MARKET REPORT

Office

Philadelphia Metro Area

IPA INSTITUTIONAL PROPERTY ADVISORS

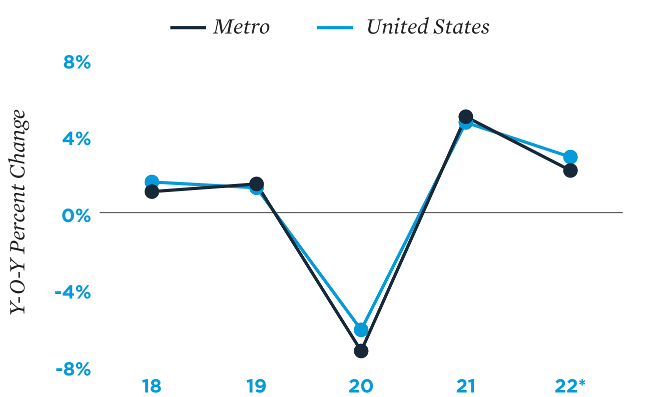
2Q/22

Prospective Tenants Pursue Suburban Leases; Core Concessions May Attract New Entrants

Offices outside of core urban areas capture notable leases. Suburban zones have been recording positive net absorption since mid-2021. Tenants took more than 2 million square feet off the market in the third quarter, marking a three-month absorption record, and an additional 750,000 square feet during the next six months. Pep Boys and Nutrisystem highlight the recognizable brands that have secured amenity-rich spaces outside the core this year. Outlying urban submarkets are also recording substantial amounts of leasing activity. University City continues to draw life science firms that collaborate with the University of Pennsylvania and Drexel University, the former institution having dramatically influenced the mRNA technology used in COVID-19 vaccines. Here, four large lease executions have recently approached 110,000 square feet, equating to roughly an eighth of this year's projected metrowide net absorption.

Core vacancy still trending upwards. Following the onset of the health crisis, Philadelphia's higher-tier office towers have struggled to retain and find tenants. Center City has yet to post a decline in availability, with vacancy here entering April at 15.6 percent, the highest level on record. On a brighter note, upcoming move-ins from AECOM and Insomnia Cookies indicate some larger firms are still pursuing area leases. Developers also expect additional biotech spillover into the CBD from adjacent University City, evidenced by lab space underway here. However, high availability will likely translate to increased concessionary activity moving forward.

Employment Trends



** Forecast*

Sources: BLS; CoStar Group, Inc.

Office 2022 Outlook

65,000 JOBS
will be created

EMPLOYMENT:

Philadelphia's job recovery is still ongoing, with employment growth in higher earning sectors outpacing the market average. The metro's traditionally office-using firms recouped all pandemic job losses before the end of the first quarter.

1,650,000 SQ. FT.
will be completed

CONSTRUCTION:

The completion of several larger mixed-use developments lifts delivery volume to a three-year high. Roughly a quarter of the space finalized will come online in University City, as builders are attracted to the area's cluster of academically-linked firms.

20 BASIS POINT
increase in vacancy

VACANCY:

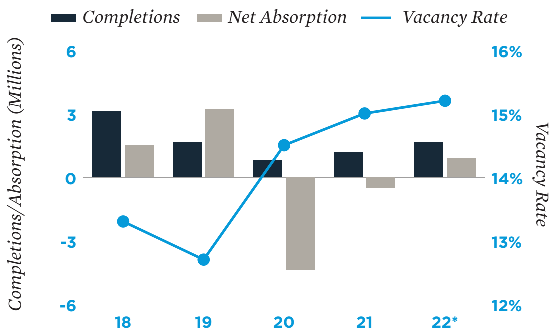
Supply additions will outpace demand, raising year-end vacancy to 15.2 percent. Approximately 40 percent of the active pipeline was pre-leased as of June, suggesting office availability may remain above pre-pandemic levels for some time.

2.0% INCREASE
in asking rent

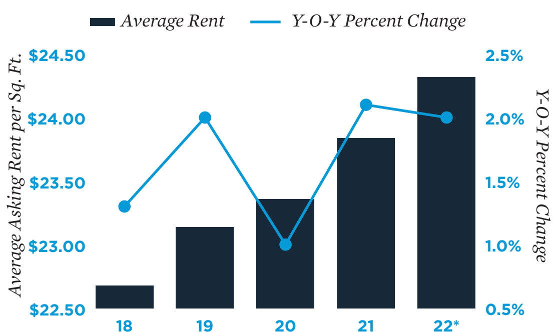
RENT:

Despite an uptick in vacancy, the addition of more amenity-rich stock should give a slight boost to the average marketed rate. Philadelphia's mean asking rent will hit $24.32 per square foot at the end of this year.

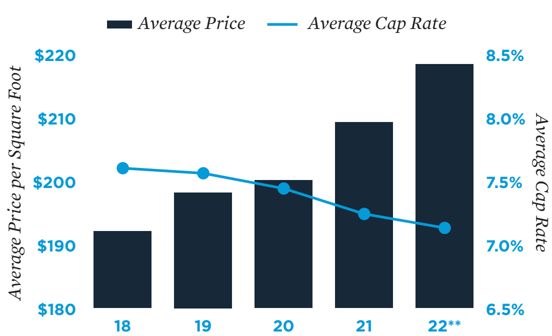
Supply and Demand



Rent Trends



Sales Trends



** Forecast ** Through 1Q*

Sources: CoStar Group, Inc.; Real Capital Analytics

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Price: $250

1Q 2022 - 12-Month Period

CONSTRUCTION

1,385,000 sq. ft. completed

- Builders expanded metro inventory by 0.5 percent over the 12-month period ended in March, the fastest rate since 2019.
- Developers focused on suburban and outlying urban zones during the past year, with the majority of new stock located to the north and west of Philadelphia proper.

VACANCY

10 basis point decrease in vacancy Y-O-Y

- Net absorption exceeding 1.4 million square feet this period supported a slight decline in availability, which ended the first quarter at 15.2 percent.
- Availability at Class B/C properties fell 60 basis points to 12.5 percent, just 100 basis points above the year-end 2019 rate. Class A availability rose 70 basis points to a multiyear high of 19.0 percent.

RENT

2.4% increase in the average asking rent Y-O-Y

- Asking rents have posted consistent year-over-year gains since the start of the pandemic, ending March at an average of $23.95 per square foot.
- Rising vacancy in the CBD suggests the 5.4 percent increase in marketed rents stems from higher quality space coming back to market. In the suburbs, where availability declined, rents increased just 1.3 percent.

Investment Highlights

- As investors anticipated an imminent return of companies to in-office operations, transaction velocity rose more than 30 percent during the 12-month span ending March over the previous yearlong period. Still, deal flow remained well below pre-pandemic totals.
- The market recorded its most rapid pricing gain since 2006, as investors with a focus on Class B assets acquired a larger proportion of newer stock than in prior yearlong spans. The average sale price increased 8 percent, ending the first quarter at $218 per square foot.
- A composition of trades favoring newer stock also resulted in a 30-basis-point compression of the average yield, which fell to 7.1 percent during the yearlong span ended in the first quarter. Despite reporting the most rapid cap rate decline since 2011, the Philadelphia office market is tied for the highest average yield among coastal Northeastern metros.
- Strong medical office fundamentals buoyed deal flow to record highs during the annual period ended March, eclipsing the record established in the prior span. Segment buyers pursued trades in the market's more affluent northern suburbs, where yields range from 6 to 8 percent.