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3Q23

# Greater Philadelphia Office Market Overview



**NEWMARK**

# Market Observations

## Economy

- The region’s labor market showed signs of weakness in the third quarter of 2023. Unemployment increased 60 basis points since the end of the second quarter of 2023 to reach 4.5%, a 12-month high.
- Year-over-year, job gains in the Philadelphia metro have outperformed the national average, growing 3.0% year-over-year compared to the nation’s 2.0% growth rate. The leisure and hospitality industry continues to lead the region’s labor market in job gains.
- Due to weaker venture capital funding, life science companies in the Philadelphia region have enacted headcount reductions and trimmed pipelines to preserve capital during leaner times.

## Major Transactions

- At the beginning of the third quarter, one of Philadelphia’s largest law firms, Fox Rothschild, announced it would downsize and relocate from 133,537 square feet at 2000 Market Street to 79,337 square feet at 2001 Market Street. This marks a 40% reduction in footprint.
- Wells Fargo leased 90,000 square feet, taking 50,000 SF at 2005 Market Street and 40,000 at Two Logan Square, and will occupy this space in the fall of 2024. The bank currently occupies 300,000 square feet at 401 Market Street, which makes this one of the largest downsizes in Philadelphia in the post-pandemic era.
- Alterra Property Group closed on the sale of 1701 Market Street and plans to convert the current Morgan Lewis & Bockius headquarters to 299 apartments. Construction will commence once the law firm relocates to its new tower at 2222 Market Street. LXP Industrial Trust was the seller. The sales price was not disclosed at the time this report was published.

## Leasing Market Fundamentals

- Quarterly absorption in the third quarter of 2023 for Greater Philadelphia was -649,808 square feet. The suburbs and city contributed around 57% and 43% of negative absorption, respectively. The Blue Bell/Plymouth Meeting submarket was the largest laggard this quarter, posting an occupancy loss of -207,395 square feet.
- A combination of sublease space term expiring and large sublease deals around the market caused sublease availability to decrease for the first time in the post-pandemic era. The 5.7% sublease availability rate was a 20-basis point decline quarter-over-quarter.
- Asking rate declines in the suburban markets have begun to show. The \$29.50/SF rate in the third quarter is \$0.18/SF lower year-over-year.

## Outlook

- Many significant leases were signed in the third quarter, which boosted YTD leasing activity to similar levels in the third quarter of 2022. These new leases reduced space demand as a percentage of the overall market down to 2.5%, which is a five-year low.
- Market vacancy will increase as tenants such as Fox Rothschild and Wells Fargo will vacate their former offices for the smaller spaces each recently leased. These downsizes, along with a few others, will add over 300,000 square feet of vacancy to the market.
- Amenities are no longer the sole differentiator for tenants in the market. The precarious financial position of some landlords has led tenants to buildings owned by well-capitalized property owners who can ensure TI allowance payments and landlord obligations.

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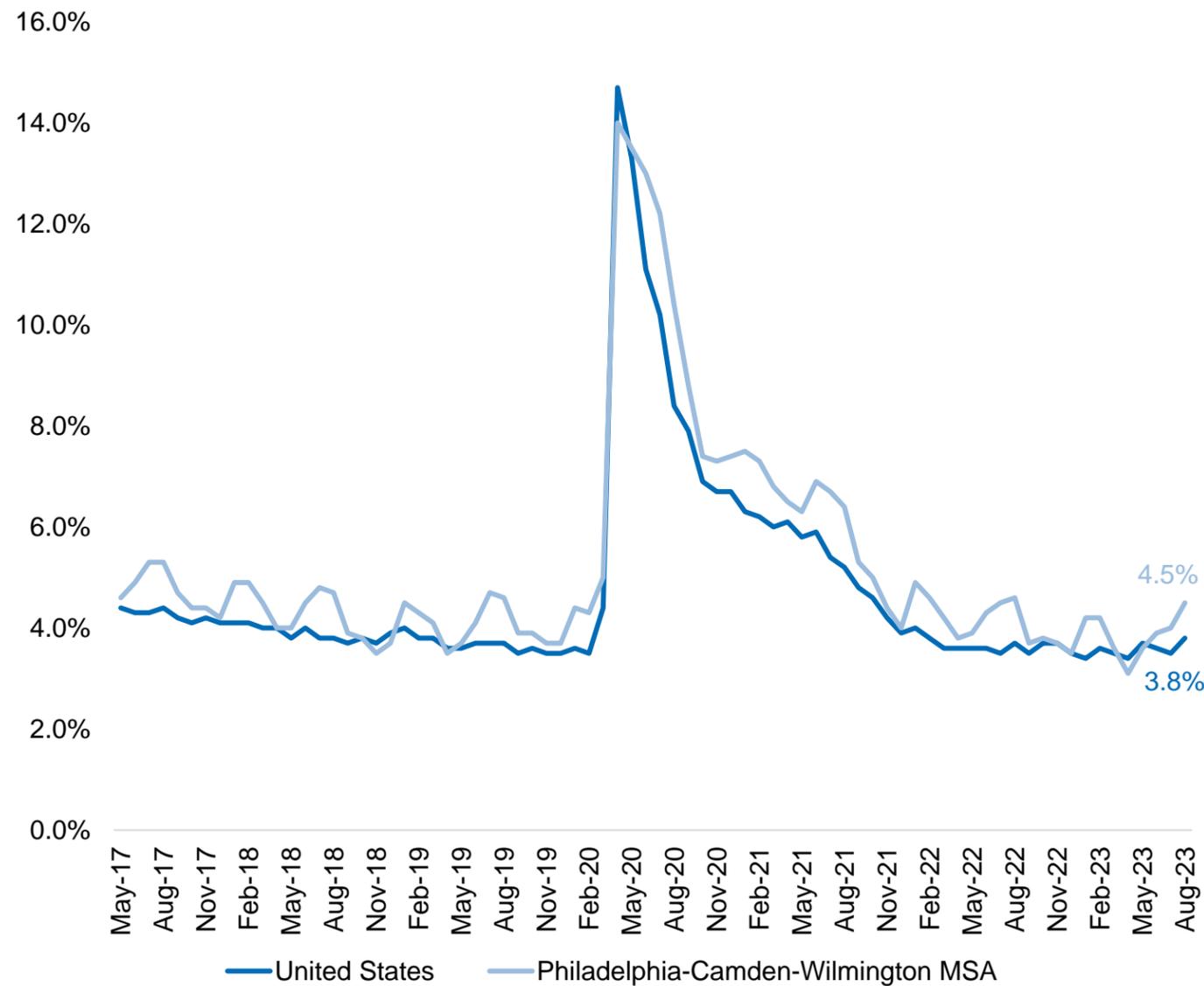
# Economy



