CBRE

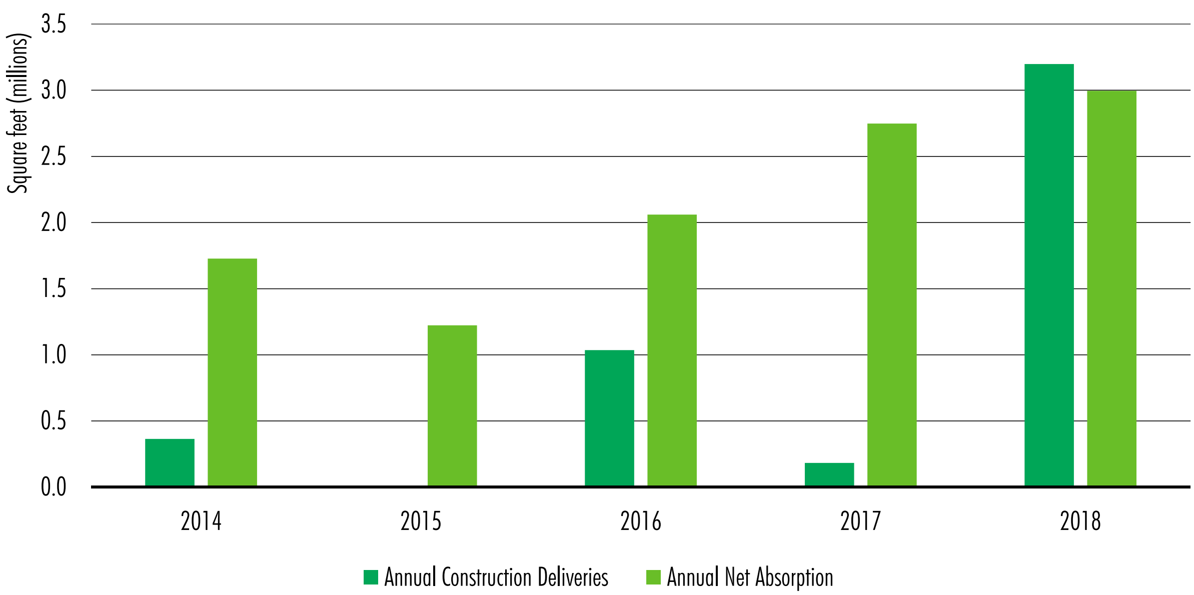
Philadelphia Office, Q4 2018

Delivery in CBD tops off historic year of occupancy gains

Direct Vacancy Rate	Overall Market Average Lease Rate	Net Absorption	Under Construction
14.5%	$25.84 PSF	423,025 SF	689,164 SF

*Arrows indicate change from previous quarter.

Figure 1: Deliveries vs. Net Absorption



Source: CBRE Research, Q4 2018.

- The development pipeline in the CBD emptied with the delivery of Aramark's new headquarters at 2400 Market Street.
- Class A asking rates in the CBD reached an all-time high in Q4 2018 at just over $33.00 per-square-foot per-year due to the ongoing trend of landlords adding amenities and improvements to their assets.
- AmeriHealth Caritas signed the largest lease of the quarter in the metro area, committing to a roughly 378,000-square-foot build-to-suit in Newtown Square. The American Board of Internal Medicine's nearly 100,000-square-foot renewal at 510 Walnut St was the largest lease signed in the CBD.

MARKET ACTIVITY

Office market fundamentals strengthened throughout 2018 with yet another quarter of growth, marking the conclusion of a historic year of occupancy gains in the region. The strong demand for office space in greater Philadelphia aligns closely with the metro area's employment trends. According to the Bureau of Labor Statistics (BLS), office-using employment growth gained momentum in 2018, adding approximately 14,500 jobs, year-over-year. This indicated that even in the tenth year since the last recession, greater Philadelphia maintained a healthy appetite for office space. In addition, office-using employment growth is forecasted to continue accelerating into 2019, a confident projection which was fortified by the multiple build-to-suit projects in the Philadelphia suburbs announced in recent quarters and are expected to commence in the near term.

