



WHITE PAPER

Time for Triage and Quick Decisions

Regional Banks and the (Continued) March of Zombie Office Buildings

July 2025

By Dimitrios Lagias, Danielle Kohn, Drew Guggeis, Nic Vecchitto, and Nina Swanson

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The US office real estate market continues to face challenges that include shifting work patterns and economic uncertainty. Banks need to reassess their office portfolios with sharper diagnostics and targeted actions.

Summary

With hybrid work becoming the new normal, the US office real estate market faces uncertainty. Some segments are holding up well, but others - particularly non-prime buildings- are under pressure. BCG's latest research reflects this, and we expect similar trends looking ahead. As loan maturities are coming up, lenders will need to act quickly and manage their portfolios carefully to achieve optimal outcomes.

Back in 2023, we pointed to a subset of office buildings that were becoming “zombies” - buildings facing low utilization rates, high vacancy levels, and financial viability slipping away. More than two years later, the zombie phenomenon is accelerating, and cracks are showing in the secondary market (e.g. office CMBS delinquency rates rising to an all-time high of 11% in June¹). Supply dynamics around new property development (at a multi-year low) and government policies (e.g. tariffs) can potentially provide some relief towards a market balance.

The risk burden of office zombie-buildings does not fall equally on all lenders. We find smaller banks continue to be most exposed, with delinquencies in some cases putting pressure on reserves. In this article, we discuss the most impactful recent trends and suggest how lenders should be refreshing their playbook to manage their office exposure with a focus on risk monitoring, asset triage, and strategic management of portfolios.

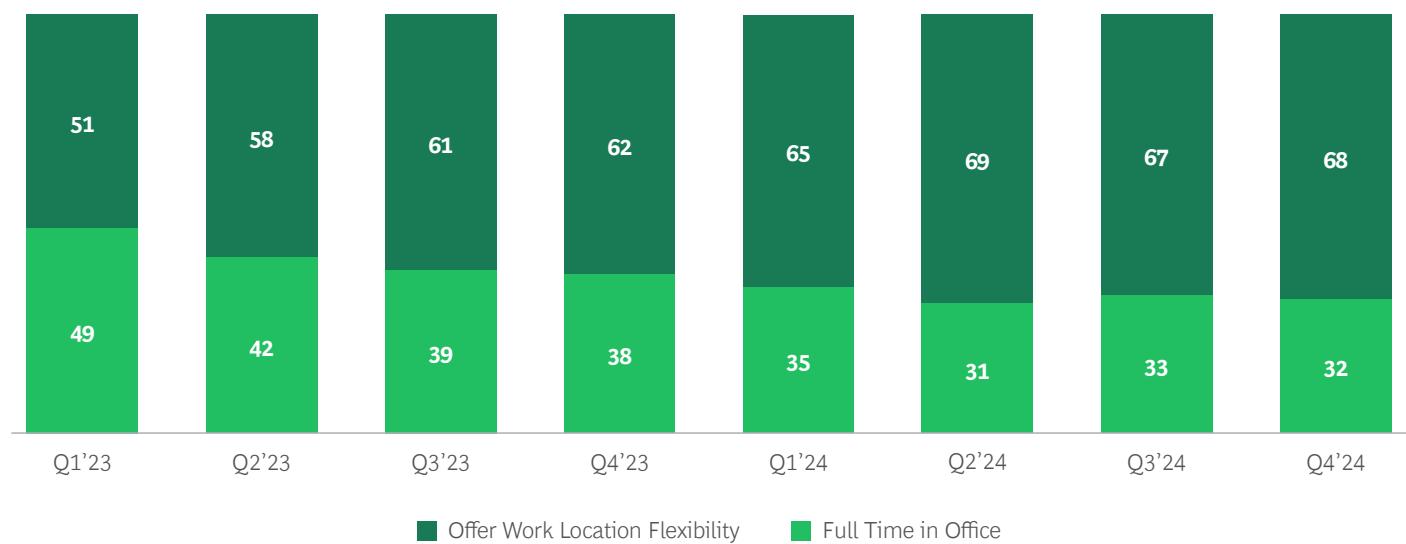
1. [CMBS Delinquency Rate Up Slightly In June, Office Hits Record High, Trepp, June 30, 2025.](#)

Work Location Flexibility Remains the Norm, Despite a Push for Return to Office

Recent headlines on hybrid work reveal a divide in employer approaches. Some large organizations, including JPMorgan Chase and Amazon, have issued return to office (RTO) mandates, while others reaffirmed commitments to hybrid or remote-first strategies². Still, the share of companies offering flexible work arrangements remain largely unchanged over recent quarters, suggesting employers have settled into a new (hybrid work) reality. As of Q4 2024, nearly 70% of US firms operated some form of hybrid or remote model, with little deviation from prior periods³. **(See Exhibit 1)**. This stabilization implies that near-term reversion to full-time, in-office work is unlikely and that the current dynamic is a durable shift in workplace norms.