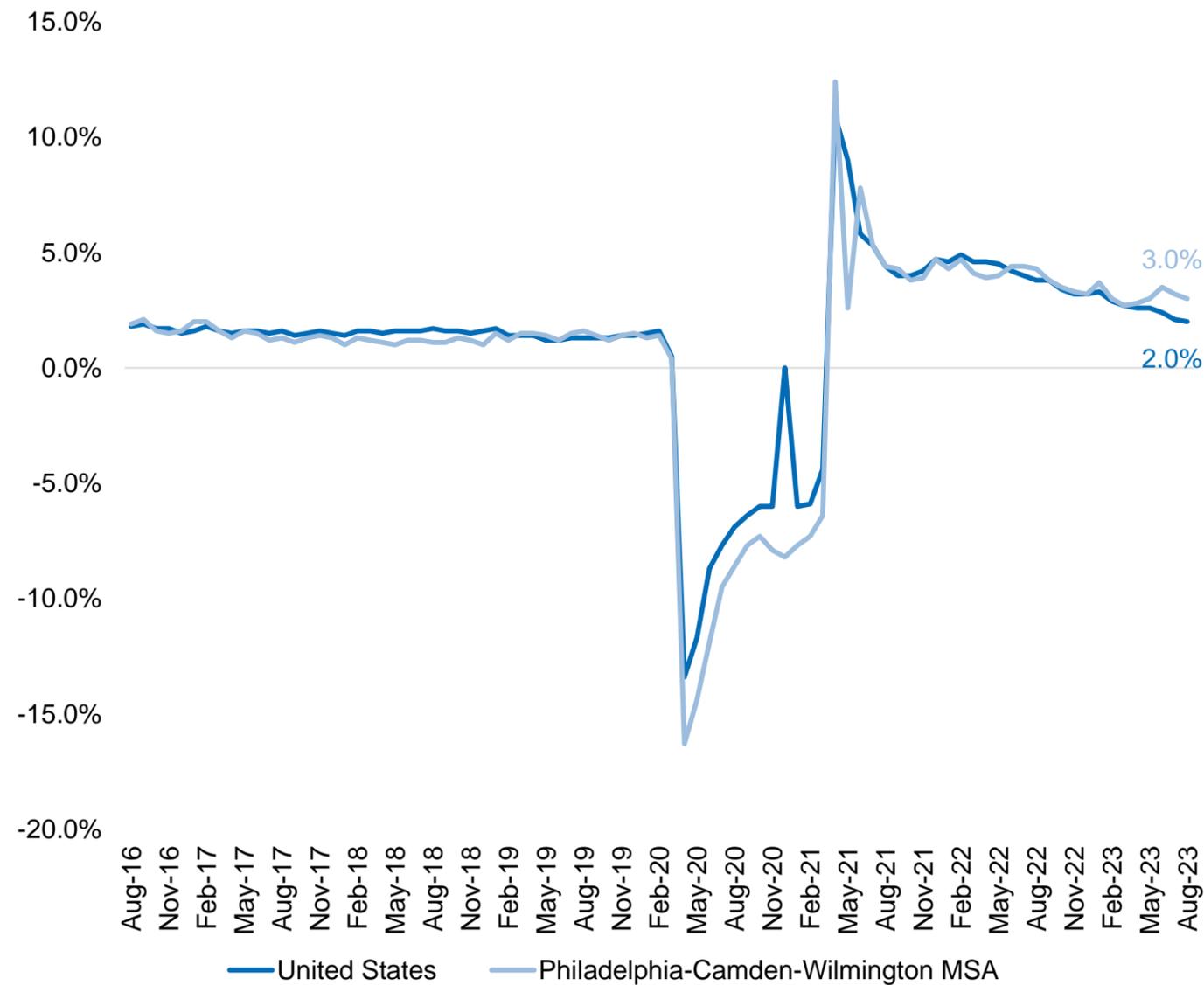
# Metro Employment Trends Signal A Slowing Economy

The Philadelphia Metro's unemployment rate rose to 4.5% in the third quarter of 2023. This is the highest it's been since August of 2022. Employment reductions have been observed in the education and health services industry as well as in government.

