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USA Regional Real Estate

Pennsylvania

Hangley Aronchick Segal Pudlin & Schiller

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PENNSYLVANIA

LAW AND PRACTICE:

p.3

Contributed by Hangley Aronchick Segal Pudlin & Schiller

The 'Law & Practice' sections provide easily accessible information on navigating the legal system when conducting business in the jurisdiction. Leading lawyers explain local law and practice at key transactional stages and for crucial aspects of doing business.

Law and Practice

Contributed by Hangley Aronchick Segal Pudlin & Schiller

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Hangley Aronchick Segal Pudlin & Schiller has offices with a strong real estate presence in Philadelphia, Pennsylvania, and Cherry Hill, New Jersey. Its real estate team work collaboratively with attorneys from many of the firm's other practices, including corporate law, commercial litigation, environmental law and bankruptcy. Key practice areas are acquisition and disposition, brokerage agreements, business advice, de-

sign and construction, development, expert witness, financing, leasing, organizational structuring, and zoning and land use. The firm's lawyers guide and counsel clients through all aspects and phases of their real estate transactions, from deal structuring to restructuring, from acquisitions and sales to zoning and land use, from design and construction to leasing and management, and from financing to foreclosures.

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1. General

1.1 Main Substantive Skills

The main substantive skill required to practice real estate law continues to be an understanding of the client's business and how real estate relates to the client's business. It often means having a strong understanding of the needs of the "core"

players in the real estate market, such as developers, lenders and institutional investors. Just as often, however, it means understanding how a business utilizes real estate where real estate is not the main business of that client, such as retail, office and warehouse users, hospitals and universities. As

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companies operate in ever-wider areas, an understanding of trends in the real estate markets nationally and globally is more important than understanding unique market concerns, though understanding local laws and customs can be important where the client is engaging the firm for that unique knowledge.

Of course, clients will expect attorneys to be able to communicate orally and in writing, and to be able to draft documents coherently and efficiently. As technology changes, it is important for the attorney to keep abreast of technology, but many attorneys are doing so at the expense of learning oral and face-to-face communication. Thus, the attorneys in private practice who can both know the technology commonly used by the client and also express themselves in person and by telephone can distinguish themselves from their peers.

The ability to work within clients' budgetary concerns also remains a priority. Some familiarity with tax law is helpful, but because tax law has become so specialized, it is rare that a real estate attorney will actually know enough tax law to be able to deal with tax issues in real estate transactions without assistance from a full-time real estate tax professional.

1.2 Most Significant Trends

The major trends in the Pennsylvania real estate market over the last 12 months are as follows:

- Developers of urban residential multi-family projects have become more cautious. Certain developments have scaled back in size as concerns about over-supply abound. There have been indications that condominiums are in greater demand, especially at the luxury end of the spectrum with larger units, as empty-nesters relocate to central cities, but it remains to be seen whether this will cause a wide-scale change in the ownership structure or size of units.
- With some exceptions (such as King of Prussia), suburban real estate continues to be mostly stagnant in all sectors other than industrial.
- Technology has continued to generate white-hot demand for industrial/warehouse real estate, with huge 1,000,000-plus square foot projects being the most sought-after. With a vacancy rate of under 5% in the eastern and central parts of the state, over 20,000,000 square feet of space is under construction, with the top five started as speculative projects. There is also a movement toward finding smaller industrial spaces in the "last mile" to make quick distributions to customers of high volume products.
- Despite the depressed pricing of natural resources, natural resources transactions continued to dominate news in the northeast corner and western portion of the state, where there were a number of swaps of assets between companies.

There were a number of major transactions in 2017.

Regarding office space, M&J Wilkow out of Chicago, in a joint venture with DRA Advisors, acquired the former Westinghouse building in Pittsburgh from Germany-based GLL Real Estate Advisors for a reported USD81 million, netting by some reports nearly USD15 million over the 2011 sales price.

Not to be outdone, Philadelphia boasted two large transactions of its own: the sale of the old Wanamaker Department Store building (a mixed-use retail and office building) to Rubenstein Partners for a reported USD194 million, and the acquisition by New York-based Nightingale Group of the 1.8 million square foot, two-towered Centre Square for USD328 million.

There was also a large volume of important transactions in the industrial sector. General Mills and BMW renewed leases for over 1,000,000 square feet, while Dermody Properties unloaded several buildings of over 2,000,000 square feet in the aggregate after acquiring the 1.3 million square foot Capital Logistics Portfolio from Woodmont Properties.

