Greater Philadelphia Office, Q3 2018

Occupancy grows at record-breaking pace

Net Absorption	Vacancy Rate	Asking Lease Rate (FSG)	Development
2,122,798 sq. ft.	14.5 %	$25.85	815,000 sq. ft.

Figure 1: Q3 2018 Greater Philadelphia Metro Office Completions by Market

*Arrows indicate change from previous quarter

Source: CBRE Research, Q3 2018

Downtown: Record-breaking amounts of completed construction delivered mostly pre-leased. This, coupled with some space removal as a result of conversions, pushed vacancy down 150 basis points.

Suburbs: Demand turned positive this quarter while rents softened somewhat. This is largely a result of price cooling after significant demand growth during 2017.

Northern Delaware: The sale/lease-back of two Bracebridge buildings added another 517,000 sq. ft. of inventory to the Wilmington CBD submarket.

Southern New Jersey: American Water's new build-to-suit headquarters delivered, accounting for nearly half of that market's positive net absorption in Q3 2018.

Lehigh Valley: Nearly 300,000 sq. ft. of office product remains in the pipeline, which if delivered pre-leased, should jumpstart net absorption, a figure that was mostly flat this quarter.

The greater Philadelphia office market's inventory grew by an astonishing 2.1 million sq. ft. during Q3 2018 due to several significant deliveries. The Comcast Technology Center in downtown Philadelphia started moving in employees after over 3 years under construction, and American Water's new headquarters on the Camden waterfront opened. The STAR Campus marks Northern Delaware's most significant office addition with its opening in Newark, DE. The deliveries helped bring net positive absorption to its largest measure this century, given that these buildings came to market 89.6% pre-leased. This occupancy growth -- along with some downtown Philadelphia space being slated for conversion -- pushed overall vacancy down to its lowest level since the end of the recession, 14.5%. Vacancy also tied this mark in the third quarter of 2017. Looking ahead, the construction pipeline is nearly empty with just two projects underway that are a combined 82.0% pre-leased.

Figure 2: Philadelphia Metro Office Market Statistics

SUBMARKET	Number of Buildings	Inventory (Sq. ft.)	Total Vacancy Rate (%)	Total Availability Rate (%)	Under Construction (Sq. ft.)	2018 YTD Total Net Absorption (Sq. ft.)	Avg. Asking Lease Rate ($Fsg/Psf/Yr)	Avg. Class A Asking Lease Rate ($Fsg/Psf/Yr)
Market West	52	28,218,510	10.1%	13.9%	520,000	1,698,747	$31.26	$32.44
Market East	19	6,737,314	11.3%	17.3%	0	69,739	$29.51	$31.30
Independence Hall	16	5,566,039	18.9%	20.4%	0	-42,739	$29.44	$30.20
University City	24	4,915,028	10.9%	14.1%	0	159,076	$39.22	$39.21
Downtown Philadelphia Subtotal	111	45,436,891	11.5%	15.2%	520,000	1,884,823	$31.46	$32.78
Bala Cynwyd	29	2,873,673	10.7%	12.7%	0	17,582	$31.89	$32.76
Blue Bell	80	4,178,049	20.9%	24.0%	0	101,102	$24.03	$31.55
Central Bucks County	54	1,893,682	22.9%	25.6%	0	-37,463	$18.92	$26.33
Conshohocken	26	3,394,001	12.2%	14.9%	0	-66,138	$35.61	$38.93
Delaware County	84	5,212,168	13.2%	22.3%	0	-47,218	$25.88	$27.19
Exton/West Chester	91	4,120,931	15.7%	17.7%	0	-73,513	$24.08	$27.57
Fort Washington	44	3,237,309	25.1%	25.5%	0	-139,261	$23.26	$26.51
Horsham/Willow Grove	82	4,991,891	13.9%	17.7%	0	67,027	$23.66	$27.43
Jenkintown	21	1,352,695	14.9%	16.0%	0	-11,166	$22.98	$23.93
King of Prussia/ Valley Forge	231	16,815,762	11.6%	17.2%	0	117,364	$26.66	$31.06
Lower Bucks County	111	5,256,034	18.7%	24.1%	0	134,530	$22.91	$24.32
Main Line	46	2,768,565	8.7%	11.9%	0	-9,015	$37.00	$38.06
North Penn	14	936,088	37.6%	37.8%	0	-1,053	$19.45	$18.69
Plymouth Meeting	37	2,352,075	18.5%	22.3%	0	-8,940	$32.36	$32.09
Upper Main Line	37	1,110,487	13.6%	16.3%	0	42,325	$25.09	$29.42
Suburban Philadelphia Subtotal	987	60,493,410	15.2%	19.4%	0	86,163	$25.59	$28.91

Source: CBRE Research, Q3 2018.

