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Airspace Conveyance Policy Changes

New York City's new requirement has widespread implications.

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IN RECENT YEARS, New York City real estate owners have capitalized on their investments by selling or leasing every conceivable part of their property, from wall surfaces for advertising space to rooftop surfaces for cell towers. Increasingly, these owners are considering the sale of airspace.

There are several reasons an owner may want to convey airspace separately from the underlying land. Parcels consisting of an airspace envelope have been transferred to enable the purchasing party to obtain tax exemptions available only to owners,[1] to avoid legal restrictions on use pertaining to the current owners, or as an alternative method of carving up a single parcel of real property among separate owners without resorting to the condominium form of ownership.[2]

> Virtually **every New York City transaction** involving the transfer of development rights now requires the creation of a legally defined **airspace parcel**, the utilization of an **'airspace deed'** to convey the parcel, and the subdivision of the underlying lot to create a new **tax lot for the airspace** on the city's tax map.

In 2008, the New York City Department of Finance (DOF) adopted a new policy regarding airspace conveyances and other transfers of air rights. Effective Sept. 1, 2008, the DOF declared that no "Air Rights document(s)" may be filed with the Office of the City Register (now known as the Division of Land Services), without first having an "Air Rights lot…issued, finalized and approved by the [NYC] Surveyor").[3] Under this policy, documents involving air rights are no longer accepted for recording against partial lots.[4]

As a result of this policy change, virtually every New York City transaction involving the transfer of development rights now requires the creation of a legally defined airspace parcel, the utilization of an "airspace deed" to convey the parcel, and the subdivision of the underlying lot to create a new tax lot for the airspace on the city's tax map. The implications of this policy change are widespread.

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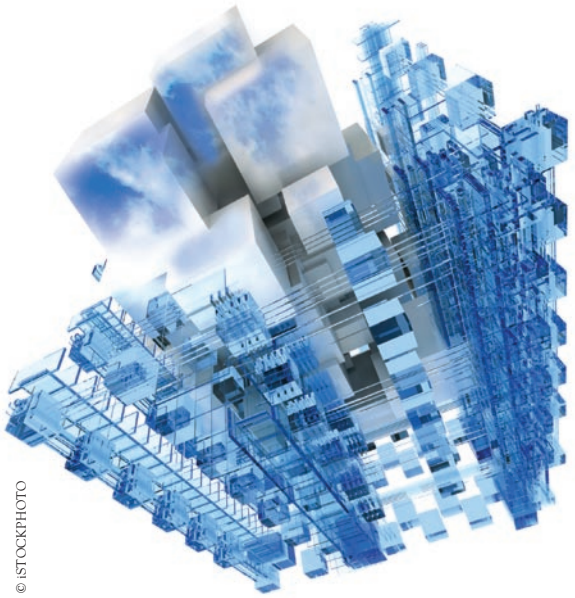
Defining the Terms

The DOF's change in policy raises the question of what is meant by "Air Rights documents." "Air rights" refer to the entire bundle of rights of an owner of real property to use, control and enjoy the airspace above his land. While FAA regulations and various statutes have limited an owner's air rights somewhat, at common law a real property owner was considered to own the airspace above his land to an indeterminate extent and to enjoy all the rights of real property ownership with respect to such airspace.

"Development rights," which are the rights in which many owners and developers in New York City are most interested, are only one part of this bundle of air rights; they refer to the right of the owner to build upon or otherwise develop his land. An even smaller subset of these rights includes transferable development rights, often referred to as "TDRs."

TDRs are a creation of municipal or other local law. As increasingly complicated zoning restrictions have limited the encroachment of buildings into the air, the city of New York has developed several different mechanisms allowing property owners to transfer their rights to build larger buildings to owners of neighboring, and sometimes distant, properties.

The policies behind the allowance of such transfers vary, from providing a measure of compensation for what otherwise may be considered a government taking, to encouraging development of affordable housing and raising



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funds for public works projects, such as school construction. Real estate developers often seek to purchase TDRs as a means of increasing the allowable floor area ratio (FAR) of their projects. The vast majority of "air rights" transactions in New York City are TDR transactions.

Old Deal Structure, Documentation

Prior to the DOF policy change, a typical transaction involving TDRs in New York City required only the creation of a zoning lot merger in accordance with the provisions of §12-10 of the New York City Zoning Resolution (ZR).[5] Pursuant to the ZR and requirements of the New York City Department of Buildings (DOB), a zoning lot merger requires only four documents:[6]

- a Certificate of Parties in Interest issued by a title company licensed to do business in the state of New York, setting forth all parties having an interest (as defined in the ZR) in the properties from which (the "sending parcel(s)") and to which (the "receiving parcel(s)") the rights were to be transferred;
- a Declaration of Zoning Lot Restrictions between the purchaser and seller of the development rights (and any other interested parties wishing to join in the declaration);
- a Waiver of Declaration of Zoning Lot Restrictions by any parties in interest not joining in the declaration (usually including a subordination clause for any mortgages, leases or other interests that may encumber the develop rights); and
- a Zoning Lot Description and Ownership Statement describing the properties to be merged, the proposed new zoning lot, and the ownership of the parcels involved in the merger.

