

PHILADELPHIA OFFICE MARKET

SEVEN YEARS INTO THE CYCLE, MARKET SIGNALS ANOTHER YEAR OF GROWTH

Philadelphia's regional office market began the new year with overall positive net absorption, stable vacancy, rent growth and demand-driven new construction activity—the cornerstones of a healthy market in balance. The likelihood of continued positive performance in 2019 was bolstered by robust job gains in office-using sectors in both the CBD and suburban office markets, where year-over-year employment increased by approximately 1.4% and 1.0%, respectively, according to the U.S. Bureau of Labor Statistics. Local NKF brokers reported an uptick in market velocity as the first quarter drew to a close, a sign which, together with the aforementioned positive market fundamentals and employment increases, indicates that Greater Philadelphia will reap yet another year of office market growth.

Philadelphia Central Business District (CBD)

New leasing volume in Philadelphia's CBD, while healthy, was eclipsed by foreseen retractions in first-quarter 2019. Approximately 56,000 square feet of negative net absorption was tallied, and overall vacancy in the CBD inched up 10 basis points quarter-over-quarter to 13.5% as a result. This was due primarily to Aramark relinquishing space at the Wanamaker Building following the delivery of the company's new headquarters at 2400 Market Street during the previous quarter. Aramark employees were relocated to the new HQ and space at 1835 Market Street.

Several developing CBD office trends took on further definition this quarter. Rent growth dynamics, a swell of new-to-market tenants and expansion in the life sciences industry are all poised to be the notable trends to follow this year.

New Owners, New Rents

Average asking rents hit new highs in the CBD for the past ten consecutive quarters, rising to \$32.83 per square foot in 1Q19, nearly a dollar gain year-over-year. While strong and sustained demand for high-quality space has made the rate landscape more competitive, another driving force behind this robust streak of rent growth is the churn in ownership of major downtown office assets. During the past 24 months, \$1.8 billion in office sales have closed in the CBD market, with new owners frequently raising rents following a campaign of capital improvements. This trend has had a two-fold effect of reinvigorating the downtown office market, and resetting the value of Philadelphia office space, which has been growing steadily past the \$30 average mark

CURRENT CONDITIONS

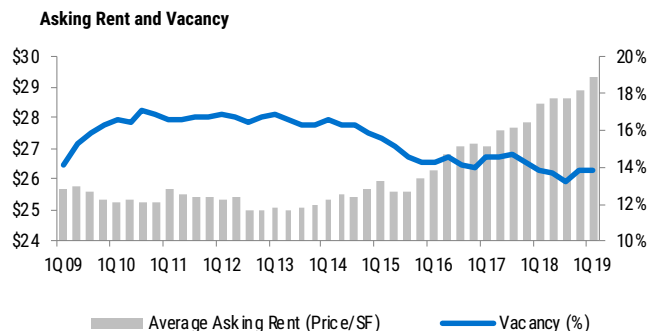
Vacancy remained unchanged over the prior quarter at 13.8%.

AmeriSourceBergen's new headquarters broke ground in Conshohocken.

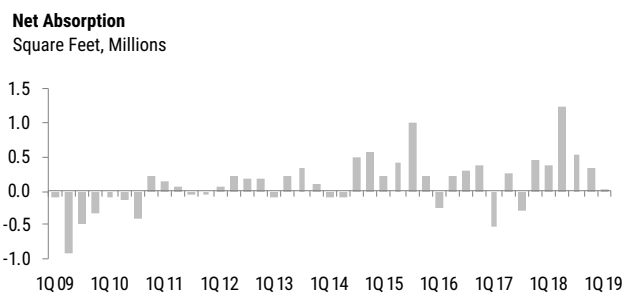
One of the Philadelphia CBD's most significant trophy office properties, 1735 Market Street, sold for approximately \$352/SF.

