

PHILADELPHIA OFFICE MARKET

NO SUMMER SLUMP: THE THIRD QUARTER IS 2019'S STRONGEST YET

A collection of large occupancies across the market drove net absorption to total 259,000 square feet in the third quarter of 2019, a big boost up from the past two quarters where absorption netted out to essentially zero. New-to-market tenants and headquarter relocation/expansions were the primary engines of this quarter's stellar performance. Market-wide, vacancy was trimmed by 20 basis points to 13.6%, and average asking rents continued to escalate, growing a full dollar year-over-year to \$29.58/SF.

Philadelphia Central Business District (CBD)

The trend of new-to-market tenants flocking to the CBD has been a significant driver of the city's office market resurgence for years, and this quarter's activity was again highlighted by a continuation of this trend. Two of the three largest deals in the CBD were firms new to the city – coworking provider CommonGrounds and Munich Reinsurance Company, which both leased at 1700 Market Street (62,000 and 31,000 square feet, respectively). CommonGrounds' lease has now propelled the overall coworking footprint to approximately 1.1 million square feet in the CBD. Although this is a very significant footprint, it represents only 2.3% of the 46.0 million square feet of statistically tracked downtown office inventory. Multiple coworking operators are in the market with space requirements so this footprint is certain to grow. Despite uncertainty on a national scale surrounding the handling of WeWork's announced IPO this quarter, no discernible effects have been felt in Center City's coworking landscape, where demand for coworking space – by entrepreneurial and enterprise companies alike – remains anecdotally healthy. Merck, for example, has already committed to half of the 50,000-square-foot coworking space WeWork signed for at 1100 Ludlow last quarter.

Market vacancy dropped from 13.1% to 13.0% quarter-over-quarter, pared down primarily by the two aforementioned large new-to-market leases, although an influx of new tenants on the smaller scale helped contribute as well: Formcraft signed to relocate its HQ from the suburbs to an 8,500-square-foot space at Two Commerce Square, and All4 Environmental, based in Kimberton, signed for approximately 5,000 square feet at Three Parkway. There was a handful of expansions by existing CBD tenants as well, such as the Altitude Group, which

CURRENT CONDITIONS

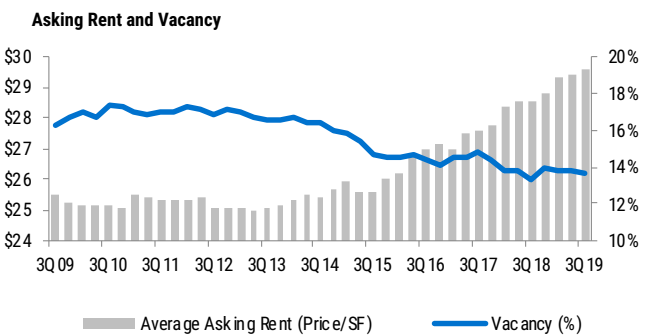
The Philadelphia office market accumulated 259,000 square feet of net absorption in 3Q19, the strongest quarterly total YTD

Coworking and new-to-market tenants drove leasing activity in the CBD; existing tenant relocations and expansions marked suburban growth

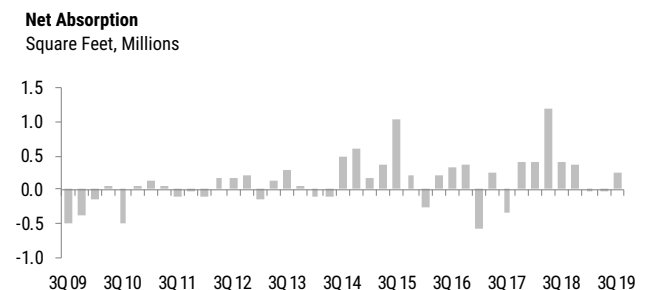
Overall asking rents grew quarter over quarter due primarily to strong increases in the CBD

MARKET ANALYSIS

Asking Rent and Availability



Net Absorption (SF, Millions)



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	109.2MSF	109.1MSF	109.8MSF	↑
Vacancy Rate	13.6%	13.8%	13.3%	↓
Quarterly Net Absorption	259K SF	-10,358 SF	419K SF	↓
Average Asking Rent	\$29.58	\$29.42	\$28.58	↑
Under Construction	0.8 MSF	0.8MSF	1.0MSF	↑
Deliveries	0.0 MSF	0.0 MSF	1.0MSF	↑

expanded by around 4,400 square feet at 1315 Walnut Street. Although there were significant vacancies this quarter - Entercom put approximately 31,000 square feet at 400 Market Street up for sublease, and PMHCC downsized by 48,000 square feet at 123 South Broad Street - net positive absorption totaled nearly 60,000 square feet across the CBD market.

