New York Law Journal

A NEW YORK LAW JOURNAL SPECIAL SECTION

ALM

REAL ESTATE
Board of New York

Web address: http://www.nylj.com

TUESDAY, JANUARY 16, 2007

Higher and Higher

Acquiring development rights through zoning lot mergers is one way to enhance land value.

BY MARC ISRAEL
AND CAROLINE G. HARRIS

ANYONE who lives, works or even has visited New York City knows that real estate is a precious commodity. With undeveloped land scarce, one of the only ways to add to the cityscape is to fully exploit the development potential inherent in a property and, then, to add to it. In New York City, a property owner can add to the value of land by using development rights (sometimes called "air rights") acquired from adjacent underdeveloped parcels.

According to the "Zoning Handbook," written and recently revised by the New York City Department of City Planning, "Development rights generally refer to the maximum amount of floor area permissible on a zoning lot. The difference between the maximum permitted floor area and actual floor area is referred to as 'unused development rights.'" Unused development rights can be bought and sold in a private transaction, without government involvement, and their cost is usually lower per square foot than the land itself. Therefore, the acquisition of development rights is an extremely popular method to enhance land value. Obviously, in the current market, they are prized.

This article focuses on the basic mechanics of development rights deals. Although the concepts explored in this article may have parallels in certain municipalities outside of the city, this article applies only to the transfer of development rights in the five boroughs of New York City. The article will provide guidance to the practitioner in the following areas:

- Understanding what a zoning lot merger is;

Marc Israel *is senior vice president and special counsel for American Land Services, and* **Caroline G. Harris** *is of counsel for Troutman Sanders, in the New York office.*

Empire State Building NYLJ PHOTO/RICK KOPSTEIN

- Explaining how to merge tax lots into a single zoning lot;
- The role that the title company plays in the creation of a merged zoning lot;
- Structuring the transaction so the transfer can be protected by title insurance.

Development of Concept

A zoning lot merger is a legal concept that has grown out of the push and pull between real estate developers' century-long desire to erect taller buildings and New York City's desire to impose limits to control this Babel-like urge. The 1916 Zoning Resolution of the City of New York and, 45 years later in 1961, the completely overhauled Zoning Resolution established regulations to govern the size and shape of buildings. Under the 1916 Zoning Resolution, light and air were protected through height and setback requirements based on lot size and adjacent street width. However, developers figured out that they could make agreements with adjacent owners to include the adjacent lot's area in the zoning calculation in order to increase the height of new buildings. This served to undermine the goal of the 1916 law while at the same time producing some of New York's most notable buildings, including the Empire State Building.

The 1961 Zoning Resolution used new regulatory tools to protect light and air and to ameliorate other ill effects of urbanization that gnawed at the city. The new Zoning Resolution retained the use of height and setback regulations, supplementing them with fixed height limitations and open space requirements. But, the 1961 Zoning Resolution's primary tool for controlling the size of buildings was the introduction of a new concept known as Floor Area Ratio (FAR) and of a particular definition of "Floor Area" as the official limit and measure of the potential size of development permitted for a lot.

FAR is defined in today's Zoning Resolution as "the total 'Floor Area' on a zoning lot, divided by the lot area of that zoning lot." For practical purposes, FAR is the multiplier to be used to ascertain the maximum amount of Floor Area[1] that can be built on a lot on an as-of-right basis. Thus, the permissible FAR, multiplied by the lot area, equals the maximum amount of Floor Area that can be built on a lot on an as-of-right basis. FAR varies both by the zoning district in which the property is located and depends on the use (such as residential, community facility, commercial or manufacturing) for which the property is to be developed. For example, a 10,000-square-foot lot in a zoning district with a maximum FAR of 8.0 for commercial use can contain a building with 80,000 square feet of Floor Area.

Yet, the authors of the 1961 Zoning Resolution recognized the inevitability of developers' determination to build taller. They also appreciated the advantage to the city of maximizing the use of all of the Floor Area permitted within a single block. Therefore, the 1961 Zoning Resolution expressly provided for the shifting of development rights and, in effect the permitted Floor Area, from one lot to another by means of a zoning lot merger.

According to the "Zoning Handbook," a "[z]oning lot merger is the joining of two or more adjacent zoning lots into one new zoning lot. Unused development rights may be shifted from one lot to another, as-of-right, only through a zoning lot merger." Both the measurement tool of FAR and the concept that development rights, including Floor Area, could be uprooted from their source and relocated to an adjacent lot have had far reaching impact.

The 1961 Zoning Resolution expressly provided for the shifting of development rights and, in effect the permitted Floor Area, from one lot to another by means of a zoning lot merger.

Defining 'Zoning Lot'

The Zoning Resolution uses "zoning lot," not a tax lot or some other identification of a parcel, as the base unit for all zoning calculations. Thus, a zoning lot is not the same as a tax lot. Instead, it is a tract of land comprised of one or more tax lots within a single block. In fact, it is the definition of "zoning lot" that makes zoning lot mergers possible. Moreover, the relevant zoning lot for a development must be identified on any plans submitted to the Department of Buildings.

