STRADLEY RONON

RE Developments

A Publication of the Stradley Ronon
Real Estate Practice Group

WWW.STRADLEY.COM

FEBRUARY 2019

IN THIS ISSUE

Interview with Lauren Gilchrist....................................1

Chester-Upland Ruling May Mean Higher Tax Assessments for Pennsylvania Properties With Billboards........................... 6

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware

www.meritas.org

Our firm is a member of Meritas – a worldwide business alliance of more than 180 law offices in 86 countries, offering high-quality legal services through a closely integrated group of independent, full-service law firms.

Information contained in this publication should not be construed as legal advice or opinion or as a substitute for the advice of counsel. The enclosed materials may have been abridged from other sources. They are provided for educational and informational purposes for the use of clients and others who may be interested in the subject matter.

Copyright © 2019
Stradley Ronon Stevens & Young, LLP
All rights reserved.

Interview with Lauren Gilchrist

In early 2018, Stradley Ronon Real Estate Chair, Chris Rosenbleeth, interviewed Lauren Gilchrist, Senior Vice President of Research for JLL's Philadelphia office, who gave us her outlook for 2018. Chris sat down with Lauren again to review her 2018 predictions and give us her take on 2019.

Chris Rosenbleeth: Welcome back for Round 2.

Lauren Gilchrist: Thanks, it's good to be back.

CR: Last year, you predicted that 2018 would feel bigger than 2017. How do you think that played out?

LG: It definitely proved itself out, especially in the third quarter, in terms of the total leasing and capital markets transaction volumes. We would have had a record year in 2018 for downtown office sales had 1735 Market closed in 2018, but it was under contract as of the end of the year. Strong office leasing velocity largely results from the large-lease rollover cycle (two floors and greater) that we are in the middle of, where we have already seen about 2 million square feet of in-place leases sign and anticipate another 4 million square feet of leases projected to roll between now and 2022. This is somewhat atypical for Philadelphia and the product of deals that were done 10 years ago that are now expiring.

However, despite the fact that we have seen a massive number of square feet transact in both the leasing and capital markets, absorption remains weak. Ten years ago, office space averaged roughly 250-275 square feet per person. Office deals also were cheaper because we were in the middle of the Great Recession. Now, we are at the top of the market, and companies are implementing workplace strategies trending toward 175 square feet per person or less. That has caused weak absorption metrics despite high demand in the market overall.

Finally, when you think about the new construction environment, the Comcast Technology Center and 3675 Market Street both delivered, which is big news, and 2400 Market Street is wrapping up. We basically delivered the entire office pipeline that has been under construction. So, across all the different metrics, except for absorption, it definitely feels like one of the biggest years on record.

CR: One of the stories we hear in the office space is that, to some extent, a lot of the large leases are just tenants moving from building A to building B. Is that accurate, and what effect if any does that have long term?

LG: There's definitely movement in the market among existing in-place tenants, especially out of the South Broad Street corridor. If you look at who has exited South Broad over the past year, barring any backfilling, the vacancy rate along South Broad Street will increase to over 30 percent. The overall Q4 vacancy rate across the four Center City submarkets was 11.8

percent. That means that something's got to give. Whether that means repositioning obsolete office space to multifamily or South Broad becoming the last "cheap" place to do office deals remains to be seen. Those buildings have heavy columns, lower ceilings and challenging window lines and need capital to improve common spaces and add amenities. It makes a major difference in space utilization and total occupancy. For example, FMC is basically column-free. So, you lose a lot of space efficiency in some of the South Broad assets because of the heavy columns in those buildings.

Outmigration from South Broad is hardly a race to the bottom overall, and in most cases we're actually experiencing a flight to quality. For example, Montgomery McCracken and Wells Fargo both moved from South Broad Street into trophy assets in Market West, so they're actually paying more. What we hear from investors and tenants alike is that we have had a long-standing quality issue more than anything else, which is a "chicken or the egg" problem. Landlords were hesitant to put capital into buildings because the rents were so low and they thought, "We'll never make any return on our investment if we do that." What we are now seeing with new investors coming into the market is [the investor says], "These buildings are tired and are massively in need of improvements. So, if we put the capital into the building, can we raise the rates?" New investors in the market are reversing the cycle because they have demonstrated that, if you put the capital in [to the building], tenants will come, and if you improve the quality of the asset, the tenants will pay more.