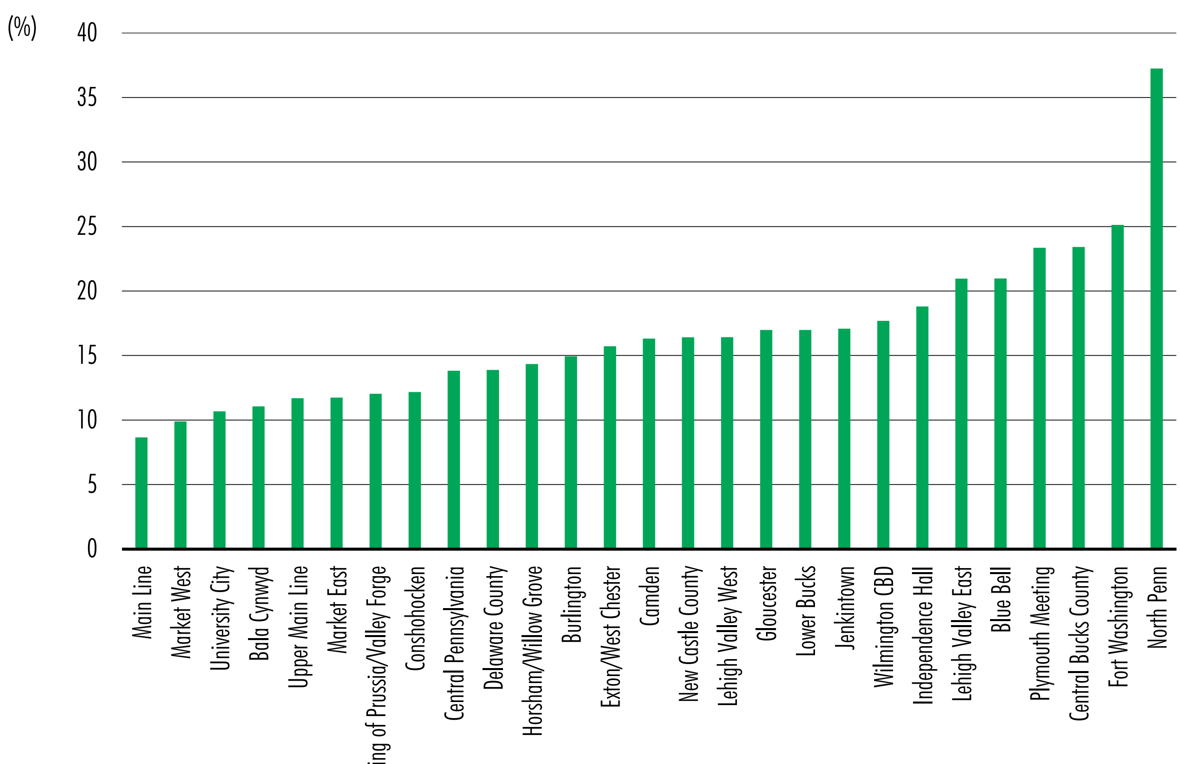
Total vacancy in the Philadelphia metro area remained flat in Q4 2018, at 14.5%. The occupancy gains seen in downtown Philadelphia with Aramark's new headquarters delivering were largely offset, region-wide, by occupancy losses in the Philadelphia suburbs, such as Optymyze's downsizing and move into Center City from Chester. Class A product maintained the tightest vacancy of all classes, down 20 basis points (bps) from Q3 2018. In contrast, more Class B office vacancy was added to supply, especially in the suburbs where Class B vacancy ticked up by 50 bps this quarter.

In spite of no change in the vacancy rate, occupancy rose yet again during Q4 2018, much of which is owed to the delivery of Aramark's new headquarters at 2400 Market Street in Center City. In fact, the CBD had the most significant impact on annual net absorption in 2018 with roughly 75% of the region's occupancy gains. The building's opening helped to largely offset the general trend of tenants downsizing – this includes Aramark, whose move slightly lowered its footprint in the city – as they become more efficient with their office space. Even though the CBD office market grappled with this trend, the vibrant health of longstanding Philadelphia-area companies like Comcast and Aramark, and new-to-the-CBD tenants like Holland & Knight and Entercom, vaulted the market to a historic year of positive net absorption.

