To: My Clients and Friends

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**A Strategic Perspective on NYC Air Rights from a Seller’s Perspective**

A building in New York City which has not built to the maximum square footage allowed by the Zoning Resolution has **Transferable Development Rights (commonly referred to as air rights)**.

These TDR’s can be sold, often at lucrative prices, creating a one-time windfall for the building’s owners. All buildings should review whether or not they have TDR’s and what opportunities may exist for monetizing them.

1. **Does the Building have TDR’s?**

Each building resides in a zoning district which has a defined allowable Floor to Area Ratio. This ratio defines the number of square footage of space the building may occupy as a function of its lot size. FAR’s range from ½ to 15 or greater, depending on the density of the zoning district. A building in a district with a 15 FAR and a 10,000 square foot lot can occupy 150,000 square footage. If that building has only built to 100,000 square feet, it then has 50,000 square feet of TDRs.

It is important to note that different rules apply to building which are landmarked and buildings which are in Special Districts (e.g. the Highline, the Theatre District) where customized, more liberal transfer rules apply. This memorandum focuses exclusively on buildings subject to the generic zoning rules and not the special more customized rules.

1. **Is there a likely buyer for the TDR’s?**

A typical commercial building, co-op, condo, or townhouse can sell its TDRs to a development which is **(i) on the same block and (ii) to which it is directly or indirectly adjacent**. Directly adjacent means sharing at least 10 feet of adjoining space.

Indirectly adjacent means being connected to another lot through a conduit lot which meets these requirements (and agrees to act as a conduit). A Seller can utilize more than one conduit lot to connect to a development site, provided the owners of these lots are willing.

**Given the relatively tight practical constraints on who can acquire TDR’s, any Buyers that emerge may well be the only opportunity that will present itself for the foreseeable future and should be taken quite seriously. Sellers may still have significant negotiating leverage due to the narrow universe of other potential TDR Sellers (given the above limitations) as well as the attractive economies of scale in building a higher building and having floors with better views.**

A well advised Seller will also carefully explore the possibility of other Buyers emerging on other adjacent sites and sites connected through conduit lots. The Seller should seek to maximize the competitive tension between the main Buyer and any other bidders or potential bidders who may emerge. Coordinating with other buildings that may serve as conduits will be an important part of a well run process to maximize value.

1. **What is the value of the TDRs?**

**Depending on location, TDR’s can be extremely valuable. As a point of reference, according to a recent study, the average price per square foot for air rights in Manhattan in 2016 was $292/square foot. The prices do vary substantially by neighborhood, with the highest priced deal in 2016 at $1258/square foot for a deal in the theatre district.**

Two basic techniques have been used by professional appraisers to appraise value of TDR’s.

**First**, applying market convention that **the TDR’s are worth 50-60% of the value of the underlying land (per square foot) to which they will attach.**

This percentage range can vary substantially downwards and upwards depending on the importance of the TDR’s to the proposed development. In unusual cases, TDR’s which are critical to a project going forward can be worth in excess of 100% of the land value (per square foot) for example.

The underlying land valuation will look to recent purchases of land in the same general locale as the Buyer’s, and weight them according to relevance (the most relevant likely being the Buyer’s acquisition of the development site itself, if recent).

Sales values of recent transactions will be adjusted (upwards or downwards) for differences in location, market conditions, zoning and other relevant criteria as compared to the Buyer’s site to best approximate fair value.

Having estimated the value of the Buyer’s land through the above method, and determined the appropriate percentage haircut to value the TDR’s, an estimated TDR valuation can be formulated.

The **Second** method of valuation is more straightforward: looking at **comparable TDR transactions in the same general locale and time period,** and, similarly, weighting them according to relevance.

While this second approach has the advantage of being more straightforward and tailored specifically to TDR’s, the first approach has the advantage of relying on the specific value of the Buyer’s land, and may therefore be viewed as more accurate.

For substantial transactions, professional appraisers can provide a formal opinion of value.

1. **Can my building get paid for acting as a conduit?**

Yes. If a developer can only access a third party’s TDR’s through using your lot as

a conduit, that gives you leverage to extract incremental value from the parties to the transaction. The third party Seller will be unable to sell his air rights (and the developer unable to acquire them) without your consent, and as such your building can extract a fee through negotiation.

The valuation of this consent fee is purely a question of negotiating leverage (e.g. how badly does the Developer need these incremental rights and how eager is the Seller to Sell) but can be very significant.

Similarly, if your building can only sell its TDR’s through a conduit site, it should expect that site to try to extract some value from utilizing it’s negotiating leverage as described above.

1. **How do I maximize my after tax proceeds?**

Since TDR’s may generally have a very low tax basis, the tax hit on any sale of TDR’s can be very substantial, approaching 50% of the value of the transaction. Careful planning is required to minimize this burden, and any potential transactions which can avoid this hit should be evaluated.

Many sellers have taken advantage of the liberal tax rules around **like kind exchanges of real estate** to defer the tax on the gain. Using the TDR proceeds to acquire other real estate is one way to avoid paying taxes, for example. This technique could involve accelerating needed structural enhancements to the building, buying in commercial leases on the building’s ground floor, or investing in structured vehicles designed to satisfy these tax requirements.