

PHILADELPHIA OFFICE MARKET

THE PHILADELPHIA REGION'S SUPPLY PIPELINE IS SET TO FILL AGAIN

In the second quarter of 2019, new supply was at the forefront of the Philadelphia commercial real estate conversation. Across the suburbs and Central Business District (CBD), new office construction projects and major redevelopments were announced, and multiple large-block tenants were poised to officially ink deals precipitating the groundbreaking of significant build-to-suits. While the large-block tenant stratum was active in decision-making during the past three months, the volume of tenants coming to market with space requirements in the small-to-midsize range tapered as the quarter drew to a close. This is likely a function of seasonal vicissitudes with high summer around the corner, but nevertheless, something to watch as national economic growth is slowing.

Philadelphia Central Business District (CBD)

The CBD currently has no office construction projects underway but that is set to change in the near future. This quarter, Drexel University announced that its College of Nursing and Health Professions will consolidate and relocate to a new office tower to be constructed in University City. In addition, one of the CBD's largest law firms, Morgan, Lewis & Bockius, was in active negotiations with developer Parkway Corp. to break ground on a new build-to-suit HQ at 23rd & Market Streets. Parkway Corp. was also in negotiations with an undisclosed insurance company for a new build-to-suit at 20th & Arch Streets. Multiple life sciences-focused developments moved closer to groundbreaking this quarter. University Place Associates secured key partnerships with Ben Franklin Technology Partners and Wistar Institute and will likely begin construction on the 240,000-square-foot 3.0 University Place by the end of the year. Also in University City, Washington, D.C.-based developer Republic Properties Group leased land from SEPTA on which to construct a proposed 125,000 SF office/lab building. Finally, two projects that do not have bearing on the office market inventory, but will boost the profile and inventory of Philadelphia's life sciences lab sector, were announced. Penovation Works will welcome a second lab incubator on the campus: the 73,400 SF building will undergo transformational renovation starting in the fall. Meanwhile, Northern California-based Iovance Biotherapeutics signed a 135,814 SF lease on a manufacturing/R&D/office facility to break ground in the Navy Yard.

Iovance Therapeutics notably was also the largest new-to-market tenant to Philadelphia this quarter, driving the total volume of companies

CURRENT CONDITIONS

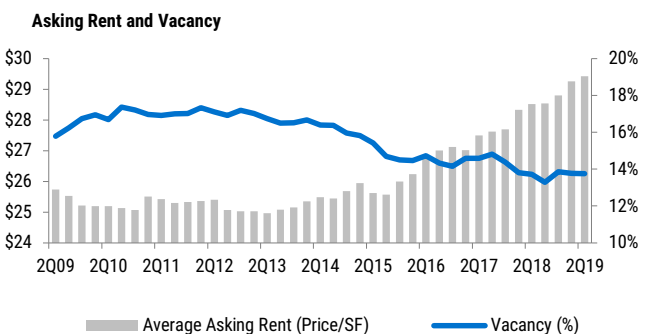
Build-to-suit projects and major redevelopments announced this quarter will grow the supply pipeline and bring new office space to market.

Coworking's continued expansion in the Philadelphia CBD primarily drove positive absorption in that market.

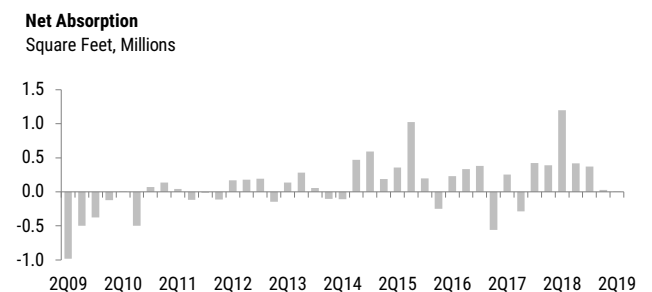
Rents grew 3.0% downtown and 3.7% in the suburbs year-over-year.

MARKET ANALYSIS

Asking Rent and Availability



Net Absorption (SF, Millions)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	109.1MSF	109.1MSF	109.9MSF	↑
Vacancy Rate	13.8%	13.8%	13.7%	↓
Quarterly Net Absorption	5,358 SF	28,091 SF	1.2MSF	↑
Average Asking Rent	\$29.43	\$29.26	\$28.52	↑
Under Construction	0.8 MSF	0.8MSF	1.0MSF	↑
Deliveries	0.0 MSF	0.0 MSF	1.3MSF	↑

moving to the city from outside the market to approximately 1.1 MSF since the start of 2018.

