FORT&RRA

ECONorthwest
ECONOMICS • FINANCE • PLANNING

Opportunities for Conservation and Infrastructure Financing in Puyallup:

Recommendations and program framework for using transfer of development rights and LCLIP

October 25, 2019

Prepared for the City of Puyallup by Forterra and ECONorthwest

TABLE OF CONTENTS

PHOTO: FORTERRA

PHOTO: FORTERRA

I. CONTACT INFORMATION

Nick Bratton and Morgan Shook prepared this report.

Forterra is dedicated to regional sustainability in all its dimensions — environmental, social and economic. Since 1989 Forterra has been at the forefront of landscape-scale conservation, restoration, and community-building efforts to help secure a positive future. For more information, visit www.forterra.org.

ECONorthwest specializes in economics, planning, and finance. Established in 1974, ECONorthwest has over three decades of experience helping clients make sound decisions based on rigorous economic, planning and financial analysis. For more information, visit www.econw.com.

For more information about this report, please contact:

Nick Bratton
Forterra
901 5th Avenue
Suite 2200
Seattle, WA 98164
206.905.6941
nbratton@forterra.org

Morgan Shook
ECONorthwest
1200 6th Avenue
Suite 615
Seattle, WA 98101
206.388.0082
shook@econw.com

PHOTO: FORTERRA

II. EXECUTIVE SUMMARY

The City of Puyallup hired the consultant team of Forterra and ECONorthwest to evaluate opportunities for the city to use two market-based growth management tools as a means to help achieve its vision for the downtown and South Hill regional growth centers while also conserving resource land and generating new revenue for public improvements.

Transfer of development rights (TDR) is a voluntary program that incentivizes growth in areas where it is desired while permanently protecting farm and forest lands through private market real estate transactions. The Landscape Conservation and Local Infrastructure Program (LCLIP, RCW 39.108) is a state program that gives cities a financial incentive to use TDR by creating a new revenue source for cities to pay for infrastructure that supports growth connected to TDR use.

The primary findings suggest that although the market for large scale multifamily development has not yet emerged, demand may change as rents rise and growth pressure from other parts of the region reach Puyallup – particularly in conjunction with expanded transit service. The use of TDR is viable in some segments of the current market and will become a more attractive option if paired with other incentives such as multi-family tax exemptions. The current mix of incentive choices for developers in certain zones could be reorganized to prioritize use of TDR, which in turn will lead to higher revenues if Puyallup chooses to participate in LCLIP.

If current growth trends continue, the city would generate approximately $5.1 million in revenue through LCLIP, while if the pace of growth accelerates the revenue could increase to $9.2 million. In all scenarios LCLIP is a viable choice for Puyallup and will provide additional resources to pay for improvements that the city wants to make. Implementation of TDR and LCLIP would entail adoption of development code amendments and an implementing ordinance.

The consultant team lays out the specific steps involved and recommends an administrative model to help the city operate a TDR program in an efficient and effective manner. Conditions are ripe at the present time for TDR and LCLIP to work and the consultant team recommends that the city adopt a TDR program in the near term, followed by LCLIP timed in conjunction with a launch project.

If current growth trends continue, the city would generate approximately $5.1 million in revenue through LCLIP, while if the pace of growth accelerates the revenue could increase to $9.2 million.

ABOUT THIS REPORT

This report is divided into two parts that provide separate but related analyses of the feasibility of two market-based, growth management programs in which the City of Puyallup is eligible to participate. These are:

- **Transfer of development rights** (**TDR**), a voluntary real estate tool that encourages new construction in areas where growth is desired while permanently conserving farms and forests, and

- **Landscape Conservation and Local Infrastructure Program** (**LCLIP**), a state-level program that gives cities access to new sources of revenue to pay for infrastructure that supports growth in exchange for agreeing to use transfer of development rights.

The TDR portion of the report examines policy questions and the mechanics of implementing this tool in a way that supports the city's conservation and growth management objectives. Recommendations include a program framework and revisions to existing incentive zoning that would make TDR successful in the Puyallup real estate market.

The LCLIP portion of the report gives an overview of how the program works in general, lays out scenarios for how Puyallup could apply the program, how much revenue it would generate, what the risks and tradeoffs entail, and a road map for adoption and implementation.

It is possible for a city to enact a TDR program without using LCLIP, however the added value that LCLIP creates makes the adoption of both a more attractive proposition. The recommendations in both parts, taken together, provide a strategy and pathway for the City of Puyallup to maximize the benefits of LCLIP.

