Current and Future Market Conditions Q1 2013

The Philadelphia Central Business District's (CBD) witnessed nominal growth in the First Quarter with 38,412 square feet of positive absorption. This brings the total vacancy in the CBD to 5.4 M SF. The overall vacancy rate remains flat at 13.2%.

Transaction highlights in the First Quarter include Drinker Biddle & Reath LLP's renewal decision at One Logan Square where the firm renewed their lease for 15 years and downsized from 209,000 SF to 155,000 SF. The GSA announced they will relocate 135,000 SF from 801 Market St to the Dow Chemical Building where they signed a new 15 year lease commitment. The Securities and Exchange Commission decided to move west from 701 Market St and lease 42,000 SF in Suburban Station, bringing the buildings occupancy to 94%. The Art Institute of Philadelphia renewed its lease at 1622 Chestnut ST for 100,000 SF. Reinforcing the low vacancy in the Trophy market was Glenmede Trust Company's decision to renew its lease in One Liberty Place for 92,000 SF for 12 years.

Large Tenants with decisions still pending include Philadelphia Health Management "PHMC" (90,000 SF), Beneficial Savings Bank "Beneficial" (125,000 SF), Price Water House Cooper (161,000 SF), FMC (156,000 SF) and Pepper Hamilton (220,000 SF).

The lengthening of deal terms continues to be a common theme. Tenants continue to take advantage of the down economy. The abundance of available space enables Tenants to 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 that give tenants contraction and termination options remain key components to any new lease.

Asking rates are beginning to inch upward with Trophy Class Buildings at $35 SF, $27.00 SF for Class A space, $23.50 SF for Class B space, and $19.50 SF for Class C space. The asking rates are the weighted average of the published rate from all vacant spaces per building class. Aggressively negotiated transactions continue to be discounted within the 80% to 85% asking range.

In Conclusion; Since Q 2 2008 we have enjoyed a very aggressive and tenant friendly market. Tenants' and Tenant advisors like KCR, have enjoyed these times and have taken advantage of a weakened economy, high local unemployment and an abundance of space in the CBD. However, we see this tenant friendly environment changing over the next 18-30 months. Why? Most if not all corporate downsizing has taken place, or will have taken place, underperforming assets have been removed from the inventory to allow for condo conversions, and leasing in Trophy Class buildings remains strong with a reported 6% vacancy. The pending relocation of PHMC (105,000/RSF) from 260 South Broad Street (converted to residential) to Centre Square and Beneficial's announcement to relocate (125,000/ RSF) from Penn Mutual Towers to 1818 Market Street will result in positive absorption on West Market Street. This absorption, coupled with practically no vacancy in the Trophy Class buildings is both healthy and encouraging to West Market Street Landlords. With limited vacancy in the trophy buildings, the vacant space in the Class A buildings will begin to be absorbed.

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KCR

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