The General Assembly Convenes for the 2018 Session

By: Bruce A. Johnson, Founding Partner, Capstan Tax Strategies
   Toby Burke, Senior Director of State and Local Affairs, NAIOP

State lawmakers returned to Harrisburg on January 2nd to begin the 2018 session following a contentious and controversial budget battle last year between the Governor and the General Assembly. It is still too early in the new session to see if there is lingering tension between the Democratic Governor and the Republican-controlled legislature that may hinder the passage of legislation in addressing state issues. On top of any potential tension between the legislative and executive branches of government, it is also an election year. Governor Wolf addressed the General Assembly on February 6th and revealed the highlights of his proposed 2018 state budget.

Governor Wolf’s budget would boost spending by about $1 billion, or 3 percent, to $33 billion for the fiscal year beginning July 1. The higher spending would go toward public schools, skills training, pension obligations, prison costs and social services for children, the elderly, and people with disabilities.

The proposed budget would rely on money from a new Marcellus Shale tax and savings in human services programs secondary to a minimum wage increase to $12/hr, up from the federal minimum of $7.25. The budget also reflects a large anticipated expansion in lottery gaming revenues.

The Governor’s administration otherwise expects no deficit next year, despite some independent projections of a gap.

Irrespective of this, the NAIOP Chapter will monitor legislative activities in Harrisburg to ensure the interests of our members and the commercial real estate industry are taken into consideration during the policymaking process. This will include an Advocacy Day at the state capital to support legislative efforts to spur economic development and job creation, such as continued funding for economic incentives (Pennsylvania First), along with more transparency and consistency in the application of state regulations.

Philadelphia’s Inclusionary Zoning Proposal On the Move

By: Bruce A. Johnson, Founding Partner, Capstan Tax Strategies
   Toby Burke, Senior Director of State and Local Affairs, NAIOP

Philadelphia’s City Council is set to vote on Councilwoman Quinones Sanchez’s bill that would require new housing projects of 10 units or more to set aside 10% of the units for affordable housing. Bill 170678, as amended, was voted out of the Committee on Rules and sent back to City Council on December 5, 2017 where it was placed on the calendar for its second reading. Currently, the bill has been slated for City Council review several times this past February, but has yet to be voted upon.

Upcoming Events

- **March 23**: Federal Tax Reform
  Haworth Showroom, Philadelphia, PA
- **April 10**: Developing Leaders Mentorship Program, Session 3
  Schuylkill Yards, Philadelphia, PA
- **April 17**: Battle of the Bands
  The Fillmore, Philadelphia, PA
- **May 1-3**: National Forums Symposium
  New York City, New York
- **June 7-8**: I.CON’18 The Industrial Conference
  Jersey City, New Jersey
- **July 30**: Annual Golf Outing
  Philadelphia Cricket Club, Flourtown, PA

Visit the events section of our website for more information and to register.
President’s Message

Dear Chapter Member:

Thank you for making our 2017 a successful year for NAIOP of Greater Philadelphia. I’m pleased to report that our Chapter’s growth, financial stability, and focus on value to our members resulted in winning NAIOP’s National Award for Membership. We are thrilled with this achievement and look forward to building on our Chapter’s successes to further enhance the experience for you, our members.

In 2018, we plan to bring more diversity in programming through new venues and unique networking opportunities. The year got off to a great start, as several of our members attended the Chapter Leadership & Legislative Retreat (CLLR) in Washington, DC. CLLR included a trip to Capitol Hill to meet with our elected officials and promote NAIOP’s agenda. NAIOP’s 3 priority issues for 2018 include (1) Infrastructure and Transportation, (2) Capital and Credit Availability, and (3) Environment and Energy Efficiency.

Upcoming events planned through July 2018 include a panel discussion on Tax Reform (March 23), Battle of the Bands (April 17), annual golf outing (July 30), the Developing Leaders Mentorship program (ongoing), and several other educational and networking events to be announced.