In the natural resources arena, the sale by CNX Land of properties in Washington County to CONSOL Energy was noteworthy.

1.3 Impact of the New US Tax Law Changes

The most significant structural changes for real estate investment in Pennsylvania in the last few years were tax law changes. First came the implementation of changes in the tax law that eliminated franchise taxes and capital stock taxes. Prior to that change, the preferred form of ownership in Pennsylvania was the limited partnership, which was not subject to those taxes. Following that change, more and more real estate purchasers are preferring to use limited liability companies to own real estate.

A second change was unique to Philadelphia and related to real estate transfer taxes. Previously, direct and indirect transfers of less than 90% of a real estate company were not subject to tax. Beginning in 2017, that number was reduced to 75% for Philadelphia real estate, making real estate joint ventures and other creative structures more difficult to use in Philadelphia.

Going forward, the Commonwealth of Pennsylvania has indicated that it is in the process of modifying its transfer tax regulations in order to close what it perceives as loopholes in state law.

2. Sale and Purchase

2.1 Ownership Structures

Prior to 2016, most real estate was held by limited partnerships because limited liability companies were subject to capital stock taxes and corporate franchise taxes. LLCs have become more prevalent since 2016, but limited partnerships are still used by those who acquired title in that form and by those who are familiar with it. Many real estate owners will use entities formed in Delaware rather than Pennsylvania for the same reasons Delaware entities are used in other states: a perception of flexibility and fewer duties imposed upon Delaware entities and their owners.

2.2 Important Jurisdictional Requirements

When transferring by deed, there are no particular differences among classifications of property for the transfer of specific types of real estate (eg, residential, industrial, office, retail, hotels). All classifications of property use the same form of deed. There is a statutory form and a more commonly used common-law form.

There can be significant distinctions among asset classes in terms of real estate transfer taxes. For example, hotels are considered businesses, and a transfer of a hotel company is not considered the transfer of a real estate company; therefore, the hotel entity is often transferred as opposed to transferring by deed. In an industrial setting, allocating a purchase price to equipment as opposed to real estate can also reduce transfer taxes.

2.3 Effecting Lawful and Proper Transfer of Title

Transfer of title is accomplished by deed. In a commercial transaction, special warranty deeds (meaning that the transferor is warranting only its own acts) are most common, though general warranty deeds (meaning that the transferor warrants against all title defects) are still sometimes used outside major metropolitan areas, especially in residential matters. Deeds are recorded with the office of the recorder of deeds in and for the county in which the property is located.

2.4 Real Estate Due Diligence

A buyers' due diligence typically depends on whether the property is a piece of land or a completed structure. The due diligence for land acquisitions includes, at a minimum:

- review of zoning, permitted uses and required permits, customarily reviewed by the buyer's special permitting counsel and the buyer's engineering consultants;
- review of availability of all utilities as to capacity and existence of service facilities, such as utility lines and sewage treatment plans, customarily performed by the buyer and its engineering consultants;
- geotechnical review of soils, customarily ordered and reviewed by the buyer and its engineering consultants;

- environmental Phase I (and, if any material conditions are disclosed, Phase II). Note: if conditions that could require remediation are disclosed, consideration is given to obtaining "Act 2" (Pennsylvania Land Recycling Program) approval from the Commonwealth of Pennsylvania to help protect the buyer from liability;
- title report and policy, customarily ordered and reviewed by the buyer's counsel and paid for by the buyer;
- review of any specific tax abatements to which the property is subject (such as Pennsylvania's "Clean and Green" law) and any tax abatements from which the completed property may benefit (such as tax increment financing or Philadelphia's ten-year tax abatement program), customarily done by the buyer's tax professionals; and
- ALTA/NSPS survey, customarily ordered and reviewed by the buyer's counsel and paid for by the buyer, though the cost of this may be shared with or, less commonly, paid by the seller.

Due diligence for the purchase of a completed structure retains all of the items referenced above except geotechnical review, but adds the review of leases and other occupancy rights, a building inspection and a review of building code violations.

2.5 Typical Representations and Warranties for Purchase and Sale Agreements

Purchase and sale agreements in Pennsylvania present a wide range of representations and warranties, and a wide range of remedies for them. Few are unique to Pennsylvania. In addition to representations and warranties commonly found elsewhere, Pennsylvania purchase and sale agreements often contain the following representations and warranties:

- a representation (if true) that the property being sold does not constitute more than 51% of certain assets, including real estate assets, of the seller. If that representation cannot be given, the buyer could be liable for some of the liabilities, such as taxes, owed to the Commonwealth of Pennsylvania unless a "clearance certificate" is obtained from the state, which cannot be obtained until well after closing; and
- in certain local jurisdictions, including Philadelphia and Pittsburgh, a representation and warranty setting forth the permitted zoning classification and legal use of the property, as well as whether there are outstanding notices of violations, is required.

