



Philadelphia Office Market

As COVID-19 Spikes, so does Vacancy in Philadelphia's Office Market

As the saying goes, "it's always darkest before dawn." In the final quarter of 2020, office occupiers across the Philadelphia market shed a net total of 685,514 square feet of space, the largest quarterly loss since 2009. Philadelphia's Central Business District (CBD) accounted for the bulk of these losses at approximately 550,000 square feet, compared to 136,000 square feet for the suburban market.

Sublease volume also rose dramatically to heights not seen in over a decade, with large-block, credit tenants and small firms alike contributing to the increase. In total, 2.7 million square feet of sublease space was available at the close of 2020.

More positively, the fourth quarter also ushered in the long-awaited commencement of COVID-19 vaccine campaigns across the country, which may lead to the resolution of the health crisis within the next 12 months. In addition, new stimulus measures passed by the federal government in December should give firms and individuals greater confidence to plan for and invest in the future, accelerating local and national recovery in 2021.

Current Conditions

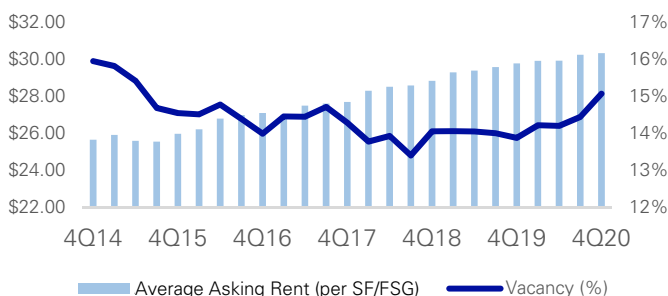
- Negative absorption tallied between the CBD and the suburbs equaled a net loss of 685,514 SF in the fourth quarter.
- Sublease volume rose to 2.7 million SF market wide.
- Overall asking rates were \$30.36/SF, modestly increasing quarter over quarter in large part due to more higher-priced Class A space on the market.

Market Summary

	Current Quarter	Prior Quarter	Year Ago Period	12-Month Forecast
Total Inventory (SF)	109.3M	109.3M	108.8M	↑
Vacancy Rate	15.1%	14.5%	13.9%	↑
Quarterly Net Absorption (SF)	-686K	-314K	151K	↑
Average Asking Rent/SF	\$30.36	\$30.27	\$29.90	↓
Under Construction (SF)	2.2M	2.2M	1.0M	↑

Market Analysis

ASKING RENT AND VACANCY RATE



NET ABSORPTION



Philadelphia Central Business District

The Philadelphia CBD recorded a second consecutive quarter of negative absorption, causing vacancy to increase 180 basis points year-over-year to 14.7% and erasing occupancy gains made in the first half of the year. In total, negative absorption measured 742,984 square feet for 2020.

The largest blocks of space returned to the market this quarter were from the Children’s Hospital of Philadelphia (CHOP) and the U.S. Army Corps of Engineers, which both gave back space at the Wanamaker. CHOP significantly downsized its footprint at the building and will vacate 230,000 square feet in 2022. The Army Corps signed to relocate from approximately 120,000 square feet at the Wanamaker into 101,000 square feet at 1650 Arch Street in late 2021. Elsewhere in the market, notable space givebacks included Phelan Hallinan at One Penn Center, AETNA at 2000 Market Street, Simon & Simon at 1818 Market Street and TD Bank at One Commerce Square.

Companies located in the CBD remained reluctant to bring employees back to the office en masse while the pandemic worsened in the fourth quarter. Many large occupiers such as Comcast have chosen to postpone reboarding until mid-2021. This was reflected in tracked actual occupancy of leased office space which hovered between 5-10.0% in the CBD during the fourth quarter.

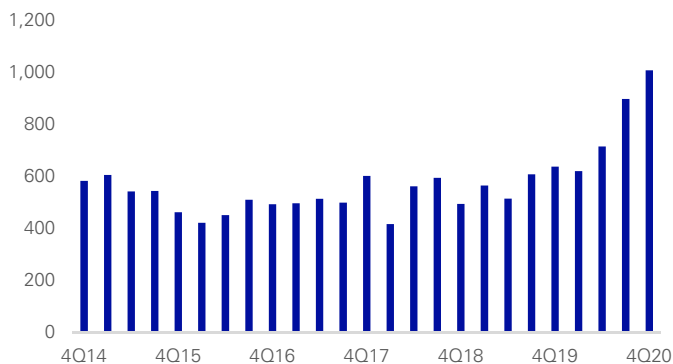
As occupiers reassessed space needs in light of ongoing remote-work strategies, sublease volume grew, cracking the 1.0-million-square-foot mark for the first time since 2010. During the fourth quarter, 21 new subleases of different sizes became available from a diverse mix of industries. Reasoning for such decisions also varied; some tenants have decided to permanently shed a portion of their space whereas other tenants are “testing the

