

Current and Future Market Conditions Q3 2023

In recent years, I have intentionally stayed away from offering details on specific tenant activity, and instead have focused on market fundamentals. However, this quarter is a time where market activity has been abundant. Furthermore, it is reshaping our business environment—and I want to touch on the good, the bad, and the ugly.

So, let me simply put this out there. Conditions are deteriorating. In Q3 of 2023, a negative 400,000 SF of absorption was produced, which primarily is attributed to the fact that the CBD's vacancy rate rose to 15% with 7M SF available.

There's No Easy Way to Say This...

It is happening right now—a seismic shift in office space. Tenants of all sizes are downsizing. The center of the CBD office market is transitioning to 20th and Market Street. This area is full of well-capitalized landlords who are attracting—and winning—new transactions. And it's something worth paying attention to.

The Good

Let's put something positive into the universe—because it's worth mentioning: The Philadelphia CBD Trophy Market remains very healthy. And tenants are flocking to well-capitalized assets that are offering a plethora of amenities.

Brandywine Realty Trust, a Philadelphia-based REIT, has been proactively pursuing new tenants, and prioritizing renewals. As such, their diligence is beginning to pay off. Consider the following wins:

- Goodwin Procter, LLP, a global law firm, officially entered the Philadelphia CBD in Q1 2023. The firm recently announced it will become the first tenant at Schuylkill Yards Tower with a new 30,000/RSF lease.
- Wells Fargo entered into a new lease at One Commerce Square and will take up 50,000/RSF.
- Fox Rothschild entered into a new 80,000/RSF lease at Two Commerce Square. Now, there is a caveat here, which will be mentioned later on in this update—but this is good for Brandywine, generally speaking.



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- Turner Construction agreed to a new 16,000/RSF space, relocating from 1500 Spring Garden. Additionally
- Morgan & Morgan agreed to a new 16,000/RSF lease at One Commerce Square.
- The Pew Charitable Trust agreed to renew its 25,000/RSF lease at One Commerce Square as well.

Kudos to Brandywine Realty Trust for recognizing the need to aggressively pursue new transactions, secure existing transactions, and not operate their business while living in a pre-pandemic haze, thinking that the market has not changed. The Commerce Square complex is beautiful, full of amenities, and has on-site parking. On top of it all, the owner is well capitalized—and not afraid to be aggressive and make deals.

The Bad

Of course, there are two sides to every coin. Now, here is the *not so good* stuff:

- KPMG will vacate 135,000/RSF at 1601 Market Street and downsize to 95,000/RSF at 1735 Market Street.
- Fox Rothschild, which I mentioned in “The Good Stuff,” will reduce its space from 125,000/RSF at 2000 Market Street to 80,000/RSF when it relocates to Two Commerce Square. Now, obviously, that was great for Brandywine—but not so great for the market in general.
- Penn Health Systems, located at 1500 Market Street, occupies 300,000/RSF and will join Aramark, Morgan Lewis, and Chubb when they leave the “traditional” CBD and head west to occupy 75,000/RSF at a new building located at 3535 Market Street. Collectively, these moves offer the West CBD alone a total in excess of 1M SF, but also represent 500,000/RSF of negative absorption to the traditional CBD.
- MRP Realty purchased 325 Chestnut Street, 400 Market Street, the Bourse Building, and 400 Ranstead Street in 2016. The D.C.-based REIT recently had these buildings under contract to be sold, but at the eleventh hour the buyer pivoted and backed away from the sale. 400 Market Street seems to be the thorn in MRP’s side with all but a handful of small tenants in the building. As such, MRP’s plans for these buildings remain unknown, but it is rumored to be considering converting 400 Market Street to residential space, which makes sense considering the location in Old City as well as its ample parking.



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- The Public Ledger Building is said to be facing a conversion to 100% residential use as well.
- The tenants that are mentioned above are transitioning from sharing a few common things; namely, age, innovation, and a lack of amenities. The buildings they are relocating to are all well financed, offer a variety of amenities, and have been retrofitted over the past decade.

The Ugly

I'm sure that by now you're thinking, "Wait, it gets worse?"

- Schnader Harrison Segal & Lewis occupies 150,000/RSF at 1600 Market Street and announced its closure after 90 years in business. This leaves 90+ attorneys and staff members looking for work.
- Willis Towers Watson, once a 250,000/RSF user of office space, sums up the commercial office space market perfectly. Four years ago, they occupied 250,000/RSF at 1500 Market Street; two years ago, they relocated to 1735 Market Street and occupied 100,000/RSF. Presently, they are subleasing their space at 1735 Market Street to KPMG (more on KPMG below) and will lease 15,000/RSF in shared office space at WeWork located 1900 Market Street. Speaking of WeWork, they recently announced a global restructuring of their leased office space. If this does not explain the state of commercial office space globally, then nothing will.
- Similar to 1500 Market Street, The Wanamaker Building, located at 100 E. Penn Square has been placed in receivership. This comes on the heels of the announcement that Digitas Inc., which occupies 110,000/RSF at the building, will defect from the defunct asset and relocate to 55,000/RSF at The Bourse Building.

Doom & Gloom: It's Our Reality

The dominos are falling, folks—and let me say that I absolutely hate the fact that I have to say that.

The following CBD office buildings are in receivership or special servicing:

- 1500 Spring Garden Street
- The Wanamaker Building
- 1500 Market Street "Centre Sq)

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- 1700 Market Street

With the loss of Schnader Harrison at 1600 Market Street, KPMG's departure from 1601 Market Street, Fox Rothschild's vacating of 2000 Market Street, and 1818 Market Street's loss of several large users of space (along with their well-known issues when it comes to funding transactions) a perfect storm has been created. Do not be surprised to see these buildings on the receivership or special servicing list shortly.

The following buildings are positioned to be converted to residential use:

- Three Parkway
- 400 Market Street
- Public Ledger Building

The above trends are not good, but Philadelphia is not alone. Remember, this is a global issue that has been gaining speed over the past few years.

In conclusion, I expect the above trends to continue for the foreseeable future, and my best guess is that the commercial real estate office market is in for some very tough sledding over the course of the next 3-5 years. Eventually there will be a course correction—we just have to wait for it.

I welcome the chance to discuss this information with you one on one. Do not hesitate to reach out to me.

Best,

Ken

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