**Unemployment Rate, Seasonally Adjusted**



**Nonfarm Payroll Employment, Non-Seasonally Adjusted, 12-Month % Change**

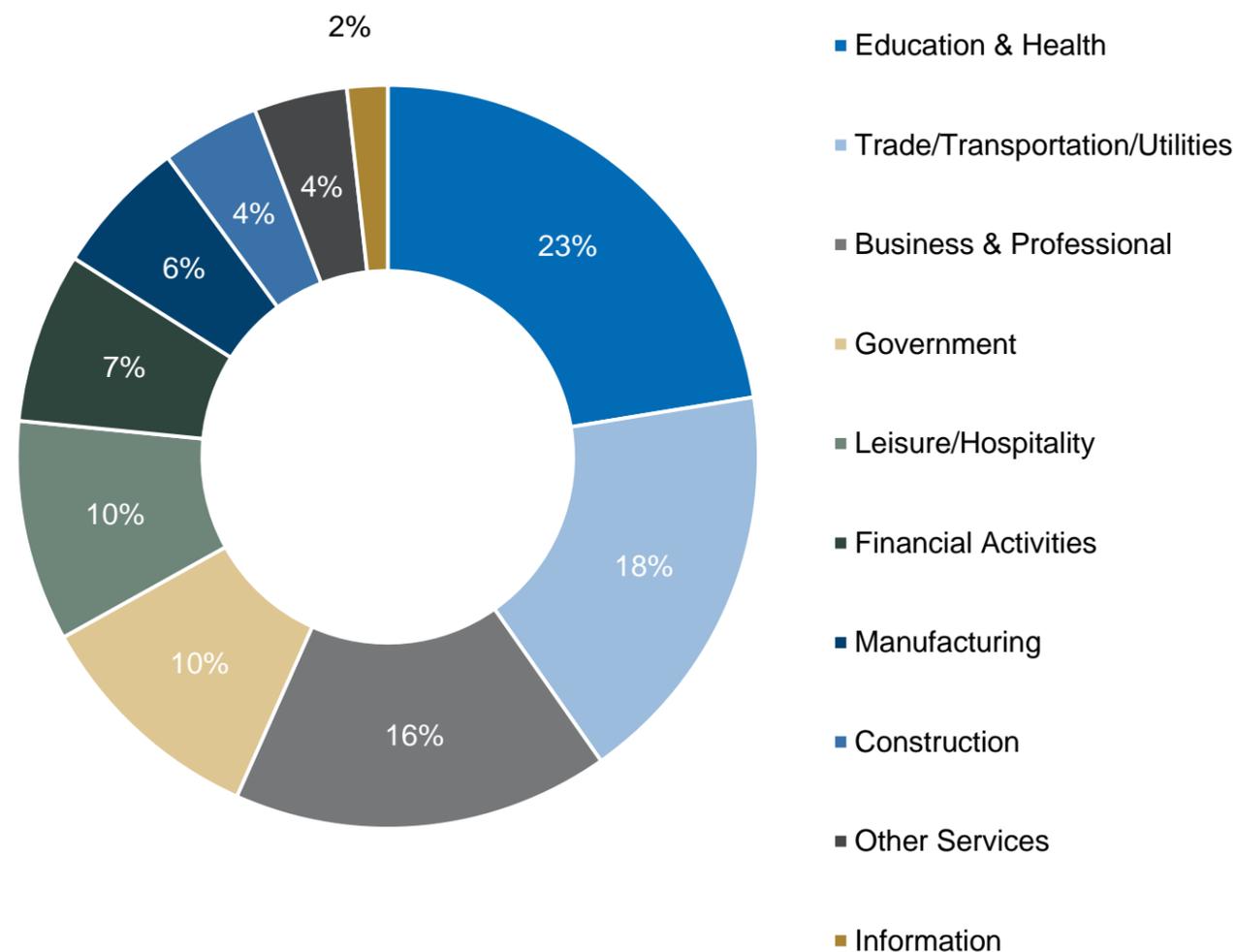


Source: U.S. Bureau of Labor Statistics, Philadelphia-Camden-Wilmington MSA

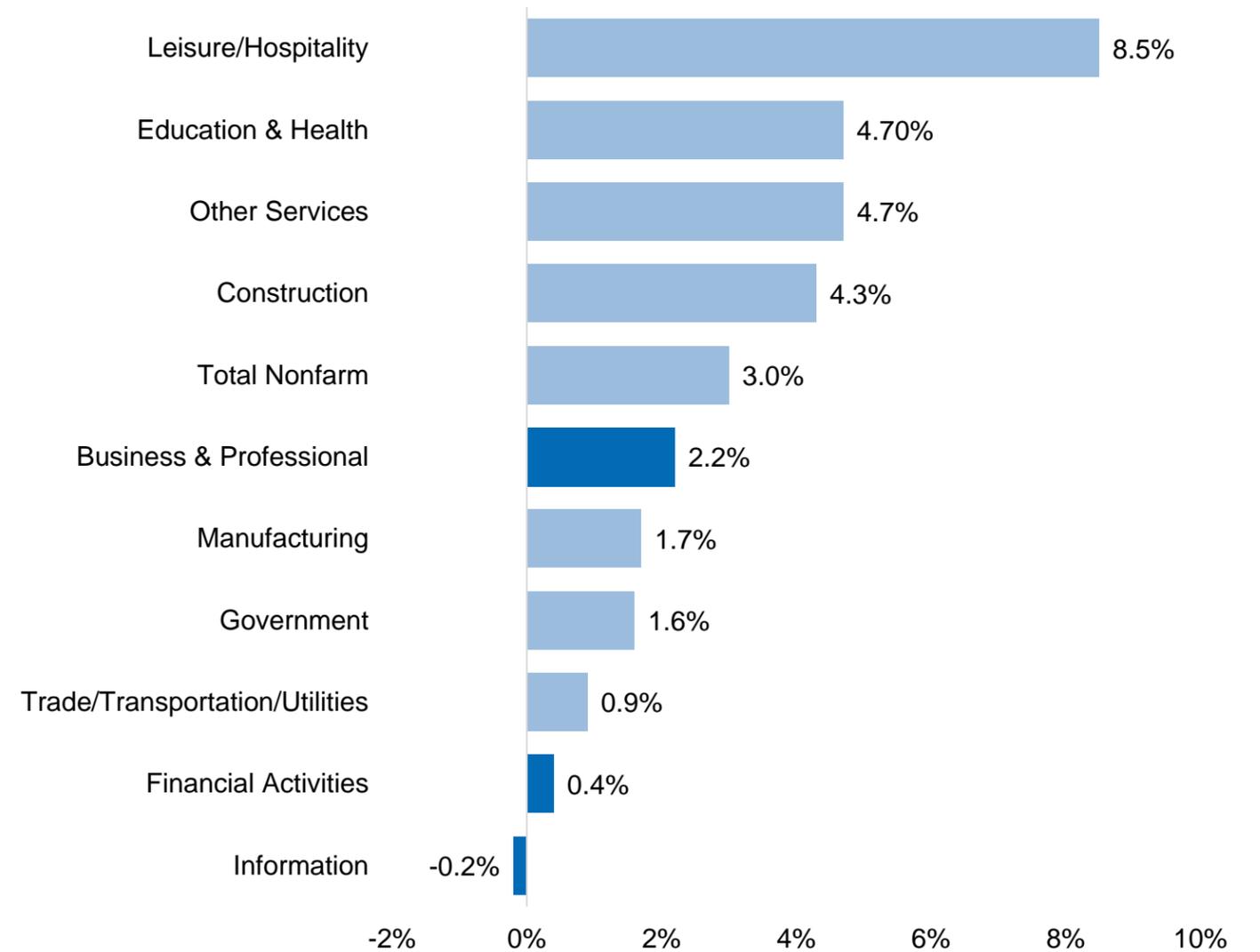
# Job Growth Driven in Large Part by Services Still Making Up for Pandemic Losses

Strong hiring in the leisure and hospitality industry has brought employment in that sector above pre-pandemic highs. Employment figures in this industry are highly seasonal, with employment losses averaging 5.3% between June and December in the seven years before the pandemic. The combination of weakening travel demand in colder months and tightening household budgets due to inflation could cause this pattern to repeat itself.