Second-quarter leasing volume in the CBD more than made up for retractions and right-sizings in the first three months of the year. Plenty of full-floor-or-more leases from companies across industries eclipsed one of the biggest downsizings looming on the CBD horizon, which finally came to fruition this quarter. The Environmental Protection Agency downsized by nearly half, signing to relocate from 1650 Arch Street into 173,007 SF at Four Penn Center. Despite that, over 100,000 SF of net absorption was tallied, pushing vacancy down 30 basis points quarter-over-quarter to 13.2%. The quarter's largest new lease was CHOP's 53,000 SF expansion at The Wanamaker, at which upgrades to the building's atrium and lobbies were unveiled this quarter. Among other significant new leases, the Campaign of Joe Biden took a full floor at Centre Square, Industrious leased 55,000 SF at Two Liberty Place and WeWork leased approximately 50,000 SF at 1100 Ludlow Street. The latter two represented the respective coworking operator's second and fifth location in the city, and Merck has already taken approximately half of the WeWork space at 1100 Ludlow Street.

The coworking expansion will continue throughout the year as more than 500,000 square feet of requirements are in the market. Providers are pursuing larger footprints to accommodate coworking requirements for major corporations, and smaller coworking occupier growth alike. However, the expansion may be hampered by existing noncompete agreements between coworking providers and landlords, preventing rival operators from taking space in the same building. The number of office properties in the CBD that can accommodate a coworking provider is dwindling.

Average asking rents continued their impressive upward march in the CBD this quarter, crossing the \$33.00/SF threshold for the first time ever, landing at \$33.08/SF. Trophy office space vacancy tightened quarter over quarter to the single digits (down 130 bps to 9.4%) with rates now in the mid to upper \$40s per SF. Overall Class A space was down 30 bps to 13.3%, and starting rents have pushed through to mid-\$30s per SF. Tenants are clearly demonstrating with their leasing habits that Philadelphia CBD office space is worth a premium – and one that is likely to keep rising in 2019 as vacancy remains low.

Southeastern Pennsylvania

Mirroring supply trends in the CBD, multiple new suburban development opportunities came to light in the second quarter. Brandywine Realty Trust received approval on plans to transform the current building at 650 Park Avenue in King of Prussia into a 100,000-square-foot new office property, and Bala Cynwyd-based Hamilton Lane has all but officially signed for approximately 130,000 SF at Seven Tower Bridge in Conshohocken, which should kick off construction on the project this year. Vacancy in Conshohocken was 10.0% this quarter, the second-lowest measure in the suburban market after Radnor/Main Line. The

remainder of Seven Tower Bridge not taken by Hamilton Lane, approximately 130,000 SF, will be a boon for prospective tenants looking to lease trophy space in a tight submarket. Major renovations on the Spring Mill Pavilion building at 1100 East Hector Street also completed this quarter, providing the Conshohocken submarket with 42,000 SF of newly converted office space.

Finally, the life sciences development wave flourishing in the city is alive and well in the suburbs, too. In June, MLP Ventures revealed impressive plans for a \$500 million renovation project encompassing the former GlaxoSmithKline campus on Swedeland Road and a portion of the Renaissance Park office complex it acquired in 2018. The re-branded "Discovery Labs" will involve 1.6 MSF of office, lab and advanced manufacturing space, all fashioned as a large-scale coworking complex. MLP Ventures has partnered with Pennsylvania Biotechnology Center of Bucks County on the project, and the Center will occupy 100,000 SF as an anchor incubator space.

Rents continued to experience upward pressure in the second quarter, the suburbs' sixth consecutive quarter of pricing growth. Class A asking rates grew in 10 of the 12 suburban submarkets quarter-over-quarter (save Jenkintown Class A rates which remained the same, and Horsham/Willow Grove rates, which depreciated by only two cents). Year-over-year, overall suburban asking rates rose 3.7% to \$27.56/SF.

Rent growth and new supply announcements were positive stories for the suburban market this quarter, where net absorption was decidedly negative – to the tune of approximately 102,000 SF of occupancy losses. This was largely due to relocations within the market, or out of market. Ricoh relocated from 110,000 SF to approximately 60,000 SF in Exton, and Incyte began withdrawing from its temporary space in Chadds Ford, which the company took during the construction of its new HQ in Northern Delaware. Incyte gave back one of the three buildings it occupied, approximately 50,000 SF, with the other two to follow later this year and in early 2020, which may prove to be a damper on the suburban vacancy rate. Overall, vacancy only grew by 10 basis points quarter over quarter, to 14.1%, aided in part by removal of a vacant building from the statistical inventory: 21st Century Charter School purchased 1245 Wrights Lane for its own use.