Today, trophy office assets have a vacancy rate of about 5.6 percent. In any other market that vacancy rate would prompt the construction of a new building because that basically means there's nowhere to go in trophy office assets. When you think about large blocks – blocks of 100,000 square feet and more – for every tenant that exists today that we know is expiring over the next three years, there are 0.65 blocks available if those tenants should want to move. As a result, we'll probably see renewals or fierce competition for those large blocks, which will bid up the price of those spaces. Or we'll see new construction build-to-suits for the largest tenants. So, this "musical chairs" environment is creating what I describe as the "haves and the have-nots." The haves are the creative office buildings, the buildings that have put in the capital to make them competitive and interesting in quality, and the trophy spaces. The have-nots are the A- and B+ buildings that are vanilla and boring and have undifferentiated amenities. At the end of the day, these office landlords will need to step up their game to attract tenants that are expiring, and that certainly means a different strategy than they employed 10 years ago.

CR: Have you heard any rumblings of new office product going up? I know we've previously discussed that rent values against construction costs make it difficult to do so.

For more information, contact Christopher W. Rosenbleeth at 215.564.8051 or crosenbleeth@stradley.com.

LG: The challenge in Philadelphia is financing. [A developer] needs 50 to 60 percent pre-leasing to obtain financing for a new multitenant building. On an 850,000-square-foot building, you need, say, 500,000 feet of pre-leasing to kick the building off. In Philadelphia, the average tenant is 11,000 square feet in the CBD. You can understand why it is difficult to find that white whale willing to pay the freight of new construction as a result. A landlord therefore has to do some creative matchmaking, potentially finding two tenants that are expiring in the same time frame that want to go into a building together that are going to equal 500,000+ square feet. That is a really challenging exercise!

There are a number of different multitenant projects that are on the drawing board that are trying to attract a tenant to kick them off. There are also a number of potential single-tenant, build-to-suit projects in the market, which is where we've had some recent successes, including projects like WuXi AppTec's fourth building down at the Navy Yard. I think it's possible that we'll see a deal done for another single-tenant build-to-suit in the next 12 to 18 months. A multitenant office building is going to be tough given the sizes of the in-place tenants and the fact that the national economy is likely to turn the corner in the not-so-distant future.

CR: Other than Amazon and Comcast II, what was the biggest story (or two stories) of 2018?

LG: The Macquarie story at 100 Independence is huge. That transaction means a lot to the market for many different reasons. First, it represents a professional, client-facing financial services firm moving to Market East, which is significant because Market East was the redheaded stepchild submarket, so to speak, for so long. That narrative has changed today because talent is the single most important factor in choosing an office location, and one of the wealthiest residential pockets of Philadelphia is directly to the south [Society Hill]. A company can differentiate based on its location as well as the aesthetics of the office space. Today, it makes sense to pay a little bit more for your real estate or to be in a slightly different location if you can attract talent. The fact that Macquarie believes in that location and that asset and what they might achieve there, I think, is a huge story for the trajectory of Market East. We saw The Bourse open at the end of 2018, which provides a vital

© 2019 Stradley Ronon Stevens & Young, LLP

food amenity for office workers. We continue to see developers penciling projects for hotels and multifamily in that area. So, I think Market East is going to continue to shine because new sources of capital have finally been able to figure the submarket out, and it's only going to continue because there's funky, cool real estate over there. Macquarie is a bellwether of things to come. That would be my biggest story of the year.

CR: Let's talk about opportunity zones. My feeling is that everybody is really excited about them but not entirely sure why or what they're excited about. From a development standpoint, I see some headwinds there, so I'm curious to get your thoughts.