EXHIBIT 1

Work location flexibility has reached a steady state in recent quarters



Source: Flex Index (flexindex.com) Q4 2024 Flex Report.

2. **RTO Mandates Have Workers Looking for Alternatives to Companies like Amazon and JPMorgan**, Entrepreneur, February 4, 2025.

3. **Q4 2024 Flex Report, Flex Index, December 3, 2024**.

Our research based on foot traffic data points to a similar conclusion. (See Exhibit 2). Office visits remain down about 35% from pre-COVID levels⁴ and more recently, office foot traffic fell 4 percentage points year-on-year in February, further cementing hybrid work as a durable model. That said, some locations are seeing more traffic than others. Miami and New York City are leading in office utilization, while Chicago and San Francisco are lagging significantly. (See Exhibit 3).

EXHIBIT 2

Office visits remain down compared to pre-covid levels

Nationwide office visits compared to Feb 2019 baseline (%)

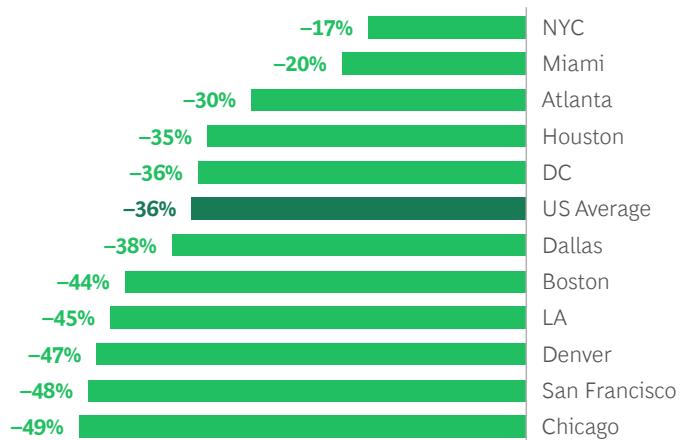


Source: Placer.AI.

EXHIBIT 3

West coast cities lagging in foot traffic while NYC and Miami see greater attendance

Office visits in February 2025 vs February 2019



The same trends are reflected in financing activity. For example, office leasing activity nationally remains about 30% lower than before COVID, and the average size of new leases has fallen by 15% since 2019⁵. This reflects rising demand for smaller, more flexible footprints. This shift will be especially important in the near term, with more than 100 million square feet of existing leases set to expire in 2025, compared to 21 million in 2023⁶. As firms re-evaluate how much and what kind of space they need, landlords may face fewer renewals, reduced occupancy rates, and higher levels of tenant churn. For banks, renewed, smaller leases could mask growing utilization risk and give the appearance of stability in office portfolios.

Government Actions Raise Questions

Early in 2025, the U.S. administration indicated plans to divest from hundreds of federally owned office buildings, raising concerns that a flood of discounted assets could depress market values. However, it has since scaled back its plans. What began as a list of 440 properties is now less than 10, totaling less than 1% of federal property square footage. This plan is insufficient to materially shift price or market dynamics⁷. Furthermore, with properties spread across multiple geographies, the risk of concentration impacts has largely abated.

4. **February 2025 Office Index: Is The Recovery Stalling?**, Placer.AI, March 11, 2025.

5. **Q1 2025 U.S. Office Marketbeat**, Cushman & Wakefield, April 22, 2025.

6. **Over 200 Million Square Feet of Office Leases set to Expire**, Cred.IQ, January 12, 2024.

7. **U.S. General Services Administration**.

Meanwhile, many federal agencies have issued RTO mandates, but these have coincided with voluntary separation programs and ongoing staffing reductions in several departments, obscuring the net effect on office utilization.