Employment by Industry, August 2023



Employment Growth by Industry, 12-Month % Change, August 2023

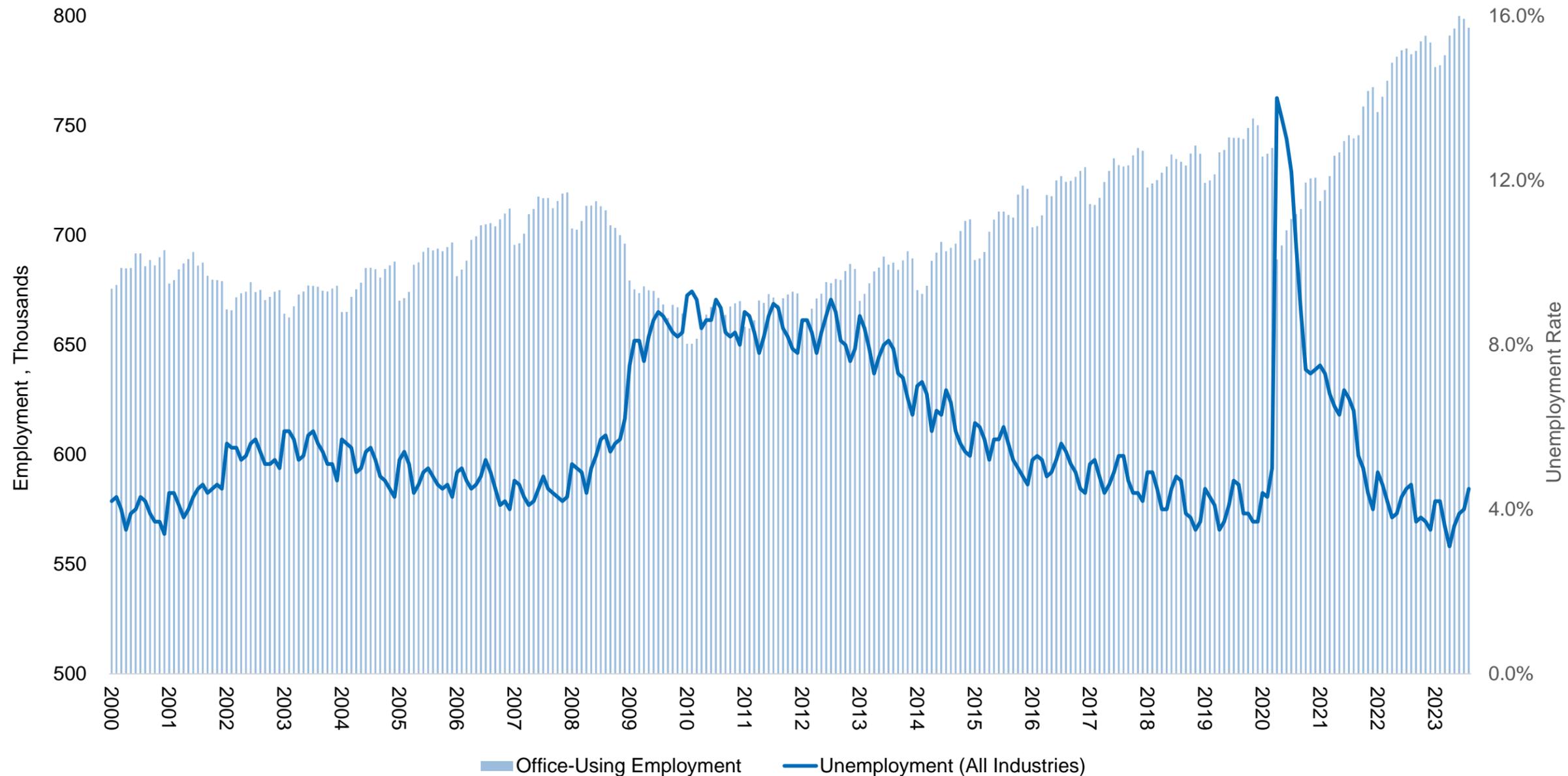


Source: U.S. Bureau of Labor Statistics, Philadelphia-Camden-Wilmington MSA

# Overall Office-Using Employment Has Rebounded

Office-using employment peaked in the middle of 2023 and ended Q3 a few thousand jobs below the high-point. Across the region, return-to-office mandates are being enacted at varying rates of success. In the second quarter of 2023, Comcast mandated employees to return to the office four days a week beginning in the fall, which has led to increased foot traffic in Center City at the end of the third quarter of 2023.

Office-Using Employment\* and Unemployment Across All Industries



Source: U.S. Bureau of Labor Statistics, Philadelphia-Camden-Wilmington MSA

Note: August 2023 data is preliminary.

\*Office-using employment includes employment in the following industry sectors: Professional & Business Services, Financial Activities and Information.

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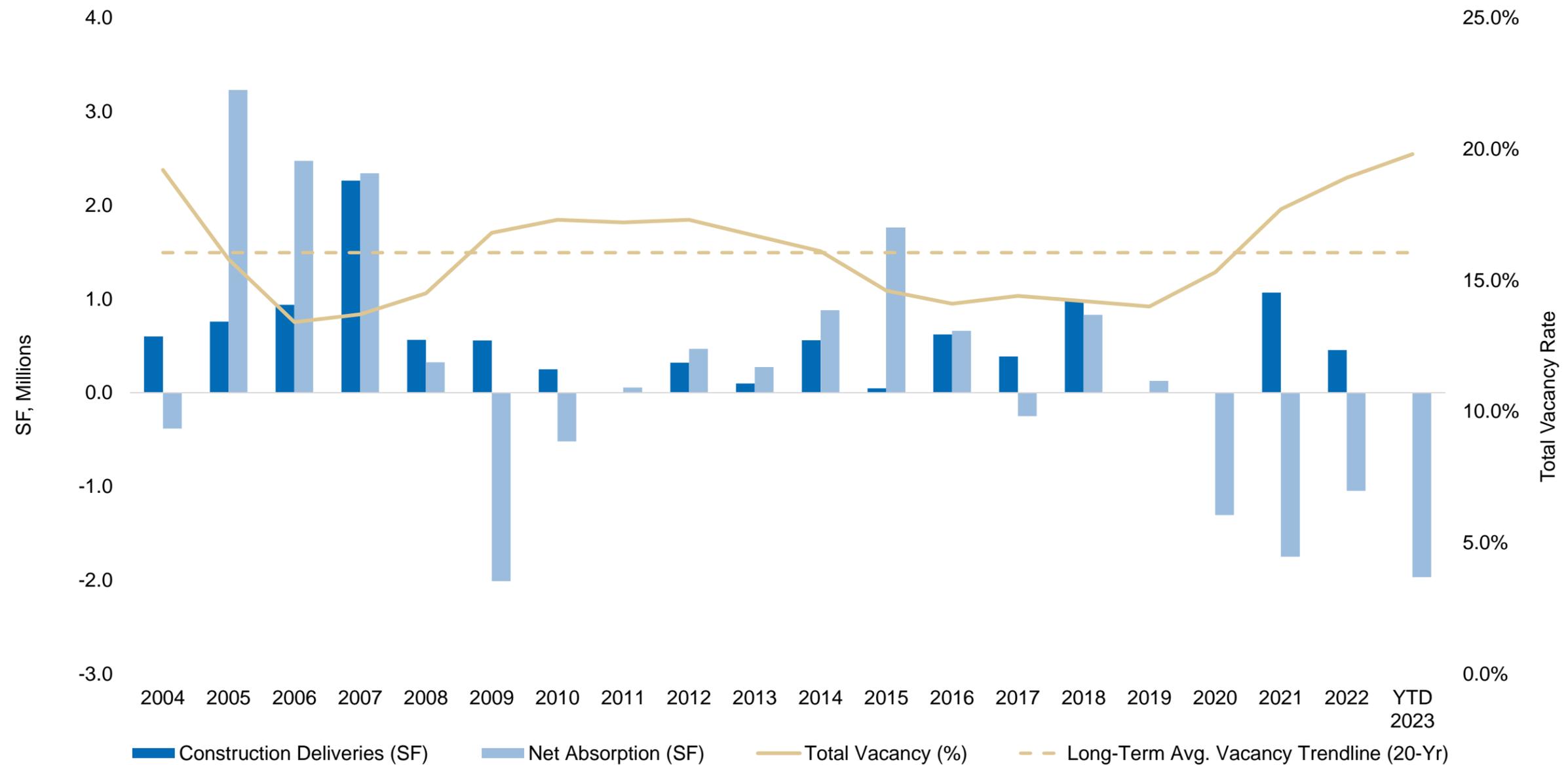
# Leasing Market Fundamentals



# Rising Vacancy Rates Pose Challenges and Opportunities in Greater Philadelphia

Vacancy has risen in the Greater Philadelphia market in the third quarter of 2023. In the Blue Bell/Plymouth Meeting submarket, occupiers such as Cbiz Philadelphia, Travelers Insurance, and Viewpoint vacated large offices, which increased vacancy in the suburban markets. The -207,395 square feet of negative absorption in the Blue Bell/Plymouth Meeting submarket accounted for nearly one-third of total absorption in the third quarter.