The parties to a transaction involving TDRs also typically executed a contract of sale describing the financial and other terms of the deal, and/or a zoning lot development agreement (ZLDA) describing the obligations of the parties and addressing issues such as future development and property use, construction, and real property taxation. Where the sending and receiving parcels were in close proximity to one another, an easement for light and air in favor of the receiving parcel was often included to ensure that future development on the receiving parcel could comply with building code requirements.[7]

Although some TDR transactions did include a conveyance of airspace by deed, this was not typical. Prior to the DOF's change in policy, many TDR deals were structured to transfer only the excess development rights of the sending parcel.

The development rights to be conveyed were often described only in general terms of excess allowable FAR,[8] or unused development rights, available to the sending parcel, and in many cases, did not even include a calculation of the exact amount or square footage of floor area available to be transferred.

> The creation of separate tax lots specifically for airspace parcels would seem to **open the door** for **possible taxation**; as it now stands, they are included on the city's tax rolls and assessed on a '**value reflected basis,**' meaning these parcels are considered to have value, but that value is **reflected into other tax lots**.

While legal descriptions of the sending parcel, the receiving parcel, and the new zoning lot were included in the required documents, the deal could be completed without including a legal description in three-dimensional space.

New Considerations

Now, parties may no longer be able to avoid upfront costs by simply agreeing to transfer whatever development rights happen to be available. Experts such as architects, surveyors and engineers are needed to study and precisely describe the rights to be transferred, by deed or otherwise, before a contract of sale is entered. An airspace survey, at the very least, is necessary to the creation of a sufficient legal description, and title to the airspace parcel must be examined and cleared before the transaction is closed.

There are timing considerations as well, if the creation and subdivision of an airspace parcel are to be completed in addition to the zoning lot merger process. Obtaining a tax lot subdivision from the DOF can be a lengthy and time-consuming process. Air rights purchasers with construction deadlines would do well to begin the subdivision process as soon as possible after entering a contract of sale for TDRs, and the parties should allow sufficient time between contract and closing for the tax lot subdivision to be completed, since the airspace deed and other documents cannot be recorded without the tax lot subdivision.

A full fee transfer of airspace, as opposed to a transfer of TDRs only, could result in unexpected difficulties for the owner of the sending parcel, since the new owner of the airspace parcel would have acquired a variety of property rights enforceable against the owner below.

For instance, in *Wing Ming Properties v. Mott Operating Corp.*, the defendants had conveyed all of their airspace to the plaintiff's predecessor in interest, reserving for themselves only the space occupied by an existing room built upon the roof of their building and several rooftop air conditioners.[9] Subsequently, the defendants' tenant removed the rooftop room and the existing air conditioning units and installed new air conditioners and a parapet wall that occupied slightly more space than the prior air conditioning units and room. The owner of the airspace parcel sued the owner of the lower parcel for trespass.

While the Court ultimately found in favor of the defendants, largely because the encroachment into the airspace parcel was de minimus, parties to airspace deals should be careful to structure them to avoid this issue. The creation of an easement in favor of the sending parcel may help to resolve it, if the easement is drafted to include all possible non-FAR structures and uses the owner of the sending parcel (and its successors) may desire to implement on the sending parcel in the future.

Another consideration for parties contemplating a fee transfer of airspace in connection with a TDR transaction is the unsettled nature of the law on the legal status of airspace parcels. There appears to be no question that, when connected to the underlying land and considered together

with it, airspace is real property.[10] Yet airspace is not included in the definitions of real property contained in the New York Real Property Law and the New York Real Property Actions and Proceedings Law (RPAPL),[11] and it has been argued that this lack of inclusion was intentional, and that airspace, once separated from the underlying land, is no longer considered to be real property for purposes of those statutes.[12]

The status of airspace as real property could have practical implications for owners of subdivided airspace parcels and other interested parties seeking to enforce their rights in or against the subdivided airspace parcel in the future.

Taxation of Airspace Parcels

Both TDRs and airspace are considered to be real property for purposes of New York City and New York state real property transfer taxes.[13] While the New York State Office of Real Property Services has maintained that air rights and TDRs are not considered to be real property for purposes of the real property tax, the issue of real estate taxation of airspace parcels is not fully settled.[14]

The creation of separate tax lots specifically for airspace parcels on the city's tax map would seem to open the door for possible real estate taxation of these parcels in the future. As it now stands, these parcels are included on the city's tax rolls and the New York City Assessors Office assesses them for tax purposes on a "value reflected basis." This means that the parcels are considered to have value, but that value is reflected into other tax lots.

While presumably the value would be reflected into the receiving lot, a downward adjustment to value is typically not made to a sending lot following an airspace conveyance. Likewise, an upward adjustment to value is typically not made to the receiving lot, unless a larger building is actually built on the receiving lot utilizing the transferred development rights.[15]

As a practical matter, real estate taxation of airspace parcels may be a long way off, since separate ad valorem taxation of these airspace lots could prove problematic from a valuation standpoint.[16] However, it is not outside the realm of possibility. Given that such parcels clearly have value, if the amounts paid in TDR deals are any evidence, a cash-strapped municipality seeking additional means of revenue may resort to such a tax.