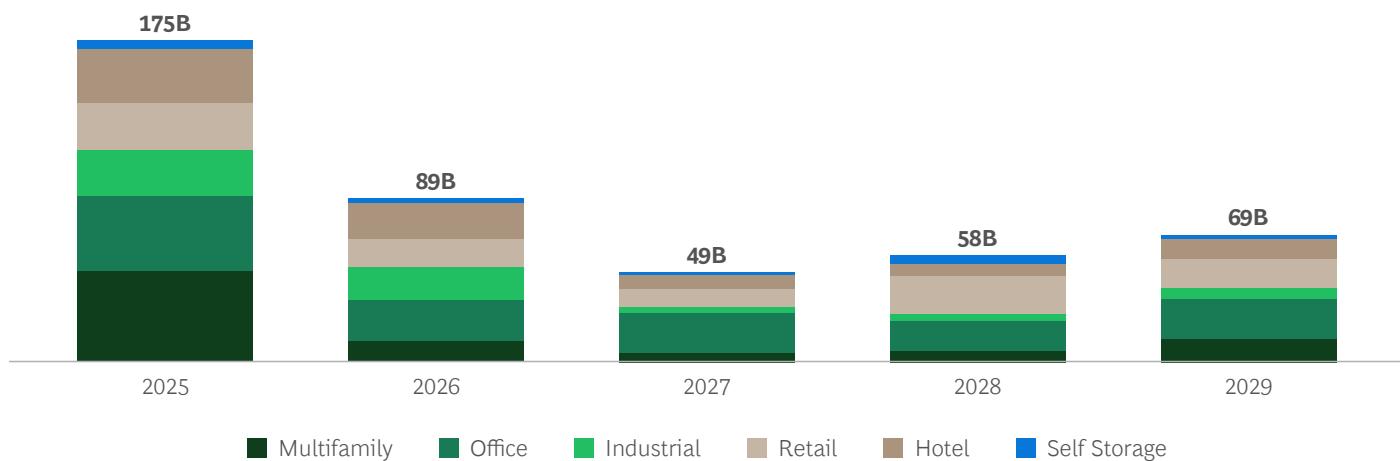
Additionally, the administration has been engaged in raising tariffs on construction materials, which have been estimated to raise CRE construction costs by 3–5%⁸. While the policy's impact remains uncertain, it would reinforce an existing trend, which is that office supply is contracting. The total pipeline of office space under construction has fallen to 26.2 million square feet — down nearly 80% from Q1 2020 — and quarterly deliveries reached just 4.1 million square feet in Q1'25, a 12-year low⁵. In a market contending with lower levels of structural demand, these supply-side constraints may help ease vacancy pressures and support the viability of existing assets.

Managing the Office Loan Book Requires Triage and Quick Decision

Roughly \$960 billion of CRE debt is set to mature over the next five years, with a growing share concentrated in challenged assets. Within CMBS specifically, office properties account for a quarter of debt coming due in the next two years⁹. (See Exhibit 4). Compounding this pressure, office CMBS delinquency rates stand at 11% as of June, exceeding levels seen during the 2007–2008 financial crisis. While many banks have opted to extend maturities or amend terms, these actions only “kick the can down the road”. For regional banks, proactive triage across office portfolios is likely to be a priority in the months ahead.

EXHIBIT 4

Office accounts for 24% of CMBS debt maturing in the next two years



Source: Cred iQ.

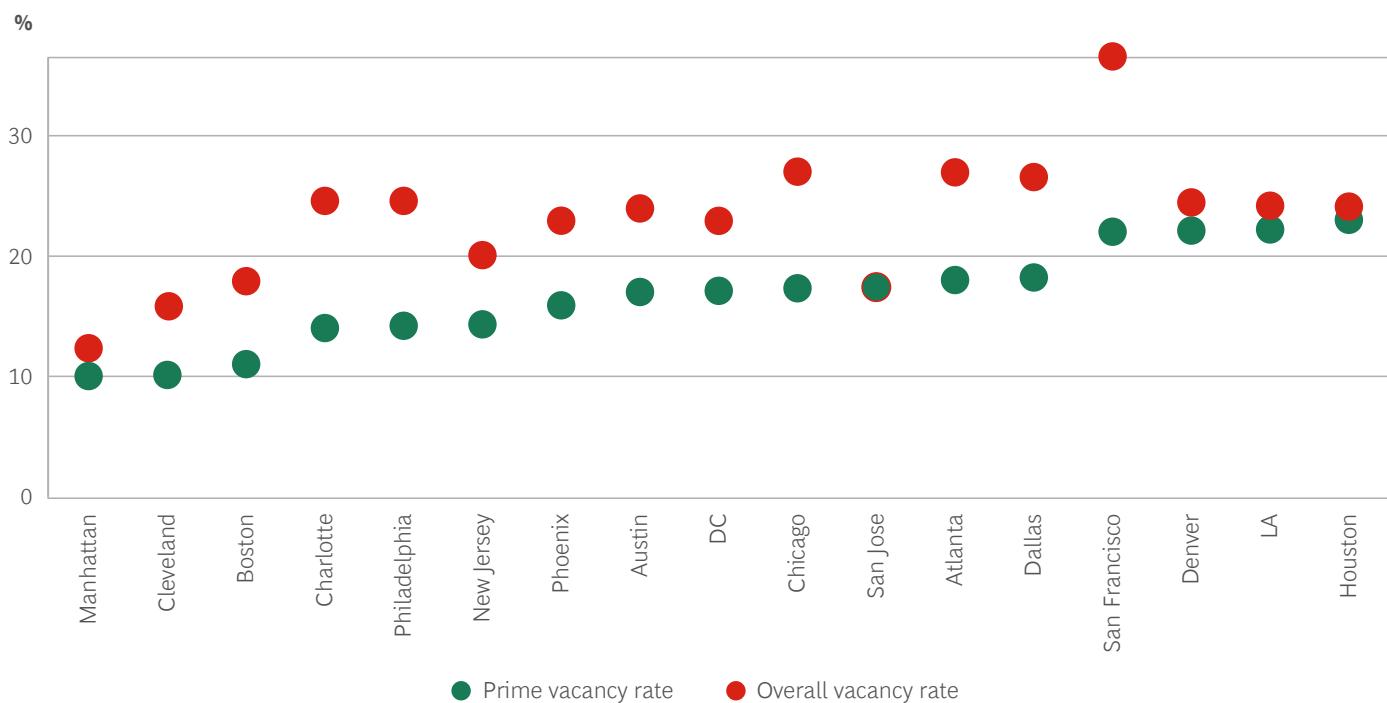
8. U.S. Tariff Regime Shocks Global Trade, Has Repercussions for Commercial Real Estate, CBRE, April 8, 2025.