2.6 Important Areas of Laws for Foreign Investors

It is most important for a foreign investor to consider tax law, environmental law, land use law and business qualification and licenses law when purchasing real estate.

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2.7 Soil Pollution and Environmental Contamination

Under Pennsylvania's Hazardous Sites Cleanup Act (HSCA – Pennsylvania's equivalent to the federal Superfund Statute), both the owner at the time of disposal and subsequent owners could be liable for existing contamination, regardless of causation by the subsequent owner (eg, if the subsequent owner fails to exercise due care or exacerbates the existing contamination). However, there are provisions under HSCA and federal law that provide protections for subsequent owners that perform "all appropriate inquiry" prior to purchase, and then manage any discovered contamination so as to avoid exposure to others, and assuming they do not exacerbate the contamination. There is no typical allocation of risk for such liabilities in a purchase and sale agreement for real estate. Sometimes the seller keeps all environmental liability and indemnifies the purchaser; sometimes the purchaser takes the property "as is" and even indemnifies the seller; and sometimes there is a specific allocation of risk based upon what is present on the property at the time of the sale. Occasionally, parties will purchase environmental insurance to cover a specific risk. There are also protections available to the extent that a buyer of real estate buys property that has gone through (or the buyer itself takes the property through) cleanup pursuant to Pennsylvania's Land Recycling and Environmental Remediation Standards Act (known as Act 2). That procedure allows the seller or buyer to identify specific conditions, create an action plan and make sure the Commonwealth of Pennsylvania will not seek to hold the buyer liable if the plan is followed.

2.8 Permitted Uses of Real Estate Under Zoning or Planning Law

Generally, a buyer ascertains the permitted uses of a parcel of real estate by reviewing the municipal zoning map, which provides the zoning classification. The buyer then reviews the municipal zoning ordinances to ascertain the generally permitted uses. Depending upon the use, a variety of other laws may regulate the use or require further licenses or permits to conduct that use. If a parcel of any substantial size is to be developed, the developer will usually be required to enter into a "developer's agreement" to perform certain public improvements (such as roads or traffic signals) and, by law, the locality must obtain security for the performance of those improvements. There are legal limitations on exactions (whether financial contributions or public improvements) that are unrelated to a development.

2.9 Condemnation, Expropriation or Compulsory Purchase

Governmental takings or condemnations are possible for a public purpose, provided just compensation is paid. In non-blighted areas, there are limitations on takings for economic development purposes.

2.10 Taxes Applicable to a Transaction

Pennsylvania has a state-wide realty transfer tax regime (applicable to the state and all localities except Philadelphia), and Philadelphia has its own transfer tax ordinance. Transfer taxes range from 2% of value to 4.1% of value in total, depending upon the jurisdiction. Customarily the taxes are split. A sale of at least 90% of a real estate company (which includes single-asset owners, among others) is subject to a state tax, and a sale of at least 75% of a real estate company is subject to a City of Philadelphia tax for properties located in Philadelphia. There are numerous exempt transactions and numerous exempt parties but, unlike many jurisdictions, the owners of a real estate company are distinct from the company itself, so a transfer from a real estate owner to its 100% subsidiary is usually taxable.

2.11 Rules and Regulations Applicable to Foreign Investors

Foreign investors may have to qualify to do business in Pennsylvania depending upon their level of activity. Foreign investors should examine tax laws carefully as well.

3. Real Estate Finance

3.1 Financing Acquisitions of Commercial Real Estate

Acquisitions of commercial real estate are generally financed with a combination of equity and mortgage loans. Other methods may be used (installment sale contracts, sale-leaseback, etc), but mortgage financing is by far the most common procedure.

3.2 Typical Security Created by Commercial Investors

Mortgages are the primary vehicles for securing an interest in real property. Pennsylvania follows the Uniform Commercial Code with regard to security interests in personalty.

3.3 Regulations or Requirements Affecting Foreign Lenders

In general, foreign lenders who do no more than advance funds secured by real property in Pennsylvania and do not have a place of business there are not subject to any special regulations or requirements.

