

Current and Future Market Conditions Q2 2022

Greetings,

In the second quarter of 2022, Philadelphia's office market has remained active. Small to medium-sized users of space continued to show enthusiasm and address lease requirements.

Modestly, there was 100,000 SF of positive absorption; however, that does not reflect Q2's surge in foot traffic nor does it show the correct level of leasing activity. The CBD's vacancy rate ended the quarter at 13.5%, with 6.1M SF available.

There were significant blocks of space that were also available that were being marketed for sublease—and this initiative has resulted in success. These spaces were well received by tenants because of their modern renovations, prime location, and long-term availability.

Trends to Watch

Over the course of the past 10-15 years, space efficiency has become a primary real estate strategy for users of office space. Accordingly, the amount of square feet leased per person/attorney has decreased across all major U.S. markets. The average attorney once occupied 750/RSF. Today's standard average is 600/RSF per attorney. Conversely, the average non-attorney professional once occupied 250/RSF; today's standard is 150-175/RSF per person. These figures reflect single-sized offices, improved space efficiency, right-sized conference centers, law libraries, and file storage areas. All largely have been replaced by advances in Cloud technologies along with the fact that tenants carry less vacancy for desired future growth. Altogether, office users have become more efficient and there is a reduction in the need for extensive support staff, as well.

And Aesthetics Matter, Too...

The marble and wood throughout the offices of yesteryear have been replaced with glass and luxury vinyl and tile. Administrative space that was initially constructed in designated areas with wood has been replaced with system furniture (cubes). The targeted space that had housed mail, copy, and fax rooms have been minimized, and today large, open areas that double as a space for a kitchen as well as a copy machine, are the norm.

Collaborative, open, and bright space is evident in most, if not all, new offices today. And it is what is demanded by tenants.

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A Bit of Reflection

As I look back upon March 2020, rental rates in Philadelphia were at an all-time high price point, and landlords were reaping the rewards. Construction prices were at unmerciful levels and tenants were committing to long-term leases.

As of Q2 this year, Philadelphia's office rates have remained flat as the pandemic carried on; however, construction prices have continued to soar to the tune of a 1% hike per week. Landlords have been forced to absorb these increases without the benefit of also boosting their rental rates. In addition, tenants are not committing to long-term leases.

As we look ahead, it would be prudent for tenants to take advantage of the flat office rents in the CBD, and secure long-term leases. Yes, they are still at an all-time high, but I believe landlords are anxiously awaiting the return to "the good ole' days" and will once again pass along the increases in construction costs to tenants by raising rents.

The Philadelphia CBD is slowly climbing out of the "wait-and-see approach" regarding real estate decisions, as both the length of a potential economic downturn and post-pandemic office use trends remain uncertain. While it is prudent to make informed real estate decisions, waiting to make a move or address a renewal could result in a missed opportunity to take advantage of the current tenant-favored market.

Below are the current quoted rental rates:

- Trophy Class space is priced at \$43.50 SF
- Class A space is priced at \$36.00 SF
- Class B space is priced at \$28.00 SF
- Class C space is priced at \$23.50 SF

And there is a simple fact: at the end of the day, Philadelphia is still a bargain when it comes to office rents as compared to NYC, Washington DC, and other major metropolitan markets.

Occupancy in CBD office buildings has plateaued at 40% +/- . And while I do believe it is unlikely that we will ever have a 5-day workweek again that spans from 9am to 5pm, it is critical for employers to mandate a return to the office. Having employees work part-time from home while being paid a full-time salary is not sustainable.



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What's more is there are other challenges. For instance, how will someone right out of college or law school be mentored, grow professionally, and develop the skills needed to interact with clients and peers? Most importantly, how will new business be developed and driven without the benefit of in-person interactions?

The answer is truly simple: it is impossible.

Businesses are at a crossroads presently and are faced with difficult realities as employees demand change, work-life balance, and flexibility, and employers require the ability to build culture, follow a business model, and generate revenue. If a happy medium, of sorts, is not uncovered and implemented, I do fear for the youngest generation of workers as they begin and navigate their careers and seek to achieve their goals.

Wishing You a Happy Summer

It's strange to think that this summer, on some level, feels much more normal than the past two. But there are still currents of uncertainty that seem to come at all of us from every single angle.

Even in light of some of the big questions that loom over our heads and worrisome situations in the world, please know that I have hope that a sense of calm and ease will eventually return. I wish you and yours a pleasant summer and hope you find much joy and laughter with your loved ones and friends.

Of course, with any questions or comments, I invite you to reach out to me directly.

Best,
Ken

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