A Resource Guide to Designing Transfer of Development Rights Programs in Washington State

Cascade Land Conservancy
for

Washington State Department of
Community, Trade, and Economic Development

June 2009

Transaction Mechanisms[22]

A technical and policy decision in designing a TDR program is the selection of a transaction mechanism, or the means of conducting the purchase and sale of development rights. The range of alternative transaction mechanisms that a TDR program may employ is broad. These mechanisms form a central component of a program and should be considered in light of these factors:

- Conservation goals: Is the objective to maximize acres conserved, maximize the number of transactions, target large or small parcels?
- Effectiveness in policy implementation: Which transaction mechanism is best suited to achieving the conservation goals of the program?
- Ease of participation: Is the transaction mechanism simple to use and understand?
- Cost effectiveness and ease of administration**:** What will the burdens be on the public agency that will be responsible for operating the TDR program? Is the mechanism appropriate for the program's resources?

This section gives a brief overview of several proven alternatives and weighs their relative advantages and disadvantages. The five most common transaction mechanisms are:

1. Simple buyer-seller
2. Buyer-seller with public support
3. Buyer-seller with private support
4. TDR bank
5. Density fee

Other alternatives exist or have been proposed, so this list is not comprehensive. Some TDR programs, such as King County's, have successfully combined multiple mechanisms.

Simple buyer-seller

Simple buyer-seller transactions occur when an eligible landowner sells development rights or credits directly to a buyer. The two parties negotiate the sale terms and price, which can vary depending on market conditions. The landowner sells an easement, which is recorded on the property from which the development rights have been severed. The buyer can apply the rights towards a development project on the receiving site. Conceptually this is the most distilled form of TDR. However, it still requires the local government managing the program to issue, track and redeem TDR certificates.

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[22] This section is adapted from *Alternative Transfer of Development Rights (TDR) Transaction Mechanisms*, Cascade Land Conservancy, July 2008

Advantages:

- This mechanism relies heavily on the private market.
- A transaction can take any form agreed to by buyer and seller.
- Public costs are the lowest of any alternative presented.

Disadvantages:

- The limited availability of information is often a major obstacle to buyers and sellers finding each other, especially at the outset when the marketplace is not well established.
- Buyer and seller interests may not align over time. Developers may need to act quickly in a rapidly growing real estate market, while sellers might want to time their sale to maximize their financial advantage.
- The private market on its own may not be effective in protecting contiguous areas, since individual developers may need to purchase only a portion of the development rights from a large sending site.
- Large projects may require the negotiation of several development rights transactions, which create added burdens for developer participation.

Examples

King County (WA), San Luis Obispo County (CA), Pitkin County (CO)

Buyer-seller with public support

The agency managing a TDR program can take several steps to improve the transparency and ease of buyer-seller transactions. These mainly involve enhancing the availability of information about the process, and include:

- Maintaining public registries of eligible landowners and interested buyers.
- Publishing historical data about the program (details of past transactions).
- Marketing the program to eligible participants.
- Influencing the marketplace by setting price floors for development rights.

Advantages

- This mechanism helps interested buyers and sellers to find each other, increasing marketplace efficiency.
- Public agency support reduces uncertainty and streamlines decision-making for the participants. As players know more about market conditions they are better prepared to make decisions about entering the market.
- Public agency support helps to address the market timing issues in simple buyer-seller transactions by better connecting buyers who need to act quickly with sellers.
- Elements of this mechanism facilitate interactions between buyers and sellers.

Disadvantages

- Land protected via this mechanism may not reflect the community's conservation priorities.
- The higher level of service provided by the managing agency requires an increase in resources.

Examples
Redmond (WA), Collier County (FL), Pinelands (NJ)

Buyer-seller with private support

This alternative relies on private transactions as the core of the program, but incorporates brokers to facilitate TDR transactions. The concept of a TDR brokerage is the same as that for traditional real estate. A TDR broker acts as agent of the seller or buyer of development rights. For a fee, the broker markets available development rights to potential buyers, helps negotiate sales agreements, and arranges an escrow process to facilitate transactions.

Advantages
- Brokers link compatible buyers and sellers to enable transactions.
- Brokers can provide professional support and expertise to buyers and sellers to help them navigate the transaction process.
- The mechanism is funded by transactions.

Disadvantages
- Increased cost of participation may deter potential buyers or sellers.
- Land protected through private brokers may not reflect the conservation priorities of the managing agency.

Example: Montgomery County, MD

Montgomery County has helped overcome the problem of incomplete information by actively engaging the real-estate agent community in the TDR market. Inquiries from developers and private parties seeking development credits are forwarded to several independent agents who specialize in the sale of development rights and act as brokers between potential sellers and buyers. This brings the program more solidly into the free market and facilitates transactions in the same way real estate agents operate in the housing market. Incorporating the pool of agents also ensures that a body of knowledge and experience will likely be involved in every transaction, reducing actual and perceived risk.