PHOTO: *Forterra*

PHOTO: *Forterra*

III. TRANSFER OF DEVELOPMENT RIGHTS PROGRAM FRAMEWORK

Transfer of development rights (TDR) is a market-based growth management and conservation tool that encourages growth in areas where communities want it while protecting resource lands where growth is not desirable.[1] Through voluntary transactions, owners of farm and forest lands sell the right to build homes on their properties – in the form of "TDR credits" – to developers who use those credits to gain additional density or other value in urban projects.[2] In exchange for selling development rights, landowners place TDR easements on their property, permanently protecting it from development while retaining all other rights and uses. The graphic to the right illustrates the process:

TDR programs can differ in purpose and implementation across jurisdictions, however they all need the same basic ingredients to work effectively. These include:

- Clearly articulated conservation objectives,
- Clearly delineated areas where growth is desired,

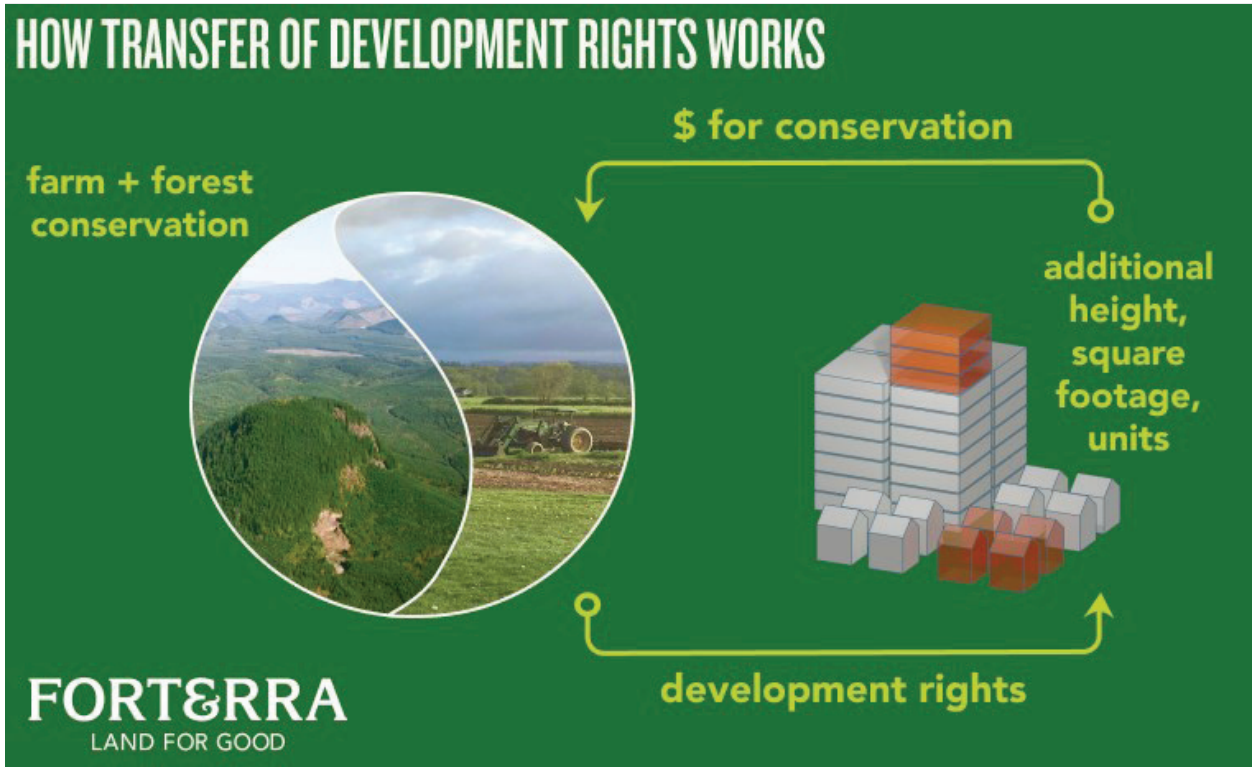

FIGURE 1: *Transfer of development rights process*

1 TDR in Washington State is authorized by the Growth Management Act, RCW 36.70A.090: A comprehensive plan should provide for innovative land use management techniques, including, but not limited to, density bonuses, cluster housing, planned unit developments, and the transfer of development rights.

2 TDR is a flexible tool that can support a range of conservation values. While programs elsewhere may reflect a variety of priorities, Puyallup's interests reflect resource land protection.