3.4 Taxes or Fees Relating to the Granting or Enforcement of Security

There is no mortgage tax, nor any other special tax or fee levied on the creation of a mortgage, other than nominal recording charges. With regard to enforcement, state transfer taxes will apply to a deed in lieu of foreclosure or a sheriff's deed unless the grantee is the holder of a mortgage in default. Philadelphia transfer taxes usually apply even where the grantee is the holder of the mortgage, unless the transfer

is between natural persons and the mortgagee sold the property to the mortgagor.

3.5 Legal Requirements Before an Entity Can Give Valid Security

If an entity is granting a mortgage, it must receive some benefit or consideration for the granting of the mortgage. Ordinarily, an entity will obtain this benefit by obtaining the proceeds of a loan. The matter becomes more uncertain if an entity grants a mortgage to secure a loan to an affiliate. Care must be taken to ensure there is sufficient benefit bestowed upon the mortgagor as distinct from the affiliate.

3.6 Formalities When a Borrower is in Default

When a borrower is in default under a mortgage loan in a commercial (as distinguished from residential) context, the lender may proceed with foreclosure immediately. In a residential context, a lender must observe numerous debtor protection procedures – some statutory and some court-devised – before proceeding to a judicial sale. Those protections may apply even if the residential property is not owner-occupied.

3.7 Subordinating Existing Debt to Newly Created Debt

Existing mortgage debt may be subordinated to new mortgage debt by written agreement signed by the existing mortgagee, the new mortgagee, and the owner of the mortgaged property. Additionally, significant modifications of a mortgage loan could result in that loan becoming, in whole or in part, subordinated to junior indebtedness.

3.8 Lenders' Liability Under Environmental Laws

In general, merely holding or enforcing a mortgage will not subject a lender to environmental liability under Pennsylvania law. However, if a lender begins to behave more like an owner than a lender protecting its security, the lender could become liable as an owner. The cases tend to be very fact-specific. As long as the lender is behaving as a lender, it will only become liable if it directly exacerbates contamination or knowingly and wilfully compels a borrower to cause a release of hazardous materials.

3.9 Effects of Borrower Becoming Insolvent

Although many debtors will choose to utilize federal bankruptcy law in order to address problems associated with insolvency, even in a bankruptcy, state law governs the existence and priority of mortgage liens. Additionally, if a person or entity transfers (including by mortgage) property without consideration while that person or entity is insolvent (or in a way so as to make that person or entity insolvent), that transfer could be deemed to be a “fraudulent transfer,” and the period for considering such a transfer invalid as a fraudulent transfer is longer under Pennsylvania law (four years) than under federal law (two years).

4. Planning and Zoning

4.1 Legislative and Governmental Controls Applicable to Design, Appearance and Method of Construction

Typically, legislative and governmental controls or regulations do not impose subjective aesthetic standards on the construction of new buildings or the refurbishment of existing buildings. One common exception to this rule is that there are regulations respecting the preservation of historic structures. As a practical matter, however, as part of the approval process, applicants seeking land development approval and variance relief are often confronted with requests from municipal professionals, board members or neighbors to make certain concessions with regard to design, appearance and method of construction, and those “suggestions” are often accepted by the applicant in an effort to secure its needed relief.

The Pennsylvania Municipalities Planning Code (Act of 1968, P.L. 805, No. 247, as reenacted and amended) (“MPC”) enables legislation that governs zoning, subdivision and land development in most of the Commonwealth of Pennsylvania (excluding cities of the first and second class) and specifically provides that municipalities may regulate land use to “promote, protect and facilitate... the public health, safety, morals, and general welfare,” and Pennsylvania courts have held that zoning ordinances that regulate “purely aesthetic considerations” are beyond the scope of authority granted by the MPC.

4.2 Regulatory Authorities

The governmental entity responsible for regulating the development and designated use of individual parcels of real estate varies depending on the jurisdiction in which the property is located. For example, in the City of Philadelphia, these regulations are governed by Title 14 of The Philadelphia Code, which is known as the “Zoning Code.” The Zoning Code vests authority for permit issuance in the Department of Licenses & Inspections. If compliant with the applicable use and development standards set forth in the Zoning Code, most proposals can secure permits from the City’s Department of Licenses & Inspections administratively. Those projects that are not compliant with the Code standards require relief granted by the Zoning Board of Adjustment. In addition, certain projects are subject to review by the Civic Design Review Committee, and applicants for all projects that require relief from the Zoning Board are required to meet with the Registered Community Organization (“RCO”) to seek community input in writing prior to the public hearing. The meeting with the RCO requires prior written notice to a list of neighbors provided by the City Planning Commission. All matters considered by the Zoning Board require public notice by posting each street frontage

of the property for at least 21 consecutive days prior to the hearing date, using posters provided by the Zoning Board.