waters” and will consider downsizing based on market interest in their sublease offering. And there is indeed interest in high-quality, plug & play sublease space – albeit, on the smaller side. Throughout the year and into the fourth quarter, some firms have taken the sublease increase as a boon, with tenants such as Mariner Investments signing to sublet a 4,350-square-foot space in Three Logan Square, and Torro, a new-to-market Utah-based firm which took a 2,450 square feet of sublease space at 1429 Walnut Street. Larger-block subleases have not been met with the same interest yet. Market participants noted an increase in requirements for shorter-term deals in the CBD during the fourth quarter, so additional subleases will be snapped up in 2021, while larger blocks will likely continue to negatively impact market vacancy.

Average asking rents in the CBD rose quarter-over-quarter to \$36.31/SF. While this gain may seem counterintuitive considering the current conditions, it is in large part skewed by a disproportionate increase in availability of Class A space which is still commanding premium rates. Behind the face value, average contract rents have declined modestly from last year but are on the whole relatively steady, as landlords have preferred to keep rates strong while instead providing greater concessions – and greater flexibility – to get deals done. Case in point is the law firm Blank Rome, which signed a renewal this quarter at One Logan Square: The company currently occupies just under 200,000 square feet whereas the renewal provides flexibility to lease as much as 175,000 square feet and as little as 100,000 square feet over the course of the 16-year lease. Blank Rome will have approximately two years to determine its precise long-term footprint within the aforementioned range. With a handful of other large-block tenants currently seeking space in excess of 100,000 square feet, it remains to be seen if the Blank Rome model finds currency in future deals.

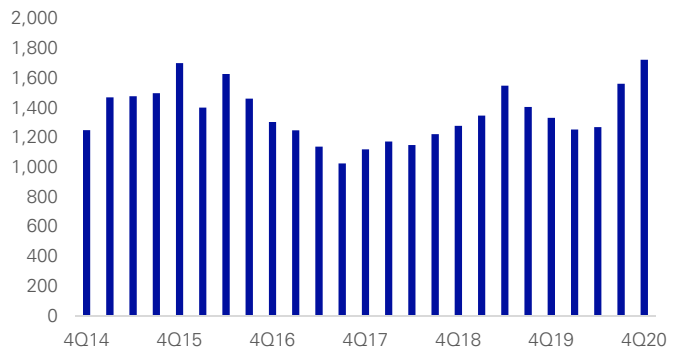
Sublease Volume: Philadelphia CBD

TOTAL SF, THOUSANDS



Sublease Volume: Philadelphia Suburbs

TOTAL SF, THOUSANDS



Philadelphia Suburbs

Office absorption in the suburban Philadelphia market was impacted negatively in the fourth quarter, but to a significantly lesser extent than in the CBD. In total, 136,023 square feet of net occupancy losses were sustained, pushing vacancy up to 15.3%. While this increase is ostensibly concerning, in a longer-term context, vacancy tends to fluctuate, and current measures are exactly in-line with the five-year average. Further analysis regarding impact across the strata of office space signals that the Class A sector has remained remarkably resilient throughout 2020, sustaining only modest occupancy losses with vacancy virtually unchanged year-over-year at 12.4% in Q4.

Downsizings were the biggest story this quarter, one of the most notable being Allstate's formal vacancy of approximately 60,000 square feet at 1200 Atwater Drive in the Exton/Malvern submarket; the insurance firm put the space up for sublease with no plan to re-board. In Horsham/Willow Grove, which sustained the largest quarterly occupancy losses across the suburban submarkets, Comcast vacated the 66,751-square-foot building at 500 Enterprise Drive as the pandemic precipitated the firm's decision to have employees from this location work remotely on a permanent basis.

The quarter also realized numerous new occupancies from tenants which signed for space earlier in the year, such as Muve Health, which occupied 14,000 square feet at 1230 American Boulevard in the 202 Corridor; expansions, such as Link Industrial's move into an additional 9,000 square feet at APEX in Fort Washington; and encouragingly, significant new leases to bolster absorption in 2021. Among them was Cornelis Networks, a new company spun out of Intel, which leased nearly 50,000 square feet of space at 1500-1550 Liberty Ridge Drive in the King of Prussia submarket.

Sublease space rose in the suburbs again in the fourth quarter, to 1.7 million square feet, yet some companies tempered the increase by taking down significant blocks. Clean Earth and Connect America both signed for approximately 30,000 square-foot sublets in King of Prussia and Bala Cynwyd, respectively, and a handful of smaller offerings were taken this quarter as well. Sublease volume is expected to rise further in 2021 but has not yet hit abnormally high levels: availabilities of this sort measured over 1.7 million square feet as recently as 2015.

