

(CORRECTED; November 19, 2007)

November 1, 2007 (Original file date)

In Re: **First State Investors 3300 LLC**

Docket No: **36RTMERZZ9914**

Statement of Record:

1. First State Investors 3300 LLC (hereafter "Petitioner") filed a petition for review with the Tax Review Board ("TRB" or "Board") on May 25, 2005 for review of 2004 Realty Transfer Tax (RTT) assessments with accrued interest and penalties on 3 Philadelphia properties.
2. The petition was rejected by the Tax Review Board as being beyond the requirement set forth in The Philadelphia Code Chapter 19-1702(1) for filing such petitions within "60 days after the mailing of a notice... or determination to the petitioner..." that sets forth the claim or liability being assessed by the Department of Revenue.
3. Petitioner requested and was granted the right to proceed Nunc Pro Tunc before the Tax Review Board.
4. A status hearing was held on November 8, 2005 at which time the parties agreed to prepare a Stipulation of facts to be submitted to the Tax Review Board on or before February 7, 2006.
5. In addition, on November 8, 2005 an initial hearing schedule of March 14, 2006 and March 16, 2006 was also set. The hearing continued on July 11, 2006, July 13, 2006, and September 14, 2006. Following the conclusion of the evidentiary hearing on September 14, 2006, a briefing schedule was set by the Board. Final oral arguments were heard by the Board on February 20, 2007 after which the Board took the matter under advisement.
6. A public hearing was held on May 8, 2007 at which the Tax Review Board announced its decision to grant the petition in favor of Petitioner.
7. The City of Philadelphia has appealed to the Philadelphia Court of Common Pleas.

Findings of Fact:

1. The Joint Stipulation of Facts, numbered 1 through 26 with Appendix I and Appendix II containing specific provisions of the Philadelphia Realty Transfer Tax Ordinance and Philadelphia Realty Transfer Tax regulations, submitted by the parties is hereby incorporated by reference, and repeated in part below.
2. Petitioner is a limited liability company formed in 2004 to own and operate commercial real estate for its parent company, American Financial Realty Trust.
3. Petitioner and Wachovia Bank, National Association ("hereafter "Wachovia") entered into a single transaction whereby Wachovia sold and Petitioner purchased 147 properties (the "Portfolio") owned by Wachovia, located in 10 states. Three of the properties were located in Philadelphia.

4. The Philadelphia properties are 101 North Independence Mall East (hereafter the "Independence Mall Property"), 601 – 07 Chestnut St. and 30 – 34 South 6th St. (hereafter the "Chestnut Property"), and 7034 – 48 Castor Avenue (hereafter the "Castor Ave. Property")
5. At the time of the sale, Wachovia was occupying, in whole or in part, some of the properties in the Portfolio for use in its banking business.
6. The real estate transfers occurred on September 22, 2004.
7. Philadelphia Realty Transfer Tax (RTT) was paid by the parties based on what they determined to be the actual consideration agreed to and paid pursuant their Purchase and Sale Agreement. Each property was considered to be sold for its depreciated or adjusted book value.
8. The amount of \$772,230 was remitted to the City of Philadelphia for RTT in November 2004 as follows:

Independence Mall Property	\$718,893.00
Chestnut Property	22,733.00
Castor Ave. Property	<u>30,604.00</u>
Total	\$772,230.00

9. An additional aspect of the transaction was the agreement to allow Wachovia to lease back only the space it actually needed in each property.
10. Petitioner and Wachovia negotiated a base rent of \$5.95 per square foot plus additional leasing compensation to Petitioner in the form of a proportionate share of operating expenses and other capital and maintenance costs for the properties. The rent to be paid was the same for each property and not determined on a property-by-property basis.
11. Wachovia identified the portfolio properties, including a group of "must take" properties.
12. Both parties agree that Petitioner and Wachovia engaged in an arms length business negotiation and sales transaction. The Purchase and Sale Agreement for the Portfolio was executed on May 10, 2004.
13. At the closing, the final purchase price was arrived at by adjusting each property's book value for further depreciation or new capital improvements, where warranted.
14. The final purchase price was \$504,613,403, which was the sum of Wachovia's book values for all of the properties that were part of the sales transaction on September 22, 2004, the Closing Date. In total, 147 properties were sold that day. The City of Philadelphia is seeking additional Realty Transfer Tax of \$741,829.00 plus accrued interest and penalties.

