In Q3 of 2024, there was a negative absorption of approximately 100,000 rentable square feet (RSF)- with the CBD's vacancy rate reaching 16.3%. This means there is a whopping 7.3M square feet presently available.

An Ever-Changing Landscape

There have been some considerable evolutions within the traditional timeline of an office lease transaction.

Historically speaking, tenants would be advised to approach their pending lease expiration anywhere from 12 to 30 months in advance. This, of course, depends upon a variety of factors, such as size, who the landlord is, individual preferences related to relocation, and/or the need or requirement to stay put. Before COVID, this is how long office lease transactions took at a minimum to complete… and that was only **after** business terms were agreed to. Think about it like this:

- 30 days to negotiate a new lease
- 30 days to finalize construction drawings
- 30 days to apply for city permits
- 90 days to build out a new space

Now, in a post-pandemic world, there is a new reality. And again, these numbers are indicative **after** all business terms are agreed to:

- 45 to 60 days to negotiate a new lease and 3-5 weeks to finalize a lease amendment
- 45 to 60 days to finalize construction drawings
- 30 to 45 days to apply for city permits
- 90 days to build out new space

In the post-COVID world where everything is taking much longer, it would be advisable to address your pending lease requirement 15 to 36 months in advance. Again, this timeframe depends on your size, location, who your landlord happens to be, and your individual preferred and targeted outcomes. As such, this timeline can vary wildly!

Now, the reasoning behind addressing your lease so far in advance in today's world is because of a variety of reasons. Consider the following:

- Landlord status
- Landlord debt service
- Uncertainty around certain buildings in receivership
- Possible use conversion
- A three-day in-person work week is the new norm
- Everything is taking much longer

Some Interesting Tidbits

- The office sector has witnessed a significant decrease in transaction volume.
- Office users below 10,000 SF dominated the limited market activity during Q3 this year.
- Pre-Covid, 50% of the tenants with leases expiring would relocate—with the other 50% pursuing lease renewal. Today, 75% renew their leases and 25% relocate.
- Tenants have become more comfortable, and they are seeking longer-term lease commitments of seven years on average. This is opposed to 1-3-year extensions that were experienced during the period of 2020-2023.
- Construction pipeline continues to shrink- will the cost of construction come down?
- Foot traffic in the Philadelphia CBD is a shell of what it used to be. Streets that were once occupied by professionals seeking a break during the workday or a place to have lunch are now occupied by tourists, local residents, and increased levels of homelessness.

A Tenant-Friendly Market Is Once Again a Reality

The Philadelphia office market has become a competitive arena among landlords who are hungry for new tenants and desperate to retain existing tenants.

Landlords and their respective agents can spin it a million ways to Sunday, but if anyone tells you otherwise, they are wrong.

With more direct and sub-let space available in the market, there is an increase in competitive and ***flexible*** opportunities for tenants. And this increase in opportunities for tenants means there is a boost in competition among landlords.

Subsequently, as rivalry spikes, tenants will realize more options, which means a highly competitive environment will serve as the backdrop.

Landlords will be in hot pursuit of any prospective tenant that gives them attention; thus, tenant-friendly transactions will flourish.

If you are a tenant that does not take advantage of the existing market conditions, you will likely be remiss as landlords, at some point, will seek to recoup lost revenue and decreased profit margins.

Current Quoted Rental Rates

Quite evident is the increase in asking rates exclusive to Trophy space… and the decrease in asking rates that are exclusively observed in Class A space.

- Trophy Class space is priced at $45.50/SF
- Class A space is priced at $33.00/SF
- Class B space is priced at $28.00/SF
- Class C space is priced at $23.50/SF

In Summary

The CBD office market is currently stagnant, with limited growth expected as we approach the end of 2024. The Philadelphia office market is experiencing a prolonged decline, characterized by its relatively small size—45 million square feet of office space—compared to major metropolitan markets like New York (450M square feet), Los Angeles (220M square feet), Chicago (160M square feet), Washington, D.C. (120M square feet), and Phoenix (130M square feet).

When excluding owner-occupied buildings such as those belonging to Comcast and Independence Blue Cross, as well as significant users like Aramark, Morgan Lewis, Chubb, and FMC—who have recently constructed their own office towers—the remaining market becomes exceedingly limited. Additionally, many tenants, regardless of their size, are projected to reduce their office footprints by 25% to 30%, further constricting the already tight market.

Of course, I always welcome your feedback and questions. Do not hesitate to reach out to me directly.

Best,

Ken

Current and Future Market Conditions Q3 2024