## Historical Construction Deliveries, Net Absorption, and Vacancy

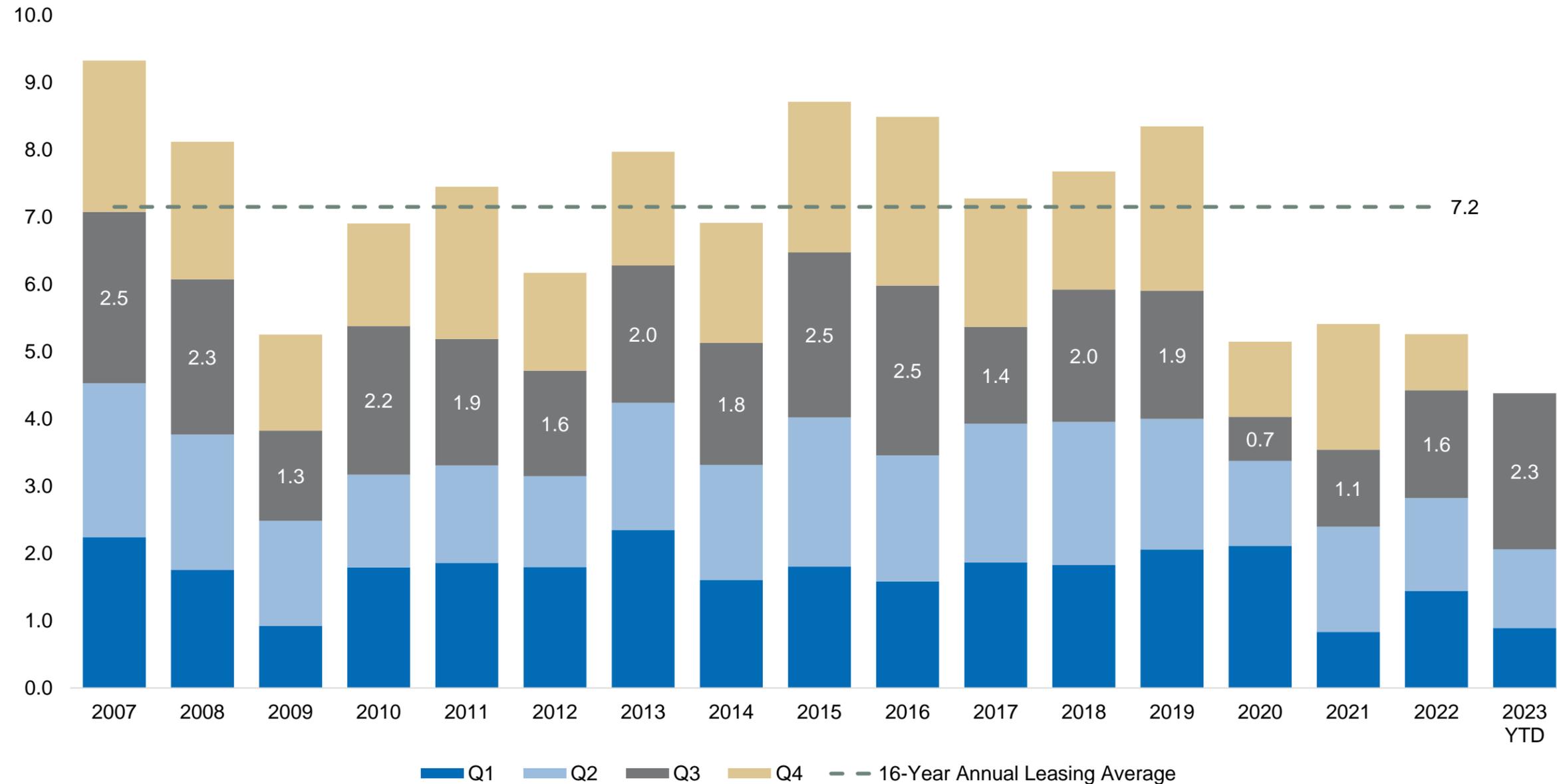


Source: Newmark Research

# Multiple Downsizing Deals Buoy Leasing Figures

New downsizing leases by Fox Rothschild, Wells Fargo, and KPMG boosted leasing totals to their highest quarterly level since the fourth quarter of 2019. Additionally, current year-to-date leasing activity is in line with figures recorded at the end of the third quarter of 2022. Post-pandemic, leasing in the fourth quarter averaged 1.26M square feet. A total similar to historical averages would give 2023 the best annual leasing total since the onset of COVID-19.

## Total Leasing Activity (msf)

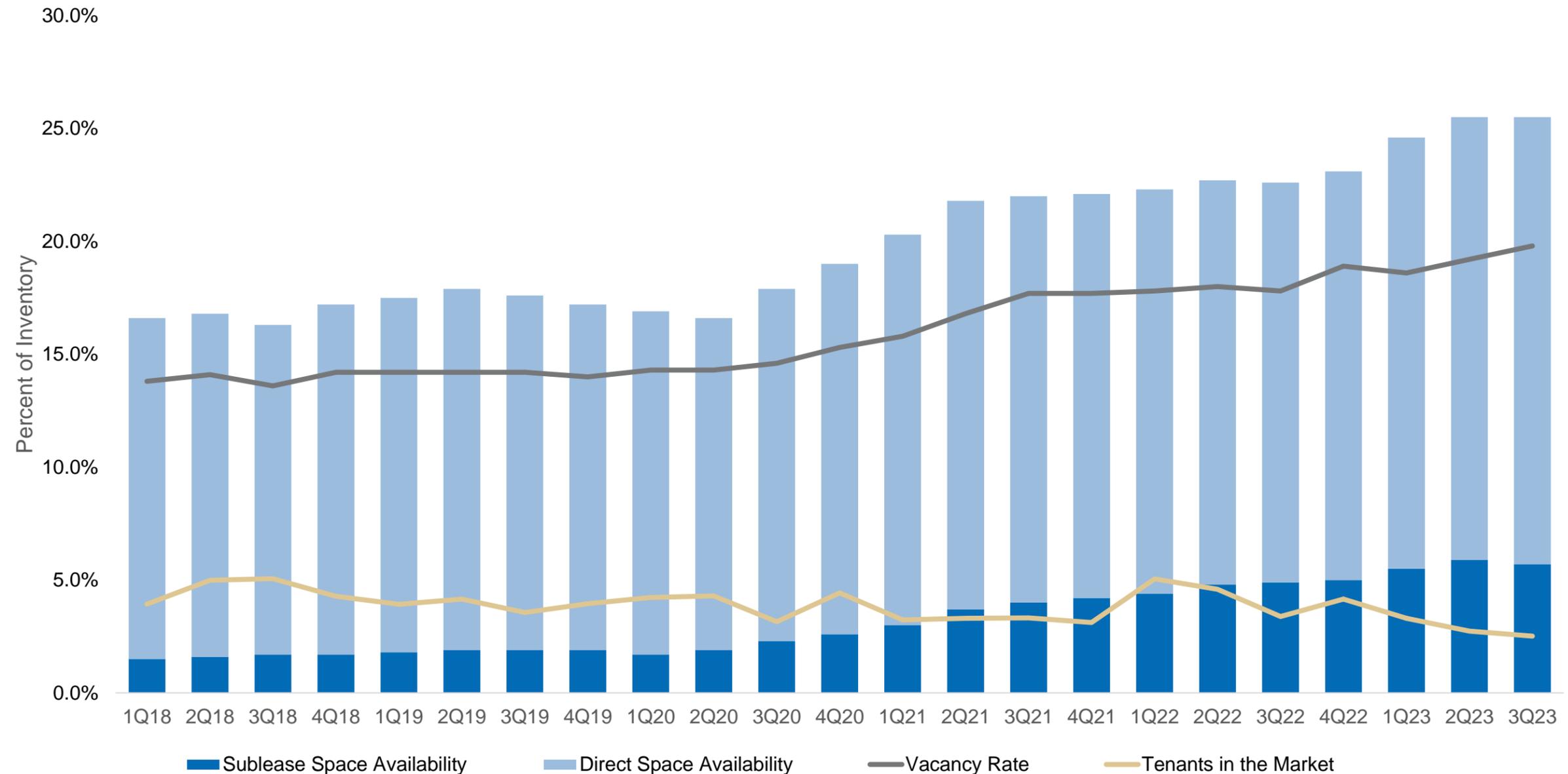


Source: Newmark Research, CoStar

# Availability Continues to Increase While Tenant Demand Drops

The downside of major leases transacted in the third quarter is a sharp decline of space requirements in the market. Currently, existing space demand makes up 2.5% of the overall market, a five-year low. Sublease deals by KPMG and Post & Schell, as well as term expiration for sublet space in the market, have caused sublease availability to decline for the first time since the pandemic started. At the end of the third quarter of 2023, the overall availability rate was 25.5%.

