



New York City development tools: Inclusionary air rights part 2 - by Patrick O'Sullivan and Michael Smith

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Part 1 of this four-part series appeared in the December 1st edition.

The generation of inclusionary air rights provides owners with an opportunity to improve a development project's economics. This second part of our series focuses on how an owner can

monetize these inclusionary air rights through a sale and transfer. We will provide the A-B-C's of the inclusionary air rights transfer.

If an owner is not incorporating the inclusionary air rights being on its site, it can transfer the air rights to a receiving site that is either within (i) the same community district or (ii) an adjacent community district that is within half mile of the generating site. The air rights, which are referred to as "floor area compensation" in a sale transaction, are typically transferred pursuant to a purchase and sale agreement. Before executing an agreement, a purchaser should conduct the necessary diligence to confirm that the air rights can be used on its property, which is referred to as the "compensated zoning lot."

Since the parties often will enter into a purchase agreement before work on the generating site is complete, a purchaser needs to get comfortable that the generating site owner can complete its project. Until a purchaser pulls a building permit to use the air rights, which may be years after money has changed hands, the purchaser receives no confirmation from the city that the transaction was effectuated correctly and resulted in the generation of air rights. Moreover, a purchaser cannot obtain title insurance for an inclusionary air rights purchase. This is different from a transfer by zoning lot merger (the most common type of development rights transfer in the city), where a development rights endorsement is available and the title company typically plays an active role in independently verifying that all "parties in interest" have consented.

The purchaser also should be mindful of whether a lender consent is required in the case where the inclusionary air rights are part of the mortgaged property collateral on the generating site. A seller may provide its lender with protections regarding inclusionary air rights (such as physical possession of HPD certificates until the loan is repaid and/or bad boy recourse guaranty carveouts for unauthorized transfers). However, in other instances, a seller may not even agree that the inclusionary air rights are encumbered. See, e.g., *CB Frontier LLC v. LStar Capital Fin. II, Inc.*, 2017 NY Slip Op 6621.

Additionally, the seller needs to notify HPD of the proposed transaction and may have to obtain HPD's approval of the purchase price. Ultimately, the seller can request that HPD deliver a permit notice, the "DOB Letter," to the City's Department of Buildings (DOB), describing the affordable housing being preserved at the generating site. Once DOB receives the notice, it can issue permits to the purchaser's site for the portion of the development utilizing the inclusionary air rights.

Once the work contemplated on the generating site is complete, HPD will allow the parties to proceed with closing.

Should you have a project underway or in consideration, we would be pleased to discuss methods to use inclusionary air rights under current zoning. While this article provides an overview, there are a multitude of creative inclusionary air rights strategies that we have seen parties use to improve economics of a project.

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