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Office National Report

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Distress Rises for CBD Properties

- Property discounts remain plentiful as distress continues to rise. Pressure is building for properties unable to adapt to shifting demand while other office properties thrive.
- The national vacancy rate is 17.7%, down 230 basis points from the peak in March of last year. Though vacancy is on the decline, office utilization has not meaningfully increased, and hybrid work continues to be widely accepted. Kastle's Back to Work Barometer shows office attendance has been hovering around 55% for the last few years. The core problems for office remain, and the likelihood of a sustained and sharp decline in vacancy is low. What we are seeing is a bifurcation across different property types; we expect this to continue, especially as AI proliferates across the economy.
- Of the over 800 million square feet in transactions since 2024, 19.4% were in distress, up from 6.2% of transactions between 2021 and 2023. Properties in urban city centers are experiencing much higher rates of distress. Since 2024, 34.6% of transactions (based on square feet) in commercial business districts were distressed, compared to 24.5% for urban areas and 12.1% for suburban areas. Moreover, the average size of a distressed transaction was around 200,000 square feet among sales since 2024, up from around 100,000 pre-Covid. Larger properties have shown they lack the flexibility needed to handle substantial swings in demand, and distress has risen as a result.
- Properties in commercial business districts struggle to maintain value as flight to quality persists and demand consolidates into fewer properties. Since 2024, 73% of properties sold in CBDs with two or more sale prices for comparison were discounted, compared to 48% of urban transactions and 42% of suburban transactions. Seattle has suffered the compounding effects of hybrid work and mass tech layoffs on its urban core. A 47% vacant, 44-story office tower in Seattle's CBD is under contract to be sold for \$280 million, a 54% discount to its 2019 sale price, per Bloomberg. If the transaction is completed, Spear Capital will buy U.S. Bank Center from Blackstone subsidiary Perform Properties.
- A historically low supply pipeline will help reduce pressure on properties in the coming years, but uncertainty from rising inflation and AI adoption will demand more flexibility from owners. Opportunities will grow for properties that can withstand these changing demands, and we expect increased influence from coworking and continued flight to quality.

