

Air Rights and Mineral Rights on City-owned land and Public Rights-of-Way

Economic Development and Housing
Committee

April 17, 2006

Purpose

- To provide information regarding the current process for the sale and license of air rights and mineral rights on city-owned land and public rights-of-way
- To explore changes in the methodology and/or process
 - When to retain air rights and mineral rights
 - How air rights are valued

Abandonment and License Fees

- Public rights-of-way are currently abandoned (sold) and licensed for partial real property interests:
 - Subsurface
 - Air Rights
 - Fee Simple (all interest in real property)
- There are other interests in real property but this discussion is limited to the interests mentioned above

License Fees

- Currently, license fees are established by the Dallas City Code. Some license fees are determined strictly by use and in other instances, a distinction is made for fee simple, subsurface or air rights uses
 - Examples
 - Use = awnings/canopies, signs/monuments, landscaping – fee determined by use
 - Fee simple = sidewalk cafes – fee determined using the surface use formula (area X market value X 85% (percentage for surface use) X 12%)
 - Subsurface = telecommunications – fee determined using the subsurface use formula (area X market value X 30% (percentage for subsurface use) X 12%)
 - Air Rights = balcony overhangs (area X market value X 85% X 85% X 12%)

Abandonment Fees

□ Abandonment Fees

- Currently, abandonment fees are established by the Dallas City Code and with a distinction made depending on whether the abandonment request area is fee simple, easement, subsurface or air rights
 - Fee simple = Area X Market value X % (discount allowed up to 15% for utilities)
 - Easements dedicated at no cost to the City (except street and alley) = processing fee of \$5,000
 - Subsurface = Area X Market Value X % (discount allowed up to 70%)
 - Air rights = Area X Market Value X % (discount allowed up to 30%)
- Building encroachments in the public rights-of-way are generally abandoned subject to the right of reverter in the event the building is destroyed or removed and not promptly replaced.

Issues

- Recently questions have arisen regarding how air rights are sold and whether the city is receiving the most monetary value for its air rights
- Additionally, mineral rights are now on the forefront since new technologies and high prices have made extraction economically viable for natural gas and oil located within north Texas cities. (Barnett Shale located under land in Tarrant County, DFW and possibly other areas in Dallas)

Definitions

- Air rights are defined as the rights of an owner to use or control the air space above the physical surface of the land and may be with or without ownership of the surface of the property
- Subsurface rights are defined as the rights below the surface of the land and may include mineral rights
- Fee Simple rights are defined as the greatest possible interest one can have in real property, an unconditional, unlimited interest that is perpetual

Definitions

- Bundle of Rights is defined as the rights in real property that the owner has the right to sell, lease, use, give away, enter/exit or the right to do nothing to the property. Any one of these rights can be transferred or conveyed to another. The full bundle of rights in real property includes: air, surface and subsurface rights (total = fee simple). A property impaired by an easement, eminent domain threats, zoning, police power or deed restriction all diminish the full bundle of rights (ownership)
 - Example: the city may have an easement across a residential lot for a water line. The owner can only use that easement area for things that do not interfere with the rights under easement

Historically

- Abandonment fees - in the past 20+ years (prior to the review by the Real Estate Task Force), the city has valued the abandonment of whole or partial interests in the rights-of-way it owns as follows:
 - Fee simple = 55% to 85% of market value
 - Air rights = 55% to 85% X 55% to 85% of market value (equated to 30% to 72% of market value)
 - Subsurface (may include mineral rights) = Area X Market Value X 30%
- License fees – included the same percentages of value with a 12% return on investment added over the term of the license, except for the flat fees charged for various uses

Demand Impact on Valuation

- The value of real property and its parts can be thought of as the relationship between desired location and a potential user. Real property values are determined by utility, scarcity and desirability. Without desirability and the ability to pay, real property that is scarce and/or useful lacks much value if no one desires it.
- In New York, land is scarce so the use of air rights has increased significantly. In Texas, however, land is still available and therefore the demand for air rights is not as great. Over the years, air rights have been sold for building encroachments, sky bridges, overhangs, etc.

