Current and Future Market Conditions Q2 2014

The Philadelphia Central Business District ("CBD") continues its slow but healthy growth as 86,000 SF was absorbed during Q2. This brings the year-to-date absorption to 142,000 SF. 5.6 million SF remain available, and the CBD's vacancy rate dropped to 14.1%

Q2 saw several large tenants finalize leases. Rawle & Henderson extended its lease at the Widener Building for 70,000 SF for an additional 5 years. Pond Lehocky Stern & Giordano, just four years after inception, and occupying 7,000 SF in United Plaza has elected to relocate 60,000 SF to One Commerce Square and has committed to a new 12 year lease. The Hay Group will relocate from its longtime headquarters within the Wanamaker Building and occupy 45,000 SF at 1650 Arch Street, where they signed an 11 year lease. Hangley Aronchick relinquished approximately 12,000 SF and committed to a new 12 year lease for 41,000 SF at One Logan Square. The Philadelphia Horticultural Society has elected to remain at 100 N 20th Street. The nonprofit gave back 30,000 SF and signed a new 14 year lease for 29,000 SF. Goldman Sachs renewed their lease for 22,000 SF in Mellon Bank Center for an additional 11 years. Brown Brothers Harriman will relocate from its longtime headquarters on the corner of 15th & Walnut to One Logan Square. The trading firm leased 21,000 SF and committed to a 15 year lease. The Chartwell Law Offices will be the first defection from Mellon Financial's sublease as it relocates to One Logan Square. The firm leased 22,000 SF for 6 years.

The majority of the growth during Q2 came from law firms, financial services firms, consulting firms, and the ever-growing education sector.

From a developmental perspective, the recent groundbreaking on the new FMC Tower at Cira South has begun. The project will add 662,000 SF of Trophy space. Comcast's new Innovation and Technology Center has begun construction and is slated for completion by early 2018

Cigna Corporation is in the market for 300,000 SF, a substantial 150,000 SF reduction from its current footprint of 450,000 SF in Two Liberty Place. Hill International, a South Jersey-based construction consulting company, is looking to relocate its headquarters to Philadelphia, and it is seeking 60,000 SF. Surprisingly, Obermayer Rebmann Maxwell & Hippel, a long-standing tenant occupying approximately 86,000 SF of the top three floors of Suburban Station, has entered the market seeking 50,000-60,000 SF. Accounting firm EisnerAmper, based in Jenkintown, is seeking 50,000 SF. Lastly, Comcast Corp is again on the prowl for 50,000-100,000 SF of space.

Statistically, rental rates inched upward, with Trophy Class Buildings at $37.00/SF, Class A space at $27.25/SF, Class B space at $23.50/SF, and Class C space at $20.00/SF. The asking rates are the weighted average of the published rates from all vacant spaces per building class. While tenants still command a fair amount of leverage, many landlords are making fewer concessions, particularly for renewals. Also, annual percentage increases in rent, as opposed to fixed bumps of $.50, are creeping back into the market.

All in all, the CBD is trending in a healthy positive direction. Landlords and their brokers alike are quick to point out lower vacancy, fewer concessions, and higher rents as a result of condo conversions and a tight Trophy market. I do not buy it. I see plenty of storm clouds brewing. When FMC vacates Mellon Bank Center, the building will lose 200,000 SF. If the likely rumor is true and Sunoco exercises their termination option, it will be another 150,000 SF loss for the Mellon Bank Center. What happens when Comcast finishes their new tower? 150,000 SF will vacate Center Square, and 200,000 SF will vacate Three Logan Square. Let's not forget about Comcast's current need for 50,000-100,000 SF? All that will go to the Innovation and Technology Center, and the CBD is again left with huge gaps to fill.

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Until these defections become reality, the CBD will enjoy some short-term stability. I am certain the new Comcast Technology Tower will be the talk of the town, and everyone will praise Comcast and the City for keeping them in Philadelphia. But let's remind ourselves, Comcast's buildings are meant for Comcast and their subsidiaries, not the average user of space. When Comcast's and FMC's new towers are finished, we are left with huge amounts of vacancy in Trophy Class and Class A buildings that the average tenant cannot occupy. If tenants take the time to examine the market closely, there are still plenty of holes and opportunities for tenants seeking friendly long-term, tenant-flexible transactions today. Tenants with leases expiring in 2016-2017 should be well-positioned to enjoy a friendly market.

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