Fundamentals may continue to soften in the first half of 2021 but are almost certain to improve upon the success of large-scale vaccination campaigns underway in the fight against COVID-19.

Philadelphia CBD Lease/User Transactions

Tenant	Submarket	Building	Type	Square Feet
Blank Rome	West Market	One Logan Square	Renewal/Downsize	Flexible
U.S. Army Corps of Engineers	West Market	1650 Arch Street	Relocation	101,000
CBIZ	Walnut/South Broad	1845 Walnut Street	Renewal	27,562
Imvax	Independence Square	The Curtis	Expansion	25,000
State Farm	West Market	Centre Square	Renewal/Downsize	12,000

Philadelphia Suburbs Lease/User Transactions

Tenant	Market	Building	Type	Square Feet
Cornelis Networks	King of Prussia	1500-1550 Liberty Ridge Drive	New Lease	46,371
Clean Earth	King of Prussia	933 1 st Avenue	Sublease	27,939
Connect America	Bala Cynwyd	Three Bala Plaza	Sublease	27,615
Rita's Franchise Co.	Bucks County	1210 Northbrook Drive	Expansion	16,833
Almirall	Exton/Malvern	101 Lindenwood Drive	Relocation	15,473

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)
CBD Total	45,935,261	1,152,000	14.7 %	-549,491	-742,984	\$38.18	\$30.58	\$34.53
East Market	6,331,084	-	15.6 %	-357,416	-296,566	\$35.71	\$27.75	\$31.38
Independence Square	5,380,384	-	17.1 %	-57,493	-104,490	\$30.42	\$33.02	\$31.96
University City	4,688,776	844,000	9.1 %	-12,955	54,332	\$39.58	\$47.06	\$40.28
Walnut/South Broad	3,977,064	-	20.2 %	-33,514	-104,901	\$36.31	\$31.52	\$30.75
West Market	25,557,953	308,000	14.2 %	-88,113	-291,359	\$39.20	\$28.87	\$36.31
Suburban Total	63,336,992	1,038,000	15.3 %	-136,023	-543,616	\$31.06	\$26.43	\$28.12
Bala Cynwyd	2,944,026	-	11.5 %	8,434	-36,513	\$36.05	\$34.75	\$34.86
Blue Bell/Plymouth Meeting	8,531,020	-	18.7 %	-62,134	-109,108	\$30.27	\$23.49	\$26.51
Bucks County	8,072,833	-	19.1 %	28,092	-61,841	\$28.26	\$23.23	\$24.66
Central/S Delaware County	4,926,227	378,000	13.8 %	-5,088	-11,330	\$30.02	\$25.22	\$27.45
Conshohocken	3,309,518	660,000	12.4 %	-32,143	-71,478	\$41.84	\$34.21	\$38.76
Exton/Malvern	8,056,977	-	12.2 %	21,908	-78,216	\$28.45	\$26.90	\$27.58
Fort Washington	3,473,964	-	16.6 %	-33,251	121,754	\$27.97	\$24.51	\$26.17
Horsham/Willow Grove	4,422,604	-	23.9 %	-48,073	-212,984	\$27.98	\$25.37	\$25.49
Jenkintown	1,081,401	-	25.5 %	-4,268	-19,808	\$25.86	\$22.01	\$24.33
King of Prussia	13,415,444	-	13.6 %	-3,396	-72,656	\$33.25	\$28.35	\$29.96
Radnor/Main Line	2,636,360	-	4.1 %	-15,538	26,924	\$45.34	\$29.68	\$39.52
Southern 202 Corridor	2,466,618	-	13.5 %	9,434	-18,360	\$28.89	\$25.56	\$27.45
Market Totals	109,272,253	2,190,000	15.1 %	-685,514	-1,286,600	\$34.04	\$27.67	\$30.36

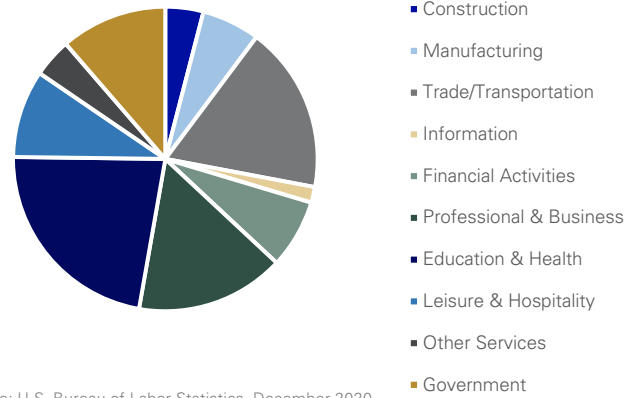
Economic Overview

The Philadelphia Metropolitan Statistical Area continued to recover lost jobs in the fourth quarter, yet the economic impact of the pandemic's new, stronger wave that hit in the fall was observed as job recuperation slowed substantially from October to November. Approximately 8,800 jobs were added in November, down from 34,500 jobs in October and notably, down from a propulsive monthly recovery of 93,100 jobs in June.