LG: I'm seeing a lot of press and not a ton of action. This whole initiative was started as a way to incentivize the development of more affordable housing. In Philadelphia, we have 82 census tracts that met opportunity zone standards and were designated. But it's important to remember that the statistical thresholds were based on the 2010 Census. So if you think about that, that data is almost 10 years old and indicative of mid-recession market conditions, right? This is why you see places like Schuylkill Yards and the eastern edge of University City being designated an opportunity zone even though, today, it doesn't make a whole lot of sense from a market perspective.

Fundamentally, a couple of things are happening. First, the IRS has not provided sufficient guidance in order to make investors comfortable and confident in the risk that they are taking in these areas, which are not entirely but largely untested from a market perspective. Second, the current regulations are very, very strict in terms of the timeline [for acquisition dates and hold periods]. Seven to 10 years is a long hold period. You have to do substantial improvements within 30 months of acquisition. These circumstances are very difficult for a lot of developers to get their hands around because they need to raise a fund, acquire and substantially improve within less than three years. A new commercial building in Philadelphia takes about three years to construct from design through opening – on a pretty aggressive timetable. So, now we're talking about smaller buildings simply because we can't get [larger buildings] done in that amount of time. On top of that, there are very specific requirements for the structure of the funds themselves and what those funds can be invested in. So, [a developer is] raising the fund, trying to get construction underway, in this certain small window of time, and has a long hold. Taken together, this means we'll likely only see activity from extraordinarily nimble capital sources that have shovel-ready projects. Otherwise, they're going to miss the markers in the legislation as it exists today. With the recent government shutdown, it is unlikely that the IRS will revise and clarify these rules anytime soon.

CR: Right; in my mind, the headwind is the hold period. If all the other things you mentioned are met, finding a developer or equity source who wants to put capital into a project and have it sit there for 10 years is going to be … not impossible but a very small subset.

LG: Right – family money and extremely flexible private equity. Even in the traditional office market, most people will underwrite a hold of five to seven years. I've heard of a couple of groups that would underwrite a hold of 10 years. Ten years in the real estate world is bordering on forever! So, there's interest, and I think smart people with very nimble capital will get in on the opportunity zone game. But I don't ultimately think the incentive is going to be game-changing.

CR: Last year, we talked about the multifamily deliveries coming in 2018 and the fact that following that there was almost nothing in the pipeline. I think that's largely still true. First, did everything deliver? What is in your crystal ball for 2019 and 2020? What are your thoughts generally on where we are in that cycle – where we are on your "clock"?

LG: We definitely have seen some of the new deliveries [scheduled for 2018] push into 2019 as a result of construction delays, which frequently occurs. Still, 2018 was the biggest year on record for multifamily in this market cycle. Shortly after you and I talked last year, I sat down with my team and we looked at where we had been historically from an absorption perspective, where we were from a delivery perspective for new product in 2018 and what was still left over from 2017 to lease. Looking at all those factors, I projected that we had about a 2.5 year "oversupply" of multifamily. This time last year I was saying, "This is the end of the cycle; we are going to see concessions ramp up massively, we are going to see the pipeline shut down, we are never going to see a multifamily building until we correct, etc."

Well, the concession piece of that was true. Halfway into 2018, we saw concessions bump from a standard of one month on a 13-month lease to two to three months on a 14- to 15-month lease. And I thought, "Here it is; we've tipped over and gone into tenant-favorable conditions." However, toward the end of the year, I thought, "Let's take these numbers back out again, let's look at the absorption for the past year, let's see what's happening."

Despite all of those headwinds, we had the biggest year for multifamily absorption in Center City on record in the competitive set that we track, totaling 1,500 units. At the end of the year, newly delivered multifamily was up to about 82 percent occupancy overall, whereas at the beginning of the year new product was 52 percent occupied. Those are pretty significant numbers and the result of, I think, the fact that we didn't have institutional-quality, new multifamily product deliver in the city for over 25 years. We saw a lot of people trading up and a lot of new residents in Center City. For these reasons, I think the multifamily market still has some room to run.

© 2019 Stradley Ronon Stevens & Young, LLP

CR: You and I talked a lot throughout 2018 about City Council. City Council threw the whole real estate community a couple of curveballs coming out of 2017 and into 2018. Largely, those were mitigated, but they are still on the horizon. What can we expect out of City Council this year and to what effect?

