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The Shape of Air: Development Potential Realized

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Commercial property owners looking for the next big thing for their buildings may only have to look up. Building owners whose properties do not use all of the development (or “air”) rights associated with their property may be able to sell these rights, capitalizing on their unused height potential.

The first step in an air rights transfer is to confirm that the property does, in fact, have unused air rights. The owner will need to check the local zoning resolution and consult with design and zoning professionals to determine how many square feet of development rights are available. The price for these excess rights often is expressed in the cost per floor area ratio (FAR) foot and fluctuates with the cost per FAR foot of development parcels themselves.

While some markets have a well-established market for these rights, pricing them can be tricky. Air rights prices trail the prices per FAR foot of stand-alone development parcels. But, in dense urban environments, the transferred rights add to the height of the structure on the receiving parcel, and upper floors command premium prices. The countervailing element is that air rights can only be sold within a limited area around the property, which limits the universe of potential buyers. Prospective sellers that price rights too aggressively may find themselves with no qualifying projects to sell them to.

If an owner does not want to sell all of the excess rights, they need to determine what portion they wish to retain and what height (or other configuration) limitations they are willing to impose on future development.

Property owners may be inclined to sell air rights when an existing structure is landmarked or not otherwise readily capable of modification; when further development is too disruptive to existing uses or cash flow; or when the financial or ownership structure is too cumbersome to develop the site.

Historically, railways and highway authorities have sold their air rights to monetize the value of an asset they are not in a position to use. For example, in 2010, the Metropolitan Transportation Authority in New York leased the air rights over its rail yard to developers for the creation of the 26-acre Hudson Yards redevelopment project.

In other instances, municipalities have combined their financial interests with urban development objectives. During the “Big Dig” infrastructure project in Boston, the Massachusetts Turnpike Authority leased the development rights over the previously elevated turnpike to offset cost overruns and reunite neighborhoods. In 2007, the city of Los Angeles authorized the creation and sale of up to nine million square feet of development rights around its convention center to encourage residential growth and generate an income stream for affordable housing, historic preservation and public transportation, among other priorities.

Of course, private owners can't create development rights the way local governments do. These rights are governed by local zoning. One of the most vibrant markets for air rights sales is New York City, and the city's zoning resolution expressly permits transfers of air rights to neighboring properties. The procedure to execute an air rights transfer in New York includes the following:

- **Contiguity.** Generally, the properties must share a common boundary of 10 feet or more and be located within a single block. Under certain conditions, development rights may be transferred to a lot across the street or, in rare instances, an area where the city is trying to incentivize new development.
- **Declaration of Restrictions.** The parties must execute and record a Declaration of Restrictions declaring both the transferring and receiving lots to be a single lot for zoning purposes.
- **Parties in Interest.** Recognizing that the seller and recipient are entering into a significant transfer of rights, the zoning resolution requires that all "parties in interest" execute or consent to the execution of the declaration. Such parties in interest include lenders and other holders of recorded interests that might be adversely affected.
- **Zoning Lot Development Agreement.** The parties will enter into a zoning lot development agreement, which will identify the air rights to be transferred; allocate to each party what development rights each has; and address what happens should various contingencies occur, such as up-zonings, down-zonings, casualty or condemnation.
- **Easement of Light and Air.** As part of the transaction, the parties might identify an upper height limitation for the buildings on the transferring parcel. This additional right can help the receiving parcel maximize the value of the rights being purchased.

Air rights transfers are a unique and fascinating tool that allows multiple parties to achieve a variety of objectives. Since they have long-lasting repercussions, they should be structured carefully and given thorough consideration. Under the right circumstances, they can create "win-win" scenarios for both the buyer and seller.

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