Philadelphia market overview

The Philadelphia CBD continues to see its vacancy rate increase and leasing activity slow.

Development stalled in the CBD as troubles in the credit market curtailed lending.

Transaction activity remains severely constrained as a result of the credit crisis and the nation's most severe recession in decades.

Supply vs. demand

Significant opportunities exist for tenants with good credit to renegotiate existing leases or achieve favorable economic and operating lease terms. The Philadelphia CBD continues to see its vacancy rate increase and leasing activity slow. There are five blocks of space over 100,000 square feet available for lease. Landlords are willing to negotiate on rental rate terms and concessions. Additionally, tenants who wish to defray the costs associated with moving, will be more confident approaching their landlords to recast or renew their lease.

Economics

February unemployment for the Philadelphia-Camden-Wilmington area finished at 8.0 percent, a more than 3.0 percentage point jump from one year ago. The Philadelphia Suburbs and Southern New Jersey's finance and mortgage-based economies stagnated and led to increased unemployment. Comparatively, the education and healthcare-based economy insulated the Philadelphia CBD from severe layoffs but current trouble in the legal services industry (as evidenced by the dissolving of WolfBlock, LLP) could lead to future dismissals.

Development

Development stalled in the CBD as troubles in the credit market curtailed lending. After breaking ground in November 2007, Brandywine Realty Trust suspended construction on the 600,000 square foot Cira Centre South. The City Council approved Walnut Street Capital's plans for the 2.2 million square foot American Commerce Center but no ground-breaking date has been set.

Investment activity

Transaction activity remains severely constrained as a result of the credit crisis and the nation's most severe recession in decades. Overall volume was down 70% in 2008 and early results for 2009 show significant further decreases in transaction activity year over year. A reversal in trend for 2009 would require significantly increased liquidity in the real estate debt markets or a major increase in the velocity of distressed asset sales.

Distressed sales may take much of 2009 to develop as the number of troubled loans approaching maturity increases. These sales could be pushed into 2010 or beyond as many lenders are extending term or granting borrowers forbearance. There are currently over $300 billion in commercial mortgages estimated to mature each year from 2009 through 2011.

Pools of opportunistic equity have gathered on the sidelines waiting for these distressed assets to hit the market and create a perceived market "bottom". As transaction activity begins to increase, data will be provided to an information starved market. This will collectively provide effective trading ranges for all assets, giving guidance to both buyers and sellers in the current environment. When these transactions occur, we will likely see cap rates at least 250 to 300 basis points higher then their bottom in 2007.

A significant increase in activity will also require an upsurge in liquidity in the debt markets. CMBS debt, which had steadily increased over the last decade, so that at its peak in 2007 it represented over $230 billion of activity and was over 55% of the commercial real estate debt market, is currently almost non-existent. The remaining debt options, commercial banks and insurance companies, have actually allocated lower amounts of debt capital in 2009 than in previous years. Magnifying this lack of liquidity is the fact that underwriting standards and mortgage terms have tightened for all active lenders.

