

# PHILADELPHIA OFFICE MARKET

## MARKET ACTIVITY CONTINUES AMID COVID-19 DISRUPTION, BUT LONG-TERM LEGACY IS UNKNOWN

In the second quarter of 2020, Greater Philadelphia's office market was in unprecedented territory. The quarter began with the region under a shelter-in-place mandate and ended with enough improvement in virus case volume that many segments of the local economy advanced into stages of reopening. In between those bookends, approximately 400,000 jobs were lost in Greater Philadelphia, a staggering number that may take years to recoup, although preliminary figures for May 2020 indicate the region has started to add back jobs. The global pandemic continues, but Pennsylvania gained national recognition for its strong, successful response. It is likely that the brunt of the economic blow dealt to the region has been contained to the past three months.

Office market activity slowed substantially during the second quarter but, encouragingly, new office leases were still signed; among them were numerous expansions in both the suburbs and the Central Business District (CBD). The long-term legacy of the COVID-19 crisis as it relates to the local office market is unknown. Shelter-in-place mandates forced the vast majority of office tenants to embrace work-from-home strategies, which by many accounts did not dampen productivity (although a three-month period with a unique set of circumstances may not provide an accurate barometer). Since the shelter-in-place mandate was lifted, many major office tenants have set "re-boarding" plans, generally to start at office occupancy, measuring 25.0% to 30.0% of normal levels, with staggered start times or set shifts. An anecdotal survey of re-boarding plans shows commencement dates anywhere between June 2020 and into the next year, but some companies are delaying re-boarding indefinitely for myriad reasons. Across the board, employers are and will continue to be reevaluating space needs in light of being forced to reckon with maintaining a remote workforce.

Some tenants with impending lease expirations will have to engage the market for relocation options and make significant decisions about space needs. Others with an opportunity to extend a current lease for a year or two before making another long-term commitment are likely to take that route in order to gain a clearer picture of their space needs and market fundamentals in the post-COVID-19 world. Short-term extensions are expected to comprise the bulk of transactional activity throughout the rest of the year; indeed, numerous tenants signed one-year extensions during the second quarter. With an uptick in extensions combined with inevitable downsizings due to economic challenges or shifts to long-term remote working strategies, office absorption is likely to be muted throughout 2020. Expansions within resilient and growing industries, such as life sciences, which drove much of the positive market activity in the second quarter, will continue being a bright spot in the market.

### CURRENT CONDITIONS

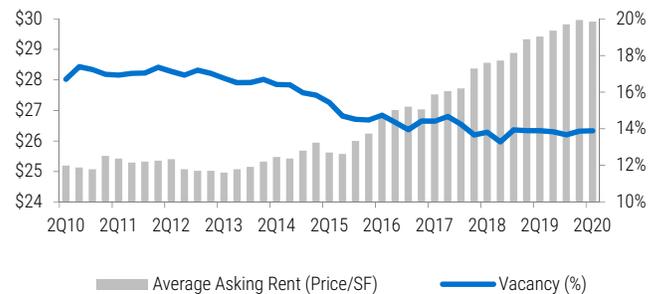
Second-quarter absorption performance varied between the CBD and the suburbs with a net loss of approximately 22,000 SF.

Office occupiers continued to lease new space during the three months of disruption. Life sciences activity was especially heightened.

Overall asking rates remained relatively stable from the previous quarter, declining \$0.06/SF.

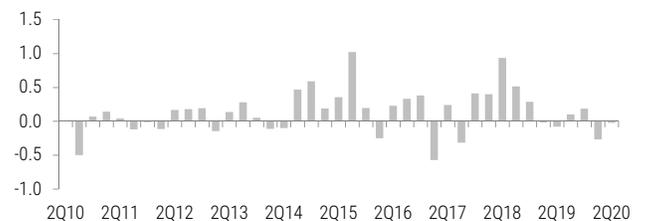
### MARKET ANALYSIS

#### 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	109.2MSF	109.2MSF	108.8MSF	↑
Vacancy Rate	13.9%	13.9%	13.9%	↑
Quarterly Net Absorption	-22K SF	-267K SF	-80K SF	↔
Average Asking Rent	\$29.91	\$29.97	\$29.42	↔
Under Construction	1.4 MSF	1.4 MSF	0.8MSF	↑
Deliveries	0.0 MSF	0.0 MSF	0.0MSF	↑