Outside of Philadelphia, most of the Commonwealth of Pennsylvania is governed by the Municipalities Planning Code, which enables municipalities to enact their own local ordinances. Land development approvals that are compliant with local ordinance will typically secure the requisite approvals from the municipality's governing body following review by the municipality's professionals. However, any required variance relief must first be secured from the local Zoning Hearing Board. Recommendations from the local and county planning commissions are also required parts of this process. Notice to surrounding property owners is typically required, which allows for public participation prior to decision making.

4.3 Right of Appeal Against an Authority's Decision

In the City of Philadelphia, any decision rendered by the Department of Licenses & Inspections with respect to an application filed seeking approval of a use or development pursuant to the Zoning Code (including a permit issued administratively) is subject to appeal within a 30-day appeal period, as is any decision rendered by the Zoning Board of Adjustment. Appeals of an administrative decision by the Department are filed with the Zoning Board. Any final decision by the Zoning Board may be appealed to the Pennsylvania Court of Common Pleas in the county in which the real estate is located.

In most of the Commonwealth outside of Philadelphia, which is governed by the Municipalities Planning Code, appeals by a landowner to the Zoning Hearing Board or the municipal governing body challenging an adverse determination must be filed within 30 days after notice of the determination is issued. There is no time limit specified in the MPC for other challenges, nor for applications for special exceptions or variances; however, municipalities and boards typically establish regulations setting reasonable appeal periods. Appeals from all land use decisions by the Zoning Hearing Board or other governing body must be filed with the Court of Common Pleas of the judicial district where the land is located within 30 days after entry of the decision or, in the case of a deemed decision, within 30 days after the date upon which notice of said deemed decision is given as set forth in the statute.

4.4 Enforcement of Restrictions on Development and Designated Use

Enforcement of the provisions of zoning ordinances is typically created by virtue of authority granted to municipal officials in local ordinances that provide for inspections by appropriate municipal officers, as well as the issuance of compliance orders and violation notices, which are enforce-

able by the courts. When a violation results in a condition which a municipality deems necessary to stop in order to protect public health or safety, or to prevent a public nuisance, cease operation orders can often be issued. The imposition of penalties for violations is another frequently utilized enforcement tool.

Generally, restrictions imposed by zoning boards on development approvals can be enforced in the same ways as zoning ordinances. For example, a municipality or any neighbor directly affected by a developer's actions can seek injunctive relief to prevent or stop a developer from continuing to violate the restriction. A municipality can also issue an enforcement notice to the developer and then impose sanctions if the developer fails to comply. In some cases, approval of a conditional use can be revoked after repeated violations.

5. Investment Vehicles

5.1 Types of Entities Available to Investors to Hold Real Estate Assets

Prior to 2016, most real estate was held by limited partnerships because limited liability companies paid capital stock taxes or corporate franchise taxes. Limited liability companies have not had to pay those taxes since 2016, so limited liability companies have now become more prevalent, but limited partnerships are still used by those who either acquired title in that form or are familiar with it. Many real estate owners will use entities formed in Delaware rather than Pennsylvania for the same reasons Delaware entities are used in other states: – a perception of flexibility and fewer duties imposed upon Delaware entities and their owners.

Corporations, business trusts, other forms of trusts and general partnerships are sometimes used to acquire or own real estate.

5.2 Main Features of the Constitution of Each Type of Entity

Limited liability companies and limited partnerships are the most favored entities for investing in real estate. In both cases, the entity is usually taxed as a partnership for federal and Pennsylvania purposes. Where a limited partnership is used, a single-asset limited liability company or corporation is often the general partner.

5.3 Tax Benefits and Costs

Corporations are subject to a net income tax. Until 2016, limited liability companies were subject to the capital stock tax or corporate franchise tax but not the net income tax, but now pay none of these taxes. Partnerships (limited or general) are not subject to either capital stock tax or corporate franchise tax.

5.4 Applicable Governance Requirements

Corporations must file articles of incorporation with the secretary of state of the Commonwealth of Pennsylvania, and must also adopt bylaws.

Limited partnerships must file a certificate of limited partnership with the secretary of state. Written partnership agreements that are unfiled provide additional details of ownership and the relationship of partners to one another.

Limited liability companies must file a certificate of organization with the secretary of state. A written, unfiled operating or limited liability company agreement provides additional details of ownership.