LG: The interesting thing about 2018 was that the curveballs came in many different forms. The thing to watch in 2019 is going to be the conversation around the 10-year tax abatement. In a lot of ways, the abatement conversation is what precipitated the curveballs in 2018. In 2019, we've already seen a strong political will to curtail or eliminate the 10-year tax abatement now that many have positioned this issue as one of Center City versus the rest of Philadelphia, or as a "tale of two cities." As a result, many people perceive the abatement as a subsidy to line the pockets of developers.

The fact of the matter is that the 10-year tax abatement is the most important piece of public policy that has enabled investment in real estate in Philadelphia over the course of the past two decades. It is often the difference between a go and no-go in the underwriting of a massive renovation or certainly a ground-up construction project. The rhetoric around the 10-year tax abatement is problematic because it fails to characterize accurately the financial conditions that we face – namely, New York construction costs with Baltimore rents. We have Baltimore rents as a result of all the other taxes that we levy on businesses in Philadelphia that reduce demand for locating here, and businesses think about taxes and occupancy costs holistically. It's all part of the cost of doing business. So, the rents are too low because the demand from business is too low, and the business taxes and construction costs are too high. It's a vicious cycle.

One of the things I try to impress upon people is that we are in an international capital market environment, and capital can be allocated to any type of investment, to any geographic location, based on projected returns and risk tolerance. The return on a real estate project – depending on the metrics you use – is somewhere between 10 and 12 percent. It is far less difficult, far less risky and far more certain to put your money in an index fund with the S&P 500 for about the same return and call it a day. If we want to see new buildings constructed in Philadelphia, we have to think about how we can make it advantageous to those capital sources to take on the risk of building a new building or doing massive improvements to an existing structure. The 10-year tax abatement is one of the tools in the tool belt that has made capital sources want to invest in Philadelphia.

In addition, what some fail to recognize is that the abatement doesn't choose where it goes. The 10-year tax abatement legislation doesn't say, "I like Center City and don't like the rest of Philadelphia." The 10-year tax abatement corrects for a market failure to provide adequate office, residential and retail product where the demand already exists. When the demand doesn't exist, it doesn't matter how much money you throw at a project, it's not going to be constructed because the rents won't support the needed return. In certain sections of the city where there hasn't been a new-construction housing, office or retail project, it isn't that the capital providers say, "Oh, we don't like [that neighborhood]"; it's that they can't achieve a reasonable return given the level of risk of developing that project, because the demand is not there and therefore the rents are even lower than what we see in Center City. So, that is my message to City Council, the public policy community and the real estate community on this issue. We are likely to experience a really strong challenge in at least curtailing the abatement in some way – geographically, the length of time, asset class or residential versus commercial. I have heard a number of developers say that their estimates suggest that if the abatement gets to be less than six years, that will effectively prevent any new construction. However, I don't think that the profit margins are so wide that we are in any position to be thinking about curtailing it at all unless we want to halt an already dwindling construction pipeline completely.

With regard to the other policy considerations on the table, I don't hear anything about reviving the construction impact tax. What's going to be very interesting over the next three to six months is to watch people wake up to higher tax bills. For example, on the office properties that we track in the trophy and Class A space, we saw an average assessed value increase of 38 percent [over two years]. On multifamily, we saw an increase of 66 percent over that same period. On the office side, these increases drive increases in use and occupancy tax as well. Because owners and tenants haven't paid these bills yet, I don't think the reality of the assessments being a functional tax increase has completely set in. The net effect is a de facto tax rate increase on top of an extremely high cost of doing business. I think there's a lot more to come on that assessment piece.

CR: I think we have spoken about this before: My theory is that part of the run-up in jobs, wages, housing, construction, etc., in places like New York, Boston and, say, San Francisco (although there's more tech involved there), is the run-up in those places of the financial services, hedge funds, venture capital and private equity industries. If I thought about it hard enough, I could probably count and name the dozen or so private equity funds in the Greater Philadelphia area. Meanwhile, there's probably 10 fund managers in any building in certain pockets of New York. I would be curious to see if the city, for example, alleviated the use and occupancy tax or gave an exemption to funds, whether you would see things pick up here in a greater way. You could have new jobs not only for those with higher degrees but also for secretaries, other office workers, mass transit workers, all these kind of things that are tangible.