MARKET ANALYSIS

Asking Rent and Availability



Net Absorption (SF, Millions)



MARKET SUMMARY

| | Current Quarter | Prior Quarter | Year Ago Period | 12 Month Forecast |
|--------------------------|-----------------|---------------|-----------------|-------------------|
| Total Inventory | 109MSF | 109 MSF | 107 MSF | ↑ |
| Vacancy Rate | 13.8% | 13.8% | 13.7% | ↓ |
| Quarterly Net Absorption | 4,226 SF | 0.4 MSF | 403,750 SF | ↑ |
| Average Asking Rent | \$29.33 | \$28.89 | \$28.45 | ↑ |
| Under Construction | 0.8 MSF | 0.4MSF | 2.3 MSF | ↑ |
| Deliveries | 0.0 MSF | 1.0 MSF | 0.0 MSF | ↑ |

since mid-2017. This “new owners, new rents” trend will continue in 2019: the sale of 1735 Market Street, one of the CBD’s premier trophy properties, closed at the end of 1Q19. The owners, a partnership between NY-based Silverstein and a local firm Arden Group, may set a new high-water mark for asking rates in existing buildings. Such an increase would likely inspire other CBD landlords to react in turn.

While the CBD has witnessed strong rent growth, the value of tenant improvement (TI) packages has also increased, allowing landlords to achieve higher rents, and tenants to get the high-quality (and costly) build-out they want in order to attract and retain top talent. Average TI packages for direct Class A 10-year-plus leases across the city grew by an impressive 29.0% from 2017 to 2018 to an average of \$54.00/SF.

High-Profile Flurry of New-to-Market Tenants

The trend of companies relocating from the suburbs to the CBD or choosing the downtown for a satellite office is not new—employers need to be close to talent, and Philadelphia remains the epicenter of the regional labor pool, with job growth in the city continuing to outpace the suburbs. Yet the flurry of new-to-market tenants this quarter was especially refreshing, as these tenants include both small- and large-footprint companies from several dynamic and growing industries. Wodify, a swiftly growing tech company, Kambi, a provider of newly legal sports betting services, and Miramar Global, a U.K.-based employment company, all announced commitments to Philadelphia this quarter, leasing a total of approximately 22,000 square feet.

Finally, Cranbury, New Jersey-based Amicus Therapeutics announced that Philadelphia would become the home of its new Global Research and Gene Therapy Center of Excellence. The new-to-market life sciences company leased 75,000 square feet in total at 3675 Market Street and will hire 200 employees. The life sciences industry is burgeoning in the Philadelphia CBD; Newmark Knight Frank is tracking more than 125,000 square feet of entirely new-to-market life sciences tenants looking for space, and there is currently very little to offer. Such demand may precipitate the groundbreaking of a new lab building in the uCity or Schuylkill Yards developments this year. In addition, Pennovation Center is moving forward on renovating an existing building next to its lab incubator at 3401 Grays Ferry Avenue. Projected to be slightly larger than the 58,000-square-foot Pennovation Center, it will provide some relief to smaller-footprint lab companies seeking new and expansion space.

Southeastern Pennsylvania

The life sciences industry also had a significant effect on the suburban market’s performance this quarter. In the largest new occupancy, expanding biopharmaceutical company CSL Behring, moved into 100,820 square feet at 500 North Gulph Road, which had undergone a \$30 million complete renovation. This occupancy again vaulted the King of Prussia submarket into the limelight; the submarket has

garnered the lion’s share of overall suburban absorption for the past two years. The overall suburban vacancy rate dipped 10 basis points from the previous quarter to 14.0%, remaining at a cyclical low.

The volume of tenant space requirements in the market indicates 2019 will be another solid year for the suburban office sector. A trend to watch, however, is the recent uptick in sublease space, which grew to nearly 1.5 million square feet in first-quarter 2019, the highest total since mid-2016. If this trend continues, it may act as a balancer to expected demand growth.

New Development and a Wave of Upgrades

This quarter, construction began on AmerisourceBergen’s new, 400,000-square-foot headquarters at the SORA West development in Conshohocken, joining the 378,000-square-foot built-to-suit for AmeriHealth Caritas at Ellis Preserve in Newtown Square. A persistent dearth of Class A or trophy large-block availabilities in the suburbs has driven the spate of build-to-suit developments over the past two years, and it is possible that the suburbs may see one or two additional groundbreakings this cycle. A couple of large-footprint tenants are still looking for quality space in the market, and activity surrounding proposed building sites at 675 East Swedesford Road in Wayne and Seven Tower Bridge in Conshohocken is reportedly heightened. One Plymouth Meeting, previously marketed as a proposed transformational office redevelopment, will be converted into senior residential living and thus removed from the pool of potential sites for prospective tenants.