9. Maturity Wall Grows with \$440 Billion Coming Due Over the Next Two Years, CredIQ, January 31, 2025.

In an uneven market, prime assets outperform significantly. These buildings maintain lower vacancy rates and command a nearly 85% rent premium, up from 60% in 2018¹⁰. (See **Exhibit 5**). Prime buildings also accounted for 45% of office leasing activity in the first quarter of 2025 despite representing only 7% of total supply. The offices along Park Avenue in Manhattan have seen resilient demand, with vacancies well below the Manhattan average, and rents reaching \$109 per square foot, a full \$25 above the Manhattan average¹¹. The prime outperformance trend plays out across most metro areas. Real estate services company CBRE reports that the overall office vacancy rate in the fourth quarter of 2024 was 19.2% (flat quarter on quarter), while the prime vacancy rate was 15.3%¹². We believe the flight to quality will continue to play out moving forward .

EXHIBIT 5

Prime office buildings outperform in most markets



Source: CBRE.

Note: Data as of Q4'24.

The middle segment of the portfolio demands a more nuanced approach, because non-prime offices are seeing significantly higher vacancy rates and more tenant concessions. In markets such as Boston, vacancy rates for Class B/C buildings have hit 25%, well above the long-term average of 11%, as tenant preferences shift to newer and upgraded spaces¹³. To remain competitive, some owners are investing in their properties. In New Jersey, a 40-year-old tower added amenities including a gym and movie theater, which doubled occupancy over five years¹⁴. Still, upgrades are not a cure-all, as some buildings are too costly or impractical to transform.

10. [Q1 2025 Office Market Report, Avison Young Market Intelligence, April 9, 2025](#).

11. [In Today's Upended Office Market, the Park Avenue Mystique Endures, Wall Street Journal, March 24, 2025](#).

12. [Maturity Extensions Obscures Office Debt-Funding Gap, CBRE, February 6, 2025](#).

13. [The Future of Downtown Boston & Commercial Real Estate: Post-Covid Changes in Work-Life Patterns, Massachusetts Taxpayer Foundation, February 2025](#).

14. [Location, Location, Golf Simulator. A Developer Cracks the Office Market Code, Wall Street Journal, September 24, 2024](#).

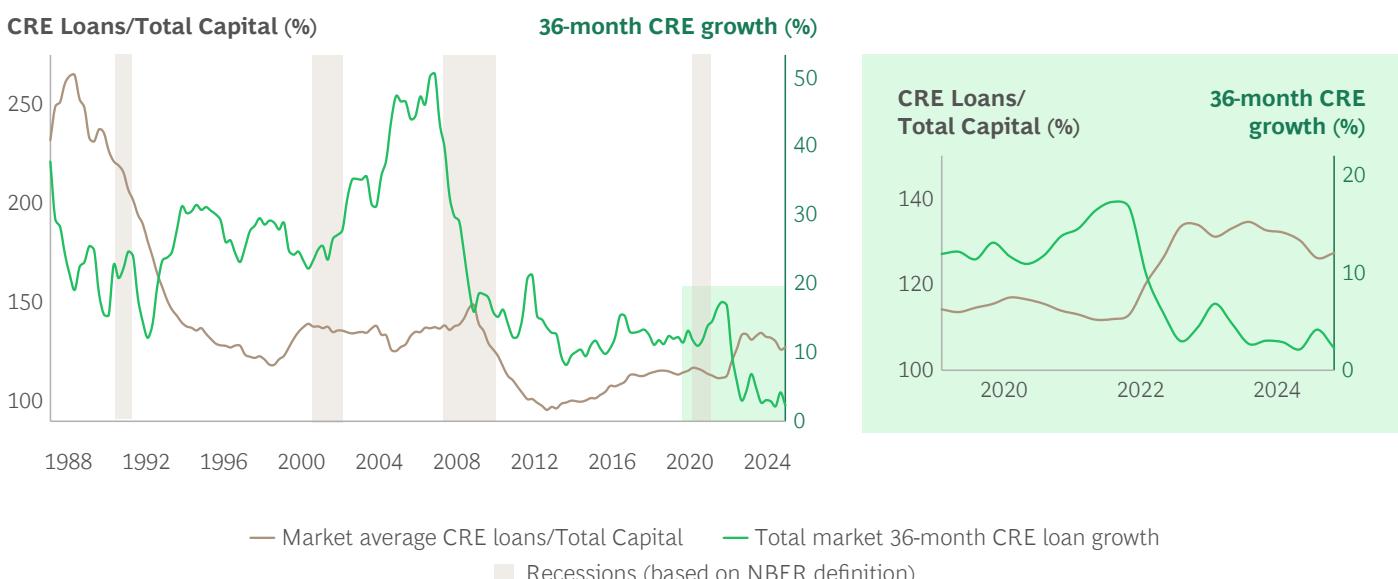
For buildings that can't compete or be feasibly upgraded, we believe the priority should shift to divestment. While market dynamics are suppressed, there is some demand from non-bank investors willing to take on risk and hold assets for long periods. In the first quarter of 2025, 53% of office buyers were family offices and private investors, compared to 32% in 2019¹⁵. In July of this year, Portland's 'Big Pink' was sold to a private investor for \$45M, a ~90% discount from its last sale price in 2015¹⁶. In August of last year, 135 West 50th Street in Manhattan was bought by a Dallas-based family-owned developer at a 97% discount¹⁷. These investors have higher risk appetites, longer horizons, and can enter the market given the steep discounts in price. While demand for distressed office buildings is suppressed, there is an active market where banks can divest.

