Yardi Matrix

National Office Report

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Distress Slowly Plays Out

- Following years of turbulence, there is less mystery surrounding what comes next for the office sector than there has been in a while. Investors that previously took a wait-and-see attitude are slowly accepting the new reality of valuations and office utilization.

- Most metrics that track office utilization have plateaued in the past year. Kastle's closely tracked Back to Work Barometer has not seen any significant recent increases in the top 10 markets that it surveys. Remote and hybrid work have become the norm for a significant number of firms, a situation that looks more permanent by the day. Further compounding problems for office owners, the Fed now expects to cut the benchmark interest rate just once this year. With many owners looking to extend or renegotiate loans, rates remaining elevated for longer than anticipated spells trouble.

- The wave of distress that many were anticipating still has not materialized, with many factors causing office sector pain to reveal itself slowly rather than hitting all at once. Lease terms that can stretch as long as 10 years mean that some tenants are still locked into prepandemic agreements and have yet to make an official decision on downsizing. The process of negotiating extensions and modifications can take months. According to Trepp, 6.9% of office CMBS loans were delinquent in May, up from 4.0% in May 2023. We anticipate that distress will continue to grow more noticeable through at least the end of next year.

- Sales activity may currently be muted by the lack of sales comps to properly price buildings. There were about 4,000 office transactions in each of 2021 and 2022. Last year, the number of sales fell by half, to slightly more than 2,000. Through May of this year, there have been 600 sales. The properties that have traded are increasingly being sold at discounts. In 2023, slightly more than 20% of all office buildings that traded were sold for less than their previous purchase price. In 2024, the share of sales that are discounted has jumped to nearly 30%.

- One silver lining for owners of existing office buildings is that the new office supply pipeline—competition for tenants in a weak market—will soon dry up. There are more than 80 million square feet being built, a figure that is much lower than prepandemic years and one that will shrink as projects deliver. Yardi Matrix has tracked just 6.2 million square feet of office starts in 2024.