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Client Alert

Basics of New York City Development Rights (“Air Rights”) Transactions

Introduction

The surge in New York City’s real estate market over the last few years has seen the return of development rights transactions, a type of deal that was virtually non-existent during the recent economic downturn.

The transfer of development rights, also referred to colloquially and somewhat inaccurately as “air rights,” can take a variety of forms, *e.g.*, transfers (i) of inclusionary housing bonus development rights, (ii) from designated landmarks or theaters, or (iii) through special mechanisms designed to promote public amenities (such as the High Line). The most common vehicle for the transfer of development rights is the as-of-right “zoning lot merger,” due to its relative simplicity and the fact it does not require discretionary approval from an administrative agency.

The following example illustrates such a transaction:

Parcel A and Parcel B are independently-owned adjacent properties, each zoned to permit development of up to 100,000 square feet (sf) of floor area. Parcel A is improved with an existing building having 65,000 sf; Parcel B is vacant. The owner of Parcel B desires to develop a new project and maximize Parcel B’s potential.

By merging Parcels A and B into a single zoning lot (permitting 200,000 sf of buildable floor area), the owner of Parcel B can purchase the unutilized floor area of Parcel A and incorporate it into its development project. This new development project can have a total of 135,000 square feet of floor

area (100,000 sf attributable to Parcel B and 35,000 attributable to Parcel A). The floor area in the Parcel A building will be limited to 65,000 sf so long as the merged zoning lot exists.

This Client Alert provides a basic outline of the required steps to transfer unutilized development rights from one property to another and will highlight important considerations for these transactions (given the long-term nature of the relationship created by merging properties into a single zoning lot).

Zoning Lot Merger

The development and use of property in New York City is subject to the City's Zoning Resolution. The various bulk regulations of the Zoning Resolution, including the regulation governing maximum permitted floor area of buildings, are applied to its basic unit, the "zoning lot." The Zoning Resolution defines zoning lot in a way that permits the merger of two or more existing lots that are contiguous for at least 10 linear feet. These lots can have common ownership or be owned by wholly unrelated parties. Once merged, the development rights appurtenant to the zoning lot can be allocated between the parties by private agreement for use within their respective buildings. The parties must conduct proper zoning due diligence prior to entering into the development rights transaction to ensure the merger and subsequent transfer can be effectuated (e.g., transfers across zoning district boundaries may not be permitted; height and setback regulations will not prevent use of transferred floor area; etc.).

The documents required to effectively create a merged zoning lot ("MZL") are outlined in the Section 12-10 of the Zoning Resolution. The format of these documents is set forth in a Department of Buildings ("DOB") intra-departmental memorandum from Acting Commissioner Irving E. Minkin, P.E., dated May 18, 1978 (the "Minkin Memo"). The following documents are required to merge multiple, separately owned lots into an MZL:

- ***Parties in Interest Certification*** – The Certification is prepared by a title company and certifies all parties that have an interest in the tax lots comprising the MZL (the "Parties in Interest"). Parties in Interest include not only fee owners, but also mortgagees, easement holders, and ground lessees, among others.
- ***Declaration of Zoning Lot Restrictions*** – The Declaration is a statement declaring the subject lots comprising the MZL and sets forth its metes and bounds description. In practice, the Declaration is signed by the fee owners of the subject lots comprising the MZL.
- ***Waiver of Declaration of Zoning Lot Restrictions*** – A waiver typically is signed by Parties in Interest other than fee owners. The Zoning Resolution and the Minkin Memo only require a basic waiver stating the party is waiving its right to sign the Declaration. It is common practice, however, to include additional language within the waiver subordinating the interests of Parties in Interest to the Declaration and the Zoning Lot Development and Easement Agreement

("ZLDA"). It is especially important to obtain subordination language from seller's existing mortgagee to protect the purchaser against the transfer's possible invalidation; otherwise, the mortgage will have priority over the contemplated development rights conveyance.

All Parties in Interest identified on the Certification must sign either the Declaration or a Waiver to effectuate the MZL.

Development Rights Transfer

Although the Zoning Resolution outlines the procedure necessary to create the MZL, it does not define the documentation required to transfer development rights effectively from one parcel to another. In practice, this transfer is accomplished through the execution and recording of a ZLDA concurrently with all MZL documents described above. The ZLDA is a heavily negotiated agreement designed to address the various rights and obligations of the parties given what, in most instances, is a permanent MZL. The ZLDA must be drafted properly since the relationship among the parties to a development rights transaction does not conclude at closing. It continues for as long as the MZL exists. Issues typically covered in the ZLDA include:

1. **Floor Area Transfer and Other Bulk Restrictions** – The transfer of unutilized floor area from one party to another and restrictions on the use of other development rights appurtenant to a property (e.g., dwelling unit count, lot coverage, yards, etc.) should be outlined clearly.
2. **Light and Air Easement** – If granted, a light and air easement benefitting the purchaser of the development rights should be defined clearly. Such an easement restricts the height of the seller's building and any installations or equipment on its rooftop, thereby preserving views for the occupants of the purchaser's new building. The easement also may allow certain windows in the purchaser's building to meet light and air requirements.
3. **Cooperation of Parties** – It is important for the ZLDA to require cooperation between the parties in connection with all building applications, especially when a purchaser plans to undertake a significant construction project. Such provisions should also be drafted to benefit the seller by requiring the purchaser's cooperation for future alterations or the rebuilding of the seller's improvements.
4. **Violations** – The ZLDA should outline each party's obligations with respect to violations that adversely affect the other party's ability to obtain DOB approvals or a Certificate of Occupancy. Rights to cure any building violations should also be addressed.
5. **Building Casualty** – The ZLDA should outline the rights of the parties in the event one or more buildings on the MZL suffers a casualty and there has been a downzoning that reduces the development rights attributable to the MZL.

6. **Enlargement of MZL**– The ZLDA should address whether the parties are able to enlarge the MZL to facilitate the acquisition of additional development rights, either unilaterally or with the approval of the other party, and the steps necessary to permit such an enlargement.
7. **Construction Easements and Obligations** – The ZLDA should cover pre-construction surveys, access for inspection, construction protection attachments, damage provisions and insurance obligations of the parties.

Conclusion

Development rights transactions allow prospective sellers to monetize the unutilized development potential of property they own without actually undertaking a construction project. Similarly, development rights transactions enable prospective purchasers to construct a building that otherwise would exceed the permitted floor area for their property. It is important for the parties to understand the mechanics of such a transaction, the relationship created between the parties, and the implications of an MZL to ensure the rights and obligations of all parties are properly identified and documented. Parties entering into a development rights transaction should work with experienced zoning professionals so they protect themselves against the risks relating to the transfer and do not inadvertently contract away rights that are not readily apparent.

Please contact Joshua J. Rinesmith or your regular Warsaw Burstein attorney to discuss any questions you may have about development rights transaction or other zoning issues.

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