Risk is Not Spread Evenly Across Banks

Banks also need to pay attention to their capital buffer. CRE loan growth is at its lowest level in decades, but overall exposure relative to capital has risen, and remains high compared with previous years. (**See Exhibit 6**). This divergence implies that total capital has declined, and banks may have less capacity to absorb losses.

EXHIBIT 6

Market CRE growth is historically low while concentration has risen to a recent high



Source: FDIC Quarterly Banking Profile, BCG analysis.

Note: Analysis of all FDIC member banks; Data as of Q4'24.

CRE exposure is most concentrated among smaller and mid-sized banks, many of which previously expanded commercial real estate lending to take advantage of attractive yields. (**See Exhibit 7**). We additionally observe a slight movement towards increased CRE concentration and further eroded capital buffer over the past three years. This indicates that not all banks are adequately responding to risks presented within their CRE portfolio. As these banks accumulate higher concentrations of CRE exposure, they often operate with thinner capital cushions, making them more vulnerable to stress. Many are seeing a rise in loans past due—but few are increasing reserves accordingly. (**See Exhibit 8**). This mismatch suggests some banks are not adequately prepared if asset quality continues to decline.

15. Family Office to Increase Real Estate Bets, Bloomberg, March 4, 2025.

16. Portland's 'Big Pink' building sold for steep discount to auto magnate, Oregon Public Broadcasting, July 9, 2025.

17. This 23-Floor Manhattan Office Building Just Sold at a 97.5% Discount, New York Times, August 1, 2024.

EXHIBIT 7

Many banks remain under-capitalized and over-concentrated in CRE; Concentration has ticked up over the last three years to a recent high