Figure 2 (cont.)

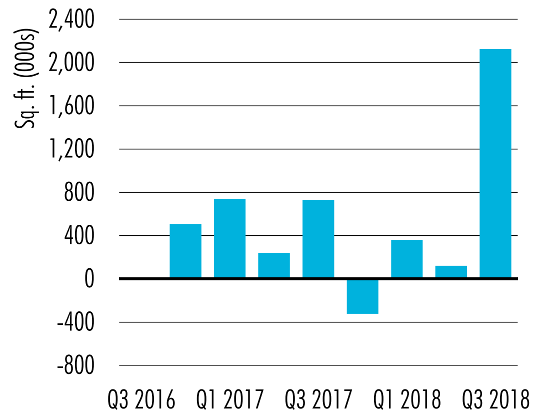
SUBMARKET	Number of Buildings	Inventory (Sq. ft.)	Total Vacancy Rate	Total Availability Rate	Under Construction (Sq. ft.)	2018 YTD Total Net Absorption (Sq. ft.)	Avg. Asking Lease Rate (FSG/Sq. ft./Yr)	Avg. Class A Asking Lease Rate (FSG/Sq. ft./Yr)
Burlington County	191	9,408,831	14.4%	18.3%	0	10,988	$20.68	$22.93
Camden County	121	7,342,103	16.8%	18.7%	0	422,524	$20.46	$24.19
Gloucester County	24	467,492	17.0%	21.5%	0	-15,340	$21.08	N/A
Southern New Jersey Subtotal	336	17,218,426	15.5%	18.6%	0	418,172	$20.59	$23.29
Wilmington CBD	38	7,263,947	19.3%	21.7%	0	-133,769	$24.73	$26.10
North New Castle Co.	42	2,290,476	17.5%	20.0%	0	21,753	$23.38	$25.41
South New Castle Co.	82	4,464,501	17.8%	19.0%	0	96,029	$21.98	$22.77
West New Castle Co.	24	1,390,793	13.2%	13.9%	0	110,164	$25.73	$26.32
Northern Delaware Subtotal	186	15,409,717	18.0%	19.9%	0	94,177	$24.05	$25.44
Lehigh Valley East	56	3,112,451	22.1%	23.5%	0	75,888	$20.56	$21.56
Lehigh Valley West	103	6,770,165	16.0%	19.3%	295,000	-69,401	$18.63	$21.73
Lehigh Valley Subtotal	159	9,882,616	17.9%	20.7%	295,000	6,487	$19.27	$21.68
Harrisburg East	150	7,685,072	15.3%	15.7%	0	61,785	$18.12	$20.89
Harrisburg West	95	3,833,654	10.8%	12.4%	0	48,691	$18.35	$19.94
Harrisburg Subtotal	245	11,518,726	13.8%	14.6%	0	110,476	$18.18	$20.51
TOTAL	2,024	159,959,786	14.5%	17.9%	815,000	2,600,298	$25.85	$29.09

Source: CBRE Research, Q3 2018.

OFFICE ABSORPTION

2018 is on pace to set the largest annual net absorption tally of this century, boosted by the aforementioned record-breaking occupancy growth this quarter. While the timing of significant construction completions drove quarterly absorption, underlying the high level of demand charted throughout the year was healthy office employment growth. The Philadelphia Metropolitan Statistical Area added 10,600 office jobs since the beginning of 2018. Office demand is a lagging indicator versus office employment changes, so one should expect future demand to grow at a pace similar to that set in recent quarters, when construction deliveries were muted.

Figure 3: Net Absorption

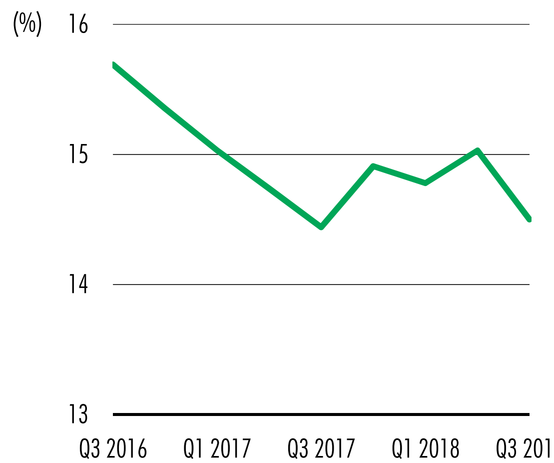


Source: CBRE Research, Q3 2018.