Compensating for the lack of both available new construction and prime existing space, landlords are renovating inventory to remain competitive and achieve higher rents. Several significant building renovations were announced this quarter: Brandywine Realty Trust will invest \$14.0 million in upgrading and amenitizing 150 Radnor Financial Center in Radnor; Alliance HSP will pursue a \$10.0 million renovation for the Spring Mill Corporate Center in Conshohocken, which it purchased in first-quarter 2019; and AREP is investing \$3.0 million in renovations to 161 Washington Street, also in Conshohocken.

Rents Hit New Highs

Average asking rents in the suburban market surpassed the \$27.00/SF mark for the first time, growing 1.5% quarter-over-quarter to \$27.33 per square foot. All classes of space attained significant gains, but the Class A and Class C sectors led the growth, illustrating tenant interest in both the high and low ends of the market. A number of office properties and portfolios are on the market for sale in Southeastern Pennsylvania, and new ownership in the suburbs, as in the CBD, has generally followed the template of capital improvements leading to rent increases. Expect further rent growth in the suburban market through 2019.

Philadelphia CBD Lease/User Transactions

| Tenant | Building | Submarket | Type | Square Feet |
|---|--------------------|-----------------|--------|-------------|
| Amicus Therapeutics | 3675 Market Street | University City | Direct | 75,000 |
| STV | 1818 Market Street | West Market | Direct | 30,000 |
| Mintzer, Saraowitz, Zeris, Ledva & Meyers | 1500 Market Street | West Market | Direct | 23,000 |
| Lundy Law | 1818 Market Street | West Market | Direct | 17,000 |
| Aramark | 1835 Market Street | West Market | Direct | 16,000 |

Southeastern Pennsylvania Lease/User Transactions

| Tenant | Building | Submarket | Type | Square Feet |
|--------------------------------|--------------------------|----------------------------|---------|-------------|
| West Health Advocate Solutions | 3043 Walton Road | Blue Bell/Plymouth Meeting | Renewal | 92,000 |
| Yprime | 9 Great Valley Parkway | Exton/Malvern | Direct | 58,700 |
| Mitchell International | 440 E. Swedesford Road | King of Prussia | Renewal | 50,037 |
| AXA | 1 Belmont Avenue | Bala Cynwyd | Direct | 45,000 |
| LifeScan | 20 Valley Stream Parkway | Exton/Malvern | Direct | 36,156 |

Greater Philadelphia Sales Transactions

| Building | Submarket | Sales Price | Price/SF | Square Feet |
|------------------------------|-------------------|---------------|----------|-------------|
| 1735 Market Street | West Market (CBD) | \$451,600,000 | \$352 | 1.3 MSF |
| Spring Mill Corporate Center | Conshohocken | \$81,000,000 | \$177 | 457,725 |
| 1000 Madison Avenue | King of Prussia | \$17,500,000 | \$170 | 102,894 |
| 100 Deerfield Lane | Exton/Malvern | \$15,500,000 | \$170 | 91,190 |

