

# Current and Future Market Conditions Q2 2018

Philadelphia's office market remained flat in Q2. Small to medium size users of space continued to grow. This growth, offset the shedding of excess space by larger users. 5.5M SF is now available and the CBD has a 12% vacancy rate as of the end of Q2.

## Noteworthy Points:

After the departure of FMC, Sunoco, and Bank of New York, Mellon Bank Center was left with 500,000 SF of vacancy in 2014. Fast forward to Q 2 2018, the building is now 95% leased. Kudos to Equity Common Wealth and their leasing team. However, with the inevitable departure of Aberdeen Asset Management, Melon Bank Center will have 50,000 SF of contiguous vacant space located on floors 31-33. This space represents the highest available contiguous vacancy in the CBD. The space will become available in September 2019, though it is likely to be leased well before the end of 2018.

"The Heat Is On" as rental rates continue to rise in the CBD. Growth occurred across virtually all business sectors with very few firms contracting their operations (excepting Towers Watson). As a result of this growth, the CBD's asking rates continued to move upward in the quarter resulting in a \$30.18/SF overall citywide average. Full service rates currently range from \$30.50/SF for Class A, \$27.25/SF for Class B, and \$23.50/SF for Class C. As would be expected, the most expensive space at \$39.50/SF is found in the Trophy Towers of West Market Street.

The escalating cost of construction has become prohibitive. It is not uncommon for a typical tenant fit out to cost between \$65.00/SF – \$75.00/SF. Landlords must embrace the need to offer significantly higher improvement allowances to tenants. Conversely, tenants must be prepared to pay significantly higher rent while providing out-of-pocket capital to complete a new renovation. The decades long trend of \$.50/SF escalations is uncommon. Current rental rate escalations are ranging from 2% -2.5%.

A trend that appears to be gaining momentum is the success of landlords in renewing tenants. Historically, 50% of all tenants renew upon lease expiration. Higher construction and move-related costs have begun to swing the pendulum towards renewals. It has become very difficult for tenants to underwrite most of their costs utilizing the tenant improvement allowance commonly offered by landlords.

As we head into the second half of 2018, storm clouds remain on the horizon later this year and possibly into next year. As discussed in Q 1, as quickly as Comcast positively changed Philadelphia's office market, a downturn could occur just as quickly. There are rumors of significant potential changes to the CBD: Macquarie Investment Management relocating 150,000 SF from Commerce Square to East Market Street and Reliance Standard Life Insurance Pennsylvania relocating 140,000 SF from One Commerce Square. Brandywine Realty Trust would then have over 400,000 SF to backfill in Commerce Square. This vacancy, coupled with Comcast vacancy (discussed Q 1) in Two Logan Square, will test whether Brandywine Realty Trust can continue to ask for premium rent. Based on history, Brandywine Realty Trust will likely seek to backfill vacancy as quickly as possible by lowering rental rate expectations while offering significant improvement allowances, abated rent and tenant concessions.



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## New Leases:

- Willis Towers Watson occupies 275,000 SF in Centre Square. The global advisory giant will reduce their footprint by leasing 95,000 SF in Mellon Bank Center where they inked a new eleven-year lease.
- Post & Shell renewed 54,000 SF in 4 PC for 5 years
- The Department of Labor relocated west, leasing 100,000 SF at 1835 Market Street for 15 years.
- Philadelphia Mental Healthcare Corporation will expand from 40,000 SF to 75,000 SF when it relocates from 123 S. Broad Street to 1601 Market Street. The non-profit signed a 12-year lease.

## In the Market:

- Reliance Standard Life Insurance Pennsylvania, located at One Commerce Square, is 160,000 SF.
- Aberdeen Asset Management, located at Mellon Bank Center, entered the market seeking to reduce their space needs from 55,000 SF to 40,000 SF.
- DLA Piper, of One Liberty Place, has begun searching for 60,000 SF.
- Dechert LLP is contemplating a relocation from the Cira Center back to the CBD as it seeks 200,000 SF.
- Pennsylvania Real Estate Investment Trust has occupied 60,000 SF in the Bellevue for the previous five decades. Now that the REIT no longer owns the Bellevue, it is seeking a more modern, updated building with 50,000 SF available.
- Wells Fargo is exploring alternatives other than 123 S Broad Street for 125,000 SF.
- Macquarie Investment Management, the successor to Delaware Investments, presently located at One Commerce Square, is seeking 150,000 SF.
- Chubb Insurance is considering consolidating several offices and is seeking 100,000 SF
- eResearch Technology of 1818 Market street has begun searching for 60,000 SF.
- Philadelphia FIIGHT, a local non-profit located at 1233 Locust Street, is looking to expand from 30,000 SF to 60,000 SF.
- Ballinger, located at 833 Chestnut Street, entered the market seeking 40,000 SF.
- Stantec Architecture, presently located at 1500 Spring Garden Street, is searching for 30,000 SF.