

Current and Future Market Conditions Q4 2017

Philadelphia's CBD rallied with 250,000 SF of positive absorption during Q4, largely resulting from Jefferson HealthCare's remarkable expansion. Absorption for the year was positive at 300,000 SF despite three relatively stagnant quarters to begin the year. The vacancy rate at year-end is 8% with 3.2 million SF still available.

New Leases:

- Jefferson Healthcare signed a new lease for 250,000 SF at 1101 Market Street. The healthcare group will initially lease 150,000 SF plus an additional total of 100,000 SF divided into 50,000 SF segments to be leased in two and four years, respectively. This new long-term lease successfully backfills Aramark's departure, which will relocate to 2400 Walnut Street. Jefferson Healthcare's explosive growth is a welcome addition to the city as it seeks to consolidate suburban mergers and acquisitions into its CBD portfolio. Additionally, Jefferson signed various lease term extensions ranging from 5-10 years on 200,000 SF at 833 Chestnut Street.
- Hussian School of Art will relocate 20,000 SF from The Bourse Building to 1500 Spring Garden Street. The school entered a long-term lease.
- Baker Tilly extended lease term at One Liberty Place for 11 years on the 44th and 45th floors.
- Simon & Simon will upgrade their image and location when they vacate 1515 Market Street to begin a new 5-year, 30,000 SF lease on the 20th floor at 1818 Market Street. The law firm will backfill the space formerly occupied by Five Below.
- Market Resource Partners leased 25,000 for 12 years in 1818 Market Street. They will occupy the building's top floor when they vacate 1650 Arch Street in 2018.
- Deloitte relinquished two floors and renewed 90,000 SF for ten years.
- Elsevier renewed 90,000 SF for 7 years at 4 PC.
- Willig, Williams & Davidson successfully leveraged a termination option and added an additional 7 years of term beyond their existing obligation.
- Comcast continued its expansion. The local cable giant leased an additional three floors (70,000 SF) in the high-rise of Three Logan Square. Outside of The Comcast Innovation & Technology Center (1.1M SF) and the new Comcast Technology Center (1.2M SF), Comcast leased an additional 500,000 SF in Two & Three Logan Square. Could a third Comcast tower be on the horizon in the next decade???
- Cozen O'Connor leased an additional floor (25,000 SF) in One Liberty Place. The firm's total leased square footage in that building is now 225,000 SF.
- Briggs Bunting & Dougherty expanded by 50% by inking a long-term lease for 18,000 SF in 1835 Market Street.
- Leaf Financial Corporation renewed their lease for 30,000 SF at One Commerce Square, and extended term 10 years.

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"Specializing in tenant representation services"

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In the Market:

- 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.
- Entercom, the parent company to CBS, is looking to relocate to the city from their long-time headquarters in Bala Cynwyd while also expanding from 15,000 SF to 60,000 SF.
- Willis Towers Watson is seeking to considerably reduce its existing footprint from 275,000 SF to 125,000 SF.
- McCormick Taylor & Associates, Inc occupies 60,000 SF in Two Commerce Square with a lease that is not scheduled to expire until 2020. However, the CBD currently lacks quality available space with views. As such the engineering firm proactively agreed to a new 60,000 SF, 10-year lease at 1818 Market Street.
- Kleinbard, Bell, Becker, LLP is seeking 25,000 outside of One Liberty Place.
- Post & Shell, located at 4 PC, is considering relocation options for 60,000 SF.
- Gordon & Rees is exploring alternatives outside of One Commerce Square for 25,000 SF.
- 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 125,000 SF.
- The Department of Labor is searching for 100,000 SF on both East and West Market Street.

Noteworthy Points:

Most real-estate observers refer to market cycles and trends, both positive, and negative, as typically lasting approximately five years. Philadelphia is currently experiencing a cycle that appears to be the exception to this rule. Historically, outsiders regarded Philadelphia as a somewhat more affordable alternative to either Washington DC or New York City. Philadelphia has momentum in every key statistical area: education, healthcare, retail, office space, multifamily housing. The city is in the midst of a renaissance that has people of all ages and stages of life returning to the city to work, live and play. The result is a long overdue market correction that should continue for the foreseeable future along with an accompanying escalation in pricing across the board. Office tenants who tried to “time” the office market with short-term renewals in 2012-2014 appear mistaken and should expect increases in rent. Tenants who entered long-term leases during the financial crisis of 2008 have enjoyed below market rents, but should anticipate a significant increase to their rent as their leases expire.

- ***Statistically, rental rates remain healthy:*** i) Trophy Class space priced at \$39.00/SF, ii) Class A space is \$29.00/SF, iii) Class B space is priced at \$26.00/SF, and iv) Class C space is priced at \$23.00/SF.

The CBD currently has a significant number of nonprofit businesses occupying space. With rates increasing 10% - 50% over the past five years, nonprofit tenants are being forced to either share office space with other nonprofit entities or to relocate to less desirable locations for affordable lease terms.

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Kudos to PMC Property Group, MRP Realty, and Arts + Crafts Holdings. These groups are pushing the boundaries of the traditional CBD by demonstrating the vision to renovate and upgrade older nontraditional buildings. As such, the CBD's inventory is growing with unique spaces that run counter to the traditional, nondescript offerings of years past.

Looking forward to 2018, I anticipate a vacancy increase (Q 1 2018) due to the addition of new inventory, corporate contractions and "shadow space." However, presuming industry leaders such as Brandywine Realty Trust (Trophy Class), ASI (Class B), and Keystone Property Group & MRP Realty (Independence Mall) do not change course, rental rates likely will continue without much change. For those tenants with office leases that expire in the next 18-24 months, now is the time to critically evaluate their office space in terms of its efficiency, functionality, location, image and occupancy costs by simultaneously comparing existing space to that which is available in the market. Capital reserves, leasing versus purchasing, timing, lease rights, expansion or contraction needs, as well as security deposits and liability must be carefully examined. Utilizing this time to make these evaluations will not only provide knowledge of the market, but will inevitably lead to options that provide the necessary leverage to negotiate effectively with a new or existing landlord.

- ❖ ***As an aside, this report has taken on a life of its own. Quarterly, I receive valuable feedback and questions from many contemporaries. I am considering hosting a Q & A conference call or breakfast. If this would be of interest, please respond in kind.***

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