OFFICE VACANCY

While a record-breaking amount of new product was added to the market during the third quarter, very little of that space delivered vacant. This helped push overall vacancy down 50 basis points (bps) to 14.5%. Class A product claimed the lowest rate out of all product classes, and Class B and C product enjoyed vacancy declines as well. The rent premium on Class A space versus Class B rose steadily since the start of 2015 and is near its post-recession high of 27%. During that same time, the spread between the two classes' vacancy rates narrowed, most likely due to price-sensitive tenants opting for more affordable Class B product.

Figure 4: Vacancy Rate

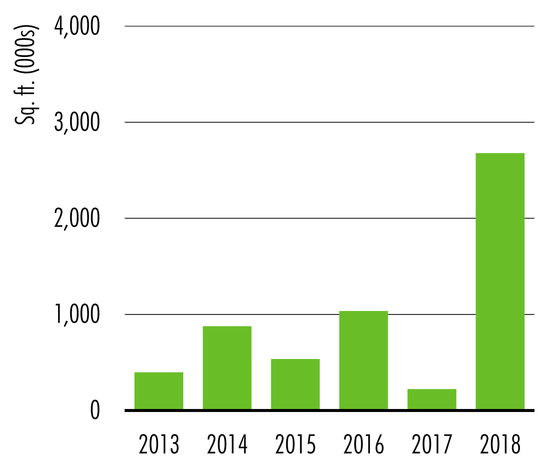


Source: CBRE Research, Q3 2018.

OFFICE DEVELOPMENT PIPELINE

With the delivery of 2.2 million sq. ft. of space during Q3 2018, the current construction pipeline sits at just 815,000 sq. ft., the lowest level since 2013. It had been announced earlier this year that ground would break on Keystone Property Group's SORA West project in Conshohocken as a built-to-suit project for AmerisourceBergen, but that has not officially started yet. Furthermore, the two projects remaining in the pipeline are expected to complete by year's end or early 2019. Continued demand and a lack of new product coming out of the ground should help buoy rents in the coming quarters.

Figure 5: Construction Deliveries



Source: CBRE Research, Q3 2018.

OFFICE LEASE RATES

Rent performance varied across the region. Downtown, all classes of product saw price appreciation while suburban rents softened somewhat. The former is a function of continued demand growth as only a few large blocks of vacant space are expected to come to market in the coming quarters. The latter is a result of a somewhat lackluster performance in the suburbs where less than 90,000 sq. ft. was absorbed to date in 2018, compared with 1.3 million sq. ft. in 2017. Across the whole of the market, rents generally went sideways this quarter, but are up year-over-year across all classes. Class A rents grew at a faster pace than Class B product, year-over-year, widening the premium for newer space that offers desirable amenities and better access to transportation nodes.

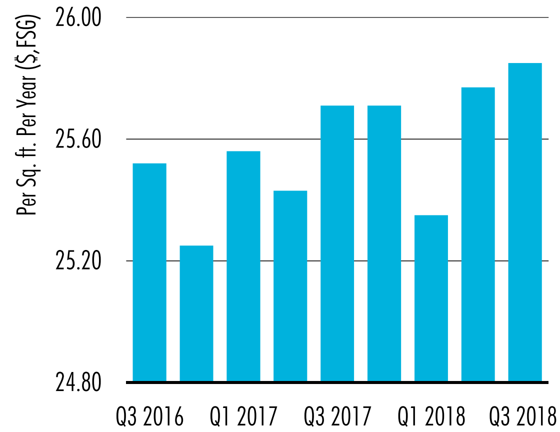
OFFICE CAPITAL MARKETS

Office sales volume in the Philadelphia metropolitan area persisted back toward long-term averages, noticeably less than the peak amounts measured in 2015 and 2016. While office buildings may not be the darlings of investors across the U.S. at the moment, there is still plenty of appetite for both downtown and suburban office product in the region. Two of the Bracebridge buildings in the Wilmington CBD sold this past quarter to Capital Commercial Investments, and Rubenstein Partners expanded their suburban portfolio by acquiring eight properties within the Lower Makefield Corporate Center.

DOWNTOWN INVENTORY

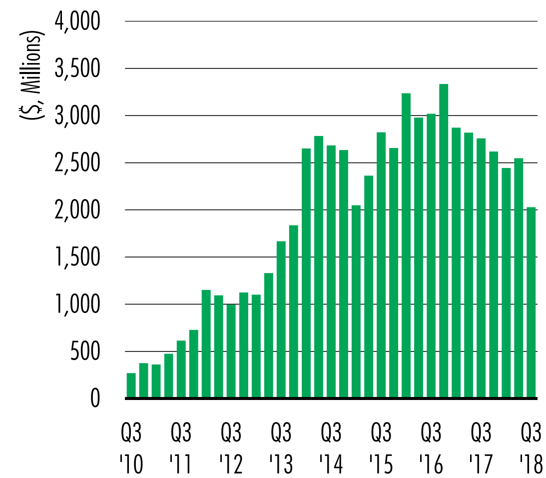
While nearly 1.7 million sq. ft. of new office inventory was added to the downtown office market with the delivery of the Comcast Technology Center and 3675 Market St., nearly 440,000 sq. ft. of space was removed as a result of pending conversions. This is not a new trend. In fact, since 2000, the amount of office space converted to other uses nearly matches the level of new office space added. While vacancy was expected to tick up as tenants become more efficient with their space, these inventory reductions act as a correction: the least desired office product was removed while newer, more modern space came to market.