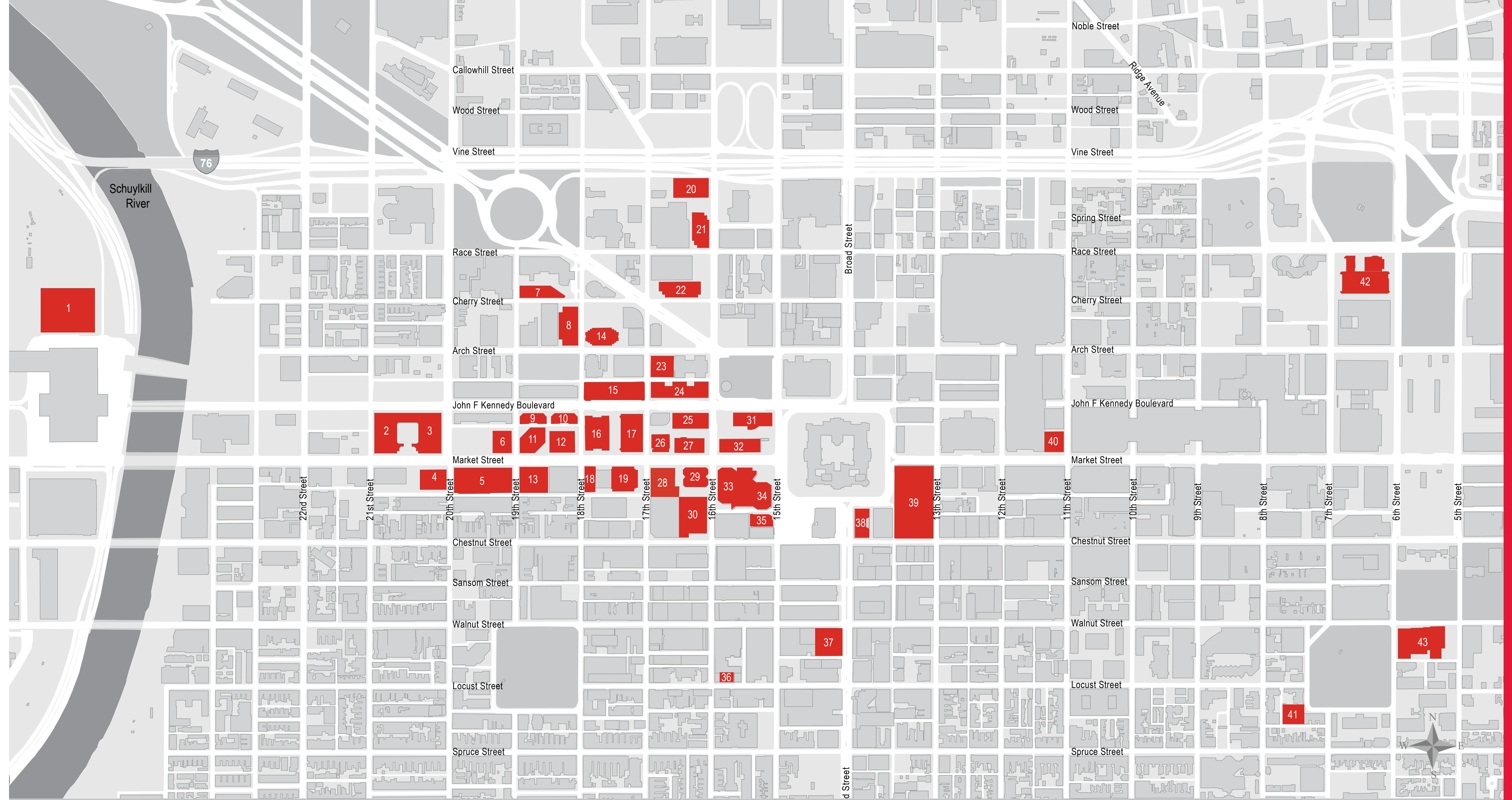
Despite all of the above, we do forecast moderate sales activity for the remainder of 2009. There is some product available for sale, there are some sellers who have specific motivation to sell assets, and there are some distressed assets that are already coming to the market. Once a few of these transactions have closed, and the recently passed fiscal stimulus package begins to have an impact on the economy, improving real estate fundamentals, there should be a sustainable increase in real estate investment activity.

Office outlook

The Philadelphia CBD will continue to experience rising vacancy rates for the rest of 2009. Currently, asking rental rates remain high but landlords will eventually lower them to reflect actual taking deals. Fewer tenants in the market will result in negative absorption increasing. Long term renewals will be more frequent as tenants look to deflect the capital costs of moving to new space and landlords look to secure credit worthy tenants.

Recent sales transactions

Building	Square feet	Price/s.f.	Leased
3501 Market Street **Buyer:** Drexel University **Seller:** Thomson Reuters	145,000	$217	0.0%
Unisys Technology Center **Buyer:** Exeter Property Group **Seller:** Unisys Corporation	360,000	$54	50.0%
Five Tower Bridge **Buyer:** KBS REIT **Seller:** Oliver Tyrone Pulver	223,736	$326	97.0%
1600 Callowhill Street **Buyer:** Urban America **Seller:** Rubicon America Trust JV NGP Capital	88,717	$180	100.0%



Philadelphia market locations

1 2929 Arch, Cira Centre
2 2005 Market, One Commerce Square
3 2001 Market, Two Commerce Square
4 2000 Market
5 1900 Market
6 1901 Market, Blue Cross
7 130 N 18th, One Logan Square
8 100 N 18th, Two Logan Square
9 1880 JFK Blvd
10 1800 JFK Blvd
11 1835 Market
12 1801 Market, Ten Penn Center
13 1818 Market
14 1717 Arch, Bell Atlantic Tower
15 1701 JFK Blvd, Comcast Center
16 1735 Market, Mellon Bank Center
17 1701 Market, Six Penn Center
18 1760 Market
19 1700 Market
20 1600 Vine, Three Franklin Plaza
21 200 N 16th, One Franklin Plaza
22 1601 Cherry, Three Parkway
23 1650 Arch
24 1617 JFK Blvd, One Penn Center
25 1600 JFK Blvd, Four Penn Center
26 1635 Market
27 1601 Market
28 1650 Market, One Liberty Place
29 1600 Market, PNC Bank Bldg
30 50 South 16th, Two Liberty Place
31 1500 JFK Blvd, Two Penn Center
32 1515 Market
33 1500 Market, Centre Square West
34 1500 Market, Centre Square East
35 1 Penn Sq W, Graham Bldg
36 1525 Locust
37 200 S Broad
38 1 S Broad
39 100 Penn Sq E, Wanamaker Bldg
40 1101 Market, Aramark Tower
41 230 W Washington Square
42 190 N Independence Mall W
43 510-530 Walnut

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Real value in a changing world

Summer 2009

Perspective on a *changing* market

Philadelphia Skyline Review

Philadelphia Skyline Review

Occupied
Direct available
Sublease available
Future available (2009 - 2012)

Our Skyline Review of Philadelphia includes and analyzes the 43 Class A buildings over 100,000 square feet in the downtown Philadelphia market—the core buildings that truly move the market.