6. Commercial Leases

6.1 Types of Arrangements Allowing the Use of Real Estate for a Limited Period of Time

A “lease” or “term of years” is the most common vehicle for occupying real estate for a limited period of time without buying it outright. Easements and licenses are the two other common vehicles that create an entitlement to use property on a less-than-permanent basis, but can also be made permanent.

6.2 Types of Commercial Leases

There are a variety of different types of commercial leases, and many ways to differentiate them. One way to differentiate leases is by identifying what is to be leased. For example, a ground lease may be used by an entity that wishes to construct a building on raw ground or ground that has been improved with site improvements. A tenant may also lease an existing building with the existing land and improvements, whereby the building becomes known as a “single-tenant” facility. A tenant may also lease a portion of a building that has space available (leased or not) for other tenants. This is a “multi-tenant facility.”

Another way to differentiate leases is by how rent is paid – ie, whether the lease is a “full service” or “gross” lease in which common area maintenance (or “CAM”), taxes, insurance, utilities and all other expenses of operation are paid by the landlord. A “triple net” lease is one in which the tenant bears all such expenses. There are many possibilities in between, the most common of which is for the first year’s operating expenses to be “grossed up” into the rent. In that event, the tenant only pays the CAM and taxes in excess of the first year’s expenses.

6.3 Regulation of Rents or Lease Terms

There is no rent control or similar limitation on the calculation of rent, nor is there any limitation on the duration of

a lease term. However, a lease term of 30 years or more is subject to a transfer tax.

6.4 Typical Terms of a Lease

Lease terms can vary widely, from “month-to-month” at the short end to ground leases for centuries. Typically, an office tenant for whom the landlord is providing incentives (free rent, tenant improvements or an improvement allowance or moving allowances) should expect a lease term to be no less than seven years and no more than 15 years. If the landlord provides no incentives, a tenant’s lease may be shorter, though if that means that the tenant must pay for substantial improvements of its own, the tenant may prefer a longer-term lease. Lease extensions at the tenant’s option are quite common.

A tenant will usually have to maintain at least the space it occupies to some degree. However, in a “gross lease,” the landlord is expected to perform all maintenance, and in a “triple net lease” the landlord performs very little, if any. Sometimes even in a triple net lease the landlord will perform certain maintenance (such as the roof or structural components). Even if the landlord passes through the cost of such maintenance to the tenant, the landlord may want to control how the maintenance is performed.

Rent is commonly paid monthly, in advance, before the first of the month. However, that is not a universal rule, and in some cases rent can be paid quarterly, semi-annually, annually or upon whatever basis the parties agree.

6.5 Rent Variation

There is no limit on changes in the rent. In theory, rent could change daily, though it is common for rent to change annually, bi-annually, every five years or in similar multiples of a year.

6.6 Determination of New Rent

Just as there is no limit on how often rent can change, the variations on how rent is adjusted are endless. Common ways to adjust rent include increasing rent by a set dollar amount, increasing rent by a set percentage, and increasing rent by reference to an index, such as the consumer price index.

6.7 Payment of VAT

There is no VAT on rent; other than taxes on income, gross receipts or net profits generally, there is no specifically designated rent tax.

6.8 Costs Payable by Tenant at Start of Lease

At the commencement of a lease, in addition to rent for the first month (which may be payable well in advance if the lease is signed in advance), a tenant may have to post a security deposit, either in cash or by letter of credit. A guarantee

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is another popular form of security for performance that must be paid before a lease commences. Finally, a tenant may have to pay architects and contractors for the build-out of its own space (with or without an allowance from the landlord), as well as moving costs and permitting costs.

6.9 Payment of Maintenance and Repair

If the lease is a “full service” or “gross” lease, common area maintenance (or “CAM”) is paid by the landlord. In a “triple net” lease, the tenant bears its proportionate share (usually measured by relative square feet of occupied space) of CAM. There are many possibilities in between, the most common of which is for the first year’s operating expenses to be “grossed up” into the rent. In that event, the tenant only pays the CAM in excess of the first year’s expenses

6.10 Payment of Services, Utilities and Telecommunications

Utilities for the tenant’s own space are generally paid for by tenants, unless the lease is a “full service lease,” in which case the landlord pays. Utilities for common space are generally paid in the same ratio as common area space, though if a tenant has a high demand or after-hours demand for utilities, that tenant’s share may be based upon actual or estimated usage.

Services such as janitorial services may be contracted for by tenants individually or, in high-rise buildings, usually by the landlord, and either included in the rent in a full service lease or billed through with operating expenses.

