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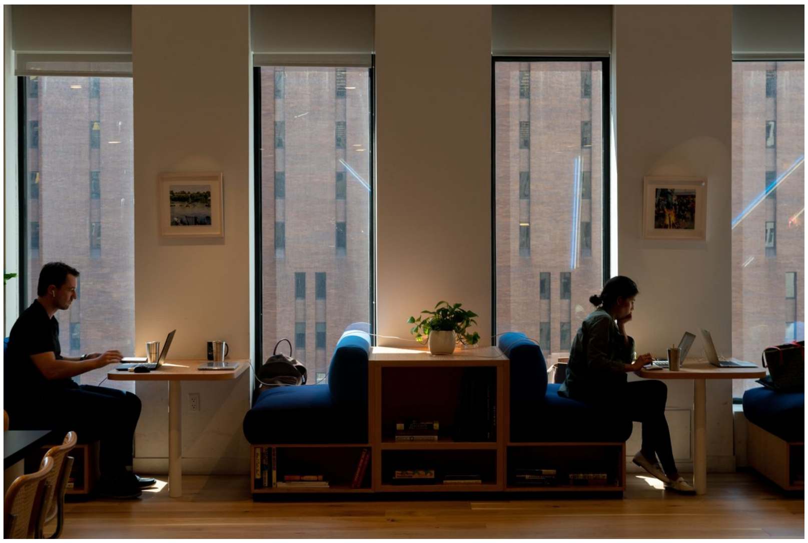
PROPERTY REPORT

Coworking Companies Expanded Rapidly. Now They're Retreating Fast

Coronavirus upends their business model, exposing those with pricey leases



A WeWork location in Manhattan in May of last year.

PHOTO: DAVID 'DEE' DELGADO/BLOOMBERG NEWS

By Konrad Putzier
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The world's biggest coworking companies are starting to close money-losing locations across the globe, signaling an end to years of expansion in what had been one of real estate's hottest sectors.

The retreat reflects an effort to slash costs at a time when the coronavirus is reducing demand for office space, and perhaps for years to come. It also shows how bigger coworking firms, in a race to sign as many leases as possible and grab market share, overexpanded and became saddled with debt and expensive leases.

The share of coworking spaces that have closed is still small. In the first half of the year, closures accounted for just 1.5% of the space occupied by flexible-office companies in the 20 biggest U.S. markets, according to CBRE Group Inc

Scott Homa, head of office research at brokerage JLL, says the impact has been modest partly because some operators have been able to get rent relief and because closing locations takes time. But JLL estimates that of the roughly 4,500 coworking locations in the U.S. a fifth, or about 25 million square feet, will likely close or change operators.

IWG PLC, the world's biggest flexible-office firm by number of locations, said recently it had closed 32 locations in the first half of this year because of the coronavirus pandemic. The company plans to close around 100 locations in the second half of the year, or 4% of its total spaces, according to its chief executive, Mark Dixon.

At Knotel, which sublets furnished offices to companies, revenue fell by around 20% in the second quarter, Chief Executive Amol Sarva said. The company plans to ditch 20% of its portfolio and has bought its way out of some leases.

WeWork has continued efforts that predated Covid-19 to end a number of leases, including a 226,000-square-foot lease in Düsseldorf, Germany, that it signed last year.

The closings mark a dramatic reversal for an industry that had emerged as one of the fastest-growing commercial property sectors. For years, flexible-office operators accounted for a rising share of new leases in some of the world's biggest cities, driving up demand for commercial properties and boosting landlords' profits.

Coworking lured masses of young professionals by offering shared, densely packed offices where they could mingle over a beer keg after work. But as many companies continue to work remotely and as social distancing governs those who do return to offices, the appeal of coworking has diminished considerably. Widespread layoffs and business closures are also damping demand for offices overall.

Still, flexible-office companies have had some success renegotiating their leases and lowering monthly rent bills, with landlords worried about replacing a tenant during the pandemic. Coworking executives also say the industry will ultimately benefit from the shift to more remote work and flexible work schedules, as more companies eschew big, long-term office leases and seek smaller spaces closer to where their employees live.

"Everybody's pretty bullish on the concept of shared workspace when we come out of this," said Shlomo Silber, CEO of New York-based coworking company Bond Collective. "But getting out of this is the struggle."

The recent announcement by Alphabet Inc.'s Google that it would extend remote work until at least next summer was another warning sign. Many companies sign coworking memberships for up to a year, and if they don't expect to return to the office soon they are less likely to renew their deals.

For coworking companies, ditching leases can be difficult and expensive. We Co.'s WeWork, for example, signs leases through special-purpose entities, but usually provides corporate guarantees or letters of credit for a portion of the lease obligation. That means the parent company is on the hook for payments even if it shutters a location.

In some cases, WeWork's lease deals include a commitment from landlords to spend heavily on the space, and the company was able to get out of leases in part by waiving that obligation.

Columbia Property Trust, for example, said during a recent earnings call that the company got out of paying $18.7 million for building out a WeWork space in Manhattan by agreeing to cancel the lease, which it signed in late 2018. The landlord also got a $6.4 million payout, Chief Executive Nelson Mills said during the call.

But efforts to close locations have led to tensions between coworking firms and landlords in a number of cases. Property owners have sued Knotel, WeWork and others over unpaid rent.

IWG has used bankruptcy for exiting lease obligations. Four single-purpose entities created to rent and manage particular locations in Columbus, Ohio, Chicago, Fort

Lauderdale, Fla., and Chapel Hill, N.C., recently filed for bankruptcy in Delaware, according to court records.

The coworking company is using a type of bankruptcy protection designed for small businesses and expanded under the Cares Act, records show. Although IWG is a major public company, its single-purpose entities that sign leases are much smaller. Filing for chapter 5 bankruptcy is often faster and cheaper than the better-known chapter 11, said Adam Stein-Sapir, a managing member of Pioneer Funding Group, LLC, which invests in claims against bankrupt companies.

IWG's Mr. Dixon said filing for bankruptcy could allow the single-purpose entities to get out of long-term lease obligations in return for a one-time penalty.

Mr. Dixon said that many of the leases IWG is jettisoning were signed with high rents at the peak of the market and those located in urban centers where workers depend on public transit, now out of favor because of the coronavirus. The company's suburban spaces, he said, are performing better.

Write to Konrad Putzier at konrad.putzier@wsj.com