## PHILADELPHIA CENTRAL BUSINESS DISTRICT

During the second quarter, the CBD accumulated approximately 70,000 square feet of positive absorption, notching vacancy down from 12.6% to 12.4%. This absorption was primarily driven by two major expansions in the life sciences field. Spark Therapeutics leased the 54,000-square-foot building at 3000 Market Street, and Passage Bio signed to expand from 9,000 square feet at Two Commerce Square to 37,500 square feet at One Commerce Square. The latter transaction followed Passage Bio's record-setting \$248.4-million IPO in March. Life sciences momentum in the City of Philadelphia and its effect on future demand for office/lab space cannot be overstated. While many requirements for space in the market have been put on hold since March, approximately 340,000 square feet of new space requirements has emerged and of that total, over 75% is related to life sciences firms. Overall vacancy in University City, the region's premier life sciences submarket, fell to 7.5% in second-quarter 2020. For lab inventory in the submarket, the vacancy rate is hovering around zero. The dearth of available life sciences space has catalyzed new development but is also compelling landlords of existing office properties to consider underutilized floors for lab conversion. Multiple office landlords were pricing out potential lab conversion projects during the second quarter.

Other transaction activity in the market was a mix of smaller-scale expansions and downsizings as well as leases from some smaller new-to-market tenants like Nucleus Global, which took 4,000 square feet at The Bourse and will relocate from South Jersey. Sublease space increased on a quarterly basis by the most in two years to 683,000 square feet. Sublease availability will undoubtedly rise further in the quarters to come, but it is possible a rise in sublease space could be offset by companies taking advantage of the flexibility such space offers. Around 5.2 million square feet of occupied office space in Philadelphia's CBD is subject to a lease expiration in the next 24 months. While some occupiers will opt for a short-term extension to delay making large-scale decisions now, others will have to engage the market for relocation options. Plug-and-play space with a shorter term and under-market rent may prove to be an attractive option for some companies unwilling or unable to make long-term commitments.

Average asking rents downtown declined slightly in the second quarter, down \$0.22/SF from the previous quarter to \$34.10/SF. This was more a function of large blocks of higher-priced space leased and removed from the competitive inventory than it was an indication that landlords are already lowering rents in response to the market conditions. It is projected that rents will soften over the balance of the year as overall demand for office space will remain muted.

## SOUTHEASTERN PENNSYLVANIA

The suburban Philadelphia office market sustained 92,459 square feet of occupancy losses during the second quarter, increasing the vacancy rate 10 basis points from the first quarter to 14.9%. The negative absorption was due to a combination of downsizings and company closures, and numerous significant occupancies pushed back to later in the year because of COVID-19 disruption. Among the quarter's largest vacancies were: Verizon, which downsized by 21,000 square feet at 8 Neshaminy Interplex in Bucks County; Marsh Creek Corporation, which closed and vacated 30,000 square feet at 704 Haywood Drive in Exton/Malvern and IBM, which vacated approximately 35,000 square feet at 650 East Swedesford Road in King of Prussia. New occupancies were limited and generally confined to smaller tenant move-ins. The largest new occupancy in the second quarter was AdaptHealth, which occupied 12,000 square feet of expansion space at 220 West Germantown Pike in Blue Bell/Plymouth Meeting.

Although market activity in the suburbs, as in the CBD, was very slow during the second quarter, some large leases were executed, including a significant expansion: Power Home Remodeling renewed and expanded at 2501 Seaport Drive in the Central/South Delaware County submarket, bringing its total footprint at the property to 180,000 square feet. Average asking rates in the suburbs were virtually unchanged quarter-over-quarter, decreasing by a single cent to \$27.57/SF.

In terms of sales volume, a handful of office sales in the suburbs closed in the second quarter, including one investment sale well in motion before COVID-19 hit. The 123,087-square-foot office building at 518 Township Line Road in Blue Bell/Plymouth Meeting was acquired by Apex Financial Advisors for \$24.9 million. Capital markets professionals project that investor appetite for multi-tenant suburban office properties may remain limited for the next 12 to 24 months until financing recovers. User sales, sale-leasebacks and triple-net, single-tenant assets will likely remain active areas of the capital markets sector. Smaller user sales in suburban locations may prove attractive to office occupiers with capital looking for full control of physical space amid risk concerns surrounding multi-tenant office buildings while COVID-19 remains a health threat. In the second quarter, multiple smaller office buildings in the suburbs were placed under contract by prospective owner-occupiers.

Leased office space in the suburbs is expected to repopulate quicker than in the CBD, as access to and within an office building, while social distancing, is often less challenging in a typical suburban low-rise building than it is in a city high-rise. This is drawing some firms based in the CBD to consider short-term deals or subleases in the suburban market, which may bolster demand in the second half of the year, or at least mitigate additional occupancy losses.