In late December, the national government passed a second relief package aimed at stimulating the economy and providing much-needed support to businesses and households. This, coupled with massive vaccine campaigns that commenced before year-end, signal economic improvement in 2021.

Employment by Industry

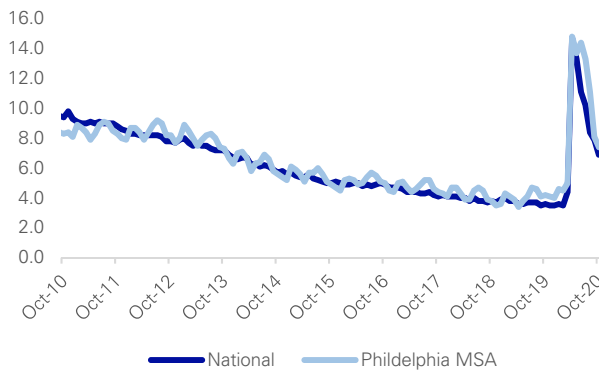
PHILADELPHIA MSA, 2019 ANNUAL AVERAGE



Source: U.S. Bureau of Labor Statistics, December 2020.

Unemployment Rate

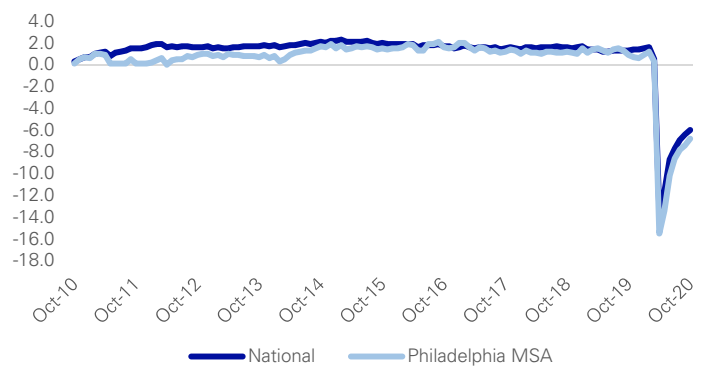
NOT SEASONALLY ADJUSTED



Source: U.S. Bureau of Labor Statistics, December 2020.

Payroll Employment (Total Nonfarm)

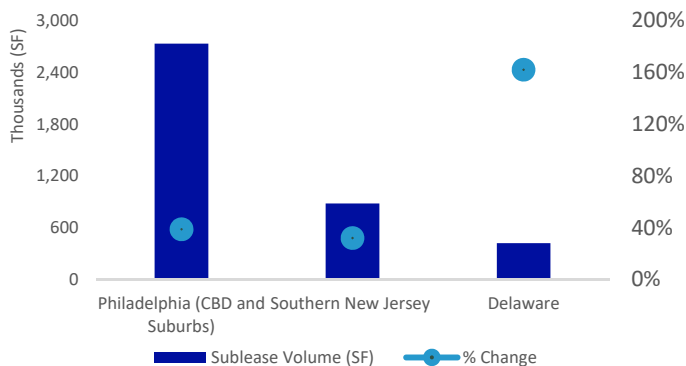
NOT SEASONALLY ADJUSTED, 12-MONTH % CHANGE



Source: U.S. Bureau of Labor Statistics, December 2020.

Greater Philadelphia Markets Sublease Analysis

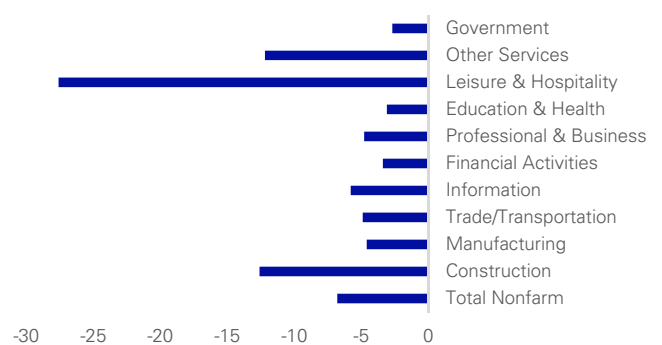
SQUARE FEET AND 12-MONTH % CHANGE, 4Q20



Source: Newmark Research, December 2020.

Employment Growth by Industry, October 2020

PHILADELPHIA MSA, 12-MONTH % CHANGE



Source: U.S. Bureau of Labor Statistics, December 2020.

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