The new-supply waiting game continued in the third quarter. No official groundbreaking announcements were made but shovels should hit dirt soon in service of multiple office projects. Parkway Corp advanced negotiations with Morgan, Lewis & Bockius and an undisclosed insurance company for new build-to-suits in West Market, 300,000 and 400,000 square feet, respectively. In University City, Drexel University's build-to-suit for its College of Nursing and Health Professions will likely break ground by year-end, with One uCity Square and 3.0 University Place both vying to begin soon afterward. These two projects are the only ones at the forefront of the proposed pipeline that would deliver with available space, although if recent history repeats, that space would not be around for long. 3675 Market Street, the most recent delivery of new supply in University City, leased the available balance within a short couple of months after completing in late 2018.

Average asking rents, \$33.66/SF in the third quarter, increased at a rate of 1.8%. For context, rents grew faster this quarter than in all of 2018, which saw growth of 1.1%. The rate at which deals are actually being signed is also increasing: a survey of new, direct leases in West Market showed a rise of 7.3% over the past three years. However, effective rates - what landlords are taking in after tenant improvements and concessions have been factored out - stayed relatively stable during the same period. Rents and construction costs will continue to rise, and tenants have demonstrated willingness to pay higher rates: the desire for office space that can both reflect the company's image and retain top talent is especially evident in the single-digit vacancy rate for the CBD's trophy set, which decreased to 9.1% from 11.4% in the third quarter of 2018.

Southeastern Pennsylvania

Multiple headquarters relocations occurred in the suburban market during the third quarter. A predominant number of these users leased a greater amount of space than they left behind, bucking the trend of companies downsizing upon relocation. Aegis Software and YPrime relocated and expanded within their respective submarkets of Horsham/Willow Grove and Exton/Malvern, and Eastern Airlines subleased approximately 19,000 square feet at CrossPoint at Valley Forge in the King of Prussia submarket, relocating the company headquarters from Charlotte, North Carolina.

Other significant expansionary move-ins this quarter included RSM, which grew from 29,000 to 45,000 square feet upon relocation to 518 Township Line Road in Blue Bell/Plymouth Meeting, Midlantic Urology's occupancy of 25,000 square feet at 656-76 E Swedesford Rd in King of Prussia (relocating from about 10,000 square feet), and Schweitzer Engineering Laboratories' relocation into 30,000 square feet at 2900 Horizon Drive, also a growth move within the King of Prussia submarket. In total, the market gained approximately 202,000 square feet of net absorption this quarter, as eight out of the twelve submarkets contributed positively to the result. Marketwide, vacancy fell 10 basis points during the past three months to 14.1%.

Supporting the healthy office occupancy narrative in the suburbs is continued growth charted in suburban office-using employment. According to the U.S. Bureau of Labor Statistics, the information, financial services and professional/business services sectors added approximately 500 jobs year-over-year to the suburban counties.

Overall average asking rates in the suburbs, \$27.40/SF were stable from the previous quarter, yet up by nearly 3.0% year-over-year. Notable contributors to this recent rent growth are new property owners, whose tried-and-true strategy is to reposition their assets in the market through significant capital investment in high-quality building amenities. Among significant office sales closed this quarter are two in particular that are likely to continue that trend. Chesterbrook Corporate Center, a 1.0MSF+ office campus in the King of Prussia submarket, sold to Rubenstein Partners, who plan to invest \$50 million in repositioning the office park. Four Falls Corporate Center in Conshohocken sold to a joint venture of Keystone Property Group and the Arden Group, with a multi-million-dollar capital improvement program planned. NKF Research is tracking numerous office assets marketed for sale in the suburbs that are drawing toward closing, which will ensure the trend continues into 2020.

On a supply note, Brandywine Realty Trust moved forward this quarter with its project to redevelop 650 Park Avenue in King of Prussia, by demolishing the existing building at the site to make way for a 100,000-square-foot office property. 650 Park Avenue joined the ranks of proposed office buildings in the suburbs that are closing in on groundbreaking, such as the 145,720-square-foot mass-timber office at 675 East Swedesford Road and the 145,000-square-foot project at 155 King of Prussia Road in Radnor/Main Line. Seven Tower Bridge, the 260,000-square-foot office building proposed in Conshohocken, is reportedly in final stages with anchor tenant Hamilton Lane and will likely be the first among the "Proposed Class" to break ground. Large, prime blocks of space are scarce in the suburban market, particularly in the western submarkets, so it is likely that at least one other project follows suit in this development cycle.

