

PHILADELPHIA OFFICE MARKET

OFFICE MARKET PERFORMANCE VARIES BETWEEN CBD AND SUBURBS, BUT BOTH FACE FUTURE CHALLENGES

The first quarter of the new decade brought whiplash change to not just the Greater Philadelphia office market but to the world, as the sweeping COVID-19 health crisis rapidly unfolded. While local office market performance in the previous decade can be characterized by steady recovery from the 2008 recession, from the vantage point of today, it is entirely unknown how the region's office market will react to the economic turmoil we are now experiencing.

Activity in the first 2.5 months of the quarter indicated that the suburban Philadelphia market may have reached an inflection point in its expansion period, as it sustained approximately 395,000 square feet in occupancy losses. Conversely, the Central Business District (CBD) continued its strong late-cycle performance with 137,000 square feet of positive absorption.

As of March 29th, national isolation advisories were extended through the end of April. While the duration of disruption will continue, the passage of the CARES Act into law in late March, coupled with swift and sweeping policy intervention by the Federal Reserve, will ensure that employers and employees alike have access to myriad avenues of economic aid to help weather the extended interruption in business operations.

Philadelphia Central Business District

The Philadelphia CBD office market was in a position of strength in the first quarter of 2020 before all non-essential businesses in the city were ordered to close on March 16th.

On the heels of robust occupancy gains, the CBD recorded a vacancy rate of 12.4% in the first quarter, down 30 basis points from 4Q 2019. Encouraged by sustained tenant demand for quality space, rent increases were prevalent, leading to the overall average asking rent hitting new highs at \$34.31/SF. The West Market submarket drove the greatest volume of positive absorption this quarter and saw elevated leasing activity compared to first-quarter 2019. Dechert, one of the CBD's largest law firms, subleased 35,000 square feet at 1735 Market Street for back-office operations; the firm is still weighing options for a relocation, or reconfiguration of their significant footprint at Cira Centre. Also in West Market, the last 30,000 square feet available at 2400 Market Street were taken by homegrown tech company Perpay, and Entercom, an existing tenant that expanded into further space in

CURRENT CONDITIONS

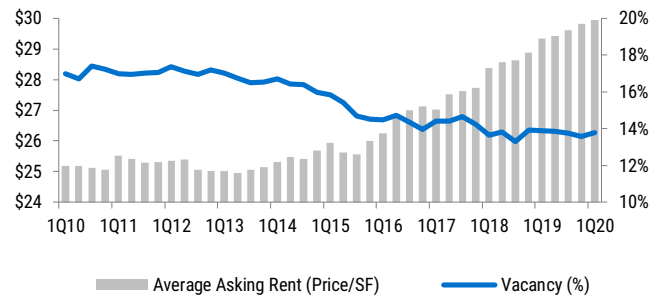
First-quarter absorption performance varied between the CBD and the suburbs with a net loss of approximately 258,000 SF before pandemic effects began to hit in mid-March 2020

Construction commenced on One uCity Square in University City

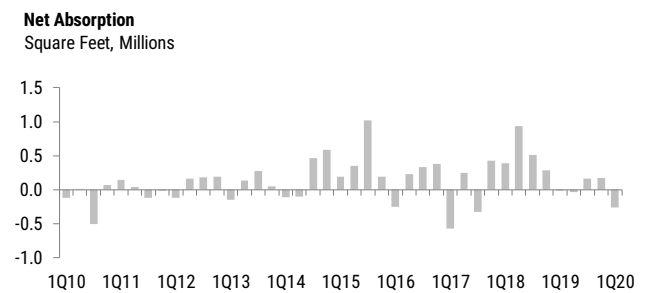
Overall asking rates increased to \$29.95/SF due to rate growth in the CBD

MARKET ANALYSIS

Asking Rent and Vacancy



Net Absorption (SF, Millions)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	109.2MSF	108.8MSF	108.8MSF	↑
Vacancy Rate	13.8%	13.6%	13.9%	↑
Quarterly Net Absorption	-258K SF	176K SF	-19K SF	↔
Average Asking Rent	\$29.95	\$29.81	\$29.33	↔
Under Construction	1.4 MSF	1.0 MSF	0.8MSF	↑
Deliveries	0.0 MSF	0.0 MSF	0.0MSF	↑

the building. This is notable as 2400 Market Street was the most recent addition of new, available space to the inventory in the city's largest submarket. The original building was entirely redeveloped and expanded on a speculative basis to 600,000 square feet. Only around 100,000 square feet of available space remained available when construction completed in late 2018. As of 1Q 2020, the entire building is now leased, demonstrating abiding tenant interest in exciting new office space.