OFFICE DEVELOPMENT PIPELINE

2018 was a banner year for construction completions in Philadelphia, with only a couple projects remaining underway. While there are proposed office projects on the horizon, many are build-to-suits, which will effectively not add much supply to the market for tenants looking for space. Alternatively, expect landlords to continue the trend of renovating existing assets, such as Brandywine Realty Trust's renovation of 500 N Gulph Road in King of Prussia.

Figure 2: Vacancy Rates by Submarket



Source: CBRE Research, Q4 2018.

Figure 3: 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	53	28,738,510	9.9%	13.4%	0	2,140,282	$31.59	$32.88
Market East	19	6,787,617	11.7%	16.2%	0	37,774	$29.44	$31.23
Independence Hall	16	5,566,039	18.8%	21.3%	0	-39,292	$29.45	$30.21
University City	24	4,915,028	10.7%	14.1%	0	169,328	$38.95	$38.88
Downtown Philadelphia Subtotal	112	46,007,194	11.3%	14.8%	0	2,308,092	$31.62	$33.01
Bala Cynwyd	29	2,873,673	11.1%	16.1%	0	6,107	$32.07	$32.76
Blue Bell	81	4,333,659	21.0%	24.2%	0	220,073	$23.95	$31.59
Central Bucks County	54	1,893,682	23.4%	26.1%	0	-47,604	$18.60	$26.33
Conshohocken	26	3,394,001	12.2%	16.3%	0	-66,524	$36.62	$39.49
Delaware County	84	5,212,168	13.9%	23.4%	0	-82,852	$26.14	$27.39
Exton/West Chester	91	4,120,931	15.7%	17.7%	0	-72,164	$23.46	$27.16
Fort Washington	44	3,237,309	25.1%	27.9%	0	-138,525	$23.33	$26.06
Horsham/Willow Grove	82	4,991,891	14.3%	18.5%	0	47,637	$19.00	$21.89
Jenkintown	21	1,352,695	17.1%	17.5%	0	-40,479	$21.81	$23.87
King of Prussia/ Valley Forge	230	16,753,594	12.0%	17.4%	0	47,507	$26.39	$30.32
Lower Bucks County	111	5,256,034	17.0%	21.4%	0	222,458	$24.22	$26.58
Main Line	46	2,768,565	8.6%	12.1%	0	-6,107	$37.10	$37.74
North Penn	14	936,098	37.2%	37.4%	0	4,471	$19.46	$18.69
Plymouth Meeting	37	2,352,075	23.3%	25.8%	0	-123,739	$30.79	$32.46
Upper Main Line	35	1,042,287	11.7%	14.7%	0	18,862	$26.03	$29.42
Suburban Philadelphia Subtotal	985	60,518,662	15.5%	19.9%	0	-10,879	$25.45	$29.20

Source: CBRE Research, Q4 2018.

Figure 3 (cont.)