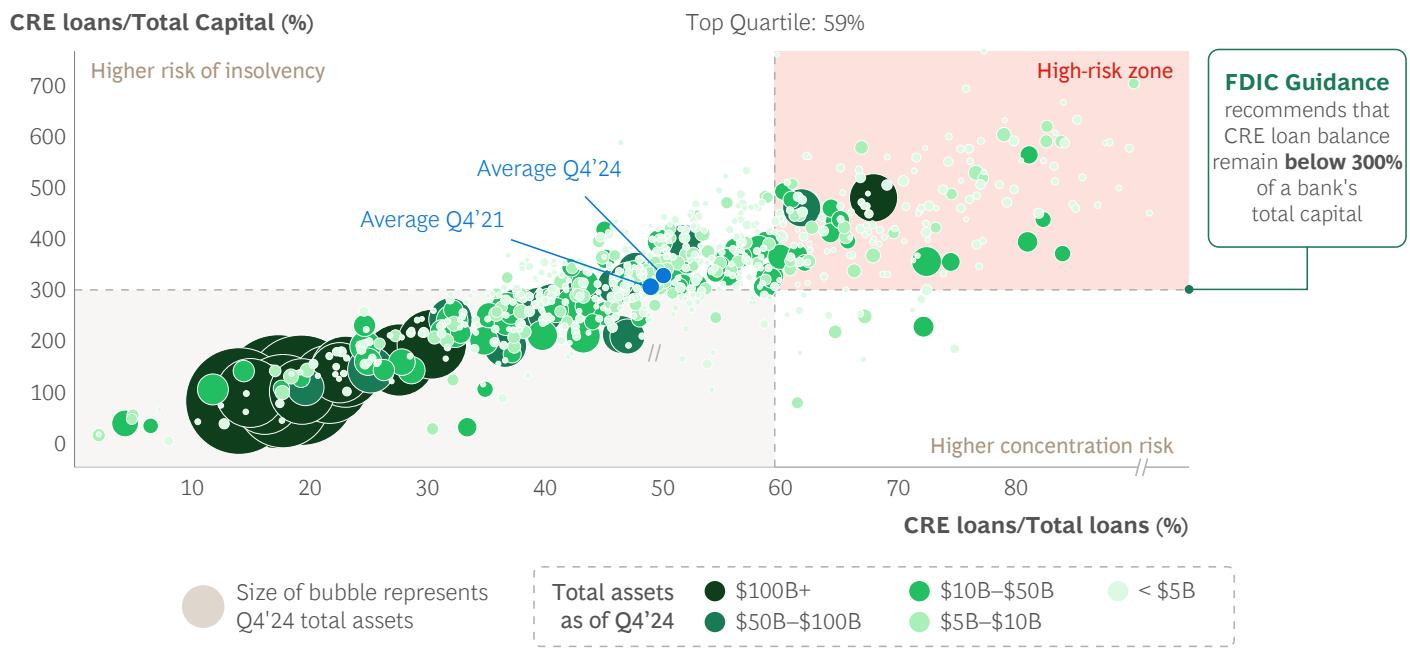
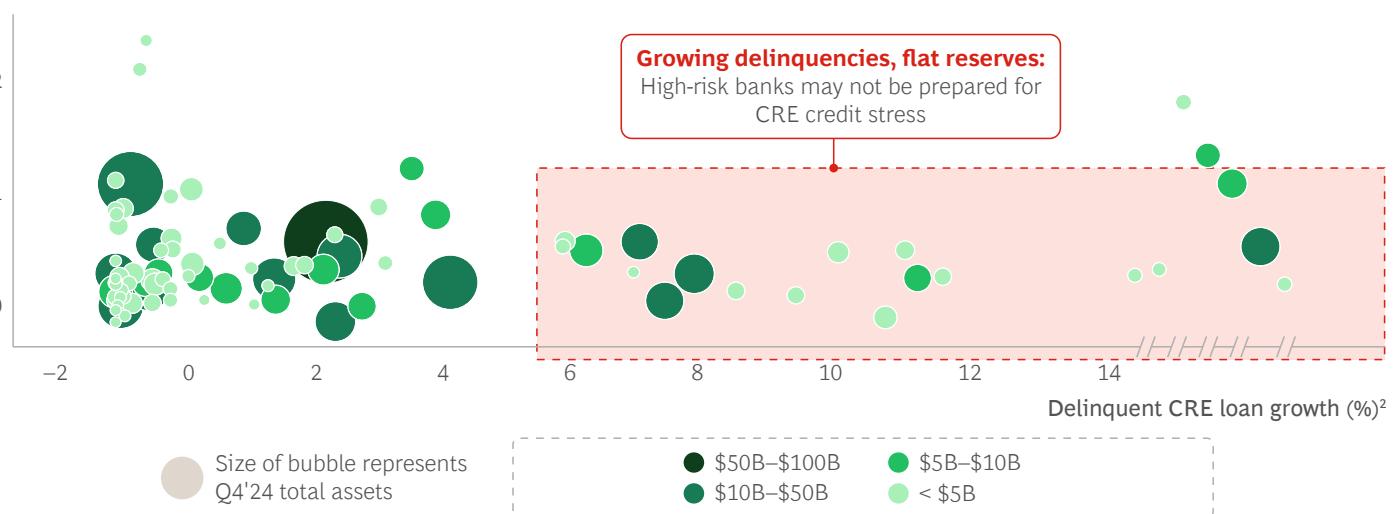


EXHIBIT 8

Select banks in the 'high-risk zone' are seeing significant growth in delinquencies while few have grown reserves while few have grown adequate reserves

