

PHILADELPHIA OFFICE MARKET

OFFICE VACANCY AND SUBLEASE VOLUME RISE, BUT MAJOR COMMITMENTS CONTINUE TO BE MADE IN GREATER PHILADELPHIA

Third-quarter market activity amid the ongoing pandemic signaled a challenging road ahead for the Philadelphia office sector. Headwinds aside, however, glimmers of positivity were detectable as numerous major tenants across the region reaffirmed their commitment to the built office environment through significant move-ins, long-term lease transactions, and groundbreakings on new buildings. In total, the region suffered a net loss of occupancy totaling 247,655 square feet during the third quarter, resulting from significant space give-backs in Philadelphia's Central Business District (CBD). These losses eclipsed the positive net absorption tallied in the suburban market.

Beyond an increase in vacant space, there was an even greater increase in sublease space this quarter. Available sublease volume rose by 24.1% during the past three months, the largest quarterly rate of increase on statistical record for the region. This increase represented nearly half a million square feet of sublease availability added to the market. Further additions are likely, as many firms across office-occupying sectors continue successful remote work strategies or grapple with economic turmoil. Despite the concerning amount of sublease space introduced to the market since the pandemic began, Philadelphia has been burdened less in this regard than many other major markets: the local sublease availability rate remained under 3.0% in the quarter, whereas it has soared to over 8.0% in San Francisco. Not all view the sublease wave with concern, as more options in the sublease market represent a benefit to tenants seeking flexibility. EwingCole, DMW Direct Worldwide and NewMarket Corporation were among numerous firms across the suburbs and CBD to sign for sublease space in the third quarter.

A positive development for the region and in particular the CBD, was groundbreaking on two notable build-to-suit office projects this quarter. Construction began on 2222 Market Street, the \$200 million, 308,000-square-foot headquarters for Morgan Lewis. In University City, Drexel University's 454,000-square-foot Academic Tower also broke ground, joining the life sciences project One Ucity Square in that submarket's development pipeline. Multiple development sites across the region are vying to be the next to break ground, and while demand from traditional office occupiers will remain muted in the near-to-midterm, demand for life sciences space continues to grow. Similar to what the market witnessed in 2Q, the largest new lease in the CBD this quarter was signed by ever-expanding Spark Therapeutics, one of Philadelphia's marquee life sciences firms. Market participants note other life sciences tenants currently in the market are exploring new development sites, so despite persistently challenging conditions, it is feasible another building may come out of the ground in 2021.

CURRENT CONDITIONS

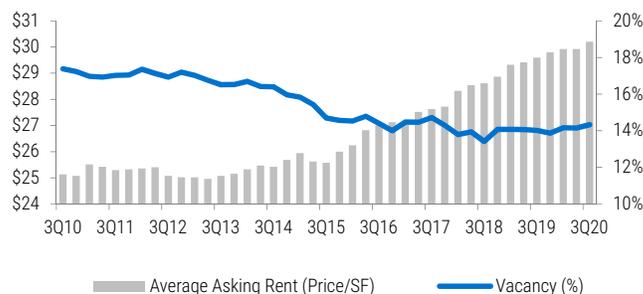
Absorption performance varied between the CBD and the suburbs with a net loss of 247,655 SF

Major CBD office groundbreakings this quarter included build-to-suits for Drexel University and Morgan Lewis.

Overall asking rates were \$30.20/SF, up from the previous quarter as pricing held downtown and some suburban properties increased rents.

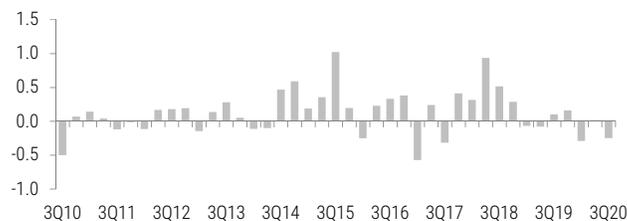
MARKET ANALYSIS

Asking Rent and Vacancy



Net Absorption (SF, Millions)

Net Absorption
Square Feet, Millions



MARKET SUMMARY

	Current Quarter	Prior Quarter	Year Ago Period	12 Month Forecast
Total Inventory	109.3MSF	109.3MSF	108.8MSF	↑
Vacancy Rate	14.3%	14.1%	14.0%	↑
Quarterly Net Absorption	-248K SF	18K SF	102K SF	↔
Average Asking Rent	\$30.20	\$29.92	\$29.59	↓
Under Construction	2.2 MSF	1.4 MSF	0.8MSF	↑
Deliveries	0.0 MSF	0.0 MSF	0.0MSF	↑