TDR Bank

A TDR bank is an entity designed to buy, sell, and hold development rights. It can be managed by a government agency or by a private firm. The government may provide an initial amount of funding (seed money) to finance development right purchases. The bank purchases development rights from individual landowners and in turn sells them to developers. Proceeds from development rights sales are reinvested in the bank to finance future purchases, creating a revolving fund.

The process of creating a TDR bank is the same regardless of whether it operates in the public or private domain:

1. Identify the administrator of the bank, including which department, agency, or firm will be responsible for and staff the bank. Or, whether the bank will be run by a nonprofit.
2. Adopt an implementing ordinance to establish the bank, articulate the purpose of the bank and specify how it will serve the goals of the TDR program.
3. Determine how the bank will be funded (if public funds are used, the city or county must comply with legal regulations on the public use of funds).
4. Create guidelines for the purchase and sale of rights, including escrow, conservation easements, payments, and other elements of transactions.
5. Establish a methodology for valuing development rights that will be purchased or sold through the bank. If the bank uses public funds from a state or local government the price must be based on the fair market value using an appraisal.

Advantages

- Banks can focus on property with a high priority for conservation that might not be addressed by the private market.
- A bank simplifies transactions for buyers and sellers by eliminating the need to find trading partners and negotiate individual deals.
- Banks can intervene in the marketplace to steer activity. They can stabilize the marketplace by standardizing price structures, absorbing excess development right supply, and accommodating fluctuations in demand.
- Banks can make sales occur in a timely fashion for buyers and sellers, who may not be ready to act at the same moment.
- Banks can be integrated with an existing purchase of development rights (PDR) program, expanding the resources available for conservation.
- Banks can facilitate larger TDR projects by selling large numbers of rights to a developer who would otherwise have to undertake multiple negotiations and transactions to support an individual project.

Disadvantages

- Administrative costs can be high. Costs may be prohibitive for smaller communities with limited staff and budget constraints.
- Banks might face skepticism or suspicion in communities that are leery of government involvement in private property issues.
- Banks require up-front capitalization and assume an element of risk that would otherwise be shouldered by the private market.
- Banks setting the price of development rights through acquisitions could have a negative impact on the private market by inflating the price.

Examples

Public bank: King County (WA), private bank: Cambria (CA)

Case Study: King County TDR Bank

As the use of TDR expands in Washington, jurisdictions adopting or revising TDR programs may determine that creating a bank is appropriate for their market. Having successfully completed a number of transactions, the King County TDR bank might serve as an example for how other jurisdictions structure their own. King County's TDR bank was established in 1999 as a mechanism to facilitate a specific transaction that was impractical to conduct entirely in the private market. This exchange of development rights was the first interjurisdictional TDR project for the region, the timing constraints of which created the need for a county TDR bank. In this particular case, the developer was not able to purchase TDR credits from the sending site at the time the landowners wanted to sell them.

As a solution to this timing problem, the King County Council appropriated $1.5 million in capital to establish the King County TDR bank. Using Conservation Futures tax dollars, the appropriation enabled the county to purchase 56 development rights from the sending site to hold for future sale to developers who had identified projects in downtown Seattle. A majority of these rights were re-sold in 2001. The capital from the sale was subsequently used to purchase additional development rights in 2009.

The King County bank was structured to purchase development rights strategically, targeting properties with the highest public benefit and eliminating the timing constraints which can hinder the market. In addition to handling TDR transactions, the King County bank acts as a central database for potential buyers and sellers of development rights in the private market. This database provides a forum for buyers and sellers of development rights to connect. King County's bank includes $500,000 in "amenity funds" set aside to provide urban infrastructure improvements in neighborhoods which accept additional density through TDR, such as parks and open space, streetscape and transit-related improvements, and cultural facilities.

Administration of the King County TDR Bank has been part of the program's success without being burdensome. The TDR bank is managed by the county's TDR program administrator, who spends about 25% of his time on these duties. While the bank's transactions are an executive decision, they are overseen by a Board of Directors from various county departments. Administrative and programmatic expenses represent approximately 10% of the bank's costs, the remaining 90% is directed towards conservation.

Through county code, the bank's buying and selling decisions are constrained to prices that do not exceed Fair Market Value (FMV) for purchase and are not below FMV for sale of development rights. While flexibility in pricing outside of FMV would allow the bank to more effectively take advantage of willing landowner prices, the restrictions are necessary for handling public funds.