**PHILADELPHIA CBD LEASE/USER TRANSACTIONS**

Tenant	Building	Submarket	Type	Square Feet
Spark Therapeutics	3000 Market Street	University City	Direct	56,000
Passage Bio	One Commerce Square	West Market	Direct	37,500
Lombard International	One Liberty Place	West Market	Renewal	17,500
Philadelphia Futures	123 S. Broad Street	Walnut/South Broad	Direct	12,000

**SOUTHEASTERN PENNSYLVANIA LEASE/USER TRANSACTIONS**

Tenant	Building	Submarket	Type	Square Feet
Power Home Remodeling	2501 Seaport Drive	Central/S Delaware County	Renewal/ Expansion	180,000
Finance of America	1 West Elm Street	Conshohocken	Direct Lease	60,000
Merrill Lynch	224 Valley Creek Boulevard	Exton/Malvern	Direct Lease	21,750
Unisys	1000 N Cedar Hollow Road	Exton/Malvern	Renewal	19,000

**GREATER PHILADELPHIA SALES TRANSACTIONS**

Building	Submarket	Sales Price (millions)	Price/SF	Square Feet
518 Township Line Road	Blue Bell/Plymouth Meeting	\$24.9	\$202	123,087
840 1 <sup>st</sup> Avenue	King of Prussia	\$5.1	\$174	29,234

## 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	-	9.9 %	6,660	52,498	\$33.23	\$27.74	\$29.65
Independence Square	5,380,384	-	14.5 %	17,023	28,322	\$30.50	\$31.72	\$31.18
University City	4,534,880	390,000	7.3 %	49,652	44,196	\$40.62	\$44.84	\$41.05
Walnut/South Broad	3,977,064	-	18.7 %	-15,649	-43,270	\$35.82	\$31.53	\$30.78
West Market	25,557,953	-	12.6 %	12,365	105,626	\$38.27	\$28.98	\$35.90
<b>CBD Total</b>	<b>45,781,365</b>	<b>390,000</b>	<b>12.4 %</b>	<b>70,051</b>	<b>187,372</b>	<b>\$37.47</b>	<b>\$30.45</b>	<b>\$34.10</b>
Bala Cynwyd	2,944,026	-	11.1 %	-14,615	-25,790	\$36.14	\$33.67	\$34.11
Blue Bell/Plymouth Meeting	8,571,469	-	18.2 %	-12,981	-33,901	\$29.56	\$23.05	\$25.69
Bucks County	8,072,833	-	19.5 %	-51,559	-94,915	\$28.84	\$23.16	\$24.56
Central/S Delaware County	4,926,227	378,000	13.2 %	16,474	11,908	\$29.04	\$24.71	\$26.70
Conshohocken	3,309,518	660,000	10.8 %	4,837	-17,255	\$42.02	\$34.06	\$38.44
Exton/Malvern	8,056,977	-	12.6 %	-8,702	-114,931	\$27.79	\$26.76	\$27.00
Fort Washington	3,473,964	-	16.0 %	686	-704	\$28.10	\$24.44	\$26.09
Horsham/Willow Grove	4,422,604	-	20.5 %	36,300	-60,083	\$27.91	\$24.88	\$25.01
Jenkintown	1,081,401	-	21.2 %	-7,526	-10,030	\$25.46	\$22.20	\$23.92
King of Prussia	13,415,444	-	13.5 %	-27,344	-111,484	\$33.65	\$26.81	\$29.34
Radnor/Main Line	2,636,360	-	3.9 %	10,195	31,009	\$44.54	\$29.51	\$39.42
Southern 202 Corridor	2,466,618	-	15.4 %	-38,224	-50,923	\$29.10	\$24.64	\$26.95
<b>Suburban Total</b>	<b>63,377,441</b>	<b>1,038,000</b>	<b>14.9 %</b>	<b>-92,459</b>	<b>-477,099</b>	<b>\$31.06</b>	<b>\$25.71</b>	<b>\$27.57</b>
<b>Market Totals</b>	<b>109,158,806</b>	<b>1,428,000</b>	<b>13.9 %</b>	<b>-22,408</b>	<b>-289,727</b>	<b>\$33.87</b>	<b>\$27.13</b>	<b>\$29.91</b>