Available Space and Tenant Demand as Percent of Overall Market

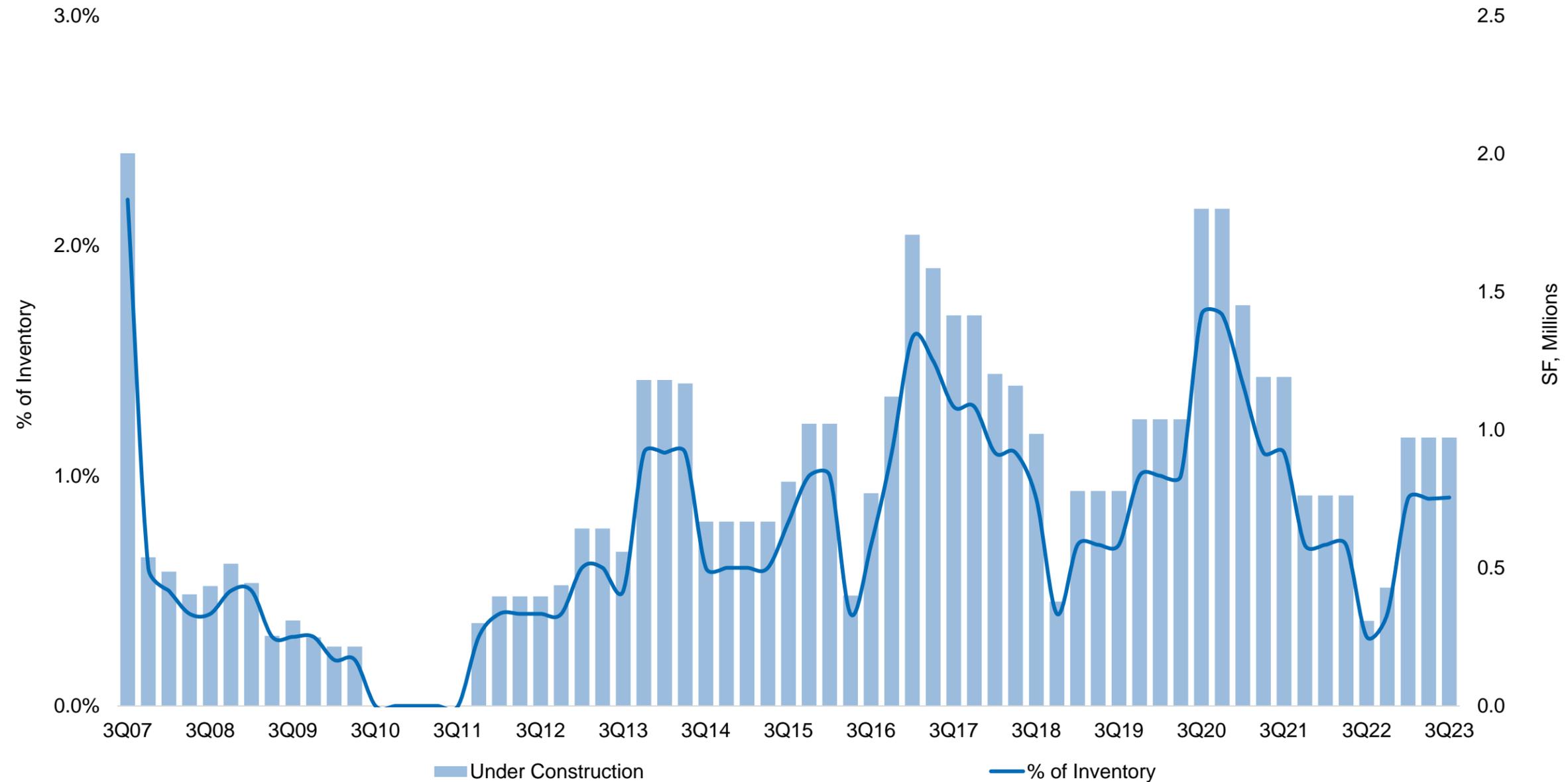


Source: Newmark Research

# Deliveries Are Impending While New Construction Slows

Construction inventory remained unchanged compared to last quarter. The installation of the Chubb Insurance building's foundation began in the third quarter. The impending addition of 2222 Market to inventory will create a sharp jump in absorption, as Morgan Lewis' current building will be converted to multifamily.