Building	Total RBA (s.f.)	Total Vacant (s.f.)
2929 Arch Cira Center	731,852	14,098
2005 Market One Commerce	942,866	75,579
2001 Market Two Commerce	1,043,098	220,480
2000 Market	666,166	168,324
1900 Market	456,922	33,930
1901 Market Blue Cross	777,906	0
130 N 18th One Logan	594,361	10,000
100 N 18th Two Logan	701,645	43,680
1880 JFK	236,956	7,139
1800 JFK	236,956	23,930
1835 Market	775,701	176,836
1801 Market Ten Penn	667,825	157,195
1818 Market	981,743	276,289
1717 Arch Bell Atlantic Tower	1,028,168	8,053
1701 JFK Comcast	1,253,876	0
1735 Market Mellon Bank	1,327,689	213,396
1701 Market Six Penn	322,317	0
1760 Market	128,128	32,272
1700 Market	841,172	204,493
1600 Vine Three Franklin	215,000	0
200 N 16th One Franklin	605,662	0
1601 Cherry Three Parkway	561,351	110,221
1650 Arch	553,349	175,000
1617 JFK One Penn	648,057	116,921
1600 JFK Four Penn	522,600	66,406
1635 Market Seven Penn	286,574	67,588
1601 Market	681,182	60,520
1650 Market One Liberty Place	1,200,000	131,886
1600 Market PNC Bank Bldg	826,731	113,473
50 South 16th Two Liberty Place	991,620	103,234
1500 JFK Two Penn	502,531	109,618
1515 Market	507,180	63,770
1500 Market Centre Square West	1,000,000	481,903
1500 Market Centre Square East	801,389	84,116
1 Penn Sq W Graham Bldg	240,634	25,288
1525 Locust	99,147	3,771
200 S Broad The Bellevue	272,793	5,888
1 S Broad	464,800	68,632
100 Penn Sq E Wanamaker Bldg	1,410,475	42,516
1101 Market Aramark Tower	632,000	25,645
230 W Washington Sq	72,000	0
190 N Independence Mall W	270,210	12,900
510-530 Walnut Penn Mutual Towers	853,840	47,440

Jones Lang LaSalle's Skyline Review analyzes 43 Class A buildings over 100,000 square feet in the Center City Philadelphia market—the core buildings that truly move the market.

The Philadelphia CBD's office market continues to see its vacancy rate increase and leasing activity slow. While asking rents continue to rise, landlords are willing to come down for actual taking deals. Fewer tenants in the market will result in negative absorption increasing.

Lease restructure

The nation's current economic situation is having a direct impact on the corporate real estate market. Relocating has become less of an option for many companies due to the cost associated with moving. Lease restructuring is a more popular alternative, which is beneficial to the tenant and the landlord.

Tenants who restructure their lease significantly and immediately reduce their rent and possibly reduce their square footage. They may also secure a tenant improvement allowance or rent abatement.

Landlords also benefit from a lease restructure because ownership is able to secure a tenant before they go out into the market. A long-term lease increases the value of the property and may enable the landlord to refinance debt on the building.

Financials in review

In a new trend, both landlords and tenants are focusing much more carefully than before on each other's respective financial strengths before completing a lease transaction. Landlords want to be confident that their up-front investment in leasehold improvements provide the anticipated rate of return via rent paid by the tenant.

On the other hand, tenants want to be as certain as possible that their landlord does not end up filing for bankruptcy or losing the property to their lender in foreclosure. Tenants also want to be assured that leasehold improvement allowances promised by the property owner in the body of the lease are actually delivered.

Capital markets

The near total absence of liquidity in the debt markets has exacerbated what would have been reduced activity to the point where there was a virtual standstill in the investment sales market in the beginning of the year. Sales transactions were down nationally by approximately 65 percent from 2007 to 2008. At least one data source has reported that activity is down an additional 85 percent year-over-year.

While the repricing of the market certainly effected velocity, many transactions have failed to close despite a motivated buyer and a motivated seller due to a lack of financing options. Financing for transactions of over $50 million is virtually non-existent. For sales of $20 million or less, bank financing, with a full or partial guarantee, is an option. However, the capital constraints in the market are such that even at these price levels it may require two or three participating banks to fund a transaction.

Philadelphia: market statistics

	Supply	Rates (average asking)	Vacancy	Vacancy (including sublease)
Overall market	44,741,007	$24.31	10.0%	12.0%
By submarket				
Market Street West	30,496,743	$25.28	10.7%	13.3%
Market Street East	8,357,143	$20.71	9.2%	10.0%
Independence Hall	5,887,121	$23.43	7.3%	8.20%

**1Q 2009 Class A & B*

Recent large leasing transactions

Location	Tenant	Square feet
1500 Spring Garden	Thomas Reuters	123,453
1600 John F Kennedy Blvd	Flaster Greenberg	26,636

Philadelphia market: rental rates / vacancy rate