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Could UCity office sale at record price spark new Philly construction?

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2.0 University Place, the year-old 98,000-square-foot office building at 30 N. 41st St. that's home to Philadelphia's federal immigration offices and other tenants, is for sale.



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2.0 University Place, the year-old 98,000-square-foot office building at 30 N. 41st St. that's home to Philadelphia's federal [immigration](http://www.philly.com/philly/blogs/inq-phillydeals/US-Immigration-moving-from-Center-City-to-West-Philly.html) (<http://www.philly.com/philly/blogs/inq-phillydeals/US-Immigration-moving-from-Center-City-to-West-Philly.html>), offices and other tenants, is For Sale by developers Scott Mazo and James Levin, of University City redeveloper Neighborhood Restorations Inc./Prime Property Management; and Thomas A. Leonard, partner at law firm Obermayer Rebmann Maxwell & Hippel and longtime Democratic fundraiser.

Asking price: \$46 million, which at around \$469/sf could make this the highest-priced office space sale to date in Philadelphia and a hopeful sign for future developers of similar projects. (Dominant Center City/UCity landlord Brandywine Realty Trust was paying [well under \\$200/sf](http://articles.philly.com/2010-08-26/business/24976411_1_brandywine-realty-trust-cira-centre-liberty-property-trust) (http://articles.philly.com/2010-08-26/business/24976411_1_brandywine-realty-trust-cira-centre-liberty-property-trust) for Center City Class A towers a few years back.) That price is \$15 million above developers' announced [\\$31 million](http://www.philly.com/philly/blogs/inq-phillydeals/Work-starts-at-West-Philly-office-building.html) (<http://www.philly.com/philly/blogs/inq-phillydeals/Work-starts-at-West-Philly-office-building.html>) construction price for the *five*-story building, which is double-LEED (<http://www.usgbc.org/leed>) Platinum-rated (inside and out) by U.S. Green Building Council standards, with a green roof and medical-grade filtered air.

The building, with its "exceptional and unique" environmental rating (for a multi-tenant building) and its location in a Keystone Opportunity state-and-local tax-break zone (easing tenant costs through 2018), has attracted interest from institutional investors, says David Dolan, broker on the sale with colleague Michael Margolis at NGKF Capital Markets. Immigration's lease has 15 years to run; the agency occupies the lower three floors. Top floor is vacant.

This was a well-timed (or lucky) project (built by Penntex Construction, lending by TD Bank): Mazo, Leonard and Levin began 2.0 University Place in the very early 2010s when city construction was still depressed; nearby Market Street is now a forest of construction cranes building housing and offices for Drexel, Penn Med and CHoP expansion.

The asking price implies a [capitalization rate](http://www.propertymetrics.com/blog/2013/06/03/cap-rate/) (<http://www.propertymetrics.com/blog/2013/06/03/cap-rate/>) below 6%, which Dolan says reflects its status as "a great new building" in a major metro market. (Low cap rate = high prices relative to rents, and a hot market.)

If Philly office prices get much above \$500/sf, will it start looking competitive to BUILD NEW OFFICE TOWERS in Center City and University City? The pending second Comcast tower, which will cost developer Liberty Property Trust [\\$900 million](http://articles.philly.com/2014-02-08/business/47129700_1_office-tower-new-tower-office-market) (http://articles.philly.com/2014-02-08/business/47129700_1_office-tower-new-tower-office-market) for 1.5 million+ sf, works out to \$600/sf for higher-end new construction. If existing buildings start to be worth nearly that much, will more tenants decide they want new digs?

Maybe so -- at least in University City, where asking rents for "Class A" (better) buildings averaged \$44.88, highest in the Philadelphia area, where the regional average is \$27.51, according to NGKF's most recent data report. Vacancy rate, at under 6%, was less than half the rate for any neighborhood in Center City (and most places in the suburbs).

Over in Center city, builders shouldn't get their hopes up, says Glenn D. Blumenfeld, of tenant brokers TactixUSA. He says 2.0 University Place "is a very unique situation, given the long term lease and the federal government credit on the largest lease."

Yes, building prices are going up: "A lot of foreign money is coming into the U.S. seeking 'safe' investments and they are buying up lots of real estate at very low cap rates." But those prices are only profitable if rents go up, too, Blumenfeld reminded me. Too bad "there are not many tenants in this market who are willing to pay \$40+/sf rents, which is what is needed to justify a new office tower."

In a posting to clients, Blumenfeld listed Center City office spaces due to go vacant over the next couple of years: at least 150,000 sf by Cigna at Two Liberty, 200,000 sf by FMC when it moves to its new headquarters, up to 500,000 sf Comcast occupies in buildings outside its headquarters that will likely be consolidated to its second tower, 200,000 sf by Sunoco as it moves to Newtown Square, 180,000 sf by BNY Mellon as it cuts employment at Mellon Bank Center, 300,000 sf at 1900 Market with Cozen O'Connor's move, not to mention the 600,000 sf still unoccupied from the former Glaxo center at Franklin Plaza when it downsized to the Navy Yard. Those blocs add up to more than 2 million square feet, or a couple of high-rise towers' worth. "As general demand continues to shrink, rents should drop," Blumenfeld predicts.

Put another way, he said: "I can't see anyone building new buildings in (Center City) without major tax breaks. With the large vacancies likely to show up in the market over the next 2-3 years, I don't think anyone is building any spec buildings that aren't in a (tax-break Keystone Opportunity Zone). You might see some single tenant buildings built for a particular company, but I'm highly doubtful that you'll see 800,000-sf office towers.

"I would imagine that the (Center City) buildings currently up for sale will be more in line with \$200/sf, which is still way below replacement cost," Blumenfeld concluded. "I don't know how you'll ever recoup your investment if you're paying over \$450/sf for a property in West Philly. It will be interesting to see what rents they get up there in 10 years."

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