## Office Under Construction and % of Inventory

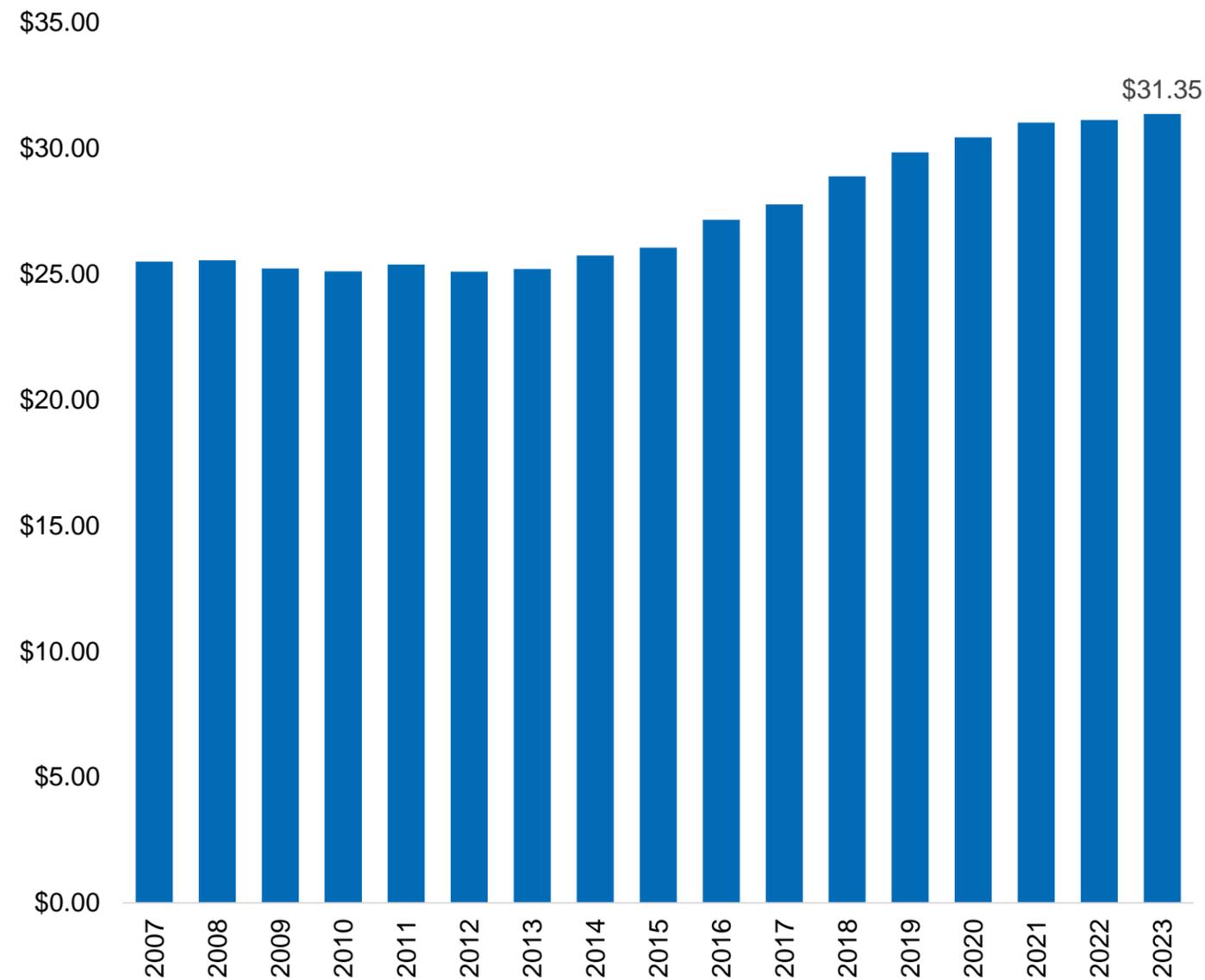


Source: Newmark Research, CoStar

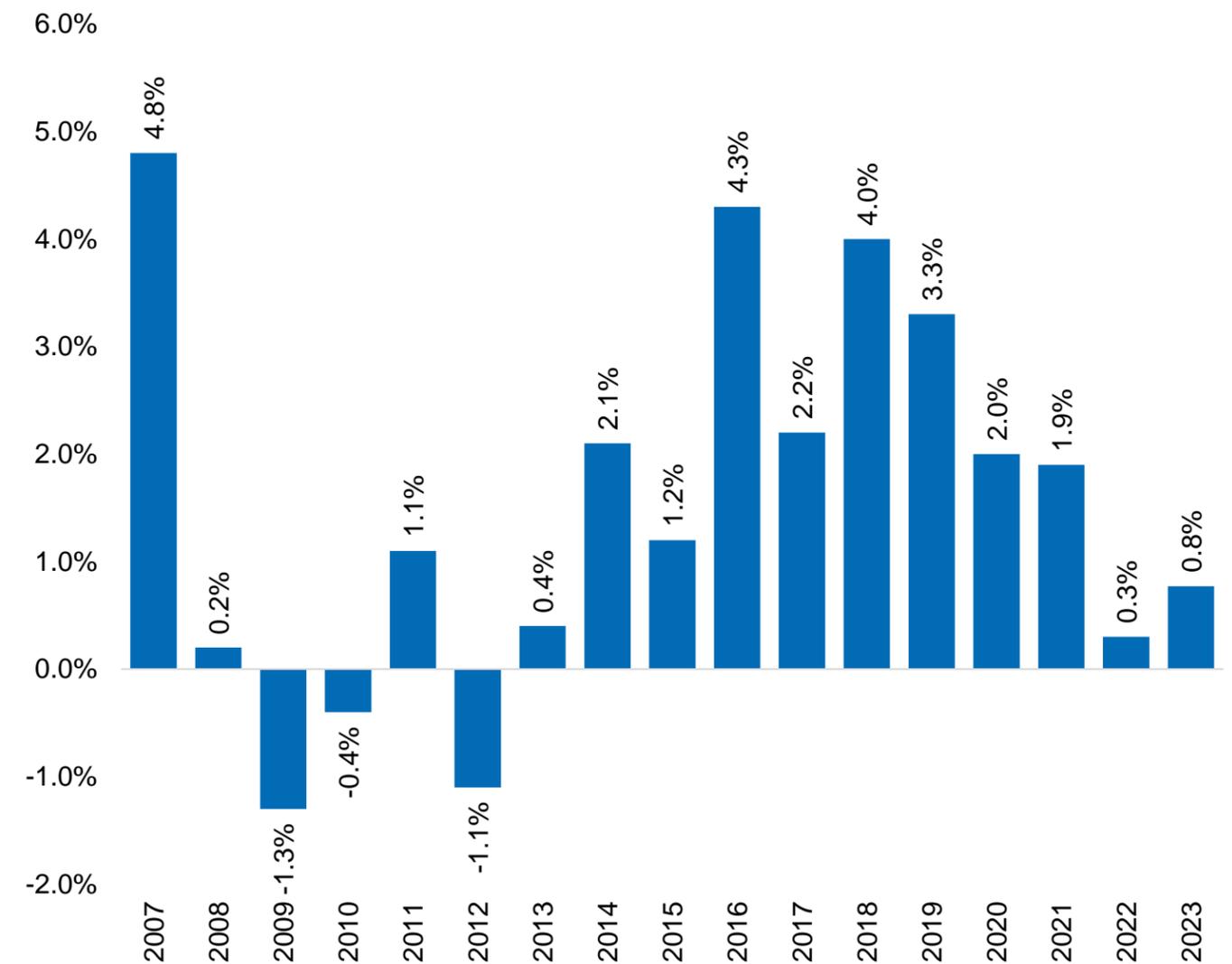
# Rents Remain Flat

Rents in the Greater Philadelphia market have maintained stability over the past two years. Well-capitalized landlords have decreased asking rates and offered significant concessions to win deals. Submarkets with a large proportion of well-capitalized ownership groups, like West Market and Radnor/Main Line, have seen some of the larger year-over-year asking rate declines. These landlords have been aggressive in chasing deals and are willing to drop asking rents and offer strong concessions to lease up their buildings.

