Current and Future Market Conditions Q2 2013

The Philadelphia Central Business District (CBD) witnessed nominal growth again in the Second Quarter with 12,443 square feet of positive absorption. The total vacancy in the CBD remains at 5.4 M SF and the overall vacancy rate remains flat at 13.2%.

Transaction highlights in the Second Quarter include Pepper Hamilton's decision to renew its lease in Two Logan Square for 268,000 SF well into the next decade. Reliance Standard will remain in Two Commerce Square, where they renewed their lease for 12 years, and expanded by an additional 13,000 SF to 137,663 SF. Philadelphia Health Management "PHMC" finally inked a new lease at Centre Sq East where they leased 120,207 SF and committed to an 18 year lease term. Beneficial Mutual Bancorp's "Beneficial", announced they will relocate from their Market East headquarters of Penn Mutual Towers to West Market St. where they will occupy 95,764 SF in 1818 Market St. As a result of Beneficial's 15 year lease commitment, the building was renamed, 1818 Beneficial Bank Place.

Large Tenants with decisions still pending include, Price Water House Cooper (161,000 SF), and FMC (156,000 SF).

While inbound demand and inherent expansion was positive for Center City Landlords, the possibility for any significant positive absorption is being offset by small, medium and large tenants who continue to rightsize. The Class A submarket continues to see a demand for tenants ranging in size from 10,000 SF to 50, 000 SF. Tenant's continue to take advantage of Class A Landlords with high vacancy. These vacancies enable Tenants to leverage relocation/ renewal negotiations and secure lower base rents for longer periods of time during transaction negotiations. When possible, tenants continue to take full advantage of this opportunity to move into upgraded spaces without paying the historic premium between asset classes. This "flight to quality" is prevalent today but may be gone tomorrow.

Lease flexibility is a relatively new concept that has emerged during this down cycle. Properly leveraged transactions enable tenants to enjoy the right to expand, contract, or terminate their leasehold at specific times throughout their lease term. These options typically de-value an asset, but whether landlords like it or not, these accordion-style leases remain key components to any new lease.

Asking rates remain flat with Trophy Class Buildings at $35 SF, $27.00 SF for Class A space, $23.00 SF for Class B space, and $19.00 SF for Class C space. The asking rates are the weighted average of the published rate from all vacant spaces per building class.

Office Buildings are loosely classified on the quality of their construction, their features, and the status of their location according to guidelines from BOMA/

Trophy Buildings- Most prestigious buildings competing for premier office users, with rents well in excess of the average for the area.

Class A- Buildings have high quality standard finishes, state of the art systems, exceptional accessibility and a definite market presence.

Class B- Buildings competing for a wide range of users with rents in the average range for the area, building finishes are fair to good for the area and systems are adequate, but the building cannot compete with Class A assets at the same price.

Class C- Buildings competing for tenants requiring functional space at rents below the area average.

In Conclusion, very little has changed in the past three months. Underperforming assets continue to be removed from the inventory to allow for condo conversions. Most recently, 1429 Walnut St. “Chestnut Place” was sold to Alterra Property Group and is slated for conversion in 2014. Leasing in Trophy Class buildings remains strong with a reported 6% vacancy. The removal of inventory coupled with practically, no vacancy in the Trophy Class buildings is both healthy, and encouraging to West Market Street Landlords. With most, if not all of the corporate downsizing having taken place, and limited vacancy in the trophy buildings, the vacant space in the Class A buildings will begin to be absorbed over the next 18-24 months.

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