The 1961 Zoning Resolution's definition of "zoning lot" focused on the contiguity of the tax lots and on common ownership of the lots in the particular tract of land as the key defining features of a zoning lot. To be considered contiguous, the two adjacent lots to be merged must share 10 feet along a common boundary. In addition, more than two lots can be merged into a zoning lot provided each lot shares 10 feet along a common boundary lot with another lot in the chain.

In the 1961 law, "ownership" included conventional fee ownership as well as long-term leases with an aggregate of 75 years including renewal terms. However, under the 1961 law other parties who may have had an interest in the property were not considered in the zoning lot merger and this led to numerous problems. A lessor with an interest in the property could lose a portion of his asset or a mortgagor could lose a valuable component of its security through the transfer of the development rights and their incorporation into a building on an adjacent lot.

Therefore, the Zoning Resolution was again amended in 1977 and a new definition of "zoning lot" was created which provides that not all tax lots in the zoning lot need to be owned by one entity. Rather, in §12-10(d) of the 1977 Zoning Resolution, the operative tool for defining a "Zoning Lot" became the "Declaration of Restrictions" by the owners of the adjacent (i.e., contiguous) properties that their respective zoning lots (usually tax lots) are to be merged into a single, larger zoning lot. Subsection (d) of the definition of zoning lot states that a zoning lot is:

> (d) A tract of land, either unsubdivided or consisting of two or more lots of record contiguous for a minimum of ten linear feet, located within a single block, which at the time of filing for a building permit (or, if no building permit is required, at the time of filing for a certificate of occupancy) is declared to be a tract of land to be treated as one zoning lot for the purpose of this Resolution.

With such a declaration as required by 12-10(d), the development rights appurtenant to the now enlarged single zoning lot can be used anywhere on the zoning lot, subject to other zoning regulations. From a transactional perspective, the 1977 amendment enabled the development rights to be sold and shifted from the seller's lot to the adjacent buyer's lot, simply by the parties' declaration that their two separate tax lots are to be deemed a single zoning lot.

Parties in Interest

In order to protect the interests of any other parties who may have an interest in the lots that could be adversely affected by the merger, the Zoning Resolution requires a "Certificate of Parties in Interest" to be issued by a title company. Depending on the scope and nature of such party's interest, as disclosed in the certificate, that party's consent to the zoning lot merger might be required.

Specifically, in connection with a subdivision 12-10(d) merger, the applicant to the Department of Buildings must provide a certificate issued to the

applicant by a qualified title insurance company showing that each party having any interest in the subject tract of land is a party in interest. A "party in interest" includes only:

> (W) the fee owner or owners thereof, (X) the holder of any enforceable recorded interest in all or part thereof which would be superior to the Declaration and which could result in such holder obtaining possession of any portion of such tract of land, (Y) the holder of any enforceable recorded interest in all or part thereof which would be adversely affected by the Declaration, and (Z) the holder of any unrecorded interest in all or part thereof which would be superior to and adversely affected by the Declaration and which would be disclosed by a physical inspection of the portion of the tract of land covered by the Declaration. Section 12-10.

Each party in interest in the portion of the tract of land covered by the declaration must either execute the declaration or a waiver of its right to execute the declaration. The declarations and the waivers must also be recorded against the merged lots. Thus, the certificate must show that all of the parties in interest in all or a part of the tract of land have executed and recorded either the Declaration of Restrictions or a waiver of the right to execute.

The failure to correctly list the party in interest and to obtain their consent to the merger through the declaration or waiver can lead to the subsequent disapproval of the zoning lot merger even after construction has commenced. Therefore, the title report and the accuracy of the title company's Certificate of Parties in Interest is critical. The Zoning Resolution also provides for the merger of lots that are all owned by one party. In that case, the Certificate of Parties in Interest is equally important. If the certificate shows that a party in interest has an interest in all or substantially the entire tract of land to be merged, its consent is not required because its interest in the land would not be impaired by the shifting of the development rights. But, if the party in interest has an interest in only a part of the tract of land, the merger would fall under Subdivision (d) and that party's consent (or waiver) would be required.

Mechanics

While some of these details seem complicated, in essence, the mechanics of a subdivision (d) zoning lot merger are very straightforward. If the seller and the buyer of the development rights agree and all the parties in interest are cooperative, then simply by their executing a Declaration of Restrictions or Waiver and providing other required documentation,[2] the merger can be effectuated.

Forms of those required documents, including the Declaration of Restrictions, Certificate of Parties in Interest pursuant to Subdivision 12-10(d) of the definition of Zoning Lot, the Waiver, and the Zoning Lot Description and Ownership Statement were drafted by the New York City Department of Buildings (DOB) and are contained in a DOB Memorandum dated May 18, 1978. With some minor additions, they remain the standard today.

