Philadelphia's office market exceeded recent expectations in the 4th Quarter, recording 150,000 SF of absorption and reducing year-to-date negative absorption to 100,000 SF. Currently, 7.6M SF are available, and the CBD vacancy rate stands at 16.9% as we close 2025.

2025 Year-End Philadelphia Office Market Report

1601 Market Street continues to face challenges, with Deasey, Mahoney, and Valentin recently departing. Unlike KPMG and Starr Insurance, which relocated, this firm ceased operations and vacated 20,000 RSF. This development raises concerns for both 1601 Market and the overall health of Center City's traditional office core.

In contrast, One, Two, and Three Logan Square reported strong leasing activity and now close the year at 97% occupancy. The "flight to quality" is now the primary factor in tenant decisions.

Tenants are increasingly avoiding the Independence Mall submarket, which has shifted from a vibrant business district to one dominated by residential conversions and biotech lab space. Keystone Property Group recognized this trend early and repositioned the Curtis Center accordingly. South Broad Street, once a hub for law firms, has lost its appeal and is now characterized by older buildings occupied mainly by small businesses and city agencies.

Chestnut and Walnut Streets, previously affordable Class C options, have largely disappeared from the office market due to conversions. The few remaining properties near 15th and 16th Streets are affected by prolonged neglect by ownership and increased street-level challenges.

Tenants now prefer the quieter, safer, campus-like environments of the Logans and Commerce Square, as shown by their high occupancy rates. An exception is 1845 Walnut Street in Rittenhouse Square, which offers similar benefits at a more competitive price. The business district's center of gravity has clearly shifted to 18th Street.

Positive Absorption & Notable 2025 Activity

Despite broader challenges, the market experienced significant 4th Quarter leasing momentum:

- Archdiocese of Philadelphia leased 80,000 RSF at Three Parkway. Because they are vacating their owner-occupied facility at 222 N 17th Street, this is considered true positive absorption.

- Ernst & Young expanded significantly at One Commerce Square and now occupies 68,000 RSF.

- KPMG leased an additional floor at 1735 Market Street, increasing its footprint to 125,000 RSF, a 25% expansion.

- Day & Zimmerman is returning to the CBD after 15 years at 1500 Spring Garden Street, and is now committing to 50,000 RSF at 1835 Market Street.

- Stantec will consolidate and relocate from 1500 Spring Garden to 30,000 RSF at Three Logan Square, which represents 50% CBD growth for the firm.

Note: 1500 Spring Garden Street is not included in the CBD leasing inventory, so both Day & Zimmerman's and Stantec's moves are considered positive CBD absorption.

The City of Philadelphia has leased large blocks of office space around City Hall. While this benefits individual buildings and increases near-term absorption, the tenant profile has contributed to the relocation of traditional office users from 15th Street, 16th Street, and South Broad Street.

Rental Rate Trends:

- Trophy Class: $48.50 / SF
- Class A: $33.00 / SF
- Class B: $28.00 / SF
- Class C: $23.50 / SF

Trophy assets continue to achieve pricing levels not seen since the early 2000s, underscoring the widening gap between best-in-class properties and the broader market.

2025 Tenant Roadmap

1. **Abated Rent:**
   One month of abated rent per year of the lease-term commitment.

2. **Tenant Improvement Allowance:**
   - Class A: $8–$10 RSF per year
   - Class B: $7–$8 RSF per year

3. **Asking Rents:**
   Trophy building rents remain high but are justified by the current vacancy. Class A and B pricing is consistent with market fundamentals.

4. **Annual Rent Escalations:**
   2.25%–2.5%.

5. **Lease Security:**
   Two to three months of base rent, decreasing over time to one month.

6. **Termination Options:**
   Termination options are now a standard component of modern leases. Ideal terms include:
   - 12-month notice period
   - Exit payment not exceeding brokerage commissions, TIs, and legal costs, calculated at a 6% interest rate.

   More complex terms can make the option difficult to exercise.

These roadmap items are achievable with the leverage gained through negotiation. Landlords may claim renewals deserve fewer concessions than new tenants, but this is incorrect. Existing tenants should receive at least the same capital and incentives as new tenants.

Many tenants do not fully explore alternative options. Whether renewing or relocating, all tenants are entitled to market terms. For existing tenants, this may require additional effort, but diligence creates options, options create leverage, and leverage delivers results.

Outlook for 2026

Significant structural change is not expected in 2026. Leasing activity may increase modestly, but much of it will involve movement within the existing tenant base. In the long term, the following trends are anticipated:

- A smaller overall office market
- Quality space commanding unprecedented premiums
- Continued westward migration toward 18th Street and the Logan/Commerce cluster

A property to watch is the Archdiocese's 222 N 17th Street, which includes 130,000 RSF and an adjacent parking lot, owned since the early 1970s. Given market trends and its location, a sale and redevelopment would not be surprising.

In closing, I invite you to reach out with any questions or to start a conversation. I hope you have a happy and healthy holiday season and a positive start to 2026.

Best,

Ken