PHILADELPHIA CENTRAL BUSINESS DISTRICT

The Philadelphia CBD sustained significant losses in the third quarter, tallying 326,745 square feet in negative net absorption. Among those to give back sizeable amounts of space were Comcast at Two Logan Square (88,000 square feet), Axalta at Two Commerce Square (36,000 square feet), Magee at One Penn Center (19,099) and Science Leadership Academy at 3600 Market Street (20,400 square feet). The latter will relocate to a new school facility, while the rest of the tenants mentioned all plan to fold into existing footprints elsewhere in the city. Numerous tenants leased new space or expanded throughout the CBD during the third quarter as well, such as Laffey Bucci and Kent, Hachette, and most notably, Spark Therapeutics, which leased 46,000 square feet at 3101 Market Street, the largest new lease in the third quarter (Spark also transacted the largest CBD lease last quarter). This lease highlights the true bright spot in the midst of pandemic turmoil and uncertainty – life sciences momentum in the CBD.

While new leases continue to be signed, demand for office space will be muted over the quarters to come. 38.0% of tenant requirements for traditional office space that were in the market in February are now on COVID-19-related hold. The most notable tenant to go on “COVID pause” was CHUBB. The CBD encouragingly witnessed two new groundbreakings for build-to-suits during the third quarter, but CHUBB, which had been in advanced talks for a build-to-suit at 20th and Arch Streets, decided to put those plans on hold due to the pandemic.

Since demand will remain muted in the near- to midterm, it is likely more net negative absorption will accumulate in the CBD market. The coworking/flexible space sector, which significantly bolstered annual net absorption in the CBD over the past five years with new-to-market and expanding operators, has been hit especially hard by the pandemic. Multiple coworking sites closed or announced closure during the third quarter. WeWork will close their location at 1430 Walnut Street, ServCorp closed at 1735 Market Street, and the Spaces location at 1626 Locust Street has been named in a bankruptcy filing by Spaces’ parent company. The flexible space concept will undoubtedly continue in some form once the pandemic period has passed, but further losses in this sector are expected in the interim.

One major note of confidence in the abiding allure of the CBD as an office location has been the lack of any significant urban exodus. Dialogue surrounding the attractiveness of the suburban vs urban market in the age of COVID-19 has been omnipresent, but since the pandemic began, only a couple smaller city-based companies, predominantly law firms, have left the CBD or have been in the market for space in the suburbs to relocate. Some tenants such as EwingCole have subleased temporary suburban office space to accommodate area employees and social distancing needs, while maintaining the CBD footprint. It is still too early to state if the CBD will lose any major tenants to the suburban market, but thus far, this trend has not materialized.

SOUTHEASTERN PENNSYLVANIA

Following two quarters of losses, the suburban Philadelphia office market reversed performance and tallied 79,090 square feet of positive net absorption during the past three months. Numerous major occupancies, some planned earlier in the year and delayed by COVID-19, transpired this quarter. The largest suburban occupancy was Toll Brothers’ new headquarters relocation – also the largest move-in market-wide, year-to-date. The home builder “right-sized” from 203,000 square feet in Horsham and relocated to 163,000 square feet in Fort Washington. Other major move-ins this quarter included Mullen Coughlin, which relocated and occupied 56,000 square feet at 426 W Lancaster Avenue in the King of Prussia submarket, and Jefferson College of Nursing, which occupied the 44,000-square-foot building at 300 Lakeside Drive in Horsham. PayPal, in a consolidation and relocation, moved into most of its 99,512 square feet of leased space at 4000 Chemical Road in Blue Bell/Plymouth Meeting, as a part of a multi-phase occupancy. Overall vacancy declined from 15.2% to 15.0% quarter-over-quarter, a metric further improved by a handful of owner/occupiers taking competitive office space off the market. Notably, Commonwealth Charter Academy purchased 70 Valley Stream Parkway in the Exton/Malvern submarket for occupancy, and the Police & Fire Federal Credit Union expanded into the balance of One Greenwood Square in Bucks County, which they own.

Between the second and third quarters, sublease space in the suburbs spiked 23.0% to approximately 1.6 million square feet, a concerning uptick. Yet, in contrast to the CBD market, in which sublease volume reached heights not seen in a decade, suburban sublease availability has fluctuated over the past few years anywhere from 1.0 to 1.6 million square feet, so is not yet at abnormal historical heights. However, some drivers behind sublease additions now versus a year ago are different: successful remote workforce strategies have compelled numerous small-footprint firms to eliminate leased office space entirely. While the make-up of subleases added since March has mostly been small to midsize tenants, this quarter, a couple notable large-block tenants put either partial or full spaces on the market for sublease, including Cotiviti’s 88,000-square-foot space at 785 Arbor Way in Blue Bell. Hamilton Lane, whose lease anchors the under-construction Seven Tower Bridge in Conshohocken, also announced it would sublease one of their floors. Whether this leads to a more wide-scale trend of large-block tenants putting space on the sublease market remains to be seen.