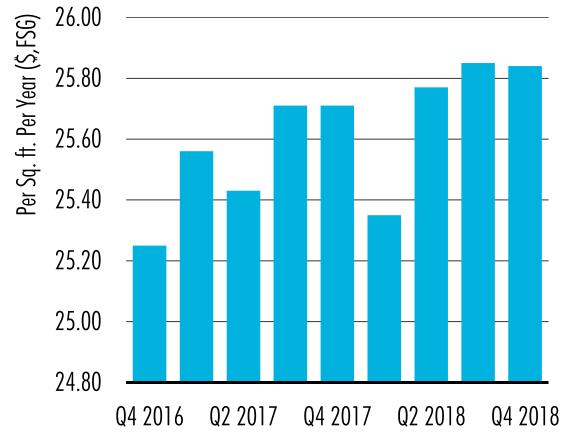
SUBMARKET	Number of Buildings	Inventory (Sq. ft.)	Total Vacancy Rate	Total Availability Rate	Under Construction (Sq. ft.)	2018 YTD Total Net Absorption (Sq. ft.)	Avg. Asking Lease Rate (FSG/Sq. ft./Yr)	Avg. Class A Asking Lease Rate (FSG/Sq. ft./Yr)
Burlington County	191	9,407,024	14.9%	18.3%	0	-43,898	$20.77	$22.91
Camden County	121	7,342,103	16.3%	17.9%	394,164	461,291	$20.06	$23.31
Gloucester County	24	467,492	17.0%	21.5%	0	-15,340	$21.08	N/A
Southern New Jersey Subtotal	336	17,216,619	15.6%	18.2%	394,164	402,053	$20.45	$22.98
Wilmington CBD	36	7,052,788	17.7%	26.8%	0	-63,908	$25.75	$26.60
North New Castle Co.	42	2,290,476	17.5%	20.1%	0	22,279	$23.46	$25.79
South New Castle Co.	82	4,464,501	16.9%	20.4%	0	135,721	$21.92	$22.59
West New Castle Co.	24	1,390,793	13.2%	13.8%	0	110,189	$26.62	$27.11
Northern Dela-ware Subtotal	184	15,198,558	17.0%	22.7%	0	204,281	$24.38	$25.46
Lehigh Valley East	56	3,112,451	21.0%	22.3%	0	110,168	$20.95	$22.06
Lehigh Valley West	103	6,770,165	16.4%	20.6%	295,000	-98,712	$20.19	$23.32
Lehigh Valley Subtotal	159	9,882,616	17.9%	21.1%	295,000	11,456	$20.38	$23.12
Harrisburg East	150	7,685,072	15.7%	16.5%	0	35,714	$18.23	$20.41
Harrisburg West	95	3,833,654	10.1%	12.5%	0	74,712	$19.25	$20.84
Harrisburg Subtotal	245	11,518,726	13.8%	15.2%	0	110,426	$18.48	$20.58
TOTAL	2,021	160,342,375	14.5%	18.3%	689,164	3,025,429	$25.84	$29.23

Source: CBRE Research, Q4 2018.

OFFICE LEASE RATES

Average asking rent growth stalled during Q4 2018, dropping by a single cent. Downtown Philadelphia was an exception, experiencing upward movement in asking rent figures, again, even though available space in the most expensive assets grew scarce. Landlords owning Class A space in the CBD are now asking more than $33.00 per-square-foot per-year on average, which is an all-time high. Although there were cyclical reasons for this as the market approaches peak position, the high rents are also a function of buildings trading in recent years. Investors are seeking to recoup capital placed into renovating and adding amenities to these assets in the form of higher face rents.

Figure 4: Office Lease Rates

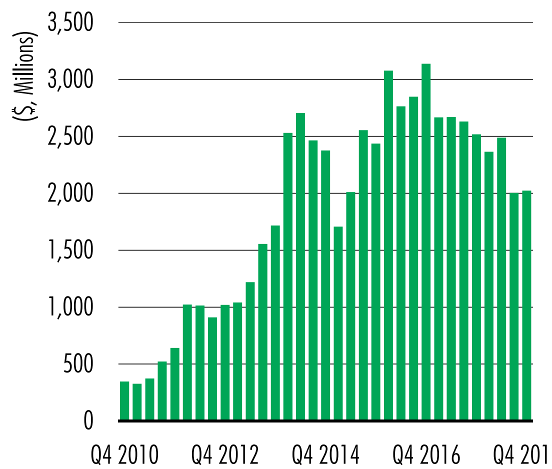


Source: CBRE Research, Q4 2018.

OFFICE CAPITAL MARKETS

Office sales volume in the Philadelphia metropolitan area nearly doubled its totals from Q3 2018, but stayed closely in line with the quarterly average for the last five years. This suggests that the third quarter's dip in sales volume was more of an anomaly than a trend, indicating investors' confidence in the asset class remains. 1735 Market St, one of the most coveted trophy assets in the city, went on the market recently, and is expected to garner the interest of elite investors. The fourth quarter saw Eight Tower Bridge in Conshohocken trade for $313 per-square-foot, and Liberty Property Trust sell multiple properties in Malvern, coming on the heels of their public commitment to exit the office market.