'High-risk zone' banks' 3-year growth in reserves and delinquent CRE loans¹

Growth in reserves (%)²

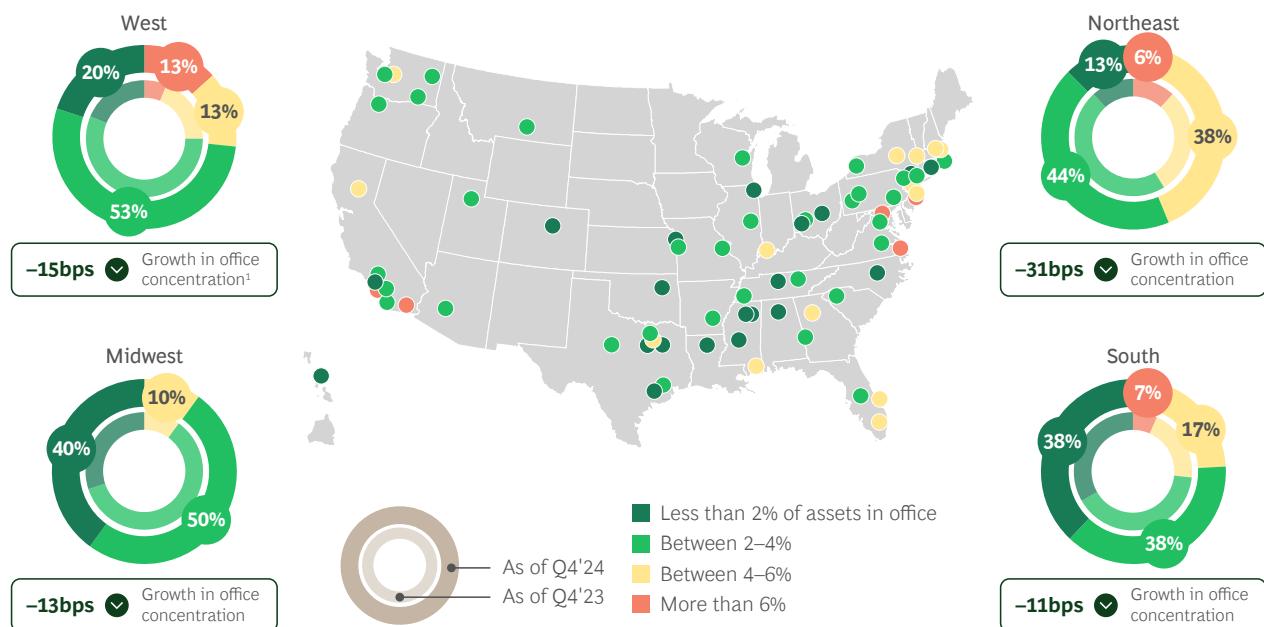


We have refreshed our analysis of office exposure for banks with \$8 billion to \$250 billion in assets. Our findings are consistent with last year's report, but with slight shifts in regional dynamics. (See Exhibit 9). We find that office exposure remains concentrated in specific regions, despite modest declines in overall exposure.

- High-office-exposure-banks (banks with 6%+ of total assets in office) in the West increased to 13% (largest among our banking universe). This may be an area of concern, especially as Western cities continue to lag in office utilization.
- Northeast banks in the high-office-exposure segment nearly halved. NE continues to have the largest share of banks above 4% concentration (44%).
- Our data suggests that the South and Midwest markets have the lowest exposure to the sector.

EXHIBIT 9

Bank exposure to office sector is improving, though concerns remain in the Northeast



Source: Investor presentations, BCG analysis.

Note: Analysis includes commercial banks with comparable business mixes between \$8–\$250B in assets where office balance data is available.
¹YoY change in weighted average office exposure/assets.

Some Banks are Taking Action

Increasing numbers of banks are taking action to address rising CRE risk. In February, for example, Flagstar Bank (formerly New York Community Bank) sold a \$343 million portfolio of loans in office and retail to Lone Star Funds¹⁸. In December, New Jersey-based Valley National Bank sold a \$925 million portfolio of multiple assets to Brookfield Asset Management¹⁹.

The market's emerging mix of asset sales, upgrades, and selective holds reflects the early contours of a more active, building-by-building mindset—one that banks will need to formalize and scale as pressures build.

18. Lone Star Buys \$343M of New York Office, Bloomberg, February 27, 2025.

19. Valley National Bank trims commercial real estate exposure in \$925 million loan sale, Costar, December 4, 2024.

Leading Banks are Getting Ahead Through Five Key Strategies

Given significant short-term pressure on CRE assets and persistent uncertainty, some banks are opting for a strategic reset. Here are five initiatives that are attracting attention:

1. Implement rigorous risk management: Some regional banks are ramping up more disciplined and robust risk management practices to identify and address CRE issues, including identification and monitoring of key risk metrics such as lease expirations, vacancy and utilization rates, and market comparables.

One way in which BCG is helping banks streamline and monitor their portfolios is through a dedicated CRE tool, which offers projection, classification, and decisioning solutions for risk management. The tool is comprised of:

- GeoAnalytics location intelligence and a predictive vacancy model, which together highlight CRE investment opportunities and help users manage distress.
- Interactive thematic mapping with the ability to select census block groups and view trended data.
- Detailed property attribute information, including monthly trends and robust filtering capabilities.

2. Solidify an office strategy: Leading banks are developing new approaches to differentiate between strategic and non-strategic assets. This means planning for the strategic assets they want to hold, invest more capital in, and repurpose/covert to a different class. Banks should also adopt a similar process for non-strategic assets, mapping which need to be sold and identifying potential buyers.

3. Build internal restructuring capabilities: As defaults rise, there may be refinancing opportunities, and some banks are beefing up their restructuring services. These include A/B loan structures (senior/junior tranches) that can attract new sources of capital and reduce exposure as banks sell underperforming loans. Some banks are turning to synthetic risk transfer mechanisms to reduce capital pressure while maintaining exposure to longer-term assets.

4. Create and utilize a portal marketplace: A portal for CRE sales can provide an outlet for distressed or repossessed properties. The seller can offload troubled parts of its portfolio while the buyer can take on risk at a lower cost, strategically enter a market, or rezone a building for alternate use.

5. Expand the product portfolio: As owners renovate, repurpose, and redevelop their properties, many will require funding, providing banks with diversification opportunities.