© 2019 Stradley Ronon Stevens & Young, LLP

LG: Well, we don't have a true economic development agenda. Instead, [the city] had a decline-management agenda for a long time, and the market has now moderately turned. Now, [the city] is effectively debating a "growth management" agenda, but we haven't actually experienced real growth. When I think about the question that you're posing about private equity, the really striking thing is that New York and San Francisco, for example, are net importers of capital. They get international capital not just in real estate but coming into private equity funds and all types of other investment vehicles that help to grow the local pie. In Philadelphia, we are not a net importer of capital; we are a recycler of capital. The dollars that we have here are perpetually recycled among the businesses here. If you think about the fact that we have pretty strong legal and accounting sectors, those legal and accounting sectors are for the most part serving the existing company base that is here and recycling the existing dollars that are made here. While Comcast is clearly a new generator of capital for Philadelphia, they are only one company. That dearth of large corporate headquarters also means that we don't have more C-suite executives here that are investing personally and philanthropically. We don't have as many companies located here to sell to corporate conglomerates. We've seen a little of that percolating with Comcast II, especially as a function of the fact that it's their innovation center, but until we see more headquarters of size, I think that we're going to continue to struggle importing capital.

CR: You were recently named President of NAIOP of Greater Philadelphia and started your term Jan. 1. Can you talk about your goals and where you see the industry being over that period, and can we blame you if the recession hits?

LG: The recession is coming … "Winter is coming," right? It's just a question of when. We are always later to that game in Philadelphia than other parts of the country. I don't think this recession will be as deep and as prolonged [as 2008-10], so I'll start by saying that.

For NAIOP, I'm very excited to take on this role because there is so much opportunity to be a force for good in the commercial real estate community. My first focus is our advocacy agenda. We want to make sure the commercial real estate community has a voice at the table in key policy decisions. I want to do that in a proactive and inclusive way, and focusing on that over the next 12 months will be a big part of my presidency, especially regarding the 10-year tax abatement. Hopefully, I can educate others on the implications of this decision for the investor community and the broader public.

Second, diversity, inclusion and bringing up the next generation of leaders in the business are critical to the mission of our organization and also to the long-term success of the real estate community in Philadelphia. The Greater Philadelphia Chapter of NAIOP started focusing on this under [immediate past President] Mark Seltzer, and we will continue this effort and expand it. It is no surprise to anybody who spends time in this industry that it is predominantly white and male. One initiative in which we were very involved in 2018 was the Nexus program, which is the summer program for high-achieving students of color in high school, to expose them to careers in the industry before they ever make it into college. I didn't know anything about commercial real estate until I started in the business about four years ago. I certainly had no idea when I was in high school or college about all the viable career opportunities. This issue is important from a social perspective but also because the clients of our businesses are increasingly diverse and need to be able to see decision-makers and experts across the table that reflect that diversity. This issue is systemic and will take a generation or more to fix, but we want to be a part of that change in Philadelphia and feel that our program is a necessary first step.

We also have a strong Developing Leaders program, and my colleague Ryan Cottone is the president of our Developing Leaders board. Our mentorship program is for individuals under the age of 35, intended to expose them to other leaders in the business. We feel that mentoring is a part of our obligation to the next generation of leaders. It's also a way to get younger people involved in our mission and activities. We're about to announce our next class of developing leaders.

A lot of people have said to me, what does my presidency mean? What do I want to do with it? I feel very lucky to have a board that espouses the same business values that I do, is not afraid to talk about them and puts their faith in leaders that are representative of these values. Our president-elect, Joe Ritchie from Brandywine Realty Trust, and I are reflective of these values. He will take over in 2021 when I will probably have a lot more gray hair than I do now. We're having a moment as an industry and as a city, and this opportunity is ours to use or lose. I intend to use the time to leave the industry and the city better than I found it.

CR: Do you have one or two predictions you want to make for 2019 that we …

LG: … can talk about in 2020? [Laughs.]