SUBMARKET STATISTICS

| | Total Inventory (SF) | Under Construction (SF) | Total Vacancy Rate | Qtr Absorption (SF) | YTD Absorption (SF) | Class A Asking Rent (Price/SF) | Class B Asking Rent (Price/SF) | Total Asking Rent (Price/SF) |
|----------------------------|----------------------|-------------------------|--------------------|---------------------|---------------------|--------------------------------|--------------------------------|------------------------------|
| East Market | 6,331,084 | - | 14.1 % | -107,270 | -107,270 | \$32.54 | \$27.96 | \$29.93 |
| Independence Square | 5,380,384 | - | 12.7 % | 18,623 | 18,623 | \$29.75 | \$30.69 | \$30.25 |
| University City | 3,912,880 | - | 11.0 % | 65,252 | 65,252 | \$41.19 | \$45.31 | \$41.82 |
| Walnut/South Broad | 3,977,064 | - | 17.6 % | 78,931 | 78,931 | \$31.96 | \$29.61 | \$29.09 |
| West Market | 26,179,953 | - | 13.3 % | -111,889 | -111,889 | \$35.65 | \$28.58 | \$33.83 |
| CBD Total | 45,781,365 | - | 13.5 % | -56,353 | -56,353 | \$35.45 | \$29.65 | \$32.83 |
| Bala Cynwyd | 2,971,802 | - | 10.0 % | -13,964 | -13,964 | \$35.96 | \$33.69 | \$33.68 |
| Blue Bell/Plymouth Meeting | 8,148,267 | - | 17.7 % | 33,705 | 33,705 | \$29.42 | \$25.20 | \$26.55 |
| Bucks County | 8,235,005 | - | 18.9 % | -21,073 | -21,073 | \$28.49 | \$22.82 | \$24.15 |
| Central/S Delaware County | 4,926,227 | 378,000 | 12.6 % | 36,126 | 36,126 | \$28.82 | \$25.09 | \$26.68 |
| Conshohocken | 3,181,518 | 400,000 | 8.5 % | 5,250 | 5,250 | \$39.23 | \$32.68 | \$36.92 |
| Exton/Malvern | 8,292,524 | - | 10.5 % | 47,743 | 47,743 | \$27.58 | \$26.47 | \$26.91 |
| Fort Washington | 3,548,964 | - | 15.3 % | -80,513 | -80,513 | \$27.19 | \$23.70 | \$24.99 |
| Horsham/Willow Grove | 4,469,314 | - | 18.9 % | -50,801 | -50,801 | \$27.98 | \$24.64 | \$24.93 |
| Jenkintown | 1,081,401 | - | 17.3 % | -8,683 | -8,683 | \$25.04 | \$22.27 | \$23.83 |
| King of Prussia | 13,346,984 | - | 13.0 % | 169,876 | 169,876 | \$32.14 | \$26.80 | \$28.88 |
| Radnor/Main Line | 2,635,337 | - | 9.5 % | 12,985 | 12,985 | \$40.73 | \$27.25 | \$40.00 |
| Southern 202 Corridor | 2,506,915 | - | 10.5 % | -70,032 | -70,032 | \$28.35 | \$25.08 | \$26.43 |
| Suburban Total | 63,344,258 | 778,000 | 14.0 % | 60,619 | 60,619 | \$30.58 | \$25.59 | \$27.33 |
| Market Totals | 109,125,623 | 778,000 | 13.8 % | 4,266 | 4,266 | \$32.85 | \$26.57 | \$29.33 |

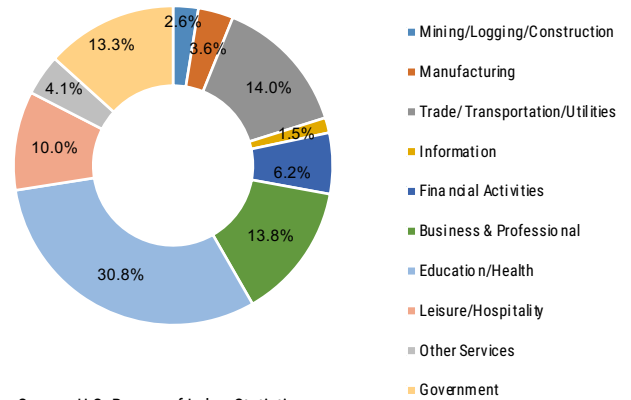
ECONOMIC OVERVIEW

Material gains in all major sectors of employment except manufacturing have added 20,500 new jobs to the Philadelphia Metropolitan Division economy since the first quarter of 2018. According to the U.S. Bureau of Labor Statistics, of the 28 metropolitan divisions nationwide that had year-over-year unemployment rate decreases, Philadelphia experienced the largest decline, dropping 0.9 percentage points to 4.7%. Education and health services, the Philadelphia region's largest industry, drove nearly half of all new job growth.

