – before the rescue – that the planned £850 million (€993 million) sale of developer Almacantar's Southbank Place in London, which contains WeWork's largest European space, had fallen through.

What borrowers think of WeWork

Borrowers speaking to our sister title PERE have mixed views on WeWork post- rescue.

One manager says: "This is the best possible near-term outcome for the company and for all its stakeholders – owners, employees and landlords. SoftBank has its own challenges, but it has access to capital and, given it is already deeply invested, a big incentive to right the ship." The source adds that a lot needs to happen to put it on the correct course, including "right-sizing" its footprint and, crucially, raising money.

However, not all are convinced about WeWork's future. "We have no intention of working with WeWork, regardless of SoftBank ownership," says Inna Khidekel, partner at US private real estate investment manager Bridge Investment Group. "Their business model is not compelling to us as an office owner-operator. From a landlord perspective, [the WeWork model] doesn't give you a lot of upside. It gives you a lot of downside. And it destroys your creditworthiness as a building owner.

"However, co-working remains of interest and will continue to grow as a piece of our business. I think we're going to see more and more of an evolution towards a partnership model."

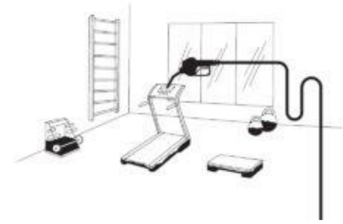
In the Asian market, Hong Kong-based real estate investment manager Phoenix Property Investors signed WeWork as an anchor tenant in 2016 at its Causeway Bay office property, Tower 535, in Hong Kong. Phoenix managing partner Sam Chu welcomes the SoftBank deal: "It is certainly good news to property owners. [SoftBank's] deep pockets might help to significantly improve the credit quality."

Another manager admits the deal was a relief: "The bailout is good news, for sure. Valuation is now is now back on Earth, and mature adults appear to be in charge."

William Scoular, co-head of UK- and South Africa-based bank Investec's structured property finance origination team, believes there has been a "dip in liquidity" for WeWork-occupied buildings for some time. "Investors have seen this coming, because they have understood the dynamic of WeWork's offer," he says. "The deal with SoftBank is a lifeline which any bank financing a property with WeWork in will welcome."

His organisation is among those that have financed assets involving WeWork. In April 2018, Investec participated in a £390 million development financing, arranged by UK bank Lloyds, of Cain International's The Stage scheme in London, which

includes 186,000 square feet (17,300 square metres) of offices prelet to WeWork.



Significant financings of assets featuring leases to WeWork include the £420 million long-term refinancing in February of Southbank Place by LGIM Real Assets, the investment management subsidiary of UK insurer Legal & General. Other lenders, including debt fund managers and investment banks, have reportedly lent against buildings let to WeWork in recent years.

Michael Kavanau, head of EMEA debt advisory at property consultancy JLL, believes lenders will continue to back sponsors with leases to WeWork, particularly if the firm represents less than 30 percent of an asset's occupancy. "Early on, lenders were cautious but supportive of landlords that had leases to WeWork," he says. "As the covenant strength came into question, we've not seen lenders back away. And now it feels it has recovered to be a fairly well-supported covenant, especially as the company will be more disciplined to meet traditional success hurdles."

> *"[WeWork] has always been a difficult company to assess from a pure credit perspective"*
>
> ***Nassar Hussain***
> ***Brookland Partners***

When Kavanau spoke to Real Estate Capital in late October, JLL was in the process of sourcing debt for a client with a lease to WeWork within a prime asset: "We're getting tremendously strong traction. One large lender said it would provide the same terms whether the space was leased to WeWork or was vacant."

The SoftBank deal aside, sources argue that lenders' attitudes to financing WeWork-occupied buildings are being shaped by several considerations. Some say the company's explosive growth led to some lenders reaching maximum exposure to a single tenant. Others argue that lenders are more cautious about WeWork than this time last year, but that they are making financing decisions based on the strength of the underlying real estate assets, rather than on WeWork's covenant.

"Some lenders are cautious, given their existing exposure to the occupier and what is being reported in the press at topco level," says Luca Giangolini, partner and debt specialist at real estate capital advisory firm CAPRA. "But we understand that, generally, they are happy with the underlying performance of the assets they have financed, and the WeWork London portfolio is performing well. Lenders are looking at the quality of the asset, the location, and the undeniable trend toward tenants

wanting greater flexibility. Overall, this represents a strong credit story."

The We Company's IPO filing revealed WeWork's London occupancy rate at 1 June to be 93 percent. One source points out that, if WeWork were to leave floors vacant, there would be plenty of rival co-working operators vying for the space.

