

The Office Market Is Recovering, Performance Is Bifurcated

This report is excerpted from the *Third Quarter 2025 Fixed-Income Sector Views*.

Office conversions are on pace to exceed new construction as struggling markets offer incentives.

Office real estate has still not recovered from the COVID pandemic, but it is adjusting to new realities. Developers have responded to high vacancy rates by curtailing new construction and accelerating demolitions and conversions. In 2024, 94 office conversion projects were completed, a notable increase from the annual average of 58 between 2018 and 2024. While these conversions, primarily to multifamily use, have not substantially increased the national housing supply, they are impactful locally, especially in cities with suitable infrastructure and incentivizing policies.

Sector Commentary

- Overall supply is declining, although the response to falling demand for office space varies by submarket. For example, San Francisco has a high office vacancy rate, but it has not experienced an uptick in conversions or demolitions.
- Most projects focus on converting legacy office spaces into multifamily units, addressing local housing needs more than national supply.
- Cities with suitable infrastructure are seeing meaningful local impacts from multifamily conversions, though nationally the housing supply boost has been limited.
- Key markets, including Manhattan, Washington, D.C., Houston, Chicago, and Dallas/Ft. Worth, are offering incentives such as subsidies and expedited processes to encourage conversion projects. Washington, D.C.'s "Office to Anything" program exemplifies this trend, offering up to 15 years of tax abatement for qualifying properties to promote conversions.

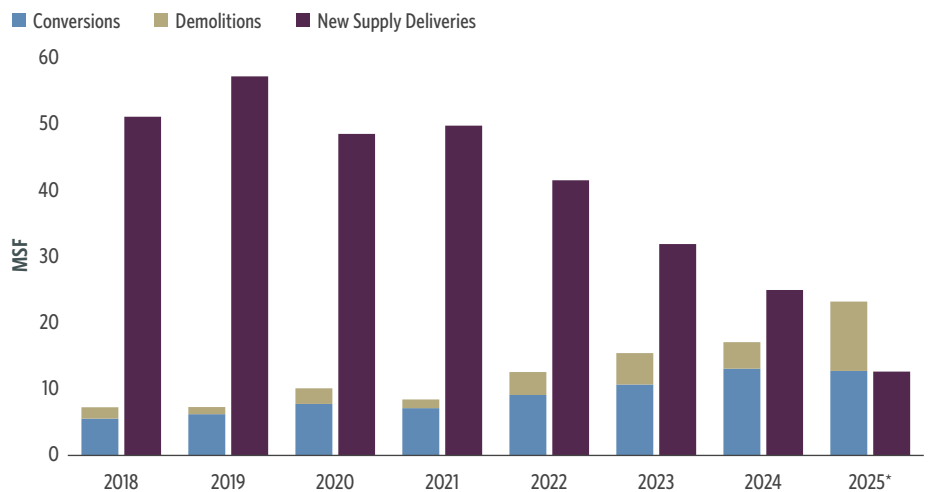
Investment Themes

- Office market performance is bifurcated, with tenants preferring newer Class A buildings with amenities over older structures.
- Developers are cautious due to potential tariffs and market uncertainty under President Trump's agenda, which may deter new demolition or construction projects.
- Five years after COVID, office investment sales and financing markets are showing increased activity. Opportunistic investors with patient capital are targeting distressed office buildings, anticipating a price bottom.
- Lenders favor well-performing office properties, though at lower leverage than pre-COVID levels. Our managed commercial mortgage loan (CML) portfolio shows a higher percentage of maturing office loans achieving refinance exits at par.
- While the office market is not yet orderly, signs of improvement are evident, indicating a gradual recovery in the sector.

By Jennifer A. Marler and Karen Karwoski

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Office Conversions and Demolitions are on Pace to Exceed New Deliveries This Year



Source: Guggenheim Investments, CBRE Research. Data as of 6.30.2025. *Forecast.

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