Thus far, average asking rents in the suburbs have avoided impact, even growing quarter-over-quarter to \$28.03/SF. While a handful of landlords lowered rents modestly, the vast majority kept rents steady or even raised them in key submarkets such as King of Prussia. Rent projections market-wide inevitably call for softening in 2021 but it’s likely that desirable space in tight, core submarkets will hold current value.

PHILADELPHIA CBD LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Spark Therapeutics	3101 Market St	University City	Direct Lease	46,371
Arch Insurance	1601 Cherry Street	West Market	Renewal	24,524
Weir & Partners	1 S Penn Square	East Market	Renewal	24,100
Hachette	123 S Broad Street	Walnut/South Broad	Direct Lease	12,528

SOUTHEASTERN PENNSYLVANIA LEASE/USER TRANSACTIONS

Tenant	Building	Submarket	Type	Square Feet
Honeywell	500 Virginia Drive	Fort Washington	Renewal	84,405
BNP Paribas	735 Chesterbrook Boulevard	King of Prussia	Direct Lease	58,877
West Health Advocate Solutions	835 Springdale Drive	Exton/Malvern	Renewal	17,087
Sabre Systems	101 E County Line Road	Bucks County	Direct Lease	12,521

GREATER PHILADELPHIA SALES TRANSACTIONS

Building	Submarket	Sales Price (millions)	Price/SF	Square Feet
70 Valley Stream Parkway	Exton/Malvern	\$15.3	\$143	106,866

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	-	9.5 %	22,295	74,793	\$35.21	\$27.74	\$30.48
Independence Square	5,380,384	-	15.7 %	-59,256	-30,934	\$30.50	\$31.65	\$31.13
University City	4,688,776	844,000	8.8 %	23,091	67,287	\$39.79	\$44.84	\$40.35
Walnut/South Broad	3,977,064	-	19.4 %	-28,117	-71,387	\$36.32	\$31.55	\$30.89
West Market	25,557,953	308,000	13.8 %	-284,758	-179,132	\$38.25	\$28.91	\$35.80
CBD Total	45,935,261	1,152,000	13.4 %	-326,745	-139,373	\$37.60	\$30.36	\$34.15
Bala Cynwyd	2,944,026	-	11.7 %	-19,157	-44,947	\$36.11	\$35.07	\$35.14
Blue Bell/Plymouth Meeting	8,531,020	-	18.0 %	10,488	-46,974	\$30.38	\$22.99	\$26.34
Bucks County	8,072,833	-	19.4 %	4,982	-89,933	\$28.89	\$23.12	\$24.62
Central/S Delaware County	4,926,227	378,000	13.5 %	-18,150	-6,242	\$29.42	\$25.00	\$26.77
Conshohocken	3,309,518	660,000	11.4 %	-22,080	-39,335	\$42.00	\$34.35	\$38.65
Exton/Malvern	8,056,977	-	12.3 %	-208	-88,083	\$27.67	\$26.84	\$26.98
Fort Washington	3,473,964	-	15.6 %	155,709	155,005	\$27.90	\$24.42	\$26.06
Horsham/Willow Grove	4,422,604	-	22.9 %	-104,828	-164,911	\$27.94	\$25.03	\$25.20
Jenkintown	1,081,401	-	21.7 %	-5,510	-15,540	\$25.36	\$22.35	\$24.16
King of Prussia	13,415,444	-	13.5 %	49,427	-54,824	\$34.09	\$28.05	\$30.11
Radnor/Main Line	2,636,360	-	3.5 %	11,453	42,462	\$44.83	\$30.64	\$39.27
Southern 202 Corridor	2,466,618	-	13.9 %	16,964	-27,794	\$28.98	\$24.73	\$26.91
Suburban Total	63,336,992	1,038,000	15.0 %	79,090	-381,116	\$31.32	\$26.32	\$28.03
Market Totals	109,272,253	2,190,000	14.3 %	-247,655	-520,489	\$34.09	\$27.50	\$30.20