Title Insurance Matters

One benefit to the use of an airspace deed in a TDR deal is that title to the TDRs is more easily insurable.

Without a deed or easement, the only title insurance option available for such a deals is a "development rights endorsement," which generally insures only that all of the parties in interest have executed the Certificate of Parties in Interest, any recorded ZLDA is valid under the ZR, and any easement for light and air referred to in the ZLDA is properly recorded. As stated by one commentator "title insurance coverage [for TDR deals], where given, involves some fancy footwork, semantically speaking."[17]

The lack of insurability of TDRs without deeds is another reason easements for light and air were often included in TDR transactions in the past. The easement was considered to be an insurable real property interest, giving the TDR purchaser an opportunity to insure the zoning lot merger.[18]

Now, the DOF's policy of requiring a tax lot subdivision prior to the recording of an airspace deed has led many title companies involved in TDR deals to refuse to offer any sort of title insurance in TDR transactions not including the creation and subdivision of an airspace parcel. Thus, while it is possible that the DOF may still allow the recording of the documentation necessary to effect a zoning lot merger without requiring a tax lot subdivision (so long as none of the documents are to be recorded against a "partial" lot), parties desiring to proceed with such transactions may have to do so without the benefit of any title insurance. Lenders are likely to refuse to finance development projects where TDR title insurance is unavailable.

Conclusion

In light of the new DOF policies, practitioners seeking to complete TDR transactions are well advised to consult with their clients early in the process regarding the costs and benefits of the TDR deal structures now available, and advise their clients of the timing considerations, tax and title insurance implications of obtaining a tax lot subdivision and airspace deed.

1. See e.g., New York State Dept. of Taxation and Finance Advisory Opinion, Petition No. M970214C, 1997 NY Tax LEXIS 284 (May 21, 1997).

2. See Alan J. Pomerantz, "Are Air Space Parcels Real Property? Maybe," New York Law Journal, Sept. 26, 1994.

3. NYC Dept. of Finance, Office of the City Register, Memorandum, Recording Air Rights (July 14, 2008). The memorandum provides that exceptions to the policy may be made "depending on the circumstances…up to the discretion of the City Register and/or the Deputy of the [applicable] borough office…".

4. The DOF adopted a policy in 2005 prohibiting recording of documents against partial lots in most cases. Deals involving TDRs were one of many exceptions to this rule.

5. TDR transactions involving landmark sites or special zoning subdistricts created for such purposes do not involve zoning lot mergers and instead are accomplished by certification by the City Planning Commission or special permit. See ZR §§74-79 et seq.; see also ZR §§81-63, 81-744, 91-64 and 94-01. See generally Marc A. Landis, Kevin B. McGrath and Lonica L. Smith, "Transferring Development Rights In New York City," NYLJ, Sept. 29, 2008, Trends in Real Estate & Title Insurance special section.

6. Forms of these required documents were drafted by the DOB and are contained in a DOB Memorandum dated May 18, 1978. With some minor variations, they remain the standard today.

7. See NYC Admin. Code §§27-732 and 27-745.

8. The ZR defines FAR as "the total floor area on a zoning lot, divided by the lot area of the zoning lot." ZR §12-10.

9. *Wing Ming Properties v. Mott Operating Corp.*, 79 NY2d 1021 (1992).

10. See e.g., *Butler v. Frontier Telephone Company*, 186 NY 486, 491 (1906) ("space above land is real estate the same as the land itself. The law regards the empty space as if it were a solid, inseparable from the soil…").

11. N.Y. Real Prop. Law §2(1); N.Y. RPAPL §111.

12. See e.g., New York State Office of Real Property Services, Opinions of Counsel, Volume 8: SBEA No. 110, May 2, 1986; Alan J. Pomerantz, "Are Air Space Parcels Real Property? Maybe," supra; cf. Model Airspace Act §§2 and 4 (1973) (declaring that airspace is real property and that all laws that are applicable to real property shall be applicable to airspace). The Model Airspace Act has not been adopted in New York.

13. NYC Admin. Code §§11-2101–11-2116; NY Tax Law §§1400–1421.

14. See New York State Office of Real Property Services, Opinions of Counsel, Volume 8: SBEA No. 110 (May 2, 1986).

15. See "Real Estate Titles," §22.13 Taxation of Airspace and Air Rights (3d ed.) (New York State Bar Association, 2001).

16. See e.g., *3775 Genesee Street Inc., v. State of New York*, 415 NYS2d 575 (Ct. of Claims, 1979) (holding that the claimant had failed to show that the airspace claimed to have been taken had any intrinsic value of its own, separate from the land, and roundly rejecting the claimant's use of an appraisal based on valuation of land in cubic, rather than square, feet).

17. "Real Estate Titles," supra, §22.12 New York City Zoning Lot Mergers (3d ed.)

18. Id.; see also Marc Israel and Caroline G. Harris, "Higher and Higher," NYLJ, Jan. 16, 2007.

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