New office projects with lab buildouts in University City have leased up even faster, with 3675 Market Street, the most recent delivery in that submarket, moving from delivery to total lease-up within a matter of a couple months between late 2018 and early 2019. Pent-up need for lab space will likely drive the same swift lease-up performance at the 390,000-square-foot One Ucity Square, which officially broke ground in January 2020 and currently stands as the sole project offering available, new space of this type to the market. Two life sciences firms (Century Therapeutics and Integral Molecular) officially signed on for a floor each at the new project in the first quarter, and more leasing announcements are likely to follow. By the end of March 2020, however, all non-healthcare construction projects were suspended in the city of Philadelphia to stave off the spread of COVID-19, which will delay current and proposed development timelines – not just for new projects but also for individual office build-outs in existing properties across the CBD.

Life sciences and healthcare companies are ever more essential in this moment of pandemic-induced economic crisis, and the CBD's strong concentration of firms in these sectors, both in terms of employment and office occupancy, may mitigate deleterious effects to the office market. The future is less certain for other industries that have expanded in scope during the past few years in the city, namely, the coworking industry, which saw its largest annual expansion last year in the CBD. The flexible office market faces an immediate crisis as well as a long-term question mark: if coworking firms are able to navigate the current economic devastation, how will people respond to the concept of shared office space when regional business operations resume?

Philadelphia's CBD continued to attract a wave of inbound tenants in the first quarter with over 100,000 square feet of new-to-market companies signing for space. While this was good news on one hand, a number of the new-to-market office tenants were in industries that have been hardest-hit by the economic crisis so far, including leisure and hospitality. Looking forward into the uncertain economic future, as firms weigh the heavier burden of occupancy and talent costs in gateway markets, more interest may be driven to Philadelphia as a talent-rich, lower-cost office market option.

Southeastern Pennsylvania

Parts of the suburban Philadelphia office market were subject to widespread business closures slightly earlier in March than the CBD market, due to the fact that Montgomery County emerged as the state's first virus hotspot. Prior to the onset of market turmoil, approximately

395,000 square feet of negative absorption accumulated in the first quarter as a result of multiple significant retractions and limited new occupancies of space. This activity pushed vacancy up 70 basis points year-over-year to 14.7%, the highest measure recorded for the suburban market since year-end 2017. Among the largest retractions were Teva's vacancy of the 120,290-square-foot building at 425 Privet Lane in Horsham, SEI and Main Line Health's vacancy of a combined 90,000 square feet at 52 East Swedesford Road in Malvern, and Hibu/Yellow Book's 60,000-square-foot downsizing at 2201 Renaissance Boulevard in King of Prussia.

Radnor/Main Line was the sole submarket in the suburban region to realize positive net absorption in the first quarter; this performance was predominantly driven by M&T Bank occupying approximately 40,000 square feet at 150 Radnor Chester Road – also the largest new first quarter occupancy across the market.

In terms of asking rent performance, some office properties predominantly in core or Western submarkets saw increases in rates while other properties across the market saw rents lowered. Due to this flux in activity, overall asking rents decreased slightly quarter over quarter to \$27.56/SF, but still demonstrated growth from measures a year ago. Given the current market situation, it is likely that overall asking rents reached an apex in growth during this economic cycle at the conclusion of 2019.

At the close of the first quarter, a little over one million square feet was in the suburban office development pipeline, spread between three build-to-suit projects. Three additional proposed projects were reportedly in advanced negotiations with anchor tenants to kick off construction this year, but timelines for current and future development are now on hold as construction ceased on all non-life-sustaining projects throughout the region. Luckily, the suburban market is not at risk of oversupply due to new development; among the projects underway, only Seven Tower Bridge offers available space to the market.

Suburban office capital markets activity was muted in the first 2.5 months of the year. Overall volume was approximately \$183 million according to Real Capital Analytics, nearly half the volume tallied in the fourth quarter of 2019. The sole major office investment property that traded hands in the suburbs was 52 East Swedesford Road, which sold for \$18 million or \$137/SF. Capital markets professionals report that there is still plenty of investor capital waiting on the sidelines to be placed, but the current economic situation will inevitably exacerbate the slowdown in the volume of local transactions noted in the first quarter. It often takes months to close a deal, and with significant reduction in asset tours and a general inability to travel, this will likely delay new launchings and cause disruption in current offerings. For investors with deep capital reserves and more appetite for risk, this situation may provide opportunities to buy strong assets at lower prices.