Conclusions of Law:

Both parties agree that this was a bona fide, arms length real estate transaction.

With this as the starting premise, the issue before the TRB is whether The Philadelphia Code Chapter 19-1402(14) and accompanying Philadelphia Regulations §§302 and 306 require that Realty Transfer Tax (RTT) be paid based on the actual cash consideration paid by the buyer to the seller, thus ending the Board's analysis. Or, if as the City contends, the deed sets forth only a nominal consideration is the actual consideration on which RTT is to be calculated the cash paid plus the value of the leasehold interests i.e. do the cash and non-cash consideration equal the sale price for RTT purposes regardless of the fact that the transaction is a bona fide, arms length deal? The City contended that the lease arrangement was such a bargain to Wachovia that it was proof that the cash consideration was nominal and that the value of the leasing arrangement had to be added as additional consideration to make the deal worthwhile to Wachovia.

It was the determination of the TRB that it was necessary to look at the totality of the sales transaction as a business transaction for the 147 properties between the buyer and seller. All properties were valued uniformly, at the book value. For some, this may have been above market value and for others, below market value. Special consideration was not given to the three Philadelphia properties in the deal. The Board found that this business transaction should be considered as a whole and that it was not a situation where 3 individual properties could be pulled out for individual evaluation separate and apart from the other 144 properties that made up the deal.

It was the finding of the Tax Review Board that the consideration was not nominal, such that the Board would look outside the cash consideration paid for other non-cash compensation, such as to the leasing arrangement. In addition, the Board did not find that the leasing arrangement provided Wachovia with a bargain deal with so much value that the cash consideration had to be considered nominal.

The City's expert testimony, while admitted into the record, did not persuade the Board. The City provided James Luciani, Real Property Evaluation III for the City of Philadelphia Board of Revision of Taxes, as an expert witness. Petitioner objected on several grounds. Mr. Luciani's curriculum vitae or resume, and an expert's report were not provided sufficiently in advance of the TRB hearing despite several requests. As a city employee, Mr. Luciani's objectivity in the matter was a concern. And, Mr. Luciani's experience was limited to Philadelphia properties only and he therefore could not evaluate any of the 147 properties in this deal other than the 3 Philadelphia locations.

The Board accepted Mr. Luciani as an expert with the understanding that it is within the Board's prerogative to determine the weight to give to the testimony of any expert testimony in its deliberations.

Mr. Luciani was admitted as an expert for the purposes of the 3 Philadelphia properties. See Notes of Testimony, July 13, 2006, pages 29-30.

Mr. Luciani testified to the estimated market value for each of the 3 Philadelphia properties, separate and apart from the total transaction. He explained the evaluation and appeal process for each of the properties that led him to conclude that the sales price attached to each of them was below the amount that would be expected in an open and competitive market.

Mr. Luciani inspected the 3 properties to determine if the cash consideration attributed to each of them was adequate based on his determination of their market values from his experience and knowledge of the Philadelphia market. Mr. Luciani defined "market value" as what a prudent buyer and a prudent

seller would pay for real estate, in an open and competitive market, barring any undue stimuli, which could mean a business transaction that could skew the sale price." See Notes of Testimony, July 13, 2006, page 37. He did not attempt to analyze the fair market value of the 144 properties outside of Philadelphia or to analyze the values of the 3 Philadelphia properties within the context of the entire deal. He was unable to offer an opinion as to whether the purchase price of \$504 million was above or below the fair market value of the 147 properties as a whole or whether the \$5.95 base rent was above or below the fair market rental for the other properties leased by Wachovia as part of this transaction. Mr. Luciani limited his testimony to an analysis of each Philadelphia property separate and apart from each other and the total transaction between the parties.

Mr. Luciani was also asked to determine market rate rent for each of the 3 Philadelphia buildings, in support of the City's position that \$5.95 per square foot was below market rent and therefore was the incentive to sell the properties at a below market value or nominal cost.

Although the leasing arrangements were all completed at the time of the sale, the Board was not persuaded that they were additional non-cash consideration for the sale and purchase of these properties.

