



KOP Remains Crown Jewel of Development in Philly Suburbs

Although Philly's Office Vacancy Rate is Rising

Jun 30, 2016 [Matthew Rothstein, Bisnow](#)

As the second quarter of 2016 draws to a close, the Philadelphia commercial real estate market is about as healthy as could reasonably be expected.

In the year to date, about 665k SF of office space has been leased in the city, according to JLL's Philadelphia director of research, Lauren Gilchrist—not a particularly exciting number, but with leasing falling about 10% across the country in the first quarter, Philadelphia has remained true to form and avoided the wild swings of some primary markets.

“We’re not overly weighted to any one economic sector,” Lauren explains.

Vacancy rates for office buildings in the Philadelphia market are on the rise in Q2 2016, but it’s actually good news for the general health of the market.

Although the vacancy rate is set to jump from a quite healthy 9.8% to 10.5%, according to Cushman & Wakefield research manager Jared Jacobs, that increase can be almost entirely credited to the opening of the new FMC Tower (below), the second half of Cira Centre, which adds 622k SF of office space to the market. FMC will immediately occupy 250k SF of that, 100k will be occupied by UPenn, and 75k of it will be occupied by Nasdaq.

Nasdaq won’t be moving over for another year, however, which means that 75k of the official vacancy number is guaranteed to be filled. Jared calls the FMC Tower opening “very good news.”

“It’s been such a while since we’ve added any office towers here, so it’s definitely a good thing,” says Jared. With such a gap in added supply to the marketplace, increased demand from businesses trying to enter Philadelphia for the first time and a consistent drive toward renovation of Class-B office product, office rent increased 8.6% in 2015, the sharpest spike since 2008.

“Landlords have been raising their rents,” Jared says, “not only in our trophy assets, but also in the lower Class-A/top of the line Class-B buildings, just because there’s been a tightening of the market.”

Part of that tightening is due to the aforementioned new tenants, but another is the tendency over the last decade or so of landlords repositioning Class-B office into Class-A multifamily or mixed-use projects—a key contributor into keeping Philly’s vacancy rate down.

The desire to repurpose Class-B office buildings has been so strong, “it’s even spurred the de-tenanting of office buildings” to make room, Lauren says.

Although Cira Centre is on the University City side of the Schuylkill River, it shares more in common with A-level office space in Center City—so much so that C&W lumps in both towers within the Central Business District for their reports, rather than University City.

Though Penn will have a presence, the towers are certainly catering more toward business clients than the "Meds & Eds" that make up University City's backbone. There's also the fact, provided by Lauren, that the FMC Tower's rent asking price is the highest in the city.

The distinction between University City and Center City figures to get increasingly blurred over time as the Schuylkill Yards project, which "will fundamentally change the landscape of University City," Lauren says, looms in the distance.

Outside of the city proper, several positive indicators have also emerged. Brandywine Realty Trust and Liberty Property Trust have collectively sold just under 60 of their suburban buildings in the past year, according to Jared, which contributed to 2015 being the most active year in a decade in terms of suburban sales—4.8M SF traded.

In the first quarter of this year, 1.1M SF has already been sold, indicating the market is "clearly carrying the momentum over from last year," Jared says. "Over the past 12 months, there have been several Class-A assets in the Philadelphia suburbs to trade for over \$300 per SF."

King of Prussia remains the crown jewel of development in the Philly suburbs, with rent increasing about 2% from the first to second quarter this year, per Lauren. The town best known for its massive mall is making a bid to be a live/work/play community unlike any other outside the city.

But King of Prussia is not alone in being a center of activity. "Radnor continues to outperform the top submarkets in the country from the suburban perspective," Lauren says.

Whether in King of Prussia, Radnor, or other intriguing spots like Plymouth Meeting or Painter's Crossing, the formula is similar to that of downtown: renovation and upgrades of existing structures that increase tenant demand and rent prices. It's a reasonable strategy, with fewer barriers to entry for capital, and it has allowed Philly's markets to stay strong ahead of Schuylkill Yards.