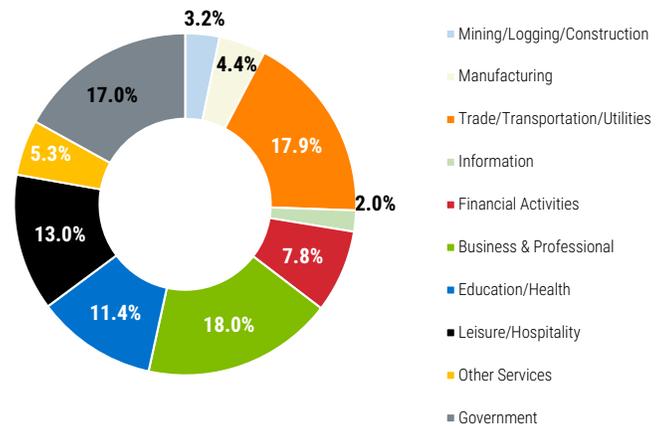
## ECONOMIC OVERVIEW

No part of the country was immune to staggering economic havoc wreaked in second-quarter 2020, including the Philadelphia Metro. Between February, pre-COVID-19, and April, unemployment in the Metro jumped from 5.4% to 15.9%. Preliminary jobs data suggests that the region is already beginning to repair the damage done; the Metro began adding jobs back in May. Additionally, new jobless claims in Pennsylvania have steadily decreased since the end of March, in contrast to fluctuating performance in many other states. It is safe to conclude the bulk of job losses related to COVID-19 disruption have already hit the region and a modest rebound has begun.

In May, the Philadelphia Metro gained 6,800 jobs, the majority in leisure/hospitality, and construction, as development projects were restarted after a state-mandated pause. This is positive news overall, but the sectors in which job losses still occurred in May were government, information and professional and business services – the latter two in particular, traditionally office-occupying sectors. Moving into the summer, tracking office-occupying sector employment trends will hopefully reveal an end to the losses and a shift to net gains.

## EMPLOYMENT BY INDUSTRY

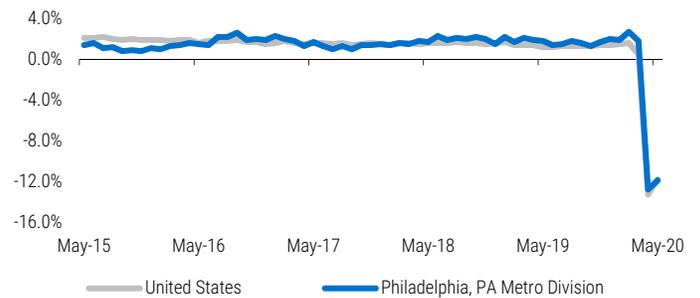
Philadelphia Metropolitan Division, 2019 Annual Average



Source: U.S. Bureau of Labor Statistics

## PAYROLL EMPLOYMENT

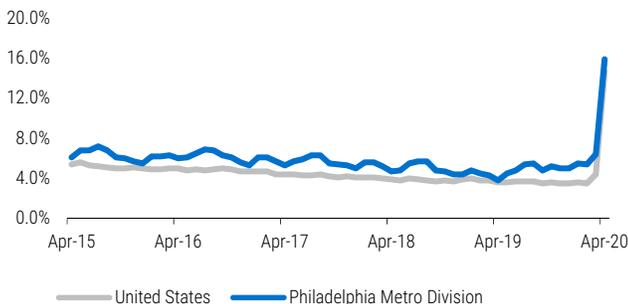
Total Nonfarm, Not Seasonally Adjusted, 12-Month % Change



Source: U.S. Bureau of Labor Statistics

## UNEMPLOYMENT RATE

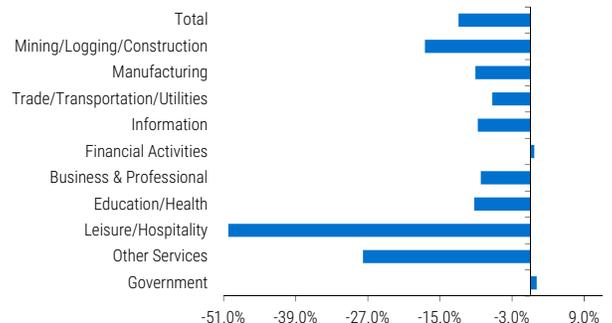
Seasonally Adjusted\*



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

## EMPLOYMENT GROWTH BY INDUSTRY

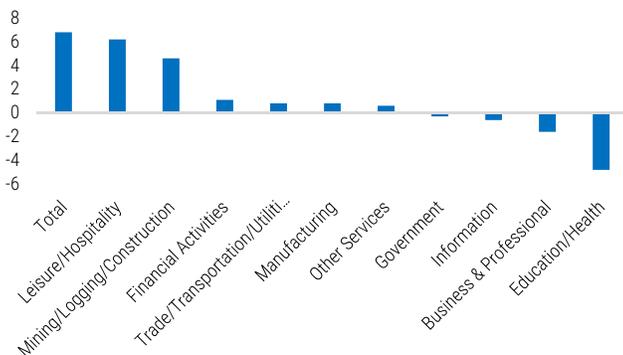
Philadelphia Metropolitan Division, May 2020, 12-Month % Change, Not Seasonally Adj.



Source: U.S. Bureau of Labor Statistics

## JOBS GAINED BY INDUSTRY

Philadelphia Metropolitan Division, April to May 2020, Thousands.



Source: U.S. Bureau of Labor Statistics



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