You will note that immediately upon reviewing the Third Quarter report of 2019, the format of the document has been changed. I will no longer be listing "new leases" or referencing "deals in the market," both of which were present in previous reports.

Here is the KCR Quarter 3 Market Conditions Report for 2019.

Beginning Q3 of 2019, Philadelphia's office market was positive 75,000 SF. This positive absorption is a direct result of new tenants to the market, and a continued strong inbound demand to the CBD. Common Grounds, another networking provider, leased 60,000 SF, and Munich RE leased 30,000 SF at 1700 Market Street. Currently, 5.1M SF are available and the CBD has a vacancy rate of 12%.

Leasing Activity Updates:

Leasing activity is robust, and when considering the last 2 decades of history, Philadelphia's CBD's office leasing market is booming.

- Philadelphia has always maintained solid education and healthcare sectors; however, with Comcast's rapid growth in the past 10-15 years, the technology segment in the city has also expanded by leaps and bounds.
- Serving as the corporate headquarters for Comcast, Philadelphia now attracts companies that want to align themselves or be in close geographic proximity to the company.
- There have been a series of mergers and acquisitions within the professional services industry—and the presence and space requirements of accounting, law, and court reporting organizations have significantly increased.
- Non-profit organizations operating in the CBD have surprisingly been able to absorb increased costs in base rent. As such, non-profit entity leasing remains strong. A perfect example of the city's enhanced appeal and desirability is the American Bible Society's announcement to relocate 350,000 SF from New York to Philadelphia.

Each quarter brings new high-water benchmarks for rent—and emerging trends keep showing themselves within the market. For instance, the new norm for rate escalations is 2.5%—as opposed to the traditional $.50/RSF.

Other Trends to Watch:

Now, there are some trends that have consistently gained momentum—and I predict they will remain steadfast. Consider the following:

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- The impact of coworking businesses on office leasing in the CBD has been considerable. Coworking continues to be a main driver of absorption. What's more, because of the increasing popularity of these centers, the landscape of traditional office leasing has changed. These spaces attract corporate users, entrepreneurial proprietors, back office support, and specialists from all sectors of the professional services industry.
- The cost of construction and labor remain a thorn in the side of both landlords and tenants alike. Tenants who are seeking relocation must be prepared to come to the table with some out-of-pocket capital to build new space or they need to be comfortable committing to a lease term of 12-15 years. Even then, the capital provided may not be enough to build new space. Most, if not all tenants who are seeking to relocate, have the same goal: Extract enough capital from their new landlord to offset the cost of construction. A traditional 10-year lease term simply will not yield enough capital per square foot to ensure a buildout is completed without out-of-pocket tenant dollars.

The Impact of Tariffs:

Tariffs on steel, aluminum, drywall, lumber, etc., do add costs to construction. These unforeseen and additional outlays coupled with the city's construction boom has made the cost of construction cumbersome for everyone. Then, pair that with a lack of any new office construction on the horizon within the city. As such, the future of office leasing in the CBD for landlords appears bullish to me. Unfortunately, I do not think tenants can expect relief anytime soon.

Statistically speaking, rental rates experienced little change in three of the four statistical categories. There was one exception: Class A rents rose $1.00/SF in Q3.

- Trophy Class space is priced at $43.00/SF
- Class A space is priced at $35.50/SF
- Class B space is priced at $28.25/SF
- Class C space is priced at $23.50/SF

Philadelphia vs. The Nation:

This is the perfect storm for commercial owners of office space. Owners and their representatives will continue to escalate office rents, and tenants will feel the brunt of it. In my opinion, Philadelphia's CBD's rental rate reform is long overdue, and is just starting to pick up its momentum. For instance, I ask you to consider the U.S. Office Markets top 15 statistical office markets based solely on asking rent:

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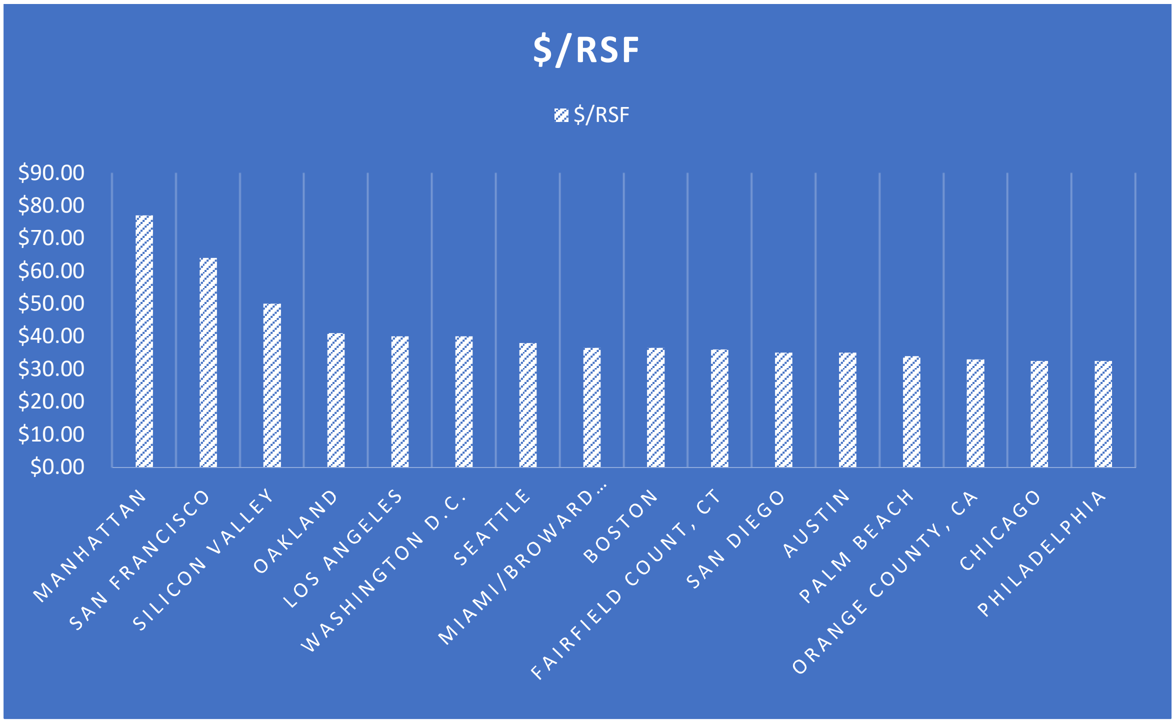

- ***1-5 Average: $52.40/RSF***
- ***6-10 Average: $37.20/RSF***
- ***11-15 Average: $34.10/RSF***
- ***Top 15 Average: $41.23/RSF***

Philadelphia's CBD average asking rent ranks as number 16 overall at $32.50/RSF—or 22% below the average of the nation's top 15 office markets.

A Final Thought:

In conclusion, there is going to be a point where the CBD's growth will slow down. When that is, I don't know—but it isn't anytime soon. However, when it does, I do not expect to see the CBD's rental rates recede along with it. Why? It's simple, really. The cost of construction has increased 100% over the previous 10 years, and rental rates have gone up 50% over the same time horizon; this leaves plenty of room for continued growth.

The cost of living, working, and playing in Philadelphia today versus 20 years ago is increasingly different—but it is for the better. Philadelphia—with Comcast's help—still has a long way to go when compared to the rest of the country. I believe there is much change and evolution just around the corner, and I think that Philadelphia is on the verge of becoming a major hub for businesses spanning a variety of sectors and industries.

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