The US office market is a mixed bag. While prime markets generally continue to perform well, lower tier segments are seeing continued pressure, caused mainly by changes in working patterns and economic factors. To respond to these challenges, leading banks are taking a proactive approach, looking to triage their portfolios and make strategic decisions on a property-by-property basis. At the same time, they are investing in new risk management tools and ensuring their capabilities are fit for purpose as the market continues to evolve.

About the Authors

Dimitrios Lagias is a Partner and Managing Director in the Seattle Office and co-lead of the firm's residential and commercial mortgage practice area. You can contact him at lagias.dimitrios@bcg.com.

Danielle Kohn is a Principal who has worked extensively at the intersection of financial institutions and risk and compliance. You can contact her at kohn.danielle@bcg.com.

Drew Guggeis is a Research Analyst focused on commercial real estate. You can contact him at guggeis.drew@bcg.com.

Nic Vecchitto is a Manager focused on real estate finance. You can contact him at vecchitto.nic@bcg.com.

Nina Swanson is a Senior Analyst specializing in sustainability and real estate. You can contact her at swanson.nina@bcg.com.

For Further Contact

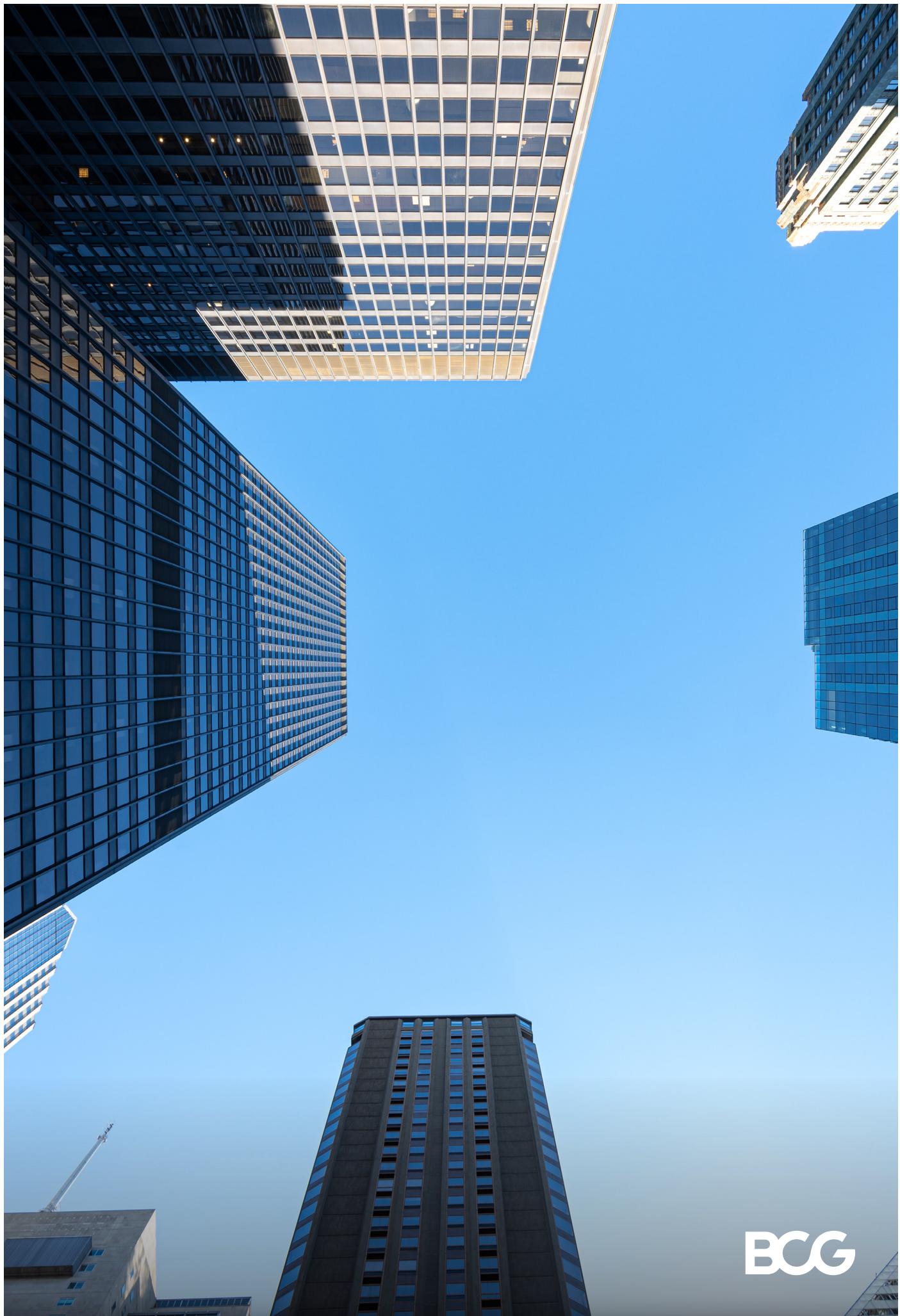
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