JONES LANG LASALLE

Real value in a changing world

/pulse/

Philadelphia / Office Insight / Q2 2011

Class A positive absorption drives market tightening

Economy

Employment in the Philadelphia Metropolitan Statistical Area (MSA) continues to steadily grow, yet at a slower pace than the nation. The Philadelphia economy saw small job growth as the market added 7,000 new non-farm jobs (0.3 percent annual job growth) over the previous year. Of the 7,000 jobs added, about 1,200 of them were in the professional and business services sector. This marks the fourth consecutive quarter that the Philadelphia MSA experienced positive job growth. Future positive job growth may be jeopardized as a large national defense contractor recently announced plans to layoff over 1,200 employees. Most of these layoffs will occur at their Bucks County location.

Market conditions

The Philadelphia office market continued to tighten through the second quarter. Flight to quality continued over the second quarter as Class A absorption was 463,396 square feet compared to Class B's negative 22,087 square feet. There was notable improvement in year-over-year absorption specifically in the CBD and Pennsylvania suburbs. Total net absorption in the CBD for the first half of 2011 was positive at 219,289 square feet. By comparison, at this time last year the CBD had negative 284,007 square feet of absorption. In the Pennsylvania suburbs, year-to-date absorption for 2011 has been positive 377,198 square feet compared to 2010's negative 880,106 square feet. Over the year, the Pennsylvania suburbs' total vacancy dropped 130 basis points to 18.5 percent with average asking rents growing from $24.29 per square foot to $24.48 per square foot.

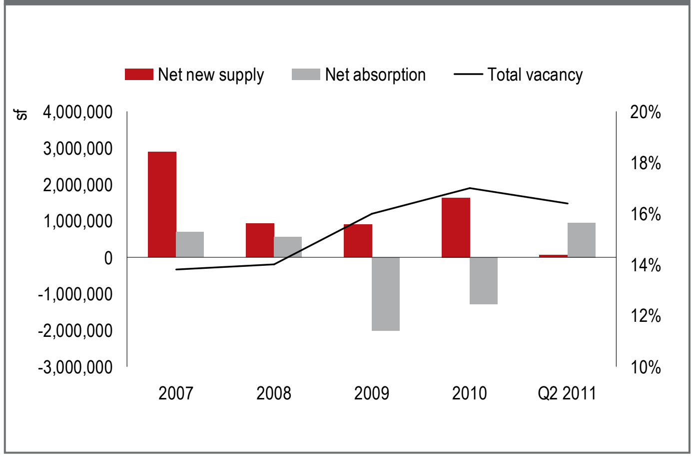
Several large leases were signed in the second quarter: CHOP renewed and expanded to 252,000 square feet in the Wanamaker building, GlaxoSmithKline renewed 197,000 square feet in King of Prussia, and DaVita Dialysis signed a new lease for 110,000 square feet in Malvern. Despite this handful of large deals, leasing activity for the quarter was principally driven by smaller deals (smaller than 25,000 square feet).

Outlook

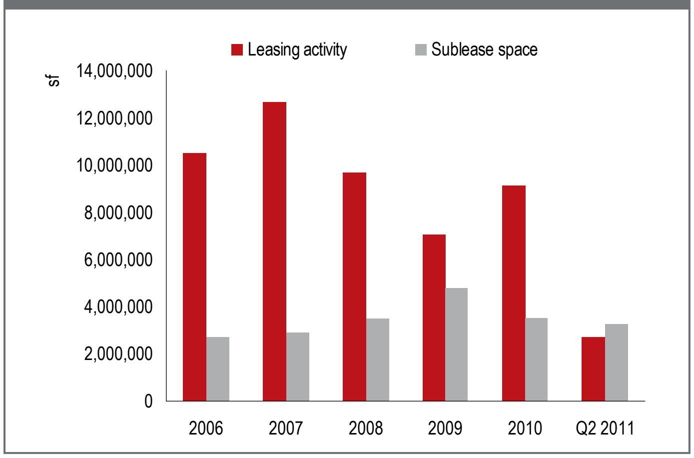
The second half of 2011 will see continued positive absorption and a downward trend in concessions for well-positioned assets as the flight to quality continues. Contiguous blocks will continue to diminish. Most submarkets will see continued tightening with the exception of Southern New Jersey where the lack of demand for new space will continue to hinder positive growth. In the CBD, several building sales are expected to close, which could lead to propelled rent growth over the near and mid-term based on underwritten assumptions.

