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Creating Value Out of Air

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Three-dimensional airspace subdivisions can add value to real estate developments.

The historic Broadway Hollywood building at Hollywood and Vine in Los Angeles is being repurposed using the airspace subdivision strategy. With this approach, lots within airspace subdivisions are treated like any horizontally subdivided land lots, which means no common ownership or liability.

As real estate developers seek to maximize value by creating or redeveloping urban properties into high-density, mixed-use developments, concerns regarding autonomy of operations for each use, conflicts among the different uses, and financial constraints can arise. Three-dimensional subdivisions—airspace lots or parcels created vertically and horizontally within a building to establish separate legally transferrable lots—is a way of addressing all of these concerns.

While a condominium approach can create similar three-dimensional airspaces, the legal requirements involved may prevent the project from achieving the same benefits as an airspace subdivision. For example:

- **Common ownership.** Mixed-use condominium projects require common ownership of the common areas within the building. This shared ownership results in unwanted shared liabilities.
- **Operations and management.** The legal requirement for a condominium owners association is another disadvantage. If conflicts arise between the commercial and residential uses, the association can be used as a weapon to hinder the commercial operations.
- **Financial obligations.** Each owner in a condominium project is a member of the condominium association with the legal obligation to repay the association's debts as well as liability for any association misconduct.

Airspace subdivision benefits include:

- **No common ownership or liability.** Lots within airspace subdivisions are treated like any horizontally subdivided land lots. Owners of commercial and residential airspace lots are not in each other's chain of title, so they have greater insulation from liabilities arising from other lots.
- **No owners association.** Owners of separate lots within a mixed-use building are free to determine the structure for common area maintenance and operation. Mixed-use projects can be operated and maintained through a

reciprocal easement agreement (REA) among the owners. Maintenance responsibilities can be undertaken by an airspace lot owner, a management company, or a nonprofit entity created for such purpose. Once the REA is in place, the separate fee ownership minimizes the need for the owners' involvement regarding the project's long-term operation and management.

- **Sale and financing enhancement.** Most of today's financing funds are designated for specific types of real property (i.e., commercial only, residential only) and cannot be used for any other development sector. Airspace subdivisions allow each airspace lot to be purchased and financed independently. Thus, the hotel portion of a mixed-use project can be purchased or financed with funds designated for hotels, the residential portion with residential real estate funds, and so on. Such additional sources of funds can be critical to making a prospective development feasible.
- **Reduced transaction costs.** Eliminating documentation for common ownership and association operations reduces the time and cost for diligence and documentation of downstream sales, leasing, and financing for the development.
- **Benefits to local municipalities and public agencies.** The added value that airspace subdivisions create results in additional property taxes for local municipalities. Furthermore, the ability to sell and finance each portion of a mixed-use development separately holds the potential for more transactions, with each transaction resulting in additional property tax assessments and business tax revenues.

Whether the real estate market is up or down, developable land continues to be scarce, and the demand for return on equity continues to be high. High-density, mixed-use developments are perceived by some to be the wave of the future and the best way to maximize returns. Three-dimensional subdivisions can greatly enhance the desirability—and the ability to finance—mixed-use developments and, therefore, increase values and rates of return. UL

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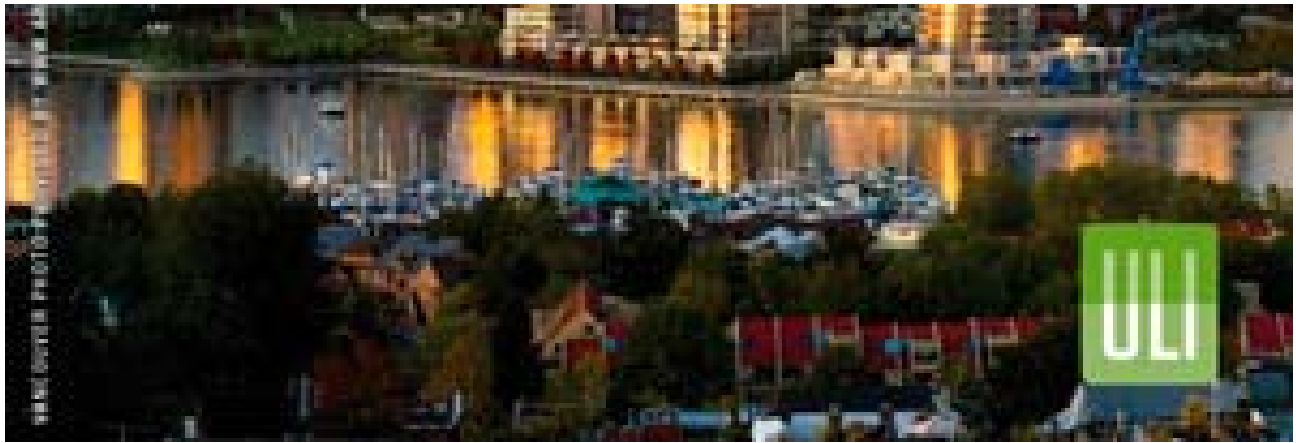
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