Air Rights - Discussion

- In New York, as with other cities, there are zoning limitations on building heights. To exceed that limit, additional air space may be acquired from others. With transferable development rights, air rights may be transferred to an adjacent parcel, across the street or to a nearby designated location. For example, some developers buy air rights as a light-protector so they can put windows along the side of the building that faces the adjacent lot.
- The value of air rights are generally thought of as a residual of the fee simple after deductions for costs and losses associated with erecting structures in or upon the air rights. Air rights may be a substantial dollar amount and a percentage of the complete fee interest value or may, in rare instances, exceed the value of the whole.

Air Rights - Discussion

- High land prices and a shortage of economically feasible parcels have developed a market for air rights in some cities across the nation. Air rights over a church in New York were sold in 2005 for \$430 per square foot (approximately double the going rate). Previously, the price of air rights was around \$200 per square foot. The sale price will be paid over a period of two and ½ years and in three payments. By buying air rights over low scale buildings, the developers were able to exceed the standard zoning limits for building heights. An article from a New York Real property publication indicates that the typical air rights values are worth about 60% of comparable land values. This average value is consistent with the information provided by the representative from the City of New York.

Air Rights - Discussion

- City needs to obtain fair compensation for abandonments
- City has the extraordinary power to extract from developers
- What do we actually need to get a fair deal
- Do we leave customers with a negative impression of the City of Dallas
- The City benefits directly (as a partner) from development in increased property and sales taxes, new jobs and high profile projects
- Do these customers want to return to Dallas for their next development and what will they tell others about their experience

Air Rights - Discussion

- When are air rights to be retained over land abandoned
 - When it is clear the City has fee simple interest in the street or alley
 - Include all streets and alleys, surplus land, floodway management areas
 - In CBD, outside CBD, highly developed areas, slow development areas
- How do we charge for those air rights
 - Do we revise the City Code or do we use the current formula endorsed by the Real Estate Task Force
 - Do we use discretion - only in those instances where it is clear the added value exceeds the appraised value

Valuation Methods

- Methods for valuing air rights include:
 - comparable sales approach – compares sales of air rights with the subject air rights with adjustments for time and location
 - income approach – considers what is to be built in the air rights and the income to be derived from such improvements

Policies of Other Cities

Cities	Sale of Air Rights?	Appraisals Required?	Other Information
New York	Rarely, no set process	Values air rights based on FAR primarily	Would value air rights based on the market value of the development rights (Zoning Lot Merger). If no FAR involved, appraiser determines value. Appraisals average 60% of market value for land
Los Angeles	Yes	No	\$6,420 deposit required. Departments charge their services against the deposit and applicant is refunded any excess or pay additional. The deposit is generally sufficient. No market value established, treats all right-of-way as an easement. City extracts infrastructure improvements, street improvements, landscaping, etc.
Miami	Rarely, no set process	No, not currently	Handled on a case by case basis, goes through various committees and a determination is made as to what the applicant could proffer to benefit the public in exchange. Currently exploring instituting a process which considers the added value of the encroachment to the developer, value would be determined by the appraisers
Boston	Yes	Yes, without specific instructions to the appraiser	Applicant responsible for due diligence - engineering and title reports, deeds, utility releases, etc. Appraisals provided by applicant using city approved appraisers. Request is reviewed by various commissions and if approved, a Release Deed is given

Policies of Other Cities

City	Sale of Air Rights?	Appraisals Required?	Other Information
San Francisco	Rarely (one abandonment in 22 years)	Yes	Handled as major/minor encroachments - application fee for major encroachment = \$2,900, application fee for minor encroachment = \$737 plus \$3 per square foot annually (major or minor). If sold (rarely) \$2,500 application fee to city public works department, \$2,500 administrative fee to real property department and \$2,500 fee to city attorney
Orlando	No	No	Air rights are handled as encroachments through Air Rights Agreements. No fee is charged
Seattle	Rarely	Yes	Building Code allows for certain encroachments. If encroachments exceed what is allowed, handled through the permit process, no set fee currently. If sold, applicant pays for appraisal and the appraiser determines the value. \$450 application fee
Chicago	Rarely	Yes, 2 appraisals required	Generally handled through permitting process - Annual fee under 5-year contract based on formula tied to height and land value set by the City, increased 5% per year, formula varies. If sold, \$250 application fee and 2 appraisals, sold for appraised value
Denver	Rarely	No	Handled as major/ minor encroachments – application fee for major encroachment = \$2,100 plus \$200 annual fee for inspections, application fee for minor encroachment = \$0 but must comply with all building codes.