PHILADELPHIA CBD LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Mindspace	100 E Penn Sq	East Market	Direct	42,000
Dechert	1735 Market Street	West Market	Sublease	35,000
Century Therapeutics	One uCity Square	University City	Direct (New Construction)	32,341
Integral Molecular	One uCity Square	University City	Direct (New Construction)	31,216
Offit Kurman, PA	1801 Market Street	West Market	Expansion	23,530

SOUTHEASTERN PENNSYLVANIA LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Paypal	4000 Chemical Road	Blue Bell/Plymouth Meeting	Direct	99,512
QualTek	1 Sentry Parkway	Blue Bell/Plymouth Meeting	Direct	39,712
Bentley Systems	690 Stockton Drive	Exton/Malvern	Renewal	30,545
Hirtle, Callaghan & Co.	300 Barr Harbor Drive	Conshohocken	Renewal	29,272

GREATER PHILADELPHIA SALES TRANSACTIONS

Building	Submarket	Sales Price (millions)	Price/SF	Square Feet
52 East Swedesford Road	Exton/Malvern	\$18.0	\$137	131,517
1050 Constitution Avenue	Navy Yard	\$61.2	\$350	175,000
480 Norristown Road	Blue Bell/Plymouth Meeting	\$16.1	\$90	180,000
Three Crescent Drive	Navy Yard	\$62.3	\$654	95,261

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	-	10.0 %	45,838	45,838	\$33.45	\$27.75	\$29.82
Independence Square	5,380,384	-	15.0 %	10,312	10,312	\$30.50	\$31.72	\$31.12
University City	4,534,880	390,000	8.4 %	-5,456	-5,456	\$40.62	\$44.91	\$41.54
Walnut/South Broad	3,977,064	-	18.3 %	-27,621	-27,621	\$35.82	\$31.57	\$30.83
West Market	25,557,953	-	12.3 %	113,980	113,980	\$38.48	\$28.98	\$36.14
CBD Total	45,781,365	390,000	12.4 %	137,053	137,053	\$37.63	\$30.48	\$34.31
Bala Cynwyd	2,944,026	-	10.6 %	-11,175	-11,175	\$36.12	\$33.67	\$34.11
Blue Bell/Plymouth Meeting	8,571,469	-	18.0 %	-20,920	-20,920	\$29.04	\$23.24	\$25.29
Bucks County	8,072,833	-	18.7 %	-43,356	-43,356	\$28.53	\$23.01	\$24.37
Central/S Delaware County	4,926,227	378,000	13.5 %	-4,566	-4,566	\$29.00	\$24.92	\$26.64
Conshohocken	3,309,518	660,000	10.9 %	-22,092	-22,092	\$42.03	\$34.06	\$38.06
Exton/Malvern	8,056,977	-	12.5 %	-106,229	-106,229	\$28.31	\$26.51	\$27.15
Fort Washington	3,473,964	-	14.7 %	-1,390	-1,390	\$27.91	\$24.42	\$25.90
Horsham/Willow Grove	4,422,604	-	21.3 %	-96,383	-96,383	\$27.84	\$25.07	\$25.15
Jenkintown	1,081,401	-	20.5 %	-2,504	-2,504	\$25.46	\$22.30	\$23.97
King of Prussia	13,419,503	-	13.5 %	-94,140	-94,140	\$33.43	\$27.39	\$29.66
Radnor/Main Line	2,635,337	-	4.3 %	20,814	20,814	\$43.40	\$26.00	\$39.22
Southern 202 Corridor	2,466,618	-	13.8 %	-12,699	-12,699	\$29.10	\$24.51	\$26.87
Suburban Total	63,380,477	1,038,000	14.7 %	-394,640	-394,640	\$31.04	\$25.74	\$27.56
Market Totals	109,161,842	1,428,000	13.8 %	-257,587	-257,587	\$33.93	\$27.12	\$29.95

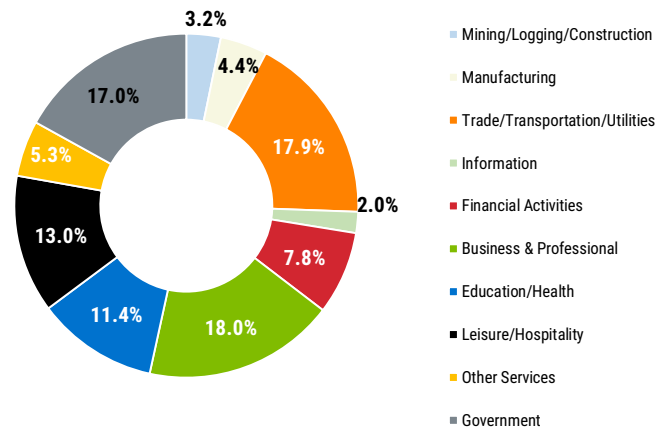
ECONOMIC OVERVIEW

Economic conditions in the Philadelphia Metro Division looked radically different at the start of the first quarter than at its conclusion in March. The latest data from the Bureau of Labor Statistics (February 2020) states the metro gained 23,900 jobs year-over-year, signaling a healthy economy in the midst of a late-cycle employment bump. The economic effects of the COVID-19 pandemic began to be felt in mid-March when at the statewide level, a surge of nearly 650,000 unemployment claims were filed in the week spanning March 15th to March 21st. Economic fallout will continue at least into the second quarter and likely beyond.