6.11 Insuring the Real Estate That Is Subject to the Lease

In a typical multi-tenant facility, the tenant will need to insure a casualty to its space and obtain liability insurance as well as worker’s compensation insurance for its own employees. The landlord will pay for casualty insurance for the building but pass through the tenants’ proportionate share with common area maintenance costs. In a single-tenant facility, the tenant may well obtain casualty insurance for the entire building but must name the landlord as an “additional insured” and provide that the landlord’s lender is a “mortgagee” under the policy.

6.12 Restrictions on Use of Real Estate

A tenant may be limited in how it uses the premises by clauses in its lease, by zoning and land use regulations, and by recorded covenants. In retail leases, it is common for tenants to have exclusive rights to certain uses that could create a restriction in other tenants’ leases.

6.13 Tenant’s Ability to Alter and Improve Real Estate

Leases generally restrict tenants from altering the real estate during the lease terms, and there is no particular limit

on how the landlord may impose such restrictions. Many restrictions require the landlord to approve the idea of the improvements, the plans and specifications, changes to the structure, mechanical systems and the roof, while some leases have a flat prohibition on all improvements (even cosmetic improvements) without the landlord’s approval.

6.14 Specific Regulations

Residential leases may be required to be on a “plain language form.” Commercial, industrial, office and retail leases are not so restricted.

6.15 Effect of Tenant’s Insolvency

See national USA explanation.

6.16 Forms of Security to Protect Against Failure of Tenant to Meet Obligations

As security for performance under the lease, a tenant may have to post a security deposit, either in cash or by letter of credit. A guaranty is another popular form of security for performance that must be furnished before a lease commences. Finally, a tenant may have to pay architects and contractors for the build-out of its own space (with or without an allowance from the landlord), as well as moving costs and permitting costs.

6.17 Right to Occupy After Termination or Expiration of a Lease

If a lease is silent, a tenant that occupies a leased space past the expiration or termination of the lease is deemed a holdover, which allows the landlord several remedies, including treating the tenant as a tenant in default and exercising all of its remedies, or electing to treat the holdover as an extension of the lease for a period, usually a year if the original lease was for multiple years.

Many leases give landlords much greater powers, such as liquidated damages of double or even triple rent for each month the tenant remains in occupancy, and others limit the landlord’s right to treat the tenant as a month-to-month tenant. In most leases, the landlord will ask the tenant to indemnify the landlord for holding over, and the indemnity could include the loss by the landlord of a new tenant that was unable to gain occupancy because of the existing tenant’s holdover. Whether the tenant agrees to such an indemnity, and under what circumstances, is often open to negotiation.

6.18 Right to Terminate Lease

Landlords will typically be permitted to terminate a lease for a monetary default, sometimes with notice and opportunity to cure, sometimes without; sometimes the notice and opportunity to cure is limited to the first one or two defaults, after which no notice is required.

Other events – such as failure to obtain insurance, failure to obtain the landlord’s consent to assignment and other specific defaults – often do not permit notice and opportunity to cure as the default can cause the landlord significant harm.

Most leases include a general default that allows a tenant to have an initial period of time to cure, such as 30 days; if the tenant is trying to cure, that 30-day period can be extended, often for a period not to exceed some longer period of time, such as 180 days.

6.19 Forced Eviction

A tenant may be ejected if it defaults under the lease. Pennsylvania has two procedures for ejection, though there is a third possibility in some limited jurisdictions. First, a landlord may “eject” a tenant. This is a garden variety lawsuit in which there is a complaint, answer, discovery and all of the typical elements of a lawsuit. Second, if the lease so permits, a landlord may “confess judgment” against the tenant by entering a judgment on the tenant’s behalf. This is an unusual procedure available in few states as it enables a landlord to enter a judgment before the tenant has its day in court. The tenant may then seek to “open” or “strike” the judgment if the tenant has a legitimate defense. If the judgment is opened, it proceeds on the same path as an ordinary lawsuit; if it is stricken, the landlord must proceed in ejection – the right to confess judgment is lost. Care needs to be taken in this event, because if the landlord succeeds in confessing judgment for possession, it may limit the landlord’s right to recover money on an accelerated basis.

An ejection action can take many months if not years; confession of judgment can take just a few months if it is not opened or stricken.

A few jurisdictions, such as Philadelphia, have established landlord-tenant courts in which ejection matters can be heard more quickly, especially if the landlord seeks no remedy other than possession. In those jurisdictions, confession of judgment for possession is unnecessary.