Previous Sales of Air Rights

- 1978 – abandoned air rights located on Main and Field Streets to Midway Development Co., Inc.
- Air rights - $462 \text{ sf} \times \$100 \text{ psf} \times 75\% \times 65\% = \$22,522$
- 1979 – abandoned air rights located near Federal and Harwood Streets to Carrozza Investments, Limited
 - Air rights – $4,410 \text{ square feet} \times \$24 \text{ psf} \times 75\% \times 65\% = \$51,597$
- 1980 – abandoned air rights located near Olive, Bryan and Pearl Streets to Dallas Skyway Partnership
- 1982 – abandoned air rights above Ervay Street to First Baptist Church of Dallas
 - Air rights – $786 \text{ sf} \times \$135 \text{ psf} \times 75\% \times 75\% = \$59,687$

Previous Sales of Air Rights

- 1982 – abandoned subsurface and deed restricted air rights located near Griffin and Main Streets to Bramalea Limited which provided additional Floor Area Ratio for the development (Bank of America Plaza Building)
 - Air rights - $15,900 \text{ sf} \times \$165 \text{ psf} \times 75\% \times 5\% = \$98,381$
 - Subsurface rights – $23,219 \text{ sf} \times \$165 \text{ psf} \times 75\% \times 20\% = \$574,670$
- 1998 – abandoned air rights over Hall Street to Baylor Health Care System as a part of a land exchange for needed street rights-of-way
 - Air rights - $8150 \text{ sf} \times \$8.50 \text{ psf} \times 85\% \times 85\% = \$ 50,050$
- 2005 – abandoned air rights over Olive Street to Anland Block C, LP
 - Air Rights - $496 \text{ sf} \times \$64 \text{ psf} \times 70\% = \$22,221$

Previous Sales of Air Rights

- 2006 – abandoned air rights and subsurface to **Icon Tower, LP** which facilitated the encroachment of balconies, building foundation soil retention systems for a basement level garage located near Houston and Olive Streets
 - Air rights - $85 \text{ sf} \times \$64 \text{ psf} \times 70\% = \$3,808$
 - Subsurface – $378 \text{ sf} \times \$64 \text{ psf} \times 30\% = \$7,258$