The City and its expert presented the leases as bargain deals for Wachovia to make their case that these leasing arrangements were part of the consideration for the purchase. The City's position was that the reason Wachovia sold these properties for below market value prices was that in return it not only got some cash but it got very favorable leasing terms that were worth a lot of money to it.

However, several factors did not support this. First, Wachovia did not lease 100% of the properties it sold or even 100% of the approximately 60% of the properties where it did lease space. The pricing structure for the sale was the same for each of the 147 properties regardless of whether Wachovia then leased a portion of the space in the property.

Mr. Luciani testified that the rent amount of \$5.95 per square foot was well below market rate rent for buildings of this nature in Philadelphia. To make his determination, Mr. Luciani used data provided by independent reporting agencies (See City Exhibits 16 and 17) as well as his own experience in valuing buildings. He used industry standards to factor in vacancy rates and operating expenses.

For the Plaza, he determined that market rent was \$21 per square foot, for the Chestnut St. property, it was \$35 per square foot, and for Castor Ave., \$15 per square foot. These rent amounts were derived from his evaluation of market conditions in 2004, the year of the transfer.

Mr. Luciani did a calculation to determine the "lost rent" over 20 years to Petitioner for each property and then the current value of that lost rent, which he added to the sale prices to arrive at his determination of the market value of the properties.

Mr. Luciani admitted that he could value market value for each property but could not value a business transaction. (Notes of Testimony, July 13, 2006, page 59). When cross-examined, he admitted that he was not able to evaluate the totality of the agreement between Wachovia and Petitioner.

This business deal involved the sale of 147 properties located across the country, for \$504 million with a leaseback arrangement for some of the space. Each property, regardless of location, was valued at its agreed upon adjusted book value. The City argues that the transaction should be unbundled and the three Philadelphia located properties should be looked at separate and apart from the whole.

The City concurs that this was a bona fide sale and an arms length business transaction between the parties. The Philadelphia Code Chapter 19-1402(14)(a) and Philadelphia Realty Transfer Tax Regulation 302 state that where there is a bona fide sale of real estate pursuant to an arm's length transaction, the value for purpose of RTT is the actual consideration agreed upon by the parties. The City argues that the rent paid by Wachovia for the three Philadelphia properties should be counted as additional consideration on which RTT should be paid.

The City bases its arguments on the following factors. The City contends that the adjusted book value amount paid for each Philadelphia property was below the market value and therefore should be considered nominal to the point where it is necessary or required to look for other consideration for the transfer. The City also contends that the lease arrangement was for a below market rate thus bolstering its argument that Wachovia was willing to enter into a transaction where the cash it received for the Philadelphia properties was below their actual value because the leaseback arrangement provided additional value for each property.

However, this transaction was far bigger than the three properties in Philadelphia. It strained credibility to ask the TRB to look at a transaction involving 147 properties across 10 states and single out three that happened to be located in Philadelphia as being misvalued or undervalued.

It is the finding of the TRB that the actual cash consideration paid for the properties was not nominal but based on an arms length negotiation for a total of 147 properties. The \$504 million agreed to based on the adjusted book value was considerable consideration taking into account all factors. For example, there were 17 "must take" properties that Wachovia insisted on as part of the sale where book value was above market value, just as there were other properties where book value may have been equal to or less than market value.

Again, along with its argument that the individual value attributed to each Philadelphia property was too low, the City attempted to bolster its position by asserting that the leasing arrangements were a bargain for Wachovia and thus the inducement to sell the 3 Philadelphia properties at such low prices.

The City's expert witness testimony on these subjects, while admitted into the record did not persuade the Board.

When presented with the specific facts of each property, including the base rent and actual operating and capital expenses, the Board was persuaded that the leaseback arrangement, while perhaps important to Wachovia's business plan and operations was not a bargain basement deal out of line with Philadelphia rents. In fact when provided with the additional information that Wachovia was to pay capital and operating expenses along with the base rent and with the actual figures, not general industry figures, the City's own expert had to agree that the rents were within a reasonable range.

Therefore the decision of the Tax Review Board was to grant the petition in favor of petitioner's request to abate the assessment of the additional RTT.

Concurred:

Derrick Johnson, Chair
Una Vee Bruce
Joseph Ferla