Figure 6: Office Lease Rates



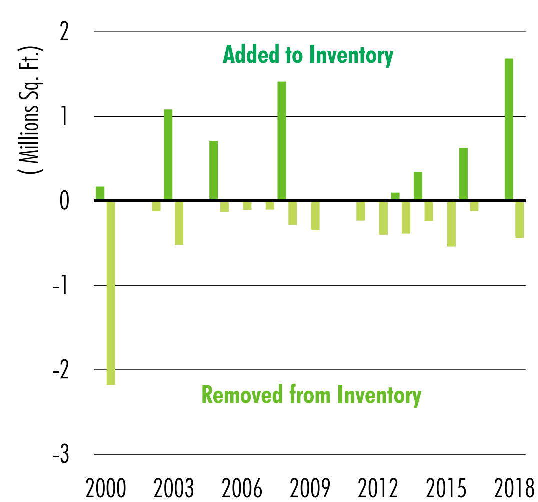
Source: CBRE Research, Q3 2018.

Figure 7: Office Sales Transactions

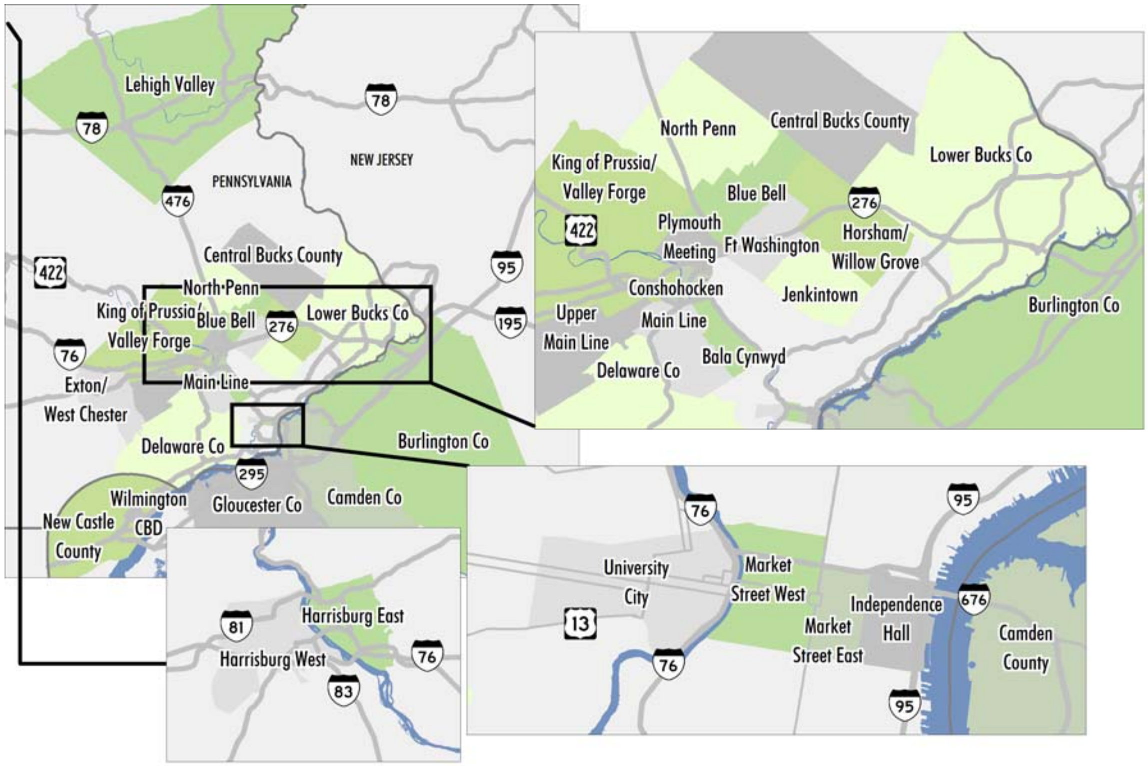


Source: Real Capital Analytics (4-qtr. Aggregate), Q3 2018.

Figure 8: Office Deliveries vs. Conversions by Year



Source: CBRE Research, Q3 2018.



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