Current and Future Market Conditions Q3 2013

The Philadelphia Central Business District (CBD) outperformed all expectations in the Third Quarter, with 152,000 square feet of positive absorption, bringing the year to date growth to 192,000 SF. The total vacancy in the CBD declined to 5.2 M SF and the overall vacancy rate decreased to13%.

Virtually all of the growth this quarter occurred in the West Market Street submarket. Transaction highlights in the Third Quarter include, Independence Blue Cross's decision to renew its 800,695 SF headquarters at 1901 Market Street for twenty years. Grant Thornton will remain in Two Commerce Square, where they renewed their lease for 12 years. The Global Professional Services Firm will expand by an additional 8,000 SF to 63,000 SF, and will relocate within the building. Axalta Coating Systems will relocate from Delaware, and lease 40,000 SF in Two Commerce Square, making the trophy asset its new corporate headquarters. They will enjoy a new 12 year lease. At 1818 Market Street, Five Below exercised an expansion option for 23,741 SF, bringing their total occupancy in the building to 59,218 SF. Comcast Corporation continues to grow and absorb space. The cable giant announced they will lease an additional 60,000 SF in Three Logan Sq, bring their total occupancy in the building to 200,000 SF. HNTB Corporation announced they will vacate 10,500 SF in 1628 John F. Kennedy Boulevard (8 Penn Center) and lease 18,000 SF for 5 ½ years in 1650 Arch Street. Radian Group will bring a new division to Philadelphia where they inked a new lease at Centre Sq East for 25,442 SF and committed to an 11 year lease term. This lease represents the last of the vacant space in the East tower. District 1199c will continue to lease 33,572 SF within 100 South Broad Street where they extended their lease early for 7 years and are committed until 2023. Heading East to Penn Mutual Towers, BDP International renewed its lease for 69,000 SF for 11 years. The Taylor & Francis Group will vacate its long time headquarters of 325 Chestnut Street, and relocate across the Street to Penn Mutual Towers. The Publishing Company leased 31,495 SF and entered into a new 10 ½ year lease commitment. With two years remaining on their lease Ewing Cole renewed 77,602 SF at The Federal Reserve Bank Building for an additional 10 years.

Large Tenants with decisions still pending include, Price Water House Cooper (161,000 SF), FMC Corporation (250,000 SF) and Bank of New York Mellon (100,000 SF).

Statistically, rental rates remained relatively 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.

With the exception of Market East, many landlords are optimistic because the number of buildings that can provide leverage for tenants is quickly diminishing. The "flight to quality" that had been so prevalent in the CBD for the past 5 years seems to be coming to an end. The fundamentals driving the current trend are the removal of inventory (Class B condo conversions), limited vacancy in the Trophy Class buildings (7%), lastly. most, if not all of the corporate downsizing has taken place.

In summary, tenants with leases expiring in the next 12-18 months will still be able to leverage relocation alternatives and have viable options. Transactions that once took place at a 10%-15% discount from asking rates are now concluding in the 5%-8% range. But as the tide shifts from tenant to landlord friendly, we can expect less aggressive relocation alternatives. As such, existing landlords become bullish and renewals will come at a premium. The million dollar question is; when and how quickly will the tides shift. Stay tuned, Q 4 should be able to paint a more clear picture, but if inbound demand remains strong and organic growth continues, we will have our answer sooner rather than later.

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