

Current and Future Market Conditions Q4 2024

Leasing volume within the CBD tracked to be the lowest quarterly amount in the last 10 years. However, the volume for 2024 YTD is still 14.5% higher when compared to the same period in 2023. This is due to an impressive second quarter.

Rents remain stable as landlords fight for tenants with concessions packages.

Renewals accounted for 75% of 2024 YTD leasing volume as the cost to relocate is prohibitive.

Leases under 10,000 square feet accounted for most of the total activity within the CBD this quarter. Despite the smaller sizes, tenants are showcasing staying power that is longer, with an average term length of six years.

Large-scale tenant move-outs impacted Q4 heavily, with Wells Fargo vacating 350,000 square feet at 401 Market Street. After downsizing approximately 200,000 square feet, the bank will occupy space at One Commerce Square and Two Logan Square in neighboring Market Street West.

Office Conversions and The Effect on The Office Market

In 2025, the debt servicers on the Wanamaker Building will proceed with converting the office area of the building to residential use. This conversion, along with 400 Market Street as well as the majority portion of the Bourse Building, the Bellevue, and Three Parkway, significantly reduces the office inventory in the CBD.

All of these conversions, along with those that happened after the Great Recession, should be viewed positively by everyone in the city.

Ultimately, dated and inexpensive alternatives are being removed from the market, and backfilled by buildings like 2400 Market Street, which was built for Aramark. Furthermore, both Comcast Towers were built specifically for Comcast and 2222 Market Street was constructed for Morgan Lewis. Chubb's new building at 2000 Arch Street is pending and there is a slew of new construction in University City.

But this is just the tip of the iceberg. There is still plenty of vacancy in the CBD for potential tenants.

However, just because there is vacancy, does not mean there are viable options.



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Ultimately, when you examine a lot of the vacancy available you begin with looking at the ownership structure, debt service, and if they are able to fund transactions. In turn, the answer to that is concerning as it relates to a large majority of what is available.

Then, if you can get past that question, you must consider the type of space that is open.

Does it have views? Does it have residual value?

The answers to those questions are ultimately... no. Not much of the availability in the CBD has residual value or solid views.

The result means that if you would like to proceed with relocation you will have to build from scratch and the cost of construction is astronomically high—and likely rising with pending foreign tariffs. Therefore, long-term lease commitments from tenants are required, unless they are willing to pay out of pocket for construction.

University City

An outlier to the traditional Philadelphia CBD office market, University City is one of the hottest markets in the country. Asking rents in University City are \$55 per square foot compared to the average \$32.50 in the CBD.

This 69% premium is attributed to new construction, location, amenities, a low vacancy rate, and because the area is known as a hotbed for tech and lab space users.

Excluding One Liberty Place, Mellon Bank Center, One, Two, and Three Logan Square, and One and Two Commerce Square, West Market Street is littered with dated space, limited views, and piles of debt. Removing those exclusions, there are not many Class A options I would be comfortable recommending to anyone seeking office space today.

What To Do with Centre Square?

Nobody has been able to answer this question.

The building is in a less than desirable location. And if I'm simply being nice, the ground value is likely worth more than the value of the building.

That said, it hit me when I read an article in the *Philadelphia Business Journal* on December 3rd that stated the Philadelphia Police Department was nearing completion of a new forensic lab at University Place 3.0 for 30,000 SF.



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I began asking myself, why does this lab need to be located in University City? I would think the perfect place for this would be Centre Square as it is closer to City Hall and the courts, rents are significantly less, and it sits a block from the District Attorney’s office located at the Widener Building.

It is no secret that the city has made a huge push to bring back all employees to the workplace—and that they are seeking office space and expansion wherever they can find it.

As such, here is a thought: the city should buy Centre Square and whenever one of their leases expires move into that building.

It answers the decades old question of “What to do with Centre Square?”

Three Decades in Review

Transaction Components	2009	2019	2024
Lease Term: Renewals: New Transactions:	3-5 Years 7-10 Years	7-10 Years 13-15 Years	3-5 Years 7-10 Years
Base Rent: Trophy: Class A: Class B: Class C:	\$35.00/RSF \$27.50/RSF \$21.00/RSF \$19.00/RSF	\$43.50/RSF \$36.50/RSF \$29.00/RSF \$23.50/RSF	\$45.50/RSF \$33.00/RSF \$28.00/RSF \$23.50/RSF
Annual Escalations:	\$0.50	2.5%	2.25%-2.5%
Tenant Improvement Allowances:	\$4.00/RSF- \$5.00/RSF per year of lease term	\$6.00/RSF- \$7.00/RSF per year of lease term	\$8.00/RSF- \$10.00/RSF per year of lease term
Abated Rent:	1 month per year of lease term	½ month per year of lease term	1 month per year of lease term
Lease Security:	15%-20% of the transaction value	2-3 months of base rent	3-4 months of base rent
Termination Options:	Standard Operating Procedure	Difficult to Obtain	Standard Operating Procedure

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Renewal Options with Meaningful Terms:	Standard Operating Procedure	Non-Existent	Non-Existent
Expansion Options:	Standard Operating Procedure	Non-Existent to Difficult to Achieve	Obtainable
Contraction Options:	Common to Difficult to Achieve	Non-Existent	Common to Difficult to Achieve

Buildout & Move Related Expenses	2009	2019	2024
Construction Buildout	\$35.00/RSF-\$50.00/RSF	\$80.00/RSF-\$100.00/RSF	\$100/RSF-\$120/RSF
Soft Costs:			
Cable & Wire:	\$3.00/RSF	\$3.00/RSF	\$3.00/RSF
Architect & Engineer:	\$2.00/RSF-\$3.00/RSF	\$5.00/RSF-\$2.00/RSF	\$5.00/RSF-\$2.00/RSF
Physical Relocation:	\$3.00/RSF		
Construction Management Fee:	0%-2%	2%-3%	1%-2%

Rounding Out 2024

I anticipate the current downturn and the resetting of office market fundamentals to persist for another 3-5 years. At the end of the day, predicting what the office market looks like in the latter part of the 20s remains uncertain. However, I do not see many corporate users occupying traditional CBD office space.

Instead, I see Philadelphia's office market much smaller, and that is scary to say because it was already a small market when compared to other markets prior to the pandemic.

Looking ahead, most tenants to occupy space in traditional CBD office buildings will be locally owned and operated companies. Corporate users will have left our market or built their own buildings. On top of it all, the city's burdensome tax structure doesn't help the cause either.

To conclude, just because the market waters are murky, does not mean that well-represented tenants cannot drive incredibly aggressive, tenant-friendly transactions. However, the key term

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there is “well-represented.” Simply raising your hand and asking for the best deal is not the answer, it is necessary to leverage all viable and healthy options.

The typical timeline to address a lease is 12-15 months in advance of lease expiration. Today, however, and considering everything that must be navigated in this process, it would be most prudent to begin the process 18-24 months in advance of lease expiration.

If you have further questions or inquiries, I welcome the opportunity to help you. Reach out at your convenience. I'd love to have a conversation.

I hope 2025 brings good tidings and prosperity.

Happy New Year,

Ken

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