6.20 Termination by Third Party

A governmental body with jurisdiction may take the leasehold or the leased property in eminent domain proceedings. In order to do so, the governmental body must file a declaration of taking, often referred to as condemnation. If the tenant has a legal basis to contest the taking (as opposed to contesting the amount of compensation), the tenant can file preliminary objections. If no party files preliminary objections, the taking becomes effective and the contest shifts to the dollars to be paid, which can take months if not years. A tenant has the right to attend the hearing at which compensation is set, and also the right to obtain compensation. The lease may allocate the landlord’s and tenant’s respective

rights to compensation. In the absence of such allocation, the court will allocate the awards with statutory guidance.

7. Construction

7.1 Common Structures Used to Price Construction Projects

Construction projects in Pennsylvania are generally structured as either as fixed-price (also referred to as stipulated sum) or cost-plus-fee contracts. Cost-plus contracts are often subject to a guaranteed cap on the total project cost.

7.2 Assigning Responsibility for the Design and Construction of a Project

Project owners usually contract directly with an architect, who is responsible for design and construction administration and who may subcontract some of the design responsibility to engineers and other professionals. Project owners will then contract directly with a general contractor, who will be primarily responsible for construction. However, other project delivery methods are also common, including but not limited to design-build contracts, employment of a construction manager, and multiple prime contracts (particularly for public contracts subject to the Pennsylvania Separations Act).

7.3 Management of Construction Risk

Risks on construction projects in Pennsylvania are typically managed through a wide variety of contractual provisions, including limitations of liability, waivers of consequential damages, insurance and bonding requirements, and pricing and scheduling arrangements. Design professionals and contractors, in Pennsylvania as well as nationally, are increasingly demanding caps on their exposure, even for damages caused by their own negligence. Unlike many other states, Pennsylvania does not place statutory limits on construction indemnities; however, courts are likely to view provisions indemnifying a party for its own negligence with a skeptical eye, and any such provisions must be stated expressly and unequivocally.

7.4 Management of Schedule-Related Risk

Schedule-related risk on construction projects in Pennsylvania may be managed through careful and co-operative development of the initial project schedule, monetary incentives for finishing early and disincentives for finishing late, including shared savings or bonuses for early completion and liquidated damages for failure to meet milestones or completion deadlines, and a variety of other contractual provisions, including precise delineation of what does and does not constitute force majeure, procedures and limitations on delay claims, and preservation of claims for consequential damages for delay.

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7.5 Additional Forms of Security to Guarantee a Contractor's Performance

It is common for owners to require performance and payment bonds as security on a construction project in Pennsylvania, but the cost of bonds is often prohibitive for smaller projects. On larger projects, most owners, lenders and general contractors will require subcontractors to be bonded, while some general contractors will prefer to obtain subcontractor default insurance. Public projects must be bonded.

7.6 Liens or Encumbrances in the Event of Non-Payment

Under the Pennsylvania Mechanics Lien Law, contractors, subcontractors, materials suppliers, architects and engineers have limited rights to file a lien for the payment of debts owed in connection with the improvement of certain real property. Pennsylvania is relatively unique in permitting advance waivers of mechanics liens, under limited circumstances. Pennsylvania also recently introduced a new online database for larger construction projects – by voluntarily participating in the database, owners may be able to better limit, track and manage lien rights. Mechanics liens take priority as of the date of commencement of the construction project, but purchase money mortgages and certain construction mortgages are given statutory priority over mechanics liens.

7.7 Requirements Before Use or Inhabitation

The process for permitting occupancy following completion of a construction project is handled on the local level and governed by local law.

8. Tax

8.1 Sale or Purchase of Corporate Real Estate

Pennsylvania imposes corporate income tax at the rate of 9.99% on the recognized gain upon the sale of real estate. State and county transfer taxes of between 2% and 4.1% of the value of the real estate are payable on the sale or purchase of real estate, depending on the locality. Transfer taxes are imposed upon both buyer and seller, and are customarily split between the two. There are a myriad of exemptions to the tax, but most real estate transfers are taxable even between corporate affiliates. If more than 51% of certain assets, including real estate, of an entity are sold, the buyer can become liable for the seller's taxes and other obligations to the Commonwealth of Pennsylvania.

8.2 Mitigation of Tax Liability

There are a variety of structures that will mitigate or eliminate transfer taxes. Historically, a so-called 89-11 structure has permitted 89% of a real estate company to be transferred without incurring the tax, which has led to a number of creative structures. In Philadelphia, that structure is no longer available because a transfer of 75% of a real estate company is now taxable.

8.3 Municipal Taxes

There are use and occupancy taxes at the municipal level that are often levied against tenants and collected by landlords.

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