Density Fee

A density fee, also known as an in-lieu fee, may be used to achieve land conservation as an alternative to other incentive mechanisms like TDR. Developers pay a fee to the sponsoring public agency to build to a higher density or intensity than baseline zoning allows, or take advantage of other incentives set forth by the program, like building to greater heights than otherwise allowed. Funds collected are used by the jurisdiction to fund PDR in high priority conservation areas. Density fees can be set to a specific dollar amount per additional unit of incentive.

While a density fee is not actually a transaction mechanism, it has many similarities to a conventional TDR transaction. The chief difference between a density fee and a traditional TDR transaction is whom the developer pays - in this instance payment is made directly to the government instead of a landowner. Framing this approach requires tact: to reduce the potential negative reception to this mechanism by developers, the government should emphasize the gains achieved.

Density Fee Programs

For a more detailed analysis and discussion of this subject, please refer to the Cascade Land Conservancy's paper:

Alternative Transfer of Development Rights (TDR) Transaction Mechanisms

Advantages

- This alternative is simple to administer and has a short transaction time for the developer.
- A fee provides certainty for developers.
- This approach allows the managing agency to make purchases that target high priority areas for conservation.
- A fee can be coordinated with a PDR program, leveraging public resources for additional purchases of development rights.

Disadvantages

- A density fee may be perceived as "selling zoning."
- If a program allows both private market transactions and a conservation fee option, coordination between the two could be difficult.
- There is a time lag between when the fee is charged and when the funds are expended for conservation.

Examples of Density Fees

As of March 2008, the **Livermore, California** TDC program is in its early stages of implementation. It has adopted an in-lieu fee ($21,591.61 per development credit) and has collected about $1.5 million in fees. Livermore has not, however, started purchasing easements in the North Livermore area, so empirical evidence of the program's performance is incomplete. Since the collection of in-lieu fees is tied to housing development, the revenue generated from fees has been affected by the housing market downturn. Livermore will be implementing the program when additional fees have been collected, or have developers conveying easements they have purchased to the city. Livermore also anticipates using the in-lieu fees in coordination with other mitigation and conservation programs as those opportunities arise.

(Frost, Susan, Livermore Principal Planner, email to author March 21, 2008)

Berthoud, Colorado, uses a density transfer fee instead of a traditional TDR program because it is easily administered. This fee is $3,000 per dwelling unit in single-family and $1,500 per unit in multi-family projects. These funds are used to purchase development rights on parcels that protect water resources, agricultural lands and community buffers. Berthoud does not consider this an impact fee because the charge is assessed only upon the developer requesting higher density within the town. The current total of Berthoud's density transfer fee fund is $229,014. The town allocates 6% of the fee to cover administrative costs of the program.

(Fulton, Bill; Mazurek, Jan; Pruetz, Rick; Williamson, Chris; *TDRS and Other Market-Based Land Mechanisms: How They Work and their Role in Shaping Metropolitan Growth;* Brookings Institution, 2004)
http://www.brookings.edu/~/media/Files/rc/reports/2004/06metropolitanpolicy_fulton/20040629_fulton.pdf

Administration

A broader policy decision that jurisdictions designing TDR programs will want to consider in light of funding, transaction mechanism choice, and conservation goals is the scope of the program's administration. In essence, are the resources available to the jurisdiction adequate to effectively administer the program? To help jurisdictions answer this question, this section profiles three examples of government involvement and describes what preparations must be in place for the successful administration of TDR programs. The levels of government involvement discussed are low, medium, and high.

City of Everett: low government involvement in TDR program administration.

Both the scope of and level of government involvement in Everett's Reasonable Use Exception program are small. Under this program, a landowner can sell development rights from a property that has environmentally sensitive areas that limit full economic use. Approval for participation in the program is administrative, so the time, cost, and risk to developers are minimized. Transactions typically involve small numbers of rights, demand for rights has remained modest, and the extent of the program is entirely within the city. Administration of the program requires a fraction of one staff member's time.

City of Redmond: medium government involvement in TDR program administration.

Redmond's TDR program is an example of a moderate level of government involvement working effectively to achieve modest but clearly defined conservation policy objectives. The program's administration is managed by one member of the city's planning staff. Redmond has conserved over 400 acres and satisfied the program's original conservation goals to such an extent that sending site eligibility is being expanded. Redmond's TDR program offers public support in the form of a user-friendly website, ample information, registries of interested participants, and maps.

King County: high government involvement in TDR program administration.

King County, Washington, has the highest level of government involvement of any TDR program in the state. The program employs two staff, manages a TDR bank, and since inception has conserved over 137,500 acres of land. The program administrators take an active approach to conservation, marketing the program to cities and seeking out transactions with landowners and developers in addition to reviewing applications to the program. The success of the program in terms of acres conserved is a reflection of the combination of King County's policy objectives, appropriate transaction mechanisms, and energetic administration.