	Key market indicators	12-month forecast	
Supply	Supply		137,674,242 sf
	Direct vacancy rate		15.43%
	Total vacancy rate		16.4%
	Under construction (% preleased)		400,000 sf (0%)
Demand	Leasing activity 12 mo. % change		-54.2 %
	YTD net absorption		939,968 sf
Pricing	12-month overall rent % change		-9.2%
	Class A overall asking rent		$26.17 psf
	Class B overall asking rent		$20.61 psf

Net new supply, net absorption and total vacancy



Leasing activity vs. sublease available space



Tenant perspective

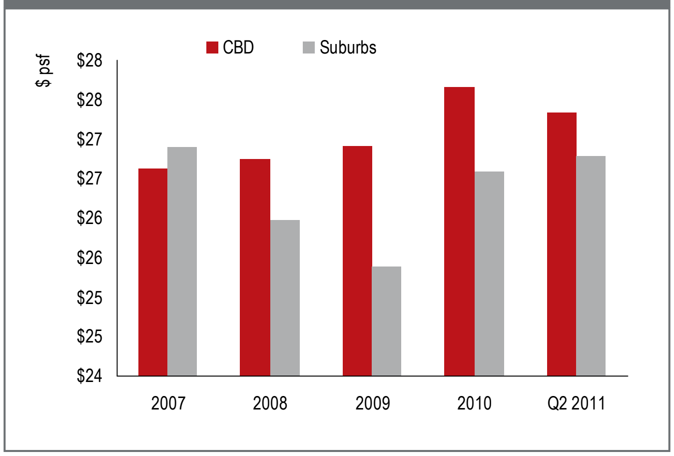
In the suburbs, there has been a decrease in 50,000 to 100,000 and 100,000 to 250,000 square foot blocks of available space. Further, available blocks of space greater than 200,000 square feet are non-existent in high demand suburban markets like King of Prussia / Wayne. For this reason, build-to-suit projects have become an attractive alternative option.

Similar to the previous quarter, large users in the CBD and the Pennsylvania suburbs looking for more than 100,000 square feet will have fewer options for high quality, contiguous blocks of available space as they continue to be absorbed. In addition, sublease availabilities are diminishing for smaller tenants seeking space.

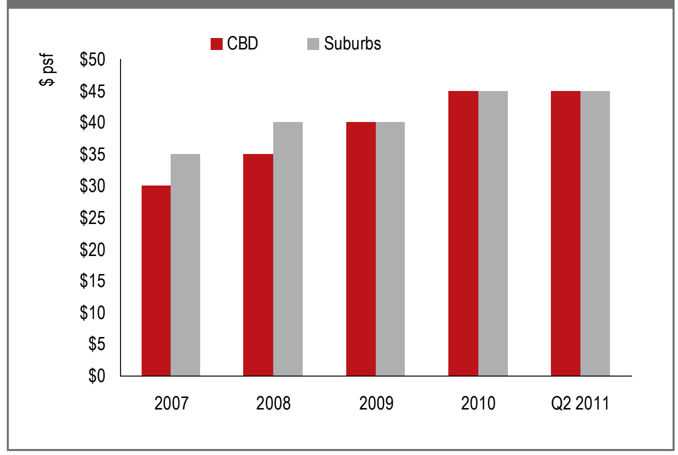
Landlord perspective

With the market bottoming out, tenant improvement concessions have remained the same over the last three quarters, averaging about $45 per square foot in allowances both in the suburbs and CBD. However the CBD did see a shift in free rent as it dropped slightly from ten months to nine months of free rent on a ten year deal. Following three consecutive quarters of positive absorption, concessions are expected to tighten, especially for well-positioned assets. Owners of Class B space are anticipating the market recovery to flow down to their buildings as Class A space gets absorbed.