However, not everyone in the market is convinced that the liquidity for WeWork-occupied buildings is holding up. Basil Demeroutis, managing partner at London-based real estate investment firm FORE Partnership, says there has been a "sharp drop" in debt liquidity: "It will take landlords some time to figure out how strong the covenant of 'WeWork 2.0' is."

> ***WeWork's path to profitability***
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> *On 22 October, SoftBank Group committed $5 billion of new funding and the launch of a tender offer of up to $3 billion for WeWork's existing shareholders.*
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> *The Japanese investment firm also agreed to accelerate an existing commitment to provide $1.5 billion of funding. In a joint announcement, SoftBank and WeWork's parent, The We Company, said the funding would provide WeWork with liquidity to "execute its business plan and accelerate the company's path to profitability and positive free cash flow". New debt was taken on as part of the refinancing. This consisted of $1.1 billion in senior secured notes, $2.2 billion in unsecured notes and a $1.75 billion letter of credit facility.*
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> *The rescue plan brought SoftBank's ownership of WeWork to around 80 percent. However, because SoftBank would not hold a majority when it came to voting rights, WeWork would be an associate, rather than a subsidiary, of the Japanese company.*
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> *SoftBank's chairman and chief executive, Masayoshi Son, said at the time: "It is not unusual for the world's leading technology disruptors to experience growth challenges like the one WeWork just faced. Since the vision remains unchanged, SoftBank has decided to double down on the company by providing a significant capital infusion and operational support."*

In November, UK business magazine Property Week reported that WeWork's proposed first letting in Glasgow had fallen through and that FORE, which would have been the company's landlord, was understood to have had concerns about the co-working operator's covenant.

"WeWork will perhaps come back with a newfound humility that changes the nature

of the discussions they often have with property owners, adopting more of a collaborative partnership approach," says Demeroutis. "But lenders are a much more cynical bunch than landlords even, so I do wonder if the subset of lenders that had previously been willing to lend to a building with WeWork in it will now have become rather more limited."

Longstanding concerns

Anonymous comments by lenders in 2019's mid-year *Cass Commercial Real Estate Lending Survey* illustrate the longstanding concerns about WeWork. "We are happy that we do not have exposure to WeWork," one lender told the UK market survey. Another said there was "no more visibility in leasing or occupier activity to the end-user/occupant, due to WeWork".

For Nassar Hussain, managing partner of real estate investment banking firm Brookland Partners, the controversy that engrossed WeWork in October had only a limited impact on market sentiment. "The WeWork covenant has always been opaque and, notwithstanding its strong brand, it has always been a difficult company to assess from a pure credit perspective," he says. "But it does have a strong brand as a landlord, offers attractive space and has a good track record of letting up space."

When lenders view WeWork as a tenant, they do so cautiously and with one eye on its lack of profit and its untested growth model. "Lenders will ultimately limit their total exposure and look for other mitigating factors that help make a transaction work," says Hussain. "If WeWork is up to 25 percent of a building, then most lenders tend to get comfortable.

Difficulties arise when WeWork is the sole tenant and then lenders have to get themselves comfortable with the quality and location of the building and the level of leverage should the building become empty."

WeWork's credentials are further complicated by the fact that co-working companies rarely put their 'topco' on the lease and only provide a limited guarantee. In a worst-case scenario, this means the company could walk away from leases with what Hussain describes as "limited and controlled exposure".

Some in the market argue that lenders were becoming more cautious even before negative headlines about WeWork began to hit the press on a daily basis. "Lenders have become more cautious about serviced office providers," says Hugo Raworth, managing director at real estate valuation advisory

specialist RERC, part of loan servicer and asset manager SitusAMC.

"A lot of deals in the City [of London] have been done based on vacant possession value, rather than against leased market values. People want to lend, but the question is what metric they use. I believe more emphasis is being placed on loan-to-vacant-possession value for co-working, depending on the structure of the income flowing from the tenant."

Co-working's future

Regardless of WeWork's plight, real estate professionals still believe in the longevity of co-working or flexible office space as a concept. Tenants' expectations have been raised and an increasingly diverse industry is emerging. WeWork is often compared, unfavourably, with IWG, formerly Regus, which has been in business since the 1980s. IWG is valued at around £3.6 billion and, unlike WeWork, makes a profit. As well as a slew of start- ups, established landlords and real estate consultancies are also busy launching co-working brands.

Techspace, founded in 2012, is a flexible workspace start-up that is growing its presence in London and Berlin. Managing director Rob Stevenson says that its target customers are companies aiming to grow their headcount by at least 10 percent annually. In his view, several business models will emerge in the sector: "I use hotels as an analogy. We will continue to see operators targeting a broad customer base, but also the emergence of those targeting specific segments of the occupational market, such as media- or technology-focused flex providers."