It is all of our committed members that help make the Philadelphia Chapter successful. On behalf of the Chapter’s Board of Directors, we look forward to working together to make 2018 another successful year.

Yours truly,

Mark Seltzer
President,
NAIOP Greater Philadelphia Chapter
Vice President, Liberty Property Trust
On December 22, President Donald Trump signed the Tax Cuts and Jobs Act of 2017. It’s the first sweeping federal tax reform bill since the Reagan administration.

The new law contains a number of important reforms, as well as left in place many provisions that are important to commercial real estate. Relevant items to commercial real estate:

- **Slashes the corporate tax rate from 35 percent to 21 percent,** and also eliminated the corporate Alternative Minimum Tax.

- **Preserves 1031 Like-Kind exchanges** for real estate but not for personal property.

- **Maintains the tax treatment of carried interest for real estate,** as long as the asset is held for three years.

- **Retains the full deductibility of interest payments** for real estate businesses. Such businesses will be required to abide by modified cost recovery rules.

- **Improves the tax treatment of Pass-through businesses.** Such businesses will now pay a top individual rate of 37 percent (reduced from the current 39.6 percent), and pass-through business income will be eligible for a 20 percent deduction. Combined, these provisions yield an effective top rate of 29.6 percent on business income, a 10-point reduction of the current top rate.

- **100% bonus rules until the end of 2022.** In addition, this also could apply for assets placed into service starting 9/28/17. Another big change is that used assets can now be eligible for bonus treatment. Additionally, bonus will also continue through 2026, but will decrease 20% in total value each year.

- **Section 179 expensing** - the annual limit has been raised to $1M, and now includes HVAC, fire/safety, roof and security system assets.

- **Qualified Improvement Property** - first instituted as part of the PATH Act of 2015, this useful tool for commercial real estate has been modified to be 15-year SL depreciation, and is applicable for bonus treatment. In addition, QIP now incorporates and replaces the previous qualified leasehold improvement tools including qualified retail and qualified restaurant property. This change came into effect 1/1/18.

- **MACRS rules held in place**

- **Preserves New Markets Tax Credits,** which had been targeted for elimination in early drafts of the bill.

- **Retains the Historic Tax Credit,** which had been eliminated in prior drafts of the bill. The HTC is now spread out over five years.

Enacting pro-growth tax reform has been a priority for NAIOP for many years. “A landlord can only do as well as his or her tenants,” NAIOP President and CEO Thomas Bisacquino says. “Our expectation is that this tax reform legislation results in long-term economic growth and job creation for our nation.”

The NAIOP Greater Philadelphia Chapter is hosting an event on Friday, March 23, that will provide commentary and details on just how this very complex law will be affecting the commercial real estate community.

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**Annual Golf Outing**  
July 30, 2018  
Philadelphia Cricket Club  
6025 West Valley Green Road  
Flourtown, PA 19031

Outing will feature two 18-hole courses, golf clinic, and new this year a tennis tournament. For more information, contact Valery Koontz, at vkoontz@naiop philadelphia.org
Waters of the U.S.: A Definition in Flux

By: Donald Brickner, Senior Environmental Scientist, Director of Environmental Permitting, Marathon Engineering & Environmental Services, Inc.
Chanelle Hurst, Development Assistant, Liberty Property Trust

If you need a permit from the U.S. Army Corps of Engineers (USACE) Regulatory Program, then you should understand the term “waters of the United States” (WOTUS). At the federal level, WOTUS are regulated under the Clean Water Act (33 U.S.C. 1251 et seq.), which establishes the basic structure for regulating discharges of pollutants into WOTUS and regulating quality standards for surface waters. Per the currently effective definition [40 CFR 230.3], WOTUS include the following, among other related features:

1. All waters which are currently used, or were used in the past, or may be susceptible to use in interstate or foreign commerce, including all waters which are subject to the ebb and flow of the tide.