CR: Right!

LG: I think by the middle of next year the national economy will have experienced a recession. Recession is typically defined as two consecutive quarters of negative GDP growth. National politics have injected a lot of uncertainty into the market but, more than that, the labor market will continue to remain a massive drag on the ability of the economy to grow. That is a structural thing that we can't do anything about because a person must be roughly 18-22 before entering

© 2019 Stradley Ronon Stevens & Young, LLP

the labor force. That's a defined pool of people already, and Generation Z is smaller than the millennial cohort. At some stage that will put a drag on the economy and the ability of companies to grow because [companies] will not be able to fill seats or will have to pay so much to do so that it will have a net negative impact on the bottom line. So, I think the national economy has to flip a little bit here.

In Philadelphia, we typically are behind the rest of the country as a function of the highly diversified nature of our economy; thus, we never see the high highs, and we also don't see the low lows. We haven't had the high highs of finance and tech in this cycle; therefore, when we do shed jobs [in Philadelphia], we will not shed as large of a percentage of overall economic activity. What's good for us is that we have done a lot to shore up the fundamentals of the real estate market over the past cycle, which is to say we have finally seen capital improvements in outdated assets and some new construction, and we have changed the dialogue around the city as a place to do business and as a place to visit.

So, I predict that this time next year we will be in, or close to, a recession nationally, and Philadelphia will soon follow thereafter. But I also think that we will weather the recession well and, when we come back on the other side, we stand a fighting chance of leading the way. We are not super expensive, we have people who want to live here, the fundamentals never got out of whack and banks have been conservative. I've been saying to potential investors over the past couple of weeks that Philly is a good place to weather a recession. This is a good place to put some capital given all the improvements we've made in the past cycle and considering that New York and San Francisco are going to take a bit of a nose dive. So, my bold prediction for Philadelphia is that coming out of the next recession, we will be leading the way. I hope to help make it so. ■

About Lauren Gilchrist

Lauren Gilchrist is Senior Vice President, Senior Director of Research for JLL in Philadelphia, where she directs JLL's local market research platform for the region. Lauren's specialties include urban and regional economics and demography. Prior to joining JLL, Lauren served as the Manager of Research & Analysis at the Center City District in Philadelphia, where she directed the organization's market and public policy research. Lauren received her MS in Public Policy and Management with concentrations in Urban and Regional Economic Development and International Trade and Development from Carnegie Mellon University's Heinz College and a BS in Business Administration from Bucknell University. She serves as the President of the Greater Philadelphia Chapter of NAIOP; on the Board of Directors for the Old City Community Fund; on the Working Group for City of Philadelphia's Global Identity Initiative; on the Affordable Housing Committee for the Building Industry Association; and on the Advisory Board for Temple University's Professional Science Master's in GIS. Lauren frequently lectures on topics related to commercial real estate and economic development for institutions including the Appraisal Institute, Building Industry Association, Carnegie Mellon University, Center City Proprietors Association, Chester County Chamber of Business & Industry, CoreNet, Economy League of Greater Philadelphia, Federal Reserve Bank of Philadelphia, International Council of Shopping Centers, International Downtown Association, PA Bar Institute, Philadelphia City Planning Commission, SIOR, Temple University, ULI, University of Pennsylvania, and U.S. Census Bureau. Lauren has had recent work cited in The Wall Street Journal, The New York Times, Globe Street, and NBC10, among other outlets. She was named a Philadelphia Business Journal "40 Under 40 Honoree" in 2016.

Chester-Upland Ruling May Mean Higher Tax Assessments for Pennsylvania Properties With Billboards

By Kevin R. Boyle and Tyler W. Mullen

In a case decided Dec. 27, 2018, I*n re: Consolidated Appeals for Chester-Upland School District,* 2018 WL 6797482 (Pa. Cmwlth. 2018), the Commonwealth Court of Pennsylvania addressed the question of whether revenue generated from billboard leases, rents or easements may be considered when determining a property's fair market value for tax assessment purposes. After examining the Consolidated County Assessment Law (CCAL), 53 Pa. C.S. § 8801, et seq., the Commonwealth Court concluded that "a property's suitability to a billboard use and income earned by the property owner from the rental of the property to a billboard operator are not excluded from a fair market valuation." Said another way, the *Chester-Upland* opinion makes clear that the revenue generated by a property owner from a billboard lease may be considered for tax assessment purposes.