Philadelphia CBD Lease/User Transactions

Tenant	Building	Submarket	Type	Square Feet
CommonGrounds	1700 Market Street	West Market	Direct	60,000
DVRPC	190 N Independence Mall W	Independence Square	Renewal	36,870
Philadelphia Works	1617 JFK Blvd	West Market	Renewal	35,000
Munich RE	1700 Market Street	West Market	Direct	30,000
Health Verity	1818 Market Street	West Market	Direct	20,500

Southeastern Pennsylvania Lease/User Transactions

Tenant	Building	Submarket	Type	Square Feet
Zoetis	2476 Swedesford Road	Exton/Malvern	Direct	65,000
Mitchell International	440 E. Swedesford Road	King of Prussia	Renewal	50,027
CompanyVoice	930 Harvest Drive	Blue Bell/Plymouth Meeting	Renewal	34,557
FXI	100 Matsonford Road	Radnor/Main Line	Direct	34,122

Greater Philadelphia Sales Transactions

Building	Submarket	Sales Price	Price/SF	Square Feet
Chesterbrook Corporate Center	King of Prussia	\$148,500,000	\$145	1.0MSF
Four Falls Corporate Center	Conshohocken	\$50,000,000	\$197	254,000
1476 Dunwoody Drive	Exton/Malvern	\$13,500,000	\$108	125,000
70 Valley Stream Parkway	Exton/Malvern	\$7,750,000	\$73	107,000

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	-	11.1 %	37,229	70,040	\$33.36	\$27.88	\$30.29
Independence Square	5,380,384	-	14.0 %	-9,643	-52,881	\$30.49	\$30.73	\$30.49
University City	4,534,880	-	10.1 %	8,100	74,655	\$41.12	\$44.13	\$41.35
Walnut/South Broad	3,977,064	-	17.9 %	-73,073	44,707	\$36.12	\$30.67	\$30.01
West Market	25,557,953	-	13.0 %	94,548	-29,015	\$37.25	\$29.28	\$34.97
CBD Total	45,781,365	-	13.0 %	57,161	107,506	\$36.77	\$30.21	\$33.66
Bala Cynwyd	2,971,802	-	11.2 %	-24,929	-50,489	\$35.99	\$33.80	\$34.35
Blue Bell/Plymouth Meeting	8,148,267	-	17.6 %	12,926	38,920	\$29.54	\$24.34	\$26.68
Bucks County	8,235,005	-	19.1 %	60,888	-35,883	\$28.65	\$22.75	\$23.92
Central/S Delaware County	4,926,227	378,000	12.4 %	25,914	46,120	\$28.68	\$24.90	\$26.55
Conshohocken	3,221,518	400,000	9.9 %	1,986	-12,747	\$39.80	\$34.52	\$37.85
Exton/Malvern	8,351,224	-	11.1 %	57,581	65,725	\$28.32	\$26.47	\$27.23
Fort Washington	3,548,964	-	15.1 %	-19,264	-70,645	\$28.14	\$23.57	\$25.70
Horsham/Willow Grove	4,469,314	-	19.0 %	41,525	-3,130	\$27.97	\$25.00	\$24.95
Jenkintown	1,081,401	-	20.0 %	-10,605	-37,571	\$25.42	\$21.98	\$23.94
King of Prussia	13,346,984	-	11.7 %	79,427	342,266	\$32.73	\$26.89	\$28.59
Radnor/Main Line	2,635,337	-	6.3 %	13,091	97,209	\$41.65	\$29.75	\$40.78
Southern 202 Corridor	2,466,618	-	16.0 %	-36,705	-241,552	\$28.69	\$24.96	\$26.80
Suburban Total	63,402,661	778,000	14.1 %	201,835	138,223	\$30.85	\$25.66	\$27.40
Market Totals	109,184,026	778,000	13.6 %	258,996	245,729	\$33.36	\$26.77	\$29.58

