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## Transferring Development Rights by Zoning Lot Merger: The Marriage Can't Go on without the Lenders

September 10, 2017 – Commercial Observer  
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The most successful marriages are combinations that benefit both individuals. So it goes in a zoning lot merger, which is like a marriage between New York City properties. In a zoning lot merger, owners combine adjacent lots into a shared zoning lot, and pool together their development rights. For example, two owners with lots that each have 100,000 square-feet of development rights could agree to a zoning lot merger that gives them 200,000 square-feet of collective rights. They could then agree to a development rights transfer that sends 50,000 square-feet from one site to another, leaving one with 150,000 square-feet of development potential, and the other with 50,000 square-feet. These transfers are increasingly common because owners with untapped development rights profit, and the developers who purchase them can construct larger buildings.

To consummate this marriage, owners typically enter into a prenuptial agreement of sorts, called a zoning lot development agreement (ZLDA). A ZLDA (pronounced Zelda) is supremely important because it dictates how the development rights will be split up, and without one, unused square footage would be free for the taking by any owner.

Owners play the lead role in ZLDAs, but the marriage can't go on without lenders. That's because under New York City's byzantine, 1,300-page Zoning Resolution, zoning lot mergers require waivers from all "parties in interest," including mortgagees of the sending and receiving sites. Lenders also play a role because in loan documentation, mortgage collateral typically includes development rights.

To consummate a zoning lot merger, a borrower typically requests a waiver of the lender's "party in interest" status under the Zoning Resolution, the lender's consent to the borrower's ZLDA, and a subordination of the mortgage lien to the ZLDA. When lenders consider these borrower requests, it's important to perform the due diligence necessary to ensure their rights and collateral are protected.

For example, after a fee title closing, purchasers walk away with physical property that can be seen and touched (land, building, keys, etc.). Development rights however, are invisible. Until a developer pulls a building permit to use the rights

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(which may be long after money has changed hands), New York City provides no confirmation that the transaction was correctly completed. For that reason, lenders should always conduct an independent zoning analysis before consenting to a zoning lot merger.

Another item lenders need to focus on is zoning compliance. Let's say a borrower enters into a zoning lot merger with a lot that contains an illegal hotel. Building violations occur on a zoning lot-by-zoning lot basis, so in that scenario, the hotel violation becomes the borrower's problem as well. To avoid such complications, lenders should conduct a zoning compliance analysis of every property that will be joining the zoning lot, and include ZLDA terms that limit further zoning lot expansion without its consent. In addition, lenders should ensure that the ZLDA provides borrowers with the means to fix future problems, including through self-help remedies and zoning lot divorces.

ZLDAs also typically have multiple provisions devoted to a borrower's ability to rebuild damaged improvements after a casualty, in part because New York City can downzone areas. If a downzoning occurs, and an owner with no remaining development rights suffers a catastrophic event, such as a building collapse, they would be unable to rebuild a true replacement building - they would have to build smaller!

ZLDAs can also include easements, purchase options, rights of first refusal and first offer, and unusual provisions. Among the most common provisions are light and air easements, which restrict the height of future buildings, and provisions that give a developer the right to cantilever a new building over its neighbor's airspace. Parties entering into a ZLDA may also be executing an unrecorded construction license agreement (CLA) that requires temporary scaffolding, access to the neighboring property or permanent underpinning beneath it. Lenders should pay close attention to these ZLDA provisions, and ensure that CLAs protect the stability of buildings on the mortgaged property.

Zoning lot mergers are increasingly common, and as major development expands into the boroughs, we should see more of them. By approaching them carefully, lenders can ensure their rights are protected while stimulating the development that drives the city forward.