# DNR Briefing Material - Volume 5

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# Revenue Potential from Trust Lands Transactions

## What is the near- and long-term revenue potential from repositioning trust land parcels in the I-5 corridor to improve financial performance?

### Candidate Properties for Disposal

There are some 200 parcels (totaling 26,000) acres of under-performing trust lands in the I-5 corridor. The department is currently preparing to dispose of some of these. The primary goal is to improve net returns to the beneficiaries by acquiring higher performing assets. The replacement properties could be any asset class (agriculture, forest, commercial) and be located anywhere in the state.

Properties are selected for disposal if they:

- have appreciated in value due to higher and better use (HBU) characteristics, and are no longer suitable for resource production;
- generate little or no income;
- are too small or isolated to manage efficiently; and/or
- are costly to manage, relative to revenue.

### Property Value and Revenue Potential

The estimated value of the 26,000 acres is about $219 million. DNR's current policy sets a target range for minimum return on investment of 5-7 percent or better, for forest, agricultural and commercial properties. If the $219 million were invested in a mix of properties, the anticipated gross returns would be about $14 million per year once the subject properties are disposed and replaced with higher yield land. The department's general re-investment strategy has been to invest two-thirds of the re-investment funds into commercial and agricultural properties, which return annual lease revenues. The remaining one-third of the funds is targeted for forestland acquisitions, the revenue from which is generated over time, because it is not practical to buy significant amounts of mature timber.

Generally, the lands under discussion are federal grant lands. As such, 25 percent of the revenue from the reinvested lands is returned to the Resource Management Cost Account (RMCA), 75 percent is distributed to the trust beneficiaries. Using long-term averages, the RMCA would receive $3.5 million and the beneficiaries would receive $10.5 million in new revenue not available today.

### Timing and Capacity

Typically, a sale or transfer with few issues takes about a year; a land exchange takes from two to four years; and a purchase takes from six to nine moths. The appraisal process can be lengthy due to technical and social issues, public processes and negotiating the terms of the transaction.

Over the past two years with an active program, the department has repositioned about 9,000 acres per year through sales, transfers, and purchases. Exchanges, which usually

take 18 months – 2 years, can increase the acres repositioned dramatically in a given year. At 9,000 acres per year, hypothetically, it could take about three years to completely dispose of and replace the I-5 properties, assuming:

- all 26,000 acres were repositioned;
- there were no controversial issues or public concerns;
- this was the department's sole transaction focus; and
- General Fund support for the Trust Land Transfer Program was available.

Realistically, a time frame of ten years or more is more likely. The less controversial parcels could be transferred more quickly; others would take substantial time. Assuming 20 percent of the properties could be auctioned or transferred in the first one to two years, with 30 percent transferred in two to four years, the remaining 50 percent would take five to ten years to complete. The General Fund appropriation for Trust Land Transfer is a key factor in repositioning the Common School Trust. Without it, the capacity for transactions would shrink to about 3,000 acres per year, and take 9-30 years to accomplish.

**Approximate Cost**

At a cost of about $1.85 million per year, the cost of repositioning the 26,000 acres would be roughly $5 million.

Once the parcels were transferred or sold, the cash would be reinvested into trust-grade properties. The re-investment period can range from 6 to 12 months, or longer, depending on the nature of the negotiations. In summary, the mean annual first decade net cash flows would be less than the $14 million previously identified.

**Factors Affecting Land Transactions**

*Legal Constraints (See Table)*
Most of the legal constraints found in the State Constitution, Enabling Act, and Revised Code of Washington have been identified in a previous report. (See attachment.) One additional legal constraint is found in the Land Bank statute (RCW 79.66) that limits the amount of land that can be held in the Land Bank at any one time to 1,500 acres.

*Appropriation*
DNR is currently limited in purchasing power by the legislative appropriation process. No matter how much money is derived from land sales in a given biennium, the Legislature sets the amount of money available for replacement acquisitions at the outset of a biennium.

Over the last several biennia, biennial appropriations have been in the $20 million - $30 million-dollar range. If the department could participate in the market for properties of $40 million or more, large blocks of forestland or large commercial developments could be acquired.

As long as the department can only operate in the $1 million to $10 million property value range, transactions costs will be higher because more properties need to be acquired in order to reach revenue goals.

*Internal Practices to Protect the Corpus of the Trusts*

The department has long been reluctant to pay for transaction costs through the transactions themselves, reasoning that any diminution in land value to pay for operating costs is a diminution of the corpus of the trust. Instead, the agency has chosen to allocate a portion of the management funds to pay for this work.

In the past, The Board of Natural Resources has given limited authority to the department in some situations to pay for transaction costs up to a maximum of 5 percent, but the agency has rarely exercised this authority. In the 2003-2005 legislative session, the department was given the authority in a budget proviso to fold transaction costs for land exchanges into the value of the exchange, when the trust's position after the exchange (including costs) was improved over the pre-exchange position.

*Public Concerns*

Political and social concerns are present in both disposing of and acquiring properties. Some local governments view state acquisition of private land as an unacceptable negative impact to their tax revenues. Other governmental organizations and conservation interests may not support the sale of forested or other public land to private owners, and counting on undeveloped trust lands to fulfill their future open space, local park or other needs. Private landowners may view the state as an inappropriate competitor in their business arena. Neighbors often do not want the state to dispose of the last undeveloped property in their neighborhood.

| Legal Constraints For Transactions | Source | Programs Affected |
|---|---|---|
| 160 acre limit to lands sold at auction | RCW 79.11.010<br>State Constitution | Land Bank Sales |
| Oral auctions only for land sales | RCW 79.11.090 | Land Bank Sales |
| No direct sales to public entities | RCW 79.11.090 | Land Bank Sales |
| Sale at auction limited to within 90 days of Board approval | RCW 79.11.110 | Land Bank Sales |
| Disposal of mineral rights not allowed except to US government | RCW 79.11.210<br>RCW 79.11.220 | Land Bank Sales, Direct Transfers, Trust Land Transfers, Exchanges |
| Platting requirement for lands within two miles of towns | RCW 79.11.250<br>State Constitution | This provision does not technically apply to "buy first" Land Bank Sales or to Transfers, but it is a consideration in "sell first" Land Bank Sales |
| Exchange land as nearly as possible on an acre for acre basis | Enabling Act | Exchanges |
| Requirement to not reduce the forest land base | 79.17.010<br>79.17.010 | Exchanges, Land Bank Sales |
| Sales of Forest Board Land not allowed | 79.22.050 | Land Bank Sales, Direct Transfers, Trust Land Transfers |
| TLT program available only to common school trust | Biennial capital budget | Trust Land Transfers |
| Intergrant exchanges required for non-school TLT properties | Biennial capital budget proviso | Trust Land Transfer |
| Public hearing requirement for exchanges. | RCW 79.17.050 | Exchanges |
| Lack of express authority to cover transaction costs within value of transaction (land and timber) beyond authority to do so for land exchanges for current biennium only | 03-05 biennial budget proviso | Exchanges, Sales, Direct Transfers |
| Can deduct up to five percent of proceeds from sales and transfers for the management fund | Board of Natural Resources Resolution #768 | Land Bank Sales, Direct Transfers, Trust Land Transfers |