2. All interstate waters, including interstate wetlands.

3. All other waters such as intrastate lakes, rivers, streams (including intermittent streams), mudflats, sandflats, wetlands, sloughs, prairie potholes, wet meadows, playa lakes, or natural ponds, the use, degradation, or destruction of which could affect interstate or foreign commerce.

The definition of WOTUS has been closely scrutinized by the federal courts, most notably in the 2001 “SWANCC” case (Solid Waste Agency of Northern Cook County v. U.S. Army Corps of Engineers, 531 U.S. 159) and 2006 Rapanos case (Rapanos v. United States, 547 U.S. 715), and is currently being evaluated for amendment as part of a two-step rulemaking process ordered by the Trump Administration. Simply put, the primary question surrounding the WOTUS definition has been and remains: how far “upstream” should federal jurisdiction extend?

Adopted in 2015 under the Obama Administration and effective as of August 28, 2015, the Clean Water Rule (80 FR 37054) was intended to clarify and refine the definition of WOTUS. However, in October 2015, the 2015 Clean Water Rule was stayed by the U.S. Court of Appeals for the Sixth Circuit; consequently, the former WOTUS definition became effective again and remains effective today. For the current status of the stay by the U.S. Court of Appeals, see below regarding the U.S. Supreme Court ruling on January 22, 2018.

Pursuant to an Executive Order by President Trump dated February 28, 2017, the Environmental Protection Agency (EPA) and USACE are now undertaking a two-step rulemaking process to rescind the 2015 Clean Water Rule and revise the definition of WOTUS. Section 1 of President Trump’s Executive Order states, “It is in the national interest to ensure that the Nation’s navigable waters are kept free from pollution, while at the same time promoting economic growth, minimizing regulatory uncertainty, and showing due regard for the roles of the Congress and the States under the Constitution.”

Step 1: On June 27, 2017, the EPA and USACE initiated Step 1 of the process by signing a proposed rule that would rescind the 2015 Clean Water Rule and recodify the identical regulatory text regarding WOTUS that was effective prior to the 2015 enactment of the Clean Water Rule (the pre-existing regulatory definition is currently effective in accordance with the rule published on February 6, 2018, as explained below).

Step 2: The second step is a rulemaking process, which included a public comment period through November 28, 2017, to re-evaluate the definition of WOTUS and produce a revised definition, with consideration to the Justice Antonin Scalia’s plurality opinion in Rapanos v. United States, 547 U.S. 715 (2006) (see below). The deadline for public comments was November 28, 2017.

On January 22, 2018, the U.S. Supreme Court ruled that challenges to the WOTUS rule fall under the jurisdiction of the district courts rather than the U.S. Court of Appeals. This ruling presents a procedural hurdle to the Trump Administration’s efforts to repeal and replace the 2015 Clean Water Rule. In response to this Supreme Court ruling, it is expected that the Sixth Circuit will lift the stay it imposed in October 2015, causing the 2015 Clean Water Rule to become effective again in most of the country unless a district court agrees to issue a nationwide injunction.

On February 6, 2018, the EPA and USACE adopted another rule that added an applicability, or effective, date to the 2015 Clean Water Rule of February 6, 2020. Given uncertainty about litigation in multiple district courts over the 2015 Clean Water Rule, this rule serves to maintain the legal status quo by directing the agencies to implement the regulatory definition of WOTUS that existed prior to the 2015 Clean Water Rule during the ongoing rulemaking process. The stated purpose of this rule is to create regulatory certainty and consistency for the regulated community.