Greater Philadelphia has suffered smaller losses in past recessions compared to other major markets like New York and Chicago, and one commonly accepted reason for that is the region's large concentration of employees in healthcare (which is a major office-occupying industry). The Philadelphia Metro has a greater concentration of healthcare employment than any other major metro in the country, which should help the region weather this recession better than some office market peers, yet again.

EMPLOYMENT BY INDUSTRY

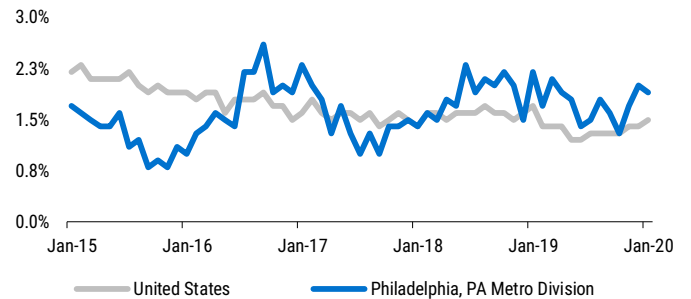
Philadelphia Metropolitan Division, 2019 Annual Average



Source: U.S. Bureau of Labor Statistics

PAYROLL EMPLOYMENT

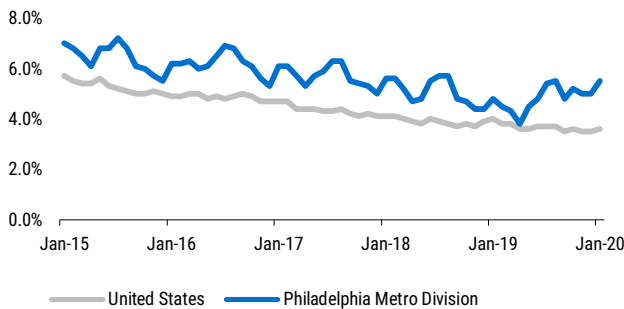
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

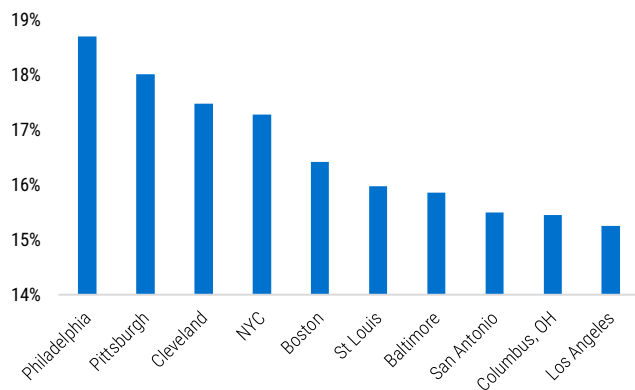
Seasonally Adjusted*



Source: U.S. Bureau of Labor Statistics, *Local Data Not Seasonally Adjusted

HEALTHCARE SHARE OF OVERALL EMPLOYMENT

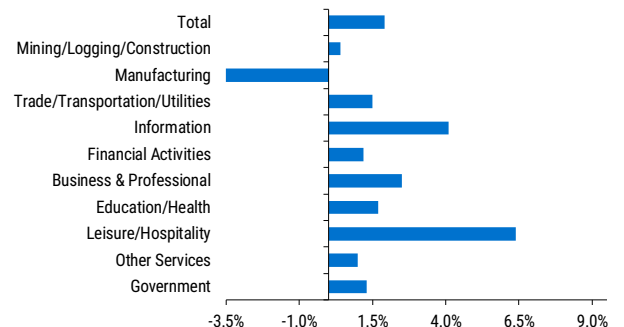
Top Major Metros



Source: JobsEQ, US BLS

EMPLOYMENT GROWTH BY INDUSTRY

Philadelphia Metropolitan Division, January 2020, 12-Month % Change, Not Seasonally Adj.



Source: U.S. Bureau of Labor Statistics



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