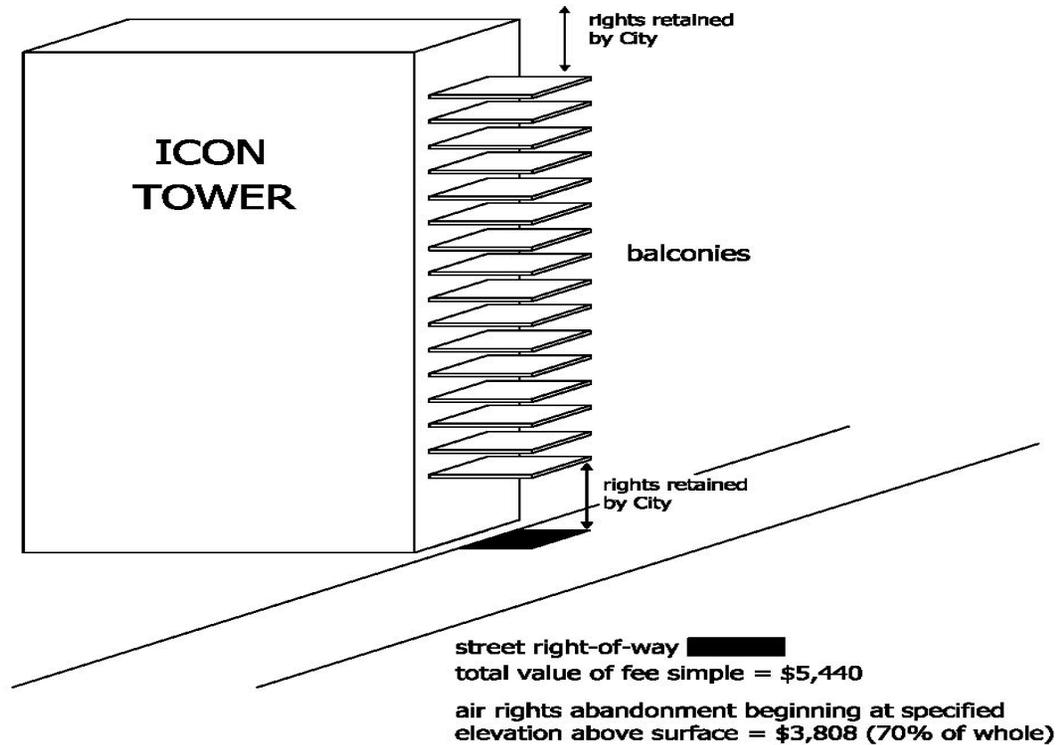
Pending Air Rights Abandonment Requests

- Pedestrian bridge over Munger Street between Akard and St. Paul
- Baylor Hospital elevator for multi-level pedestrian bridge over Hall Street

Appraisal Process for Icon Tower, L P Abandonment Request

- Icon Tower, LP requested the abandonment of air rights to facilitate balconies to serve their residential development. Their request is the catalyst for this discussion. As previously mentioned, the complete bundle of rights in real property represents the fullest interest one can have in real property and consists of many interests, for example – air rights, subsurface and minerals. Any one of these interests represents a partial interest in real property. These interests can be further broken down into various other categories, for example – leasehold, leased fee and sublease. The value of the whole may be equal to the sum of the separate parts and it also may be greater than or less than the sum of such parts. However, under the provisions of the Dallas City Code, the whole interest is valued and a percentage of the whole is attributed to the various interests, in this instance it is the air rights. Under this scenario, then the sum of the parts should not exceed the value of the whole, except in rare instances. The **Icon Tower** request was for an air rights abandonment. It was sold at 70% of the value of the whole. The appraisal was of the fee simple interest and was discounted by the appraiser to 70%, which left 30% of the total value attributable to the remainder of the whole (see next slide for illustration)

Icon Tower Illustration



Mineral Rights

- Definition
 - Mineral Rights – real property rights with the full bundle of rights accorded Air Rights or Surface Rights. Air, Surface and subsurface (may include mineral rights) make up the complete fee simple rights in real property
- No process for retaining mineral rights currently exists
- Process for retaining mineral rights on abandonment requests and sales of surplus land is currently being considered
 - Would include a waiver of surface access rights
 - Would not interfere with the surface or subsurface support of any improvements constructed or to be constructed on the land
 - Will review any impact on sales prices

Recommendations

- Air rights
 - Modify our procedures to sell air rights based on development rights in commercial developments (abandon to allowable height restrictions). In other words, retain all rights above and below the envelope of air rights to be sold
 - Continue to sell air rights pursuant to the current city code for other types of developments
 - Continue to value the air rights at 70% of market value
 - Advantages
 - Gives developers a fair price - is a clear and concise process on which they can do financial planning for a development
 - Public sector does not compete with the private sector
 - City benefits from developers being willing to continue to develop in Dallas
 - Provides a customer friendly relationship
 - City retains its air rights of land in commercial developments for future use or sale

Recommendations

- Mineral rights
 - Routinely retain mineral interests on street rights-of-way and surplus property with a waiver of surface access rights as to the minerals reserved and without reservation of a drilling site
 - Tax foreclosed properties will require the consent of the other taxing entities and may or may not contain these proposed provisions