Figure 5: Office Sales Transactions

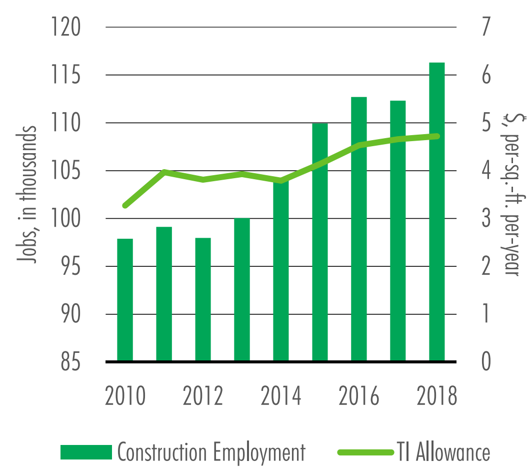


Source: Real Capital Analytics (4-qtr. Aggregate), Q4 2018.

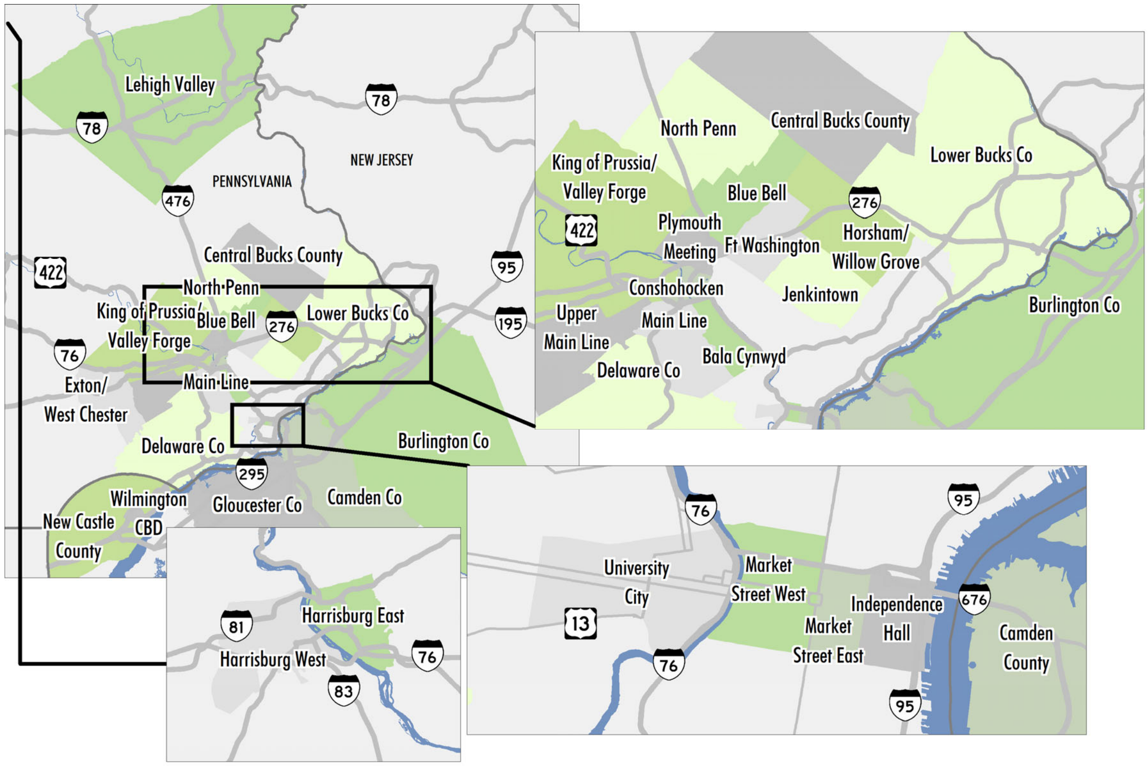
LABOR & TENANT IMPROVEMENT ALLOWANCE

Starting in 2010 following the recession, tenant improvement allowance (TI) figures steadily rose in the CBD and Philadelphia suburbs, up most recently to $4.72 per-sq.-ft. per-year of term. This aligns fairly closely with the increase in construction employment in the Philadelphia metro area starting around 2012. As the available labor force became more scarce, the cost of labor, and subsequently construction, rose, resulting in higher price tags for tenants to build out space. The region is forecasted to continue to add jobs in 2019, which could result in the continued growth of TI packages in the Philadelphia metro area.

Figure 6: Construction Employment vs. Tenant Improvement Allowance



Source: Bureau of Labor Statistics; CBRE Research, Q4 2018.



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