While the overall suburban market may experience fluctuating demand performance throughout the latter half of the year, the tightest submarkets in the region – in particular, Conshohocken, Radnor/Main Line, and King of Prussia – are likely to remain tight. Prospective tenant requirements total in the hundreds of thousands of SF among these three submarkets combined, so those with more immediate space needs may have to look elsewhere in the suburban market for large block opportunities.

Philadelphia CBD Lease/User Transactions

Tenant	Building	Submarket	Type	Square Feet
EPA	Four Penn Center	West Market	Direct	173,007
Iovance Biotherapeutics	300 Rouse Blvd	Navy Yard	Direct	136,000
Children's Hospital of Philadelphia	100 Penn Square East	East Market	Direct	53,717
WeWork	1100 Ludlow St	East Market	Direct	50,514
Holland & Knight	2929 Arch St	University City	Extension/ Expansion	41,000

Southeastern Pennsylvania Lease/User Transactions

Tenant	Building	Submarket	Type	Square Feet
Hamilton Lane	171 Washington St	Conshohocken	Direct	127,500
Genesis Engineering	One Sentry Park	Blue Bell/Plymouth Meeting	Direct	30,000
PetroChoice	640 Freedom Business Center Dr	King of Prussia	Direct	23,358
Surgent McCoy CPE	201 King of Prussia Rd	Radnor/Main Line	Direct	11,560

Greater Philadelphia Sales Transactions

Building	Submarket	Sales Price	Price/SF	Square Feet
Glenhardie Office Park	King of Prussia	\$30,720,000	\$120	256,000
Valley Square Office Portfolio	Blue Bell/Plymouth Meeting	\$19,750,000	\$67	293,870
500 Virginia Drive	Fort Washington	\$8,100,000	\$22	375,500

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	-	11.7 %	140,081	32,811	\$33.38	\$27.91	\$30.23
Independence Square	5,380,384	-	13.9 %	-45,260	-43,238	\$30.65	\$30.94	\$30.57
University City	4,534,880	-	9.5 %	50,948	66,555	\$41.12	\$43.95	\$41.05
Walnut/South Broad	3,977,064	-	16.1 %	30,123	117,780	\$35.75	\$30.37	\$29.77
West Market	25,557,953	-	13.7 %	-68,663	-130,907	\$35.52	\$28.89	\$33.89
CBD Total	45,781,365	-	13.2 %	107,229	43,001	\$35.56	\$30.06	\$33.08
Bala Cynwyd	2,971,802	-	10.4 %	-11,596	-25,560	\$35.99	\$33.75	\$34.29
Blue Bell/Plymouth Meeting	8,148,267	-	17.7 %	-4,264	29,441	\$29.54	\$24.51	\$26.72
Bucks County	8,235,005	-	19.8 %	-75,698	-96,771	\$28.72	\$22.79	\$24.25
Central/S Delaware County	4,926,227	378,000	12.9 %	-15,920	20,206	\$28.99	\$24.98	\$26.77
Conshohocken	3,221,518	400,000	10.0 %	-19,983	-14,733	\$39.39	\$34.12	\$37.26
Exton/Malvern	8,292,524	-	11.1 %	-39,599	8,144	\$28.09	\$26.42	\$27.13
Fort Washington	3,548,964	-	14.5 %	29,132	-51,381	\$27.97	\$23.85	\$25.98
Horsham/Willow Grove	4,469,314	-	18.1 %	37,146	-13,655	\$27.96	\$24.97	\$25.05
Jenkintown	1,081,401	-	19.0 %	-18,283	-26,966	\$25.04	\$22.33	\$23.70
King of Prussia	13,346,984	-	12.2 %	90,576	282,452	\$32.35	\$26.96	\$28.65
Radnor/Main Line	2,635,337	-	6.8 %	71,133	84,118	\$40.94	\$29.75	\$40.17
Southern 202 Corridor	2,466,915	-	14.6 %	-144,515	-204,847	\$29.38	\$24.38	\$26.48
Suburban Total	63,344,258	778,000	14.1 %	-101,871	-9,552	\$30.54	\$25.71	\$27.39
Market Totals	109,125,623	778,000	13.8 %	5,358	33,449	\$32.80	\$26.78	\$29.43

