

MARKET REPORT

OFFICE

Philadelphia Metro Area

IPA
INSTITUTIONAL
PROPERTY
ADVISORS

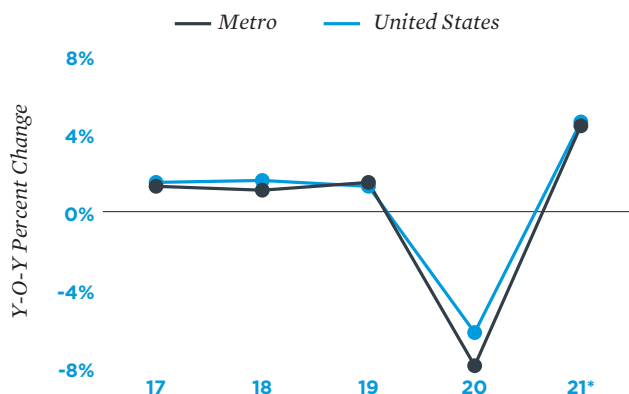
4Q/21

Office Vacancies Slow Rate of Ascent as More Companies Move Into Popular Submarkets

Early signs of office leasing recovery manifesting. While return-to-office plans for many firms remain dependent on the health situation, leasing activity is beginning to pick up. Current demand trends point to about 2 million square feet of office space being returned to the market in 2021, less than half of the 4.5 million net square feet relinquished last year. Positive net absorption was reported in 20 of Philadelphia's 38 submarkets in the second quarter as several healthcare and professional services companies moved into new floor plans. These include Penn Medicine in King of Prussia as well as AmerisourceBergen and Hamilton Lane in Conshohocken. Move-ins such as these, while planned years in advance, signal a long-term need for offices that will manifest in stronger leasing as health conditions stabilize.

Demand highest in healthcare and small suburban hubs. Amid the broader struggles of the metro, certain submarkets are outperforming. Consistent space needs from multiple healthcare and educational institutions have kept vacancy under 10 percent in University City as well as adjacent West Philadelphia. The former Mercy Philadelphia Hospital will open as the new PHMC Public Health Campus here this winter. Availability has also stayed within single digits in select suburban areas, including West Chester and Upper Bucks County. Low inventory levels in these submarkets help foster competition for quality space, supporting rent growth above the market level.

Employment Trends



* Forecast
Sources: BLS; CoStar Group, Inc.

Office 2021 Outlook



**122,000
JOBS**

will be created

EMPLOYMENT:

The creation of over 79,000 jobs year-to-date through August puts metro employers on track to expand headcounts by 4.4 percent this year. Approximately 21,000 of those roles will be in sectors that traditionally rely on offices.



**1,500,000
SQ. FT.**

will be completed

CONSTRUCTION:

About double the office space will be completed this year compared with 2020, bringing the construction total back in line with levels recorded in the 2016-2019 period. West Philadelphia and Conshohocken will welcome more new space than other areas.



**120
BASIS POINT**

increase in vacancy

VACANCY:

While construction activity is picking up, little of the space is speculative, which will help limit the upward pressure on vacancy, allowing the rate to end the year at 15.8 percent. Before 2021 availability had last breached the 15 percent threshold in 2012.



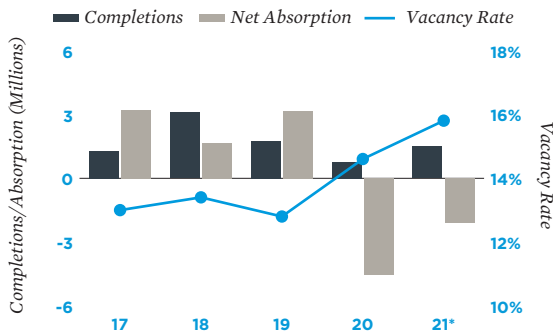
**0.8%
INCREASE**

in asking rent

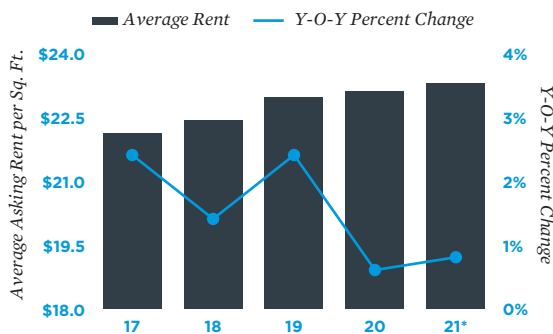
RENT:

The average asking rent will continue to hover in the \$23-per-square-foot range this year. Higher availability is pushing down on marketed rates even as the metro average is also influenced by a greater amount of Class A space that is now open for lease.

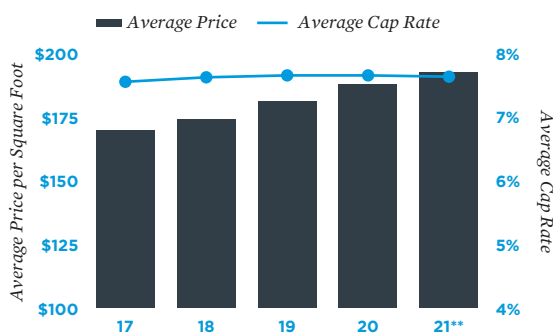
Supply and Demand



Rent Trends



Sales Trends



* Forecast ** Through 2Q
Sources: CoStar Group, Inc.; Real Capital Analytics

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2Q21 – 12-Month Period

CONSTRUCTION 665,000 sq. ft. completed

- Approximately 45,000 fewer square feet was delivered over the past year ended in June compared with the preceding 12-month period.
- Less than 150,000 square feet opened in the first half of 2021, with completions confined largely to Northeast and Northwest Philadelphia, as well as parts of Chester and Burlington counties.

VACANCY 280 basis point increase in vacancy Y-O-Y

- The release of 7 million square feet over the past four quarters has propelled vacancy to 15.8 percent, although the ascension rate is slowing. Vacancy only rose 30 basis points between April and June.
- Among major submarkets, vacancy contracted year over year in Atlantic City-Hammonton and Northeast Philadelphia.

RENT 0.3% increase in the average asking rent Y-O-Y

- More Class A office space available for lease has helped hold overall asking rents about flat over the past year at an average of \$23.25 per square foot, despite the erosion in occupancies.
- Over the past year the average suburban rent rose 0.6 percent while the mean rate in the central business district dipped 0.6 percent.

Investment Highlights

- Transaction velocity dropped about 40 percent annually over the 12-month period ended in June. After an uptick in sales activity during the second half of 2020, trading slightly moderated in the second quarter of this year as concerns over return-to-office timelines lingered.
- A shift toward more Pennsylvania assets as well as competition over well-tenanted buildings contributed to a 4 percent increase in the average sale price year over year to \$192 per square foot. Suburban offices changed hands most often in Bucks and Delaware counties where entry costs generally fell below the marketwide average.
- The average cap rate has held at 7.6 percent since 2018, although yields can fall into the low-5 percent zone for certain trades.
- In contrast to the overall investment landscape, trading velocity for medical office properties accelerated over the past year, supporting an average price of about \$260 per square foot and initial returns in the 7 percent range. Buyers were most active in Bala Cynwyd-Narberth.