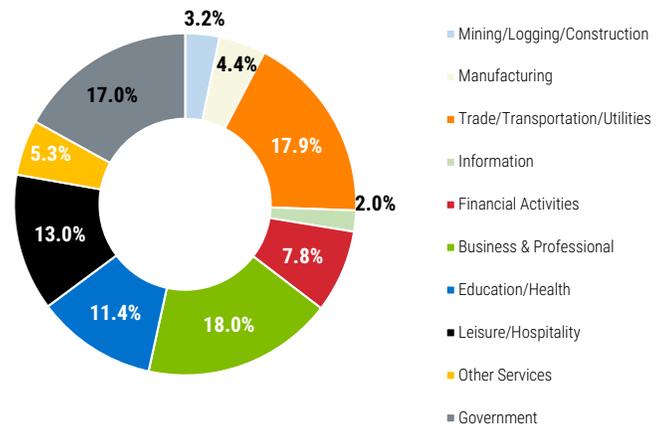
ECONOMIC OVERVIEW

The Philadelphia Metropolitan Statistical Area made further strides in economic recovery during the third quarter, with job gains escalating month-over-month from July to August. In total, 216,400 jobs have been recouped since the height of losses in April 2020. Within the MSA, jobs have rebounded at a faster pace in the suburban counties than in the city, but both markets continue to gain back jobs – and new residents. Interestingly, data suggests that Greater Philadelphia is benefitting from an accelerated influx of residents moving down from New York City’s five boroughs. According to location services company Unacast, roughly 7,500 people have made the NYC to Philadelphia move since February.

In terms of demand performance in the immediate future, market participants noted that activity has slowed somewhat in the leadup to the presidential election in November. With the added wrinkle of incumbent president Donald Trump’s COVID-19 diagnosis at the publication date of this report, corporate confidence may fluctuate both before and after Election Day, contributing to quieter office demand in the quarter to come.

EMPLOYMENT BY INDUSTRY

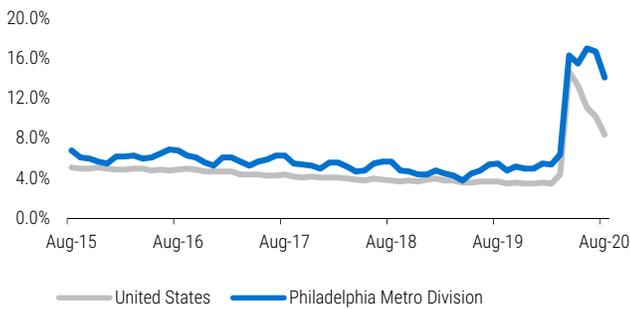
Philadelphia Metropolitan Division, 2019 Annual Average



Source: U.S. Bureau of Labor Statistics

UNEMPLOYMENT RATE

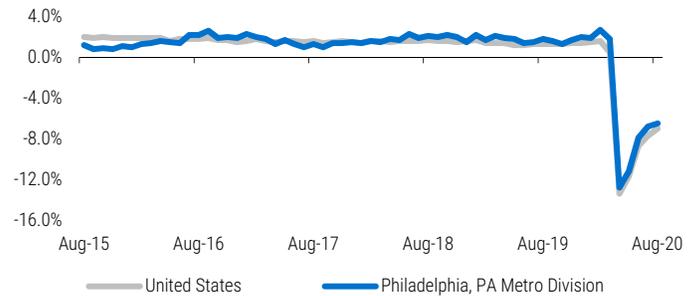
Seasonally Adjusted*



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

PAYROLL EMPLOYMENT

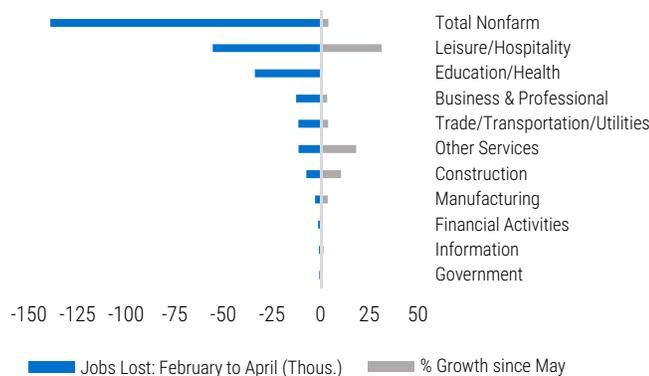
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

JOB LOSSES AND RECOVERY RATE BY INDUSTRY

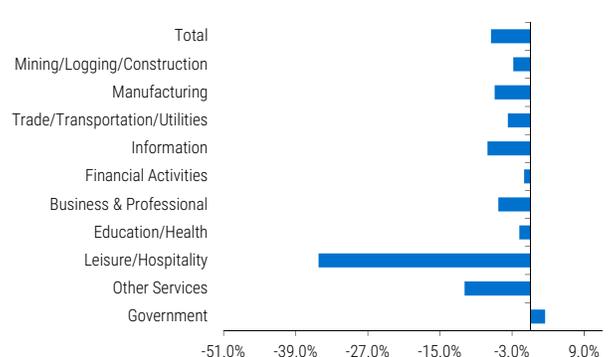
Total Jobs Lost in COVID-19 Crisis and Job Growth Since Recovery Began, Philadelphia Metro Division



Source: U.S. Bureau of Labor Statistics

EMPLOYMENT GROWTH BY INDUSTRY

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



Source: U.S. Bureau of Labor Statistics



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