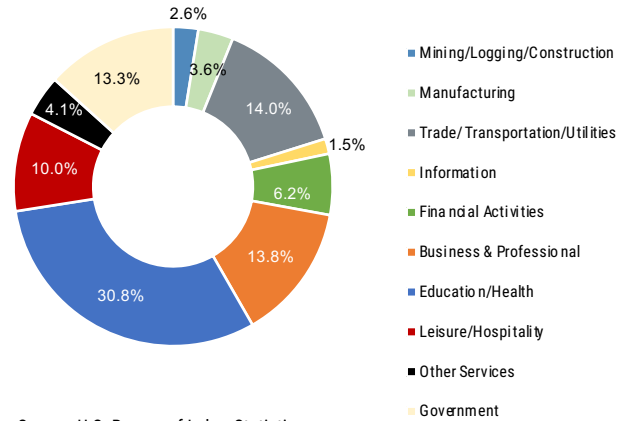
ECONOMIC OVERVIEW

The Philadelphia Metropolitan Division added approximately 19,800 jobs during the 12 months ending in August 2019, a strong showing reflected in the office vacancy rate falling throughout the region. Among the supersectors of employment, only manufacturing and trade/transportation/utilities saw slight declines from August 2018.

The Philadelphia region's most consistent industry of growth, "eds & meds", will face a (brief) setback. The city of Philadelphia's Hahnemann University Hospital, a 496-bed institution employing an estimated 2,500 people, officially closed in the third quarter following bankruptcy declaration. However, the former hospital employees will face a "hospitable" job environment: Across Greater Philadelphia, there is a greater demand for healthcare employees than there are qualified applicants to fill those roles. Greater Philadelphia's eds & meds sector will continue to grow despite the hospital closure.

EMPLOYMENT BY INDUSTRY

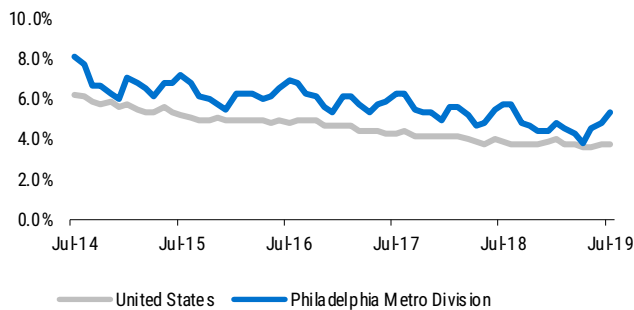
Philadelphia Metropolitan Division, 2018 Annual Average



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

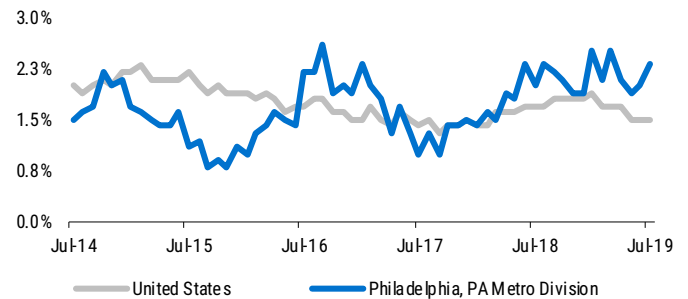
Seasonally Adjusted*



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

PAYROLL EMPLOYMENT

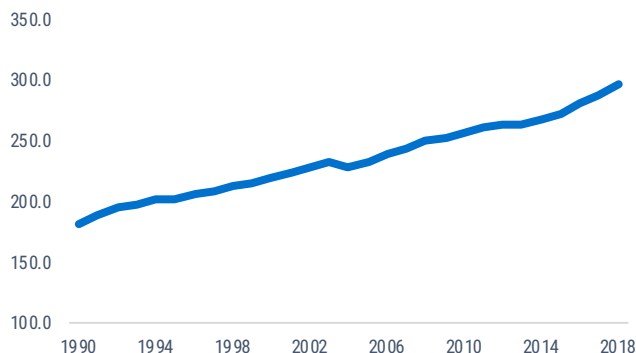
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

"EDS & MEDS" HISTORICAL EMPLOYMENT

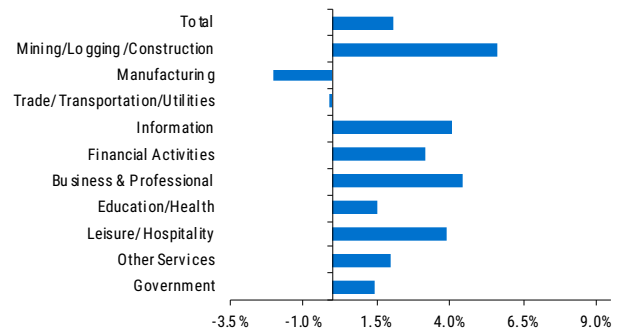
Philadelphia Metro Division, Thous., Not Seasonally Adj.



Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

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



Source: U.S. Bureau of Labor Statistics



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