The facts giving rise to the *Chester-Upland* case involve a number of real estate tax assessment appeals originating in Delaware County. A few years before the Commonwealth Court's decision, Chester-Upland School District and Chichester School District (together, the School Districts) increased assessments for 26 properties containing billboards located within their respective taxing jurisdictions for tax years 2015 and 2016. The increased assessments were subsequently appealed, and the appeals later consolidated into a single case heard by the Court of Common Pleas of Delaware County (Trial Court).

© 2019 Stradley Ronon Stevens & Young, LLP

In an April 27, 2017 order, the Trial Court denied the School Districts' attempts to increase the assessments, stating that "a taxing authority may NOT use the presence or existence of [a billboard] thereon to increase a property's real estate tax basis or assessment based upon a claim of increased fair market value." In the *Chester-Upland* decision, the Commonwealth Court disagreed with the Trial Court's holding, and more specifically the Trial Court's interpretation of the CCAL as related to a billboard-centric exemption contained in Section 8811(b)(4) thereof.

The CCAL provides statutory authority to municipal bodies located in Class 2A – Class 8 counties to impose real estate taxes. The baseline rule set by the CCAL is that all real estate is taxable, but Section 8811(b) provides a list of exceptions to the baseline rule. With respect to billboards, Section 8811(b)(4) provides that:

> No sign or sign structure primarily used to support or display a sign shall be assessed as real property by a county for purposes of the taxation of real property by the county or a political subdivision located within the county or by a municipality located within the county authorized to assess real property for purposes of taxation, regardless of whether the sign or sign structure has become affixed to the real estate.

According to the *Chester-Upland* opinion, the Trial Court erroneously interpreted Section 8811(b)(4), creating too broad an exclusion for billboards not supported by the statutory text. In particular, the Commonwealth Court opined that the Trial Court failed to distinguish physical billboard structures, which are properly excluded from assessment under Section 8811(b), from the revenue a property owner may generate via-a-vis a billboard lease or a property's potentially increased value as a prime billboard location. The Commonwealth Court stated that there is "no justification in the text of Section 8811 for the Trial Court's holding that a valuation of the real property cannot consider the effect of a lease of the property to a billboard operator or a property's suitability for a billboard use."

Prior to the *Chester-Upland* decision, taxing authorities may have disregarded not only the physical billboards themselves when calculating a property's fair market value, but also any benefits a property owner could realize from such billboards (i.e., lease revenues). The *Chester-Upland* holding, however, clearly opens the door for taxing authorities to increase property assessments on parcels containing billboards based on the revenue such billboards may generate. Properties with billboards in Class 2A – Class 8 counties could experience rising assessments as taxing authorities become aware of the *Chester-Upland* ruling. One important point, however, is that because the CCAL applies only to Class 2A – Class 8 counties, the effect of *Chester-Upland* on Philadelphia and Allegheny counties remains unclear. Taxing authorities in any county could use the *Chester-Upland* rationale as a foundation for creative (potentially aggressive) arguments connecting income generated from a property to the property's assessed value, or to attack similar exemptions such as those for amusement park rides and greenhouses.

The *Chester-Upland* ruling is certainly a potential boon for many taxing authorities that have recently been pursuing aggressive and creative methods to increase their tax bases. Given the impact *Chester-Upland* could have in the local billboard industry, a further appeal would not be surprising, especially because the Commonwealth Court acknowledged "valid concerns" raised by the taxpayers. In any event, property owners (and billboard companies) surely will be waiting to see whether the *Chester-Upland* decision is appealed to the Pennsylvania Supreme Court and whether that court agrees to hear the appeal. ■

For more information, contact Kevin R. Boyle at 215.564.8708 or kboyle@stradley.com.

© 2019 Stradley Ronon Stevens & Young, LLP