Class A overall asking rents

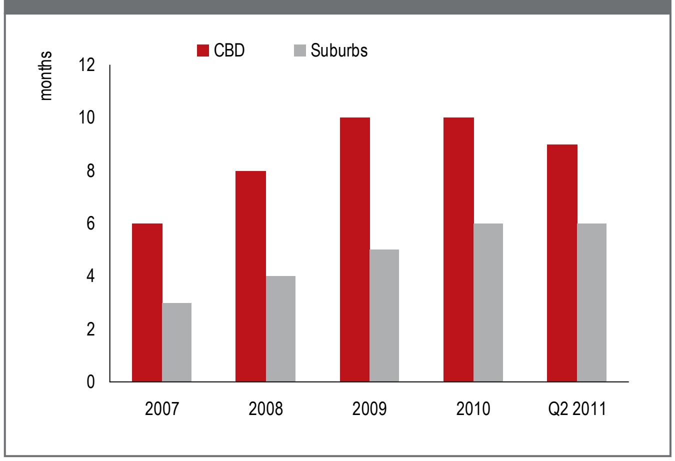


Class A tenant improvement allowance*



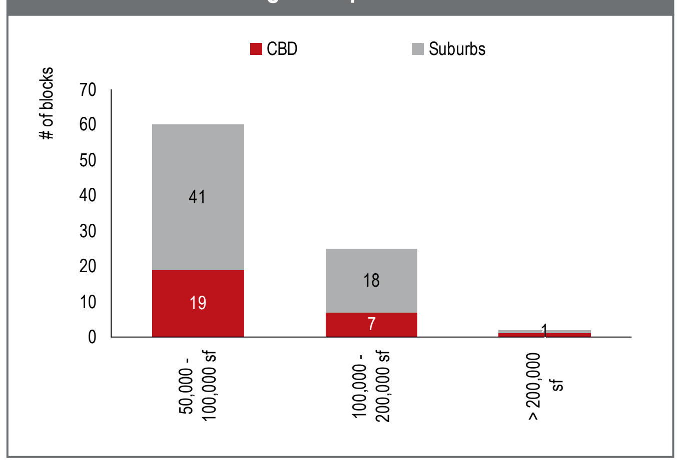
* Based on a ten year lease term

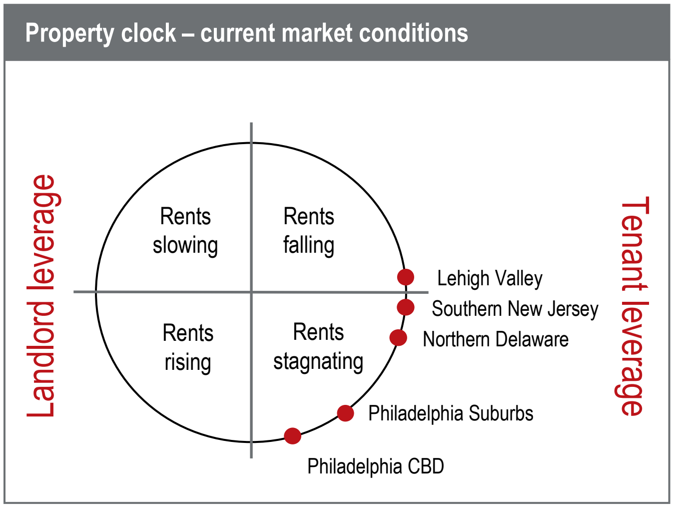
Class A free rent*

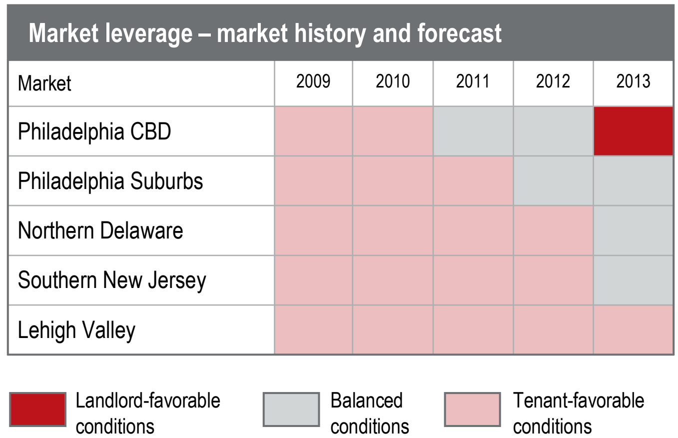


* Based on a ten year lease term

Class A blocks of contiguous space







Completed lease transactions

Tenant	Address	Submarket	SF	Type
CHOP	Wanamaker Building	Market Street East	252,000	Renewal/Expansion
GlaxoSmithKline	2301 Renaissance Boulevard	King of Prussia / Wayne	197,000	Renewal
DaVita Dialysis	2476 Swedesford Road	Malvern / Exton	110,000	New
Avantar Performance Materials*	3477 Corporate Parkway	Lehigh Valley	57,000	New
Liberty Mutual	15 Kings Grant Boulevard	Bala Cynwyd	57,000	Sale / Lease Back
TelerX	723 Dresher Road	Horsham / Willow Grove	50,000	Renewal
PearsonVue	3 Bala Plaza	Bala Cynwyd	42,000	Renewal

Completed sale transactions

Address	Submarket	Buyer / Seller	SF	$ psf
32 Property Portfolio	Lehigh Valley	PennCap Properties/ Liberty Property Trust	1,400,000	$89.00
Two Liberty Place**	Market Street West	Parkway Properties / Eola Capital	940,654	N/A
7001 Lincoln Drive	Mount Laurel / Marlton/ Moorestown	Rothman Institute / Brandywine Realty Trust	69,300	$85.00
13000 Route 73	Mount Laurel / Marlton/ Moorestown	Veritas Real Estate Investments / Liberty Property Trust	62,000	$124.00
15 Kings Grant Drive	Bala Cynwyd	Keystone Property Group / Liberty Mutual	57,000	$65.00

* Not reported by Jones Lang LaSalle in Q1 2011
** Part of national portfolio sale

Metro Philadelphia methodology: Inventory includes all Class A and B office properties > 25,000 square feet, excluding all owner occupied and medical office buildings

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