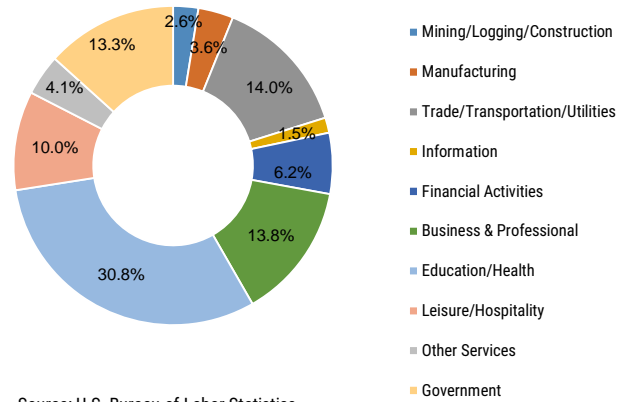
ECONOMIC OVERVIEW

The Philadelphia metro division was in fine economic form in the second quarter of 2019. Unemployment was at 3.8% in April 2019, and 17,900 more jobs were added to the region year-over-year. Among the supersectors of employment, construction saw the biggest growth in the past 12 months, commensurate with the boom in development discussed previously in this report. The local life sciences industry, responsible for the majority of this quarter's development announcements, is also booming in numerous measurable ways.

Since 2017, the Philadelphia metro has seen a significant uptick in venture capital funding within the life sciences sector. According to PWC, life sciences VC funding grew to \$277 million in the first quarter of 2019, a 72% increase year-over-year. Consequently, life sciences employment has also grown; according to the U.S. BLS, in the city of Philadelphia, life sciences R&D employment was up 15% from 2017 to 2018, and will show growth in 2019 as well.

EMPLOYMENT BY INDUSTRY

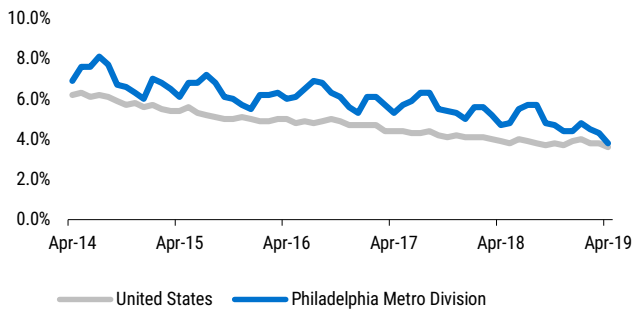
Philadelphia Metropolitan Division, 2018 Annual Average



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

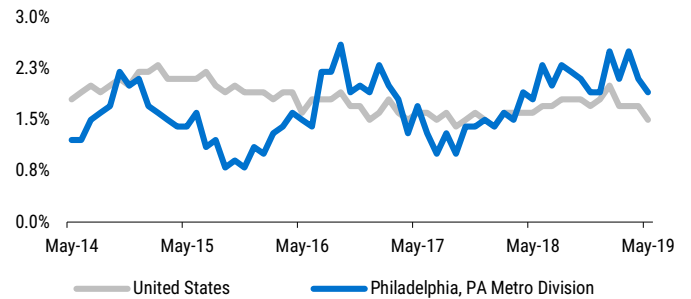
Seasonally Adjusted*



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

PAYROLL EMPLOYMENT

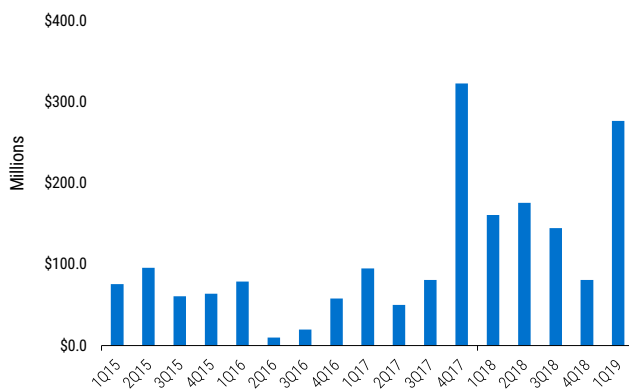
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

LIFE SCIENCES VENTURE CAPITAL FUNDING

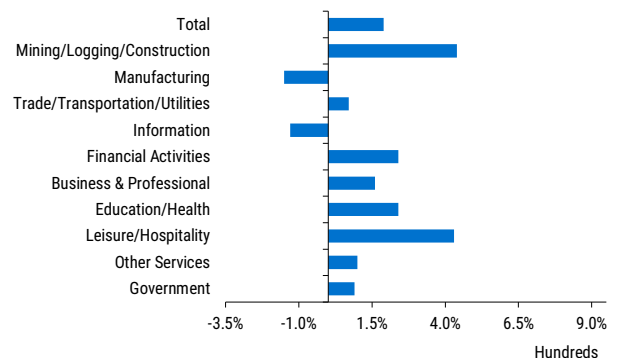
Philadelphia Metro



Source: PWC MoneyTree, NKF Research

EMPLOYMENT GROWTH BY INDUSTRY

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



Source: U.S. Bureau of Labor Statistics



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