There will be numerous national and global concerns in the new year, including Brexit fallout, trade tensions and stock/bond market indicators, but the local economy is firing on all cylinders and is expected to support growth in all sectors of commercial real estate across the region through 2019.

EMPLOYMENT BY INDUSTRY

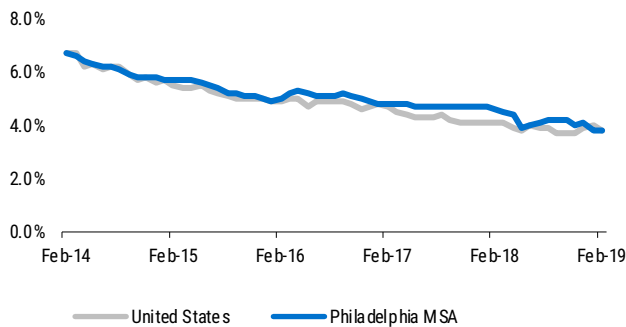
Philadelphia Metropolitan Division, 2018 Annual Average



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

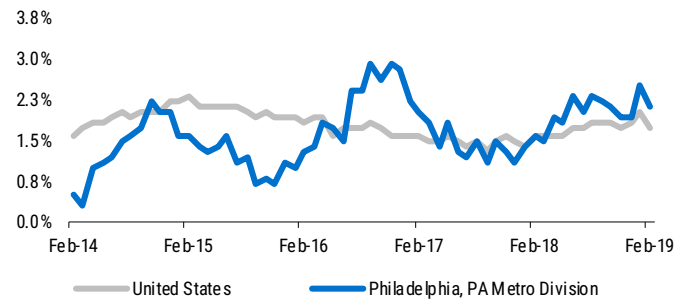
Not Seasonally Adjusted



Source: U.S. Bureau of Labor Statistics, Philadelphia Federal Reserve Bank

PAYROLL EMPLOYMENT

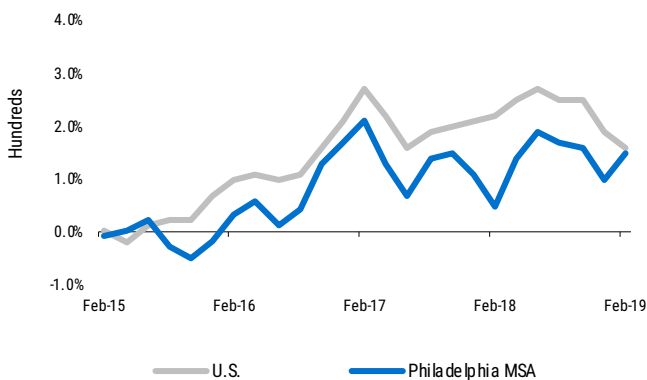
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

CONSUMER PRICE INDEX (CPI)

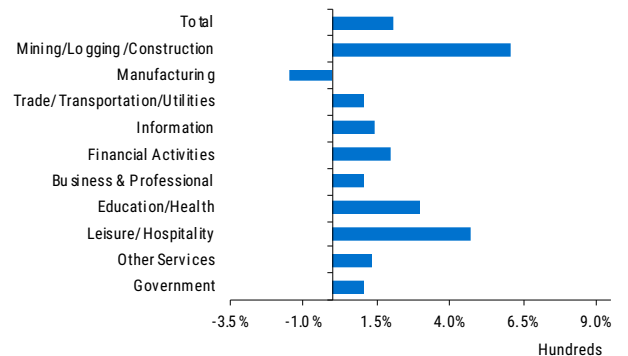
All Items, 12-Month % Change, Not Seasonally Adjusted,



Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

Philadelphia Metropolitan Division, February 2019, 12-Month % Change, Not Seasonally Adj.



Source: U.S. Bureau of Labor Statistics



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Newmark Knight Frank has implemented a proprietary database and our tracking methodology has been revised. With this expansion and refinement in our data, there may be adjustments in historical statistics including availability, asking rents, absorption and effective rents. Newmark Knight Frank Research Reports are available at www.ngkf.com/research

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