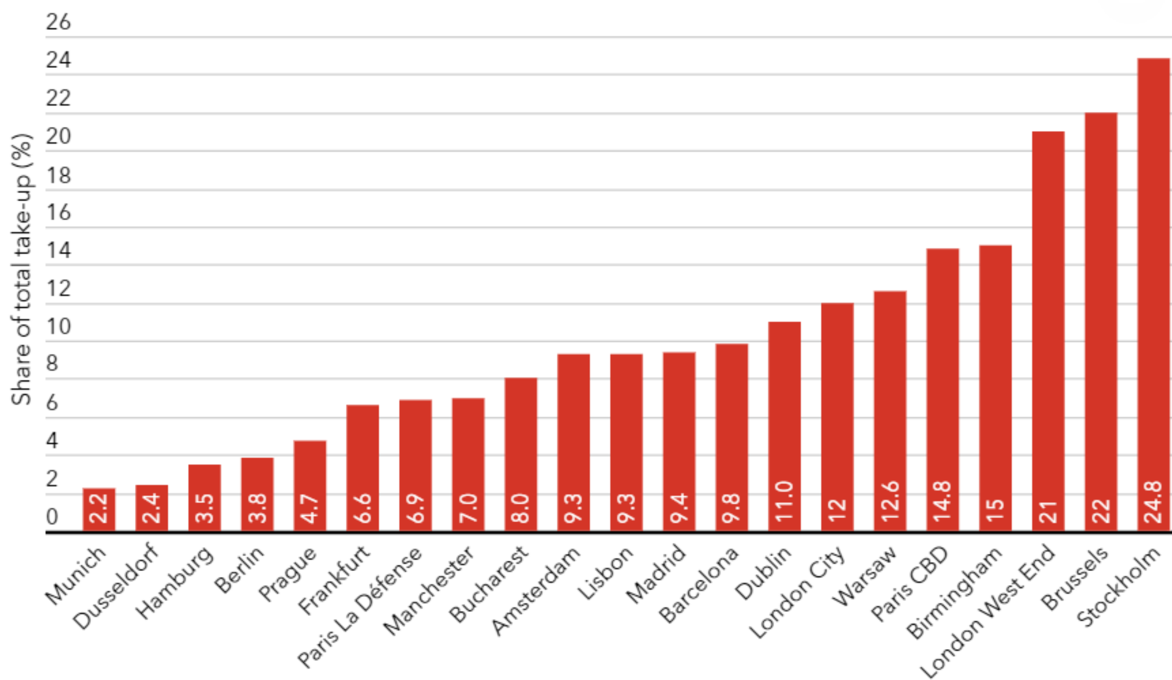
> *"Lenders and landlords are now basically dealing with SoftBank, and that should be a more attractive tenant to have in your building"*
>
> ***Michael Shields***
> ***ING***

Stevenson argues that a shift in the industry towards operators taking on management contracts, rather than long-term leases, makes sense. "I'd love it to happen – it would be less capital-intensive for operators," he says. "The reluctance is among landlords rather than operators. Landlords are concerned about the operational risk and see the flex model as one that is not yet cycle tested. However, there is an opportunity, for entrepreneurial landlords, to benefit from exposure to operational risk while there is dislocation in the market."

He adds that Techspace has looked into buying buildings to occupy: "We spoke to a

credit fund about whether it would be prepared to finance a building in which we were the sole occupant, and they were relaxed about the banks' attitude to refinancing."

Debt market sources agree the direction of the co-working industry is yet to be decided. "Co-working is not going away," says Shields. "But it will have to make money and operators cannot act like internet start-ups, spending money simply to gain scale."



Assem El Alami, head of real estate finance at German bank Berlin Hyp, says: "Some co-working operators will evolve like hotel managers in which they take management agreements, rather than tenancies. The co-working industry will continue to grow, but in a heterogeneous way. It will probably also diversify and not necessarily be dominated by one particular actor."

Investec's Scoular agrees that co-working occupiers can be strong covenants. "As a landlord and a financier, we welcome lots of income streams in a building," he says. "We really like having lots of short-term income from 100 or 200 tenants. Generally, the business centre model is a strong one. But the ones that work really well are the ones in partnership with landlords. The key difference between WeWork and the rest of the market is the long lease liabilities it takes on."

Scoular argues that a large rental liability can put pressure on a co-working business. He says many operators go into partnerships with landlords: “If they do well, the landlord does well. But if they do less well, the landlord shares that risk too. I think that is the way the market should go. It is what companies like IWG already do.”

Some expect WeWork’s recent history to shape how lenders view co- working providers, including the latter companies’ arrangements with landlords. Many also favour a broadening of the base of operators.

However, for now, lenders seem unwilling to step away from financing the buildings WeWork occupies. Despite the negative press, the company remains one of the world’s largest office occupiers, and many lenders breathed a sigh of relief when SoftBank announced its refinancing. They will be watching closely as the Japanese firm decides the next chapter in WeWork’s story.