Office Average Asking Rent, \$/SF, FS



Year-over-Year Asking Rent Growth Rate

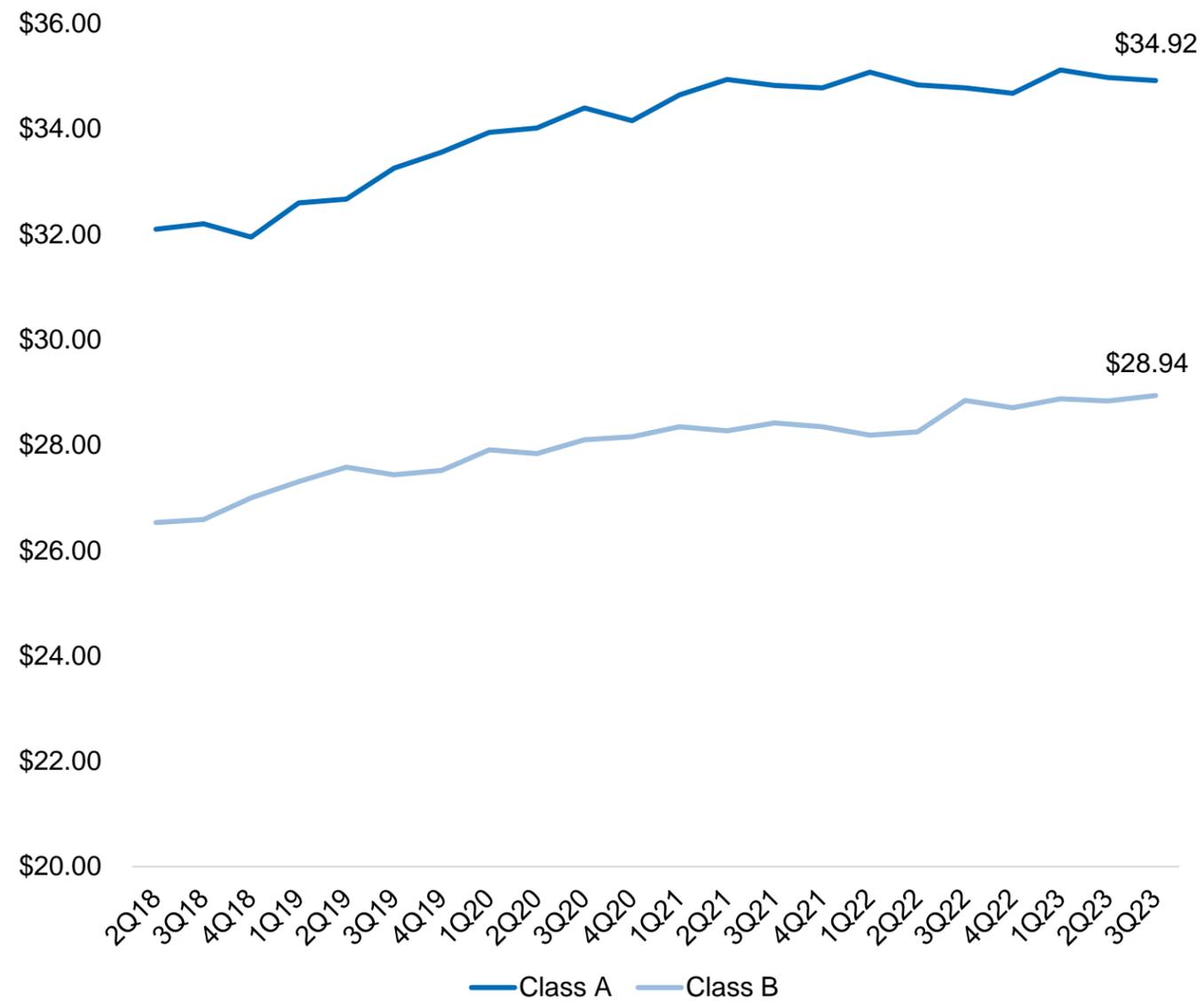


Source: Newmark Research,

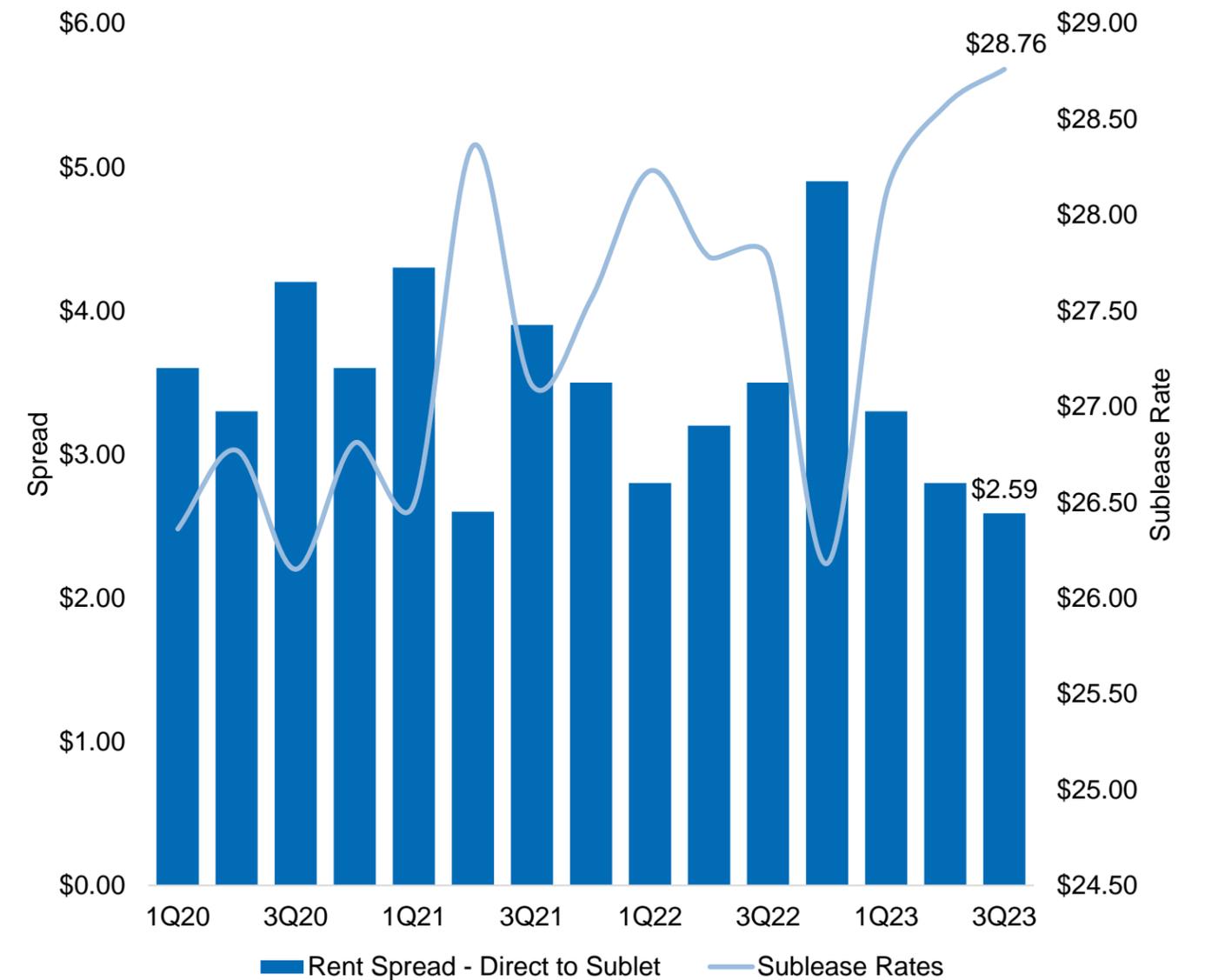
# Spreads Between Direct and Sublease Space Continue to Narrow

Since the third quarter of 2022, around 600,000 SF of existing Class A space has been added to the sublease market. The influx of high-end space to the market caused rent spreads between direct and sublet space to compress. Much of this space had significant term left in the sublease and was in great condition, which made it a competitor of direct space. Sublease space remains attractive to certain tenants in the market, as evidenced by large deals from KPMG, Post & Schell, and GreyHawk Health.

Class A and Class B Asking Rents



Sublease Rates



Source: Newmark Research, CoStar

# Large Downsizes Provide Significant Boost to Leasing Activity

KPMG, Wells Fargo, and Post & Schell were some of the largest downsize deals announced in the third quarter of 2023. Between these three groups, nearly 300,000 square feet will be vacated soon and will take significant time to lease up. Expect availability to increase in the future as many of these spaces will be brought to market.

## Notable 2Q23 Lease Transactions

Tenant	Building(s)	Submarket	Type	Square Feet
KPMG	1735 Market Street	West Market - CBD	Sublease	97,000
<i>The accounting giant subleased the space Willis Towers Watson made available. KPMG previously leased 134,000 square feet at 1601 Market Street</i>				
Avo Photonics, Inc.	500 Virginia Drive	Fort Washington	Direct Lease	96,950
Wells Fargo	2005 Market Street & Two Logan Square	West Market - CBD	Direct Lease	90,000
<i>The bank previously occupied over 300,000 square feet at 401 Market Street. Wells Fargo leased 50,000 square feet at 2005 Market Street and 40,000 square feet at Two Logan Square</i>				
Fox Rothschild LLP	2001 Market Street	West Market - CBD	Direct Lease	79,337
<i>Fox Rothschild previously leased 133,537 square feet at 2000 Market Street, which is approximately a 40% reduction in footprint</i>				
Post & Schell	1717 Arch Street	West Market - CBD	Sublease	41,175
<i>The law firm reduced its footprint by nearly half after occupying Four Penn Center for 20 years</i>				

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# Bucks County Overview

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## Class A Rents Around Greater Philadelphia Differ In Performance

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## A Stark Contrast in Performance Between “Core” and “Non-Core” Submarkets

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# Appendix



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## Submarket Overview

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