In addition to the documents required by the Zoning Resolution, in the form recommended in the 1978 DOB Memorandum, two other documents are highly recommended to be executed and recorded. Since the Declaration of Restrictions does not state which of the owners of the merged lots has a right to use the development rights an agreement must be entered into between the parties setting forth these rights. Accordingly, it is standard practice for the owners of the lots to be merged to enter into a zoning lot development agreement (ZLDA) which establishes the various rights and obligations of the parties to the merger. The ZLDA also gets recorded against the executed lots.

The Declaration of Restrictions also does not address how construction on one of the adjacent properties can affect the other. Thus, the parties usually agree to enter into an Easement for Light and Air which prevents the property owner who is going to add to his building from denying the adjacent property access to light and air.

Yet, there is another, perhaps more significant, reason to execute an Easement for Light and Air. Notwithstanding the fact that the title company executed the Certification of Parties in Interest and recorded all of the necessary documents it will still not issue title insurance for the transaction. The reason for this is simple. The parties to the zoning lot merger may have acquired valuable assets but they did not acquire real property. Instead, all that they have acquired are development rights, a creation of the Zoning Resolution, and although those rights may be valuable they are not real property and cannot be insured by a title insurance company against a future claim.

This obviously puts the parties making the merger in a difficult situation. Hundreds of thousands or even millions of dollars may have been spent acquiring the development rights and a purchaser of those rights will want to insure their investment. The solution to this problem is found in the Easement for Light and Air.

Since an easement is an interest in real property it can be assigned a dollar value and it can be insured for that amount by a title company. Therefore, although not required for a zoning lot merger, an Easement for Light and Air is an essential part of the transaction as it gives the owner of the merged lots an opportunity to insure, and financially protect, the merger.

Although a title company will not insure the development rights by themselves since they are not real property, most companies will make a development rights endorsement a part of a title policy for property they are otherwise endorsing. This endorsement insures that (a) all of the parties in interest as defined in §12-10 (d) either executed the Certificate of Parties in Interest or waived their right to do so, (b) any recorded ZLDA is a valid agreement in accordance with §12-10, and (c) any Easement for Light and Air referred to in the ZLDA was properly recorded. This endorsement provides a measure of assurance to a developer who is insuring title to a property that includes a zoning lot merger.

Conclusion

Development rights deals have become far more common in New York City as creative developers continue to look for new ways to develop the land in the city and even the air above it. Accordingly, an attorney should understand both the legal concept and mechanics required to effectuate such a deal. Indeed, it is an invaluable skill to acquire, as the land that the city sits on certainly won't expand, but developers' desire to build upon it undoubtedly will.

1. "Floor Area" is defined in the Zoning Resolution as "the sum of the gross areas of the several floors of a building or buildings, measured from the exterior faces of exterior walls or from the center lines of walls separating two buildings…" minus specified exclusions.

2. In addition, the applicant must execute and record a zoning lot description and ownership statement accurately describing the lots to be merged.

ABOUT MARC ISRAEL

Marc Israel is Senior Vice President and Special Counsel to American Land and a principal of the company. Marc heads up the sales and business development efforts for the New York City Office. After graduating from Duke Law School in 1987, he spent approximately seven years working at large law firms. In 1994, Marc opened his own law practice and continued to practice both on his own and as a partner of a small firm until joining American Land in 2004.

As a practicing attorney, he has ordered title insurance on behalf of his own clients and understands first hand the value of great service. Marc understands that in a business where fees for premiums are regulated by statute, the difference between one title company and another is superior client service. That is what he and the entire team at American Land strive for every day.

Please do not hesitate to contact Marc for any of your title or real estate needs. He can be reached in the office at 212.239.1000, cell phone 516.967.7378, or by e-mail at: misrael@americanlandservices.com.

ABOUT CAROLINE G. HARRIS

Caroline G. Harris is Counsel to Troutman Sanders LLP and focuses her practice on zoning, land use and historic preservation in Troutman Sander's Real Estate Practice Group. She represents real estate developers, land owners, lenders, not-for-profit organizations and public entities on a variety of land use and development issues. Caroline is recognized as an expert on legal issues related to development rights and frequently teaches and lectures in this area of law. She is a 1979 graduate of the University of Maryland Law School.

Please do not hesitate to contact Caroline to discuss development rights and any other zoning or real estate issues. She can be reached in the office at 212.704.6434, or by e-mail at: caroline.harris@troutmansanders.com.

American Land®

One Penn Plaza, 34th Floor
New York, NY 10119
Phone: 212.239.1000
Fax: 212.239.6970

TROUTMAN SANDERS
ATTORNEYS AT LAW

The Chrysler Building
405 Lexington Avenue
New York, NY 10174
Phone: 212.704.6434
Fax: 212.704.5938