As of February 2018, the EPA and USACE are working to review the stakeholder comments received during the Step 2 outreach process. Thereafter, the agencies plan to propose a new, narrower definition of WOTUS that would replace the approach in the 2015 Clean Water Rule, taking into consideration the principles that Justice Scalia outlined in the Rapanos plurality opinion.
Justice Scalia’s opinion considers Clean Water Act jurisdiction as including relatively permanent waters (i.e., features with year-round flow or continuous flow at least seasonally) and wetlands with a “continuous surface connection” to relatively permanent waters. A definition of WOTUS based on the Justice Scalia Opinion would exclude certain tributary wetlands that are currently regulated under the Clean Water Act, as well as those with a significant nexus to primary waters that would be regulated under the 2015 Clean Water Rule. Most environmental groups object to a narrower definition of WOTUS based on Justice Scalia’s plurality opinion and support the definition of WOTUS in the 2015 Clean Water Rule, which includes headwaters, tributaries, and wetlands with a significant nexus to primary waters, even if they do not exhibit a “continuous surface connection” to primary waters. The claim is that, even in the absence of a “continuous surface connection,” headwaters, tributaries, and wetlands serve an important role in protecting the quality of downstream primary waters (i.e., traditional navigable waters, interstate waters, and the territorial sea).

For those involved in real estate and land development (members of the regulated community), this is an important topic to follow because the definition of WOTUS affects what types of wetlands and watercourses are regulated by the federal government, and thus the level of complexity of environmental regulation to which your project may be subject. Should the filling of a headwater ditch, artificial lagoon, or isolated wetland require a permit from the U.S. Army Corps of Engineers? That is determined by the regulatory definition of WOTUS, which is currently under debate. The next opportunity for the public to provide comments should be when the USACE and EPA propose a new definition of WOTUS in the Federal Register, the date of which is unknown at this time.

In addition, budgetary issues may resurface – new taxes and fees implemented to bolster the state’s fiscal condition may have an impact on commercial real estate. Pennsylvania does not automatically conform to the federal tax code, so the influence of federal tax reform on state revenues and the budget has yet to be determined. However, there is one area of legislation where NAIOP members are eager to see conformity with the federal tax code. Pennsylvania is the only state in the country that does not recognize 1031-exchanges within its tax code. Legislators need to change this.

The Chapter places a critical role in representing commercial real estate before policymakers and will keep you informed on the legislative activities in the General Assembly and across eastern Pennsylvania.

The proposed bill was amended to address concerns raised during a public hearing on November 27, 2017 by the Committee on Rules that included testimony from the development community, affordable housing community and other interested groups. The amended version, as it currently stands, maintains the 10% set-aside for affordable housing in exchange for a density bonus or a payment in lieu into the city’s housing trust fund. The amended version narrows the application of the zoning ordinance to areas within City Center, University City, and other high density zoning districts.

NAIOP, both locally and nationally, recognize that many issues impact housing affordability, which needs a comprehensive solution. The issue of inclusionary zoning nationally raises concerns that a mandated inclusionary zoning ordinance will discourage new housing projects and only add to, not solve, major urban centers housing problems. Locally, Philadelphia’s construction costs are already amongst the highest in the nation, often requiring residential rents of approximately $3.50 per square foot per month for new mid- and high-rise construction to obtain market financing and justify the cost to build. While Center City residential housing has become more expensive during this market cycle, Philadelphia, remains one of the most affordable costs for housing among large cities nationwide.

It is anticipated that Council will continue to work through an Inclusionary Zoning bill in some format, whether this bill or another method to achieve a similar outcome. The development community, along with NAIOP, is continues to offer input to ensure the legislation will foster positive results for its intended goal, while not having a materially punitive effect whereby halting future residential development. Others factors being considered as relevant discussions topics of the impact of the comprehensive reassessment of commercial properties and the outcome of the ongoing discussion to extend the 10 year tax abatement.

Please stay tuned for additional information and interested parties should reach out to the NAIOP Board of Directors for additional information.
Chapter Merit Award for Membership

Board Members from NAIOP of Greater Philadelphia accepting the Chapter Merit Award for Membership at the Chapter Leadership and Legislative Retreat in Washington DC on February 6

Click here to see the Sponsorship Opportunities, contact Val Koontz if interested.