- Incentives to use the tool that are matched to local demand,
- A market mechanism for awarding development bonuses, and
- An administrative model.

This memorandum discusses options for each and presents recommendations for a program framework that is suited to Puyallup's needs and reflects city feedback on design and policy questions.

CONSERVATION PRIORITIES

In establishing a TDR program a city must identify those lands it wants to protect through use of the tool. These reflect the conservation priorities of the community and are called "sending areas," or those properties from which landowners can sell development rights in the form of TDR credits. In discussion with staff and council, the consultant team recommended that the sending areas that Puyallup considers should not only meet goals for protecting lands close by, but should position the city for success in using LCLIP, which has certain requirements for sending area eligibility. To balance the interests of emphasizing conservation of lands close to the city while also supporting the regional intent of LCLIP, the sending areas should include the following categories of land:

1. **Agricultural-zoned land near Puyallup.** This includes farmland in close proximity to the city, such as properties in the Alderton-McMillin Community Plan area, farms in the Puyallup Valley, and local farms selling produce in the city. See recommendations summary for additional detail.
2. **Agricultural-zoned land across Pierce County.** This includes agricultural resource land (ARL) county-wide, not necessarily in close proximity to the city but farmland of long term commercial significance.
3. **Forest-zoned land across Pierce County.** This includes lands zoned for forestry, either family-owned or commercial timber, county-wide with no geographical priority.
4. **Regional agricultural and forest-zoned land.** This includes all resource lands of long-term commercial significance designated by Pierce, King, and Snohomish Counties for eligibility under the LCLIP statute, RCW 39.108.

The protection of these lands will reduce development pressures on farms and forests while also retaining other environmental and human health benefits. Local farms produce food for residents of the Puyallup Valley, they are an important component of the county's economy, and they serve important environmental functions. Forest lands help to provide clean air and water, reduce flooding risk, and are a source of timber and other wood products. Even though these lands may be perceived as being "out there," the benefits to the City of Puyallup from conserving them are immediate and tangible.

To reflect the different values of development rights across the landscape, the consultant team designed a matrix of exchange rates that define how much bonus a developer gains for buying a TDR credit. This matrix also reflects city conservation priorities and is covered in detail in the market mechanism section. Inclusion of regional resource lands is a requirement of the state statute governing the use of LCLIP and is intended to help realize the regional scale of the program.

Puyallup expressed an interest in exploring how TDR could conserve open space within the city. Examples of this application of the tool exist elsewhere in the region, as Tacoma and Seattle both have provisions within their TDR programs for in-city protections. The conservation of open space inside cities is an important goal, as access to parks and natural areas is part of what defines a community and makes it a great place to live. At the same time, the economic constraints of achieving this aim through TDR present challenges.

The city has a finite amount of capacity in which to place TDR credits through bonus density in new construction. If the city chooses to accept credits from sending areas in Pierce County and through the regional market, prices for those credits will tend to be lower and the program can award a smaller amount of bonus density for developers buying those credits. This means that for a fixed amount of development capacity, the city would place more TDR credits, thereby conserving more land. If credits are more expensive, reflecting higher real estate prices within the city, the program would need to award more bonus density to make it economically attractive for developers to buy them. For a fixed amount of development capacity, the city would place fewer credits because each one would consume more bonus capacity than would a farm or forest credit. The end result would be less conservation overall.

Another tradeoff would be competition among public priorities. If Puyallup has a finite amount of bonus development capacity, focusing conservation in different types of sending areas will yield different benefits. By prioritizing conservation of Pierce County resource lands (and making eligible other sending areas through the regional program), Puyallup could generate millions of dollars of new revenue for infrastructure investments – public improvements that will also enhance the quality of life in the city (see LCLIP section). Use of TDR for in-city conservation does not confer this benefit. Furthermore, revenues from LCLIP can

be used to acquire land for parks within the defined LCLIP boundary. In summation, designating sending areas as recommended would create a wider array of benefits for Puyallup beyond just the revenue aspect.

RECEIVING AREAS

The second major decision in TDR program design is deciding where the city wants to encourage growth. Places where developers can gain more value for projects by using TDR are called "receiving areas" and can be established by a variety of methods. Analysis of the market for growth in Puyallup showed a strong demand for single-family housing at present and continuing in the near-term. As a market-based tool, TDR works best when connected to demand for growth. In Puyallup's case, adding density to single-family neighborhoods is a choice that would need to be broached through a broader community conversation, and in the long term would not support the use of LCLIP. In consideration of these factors, as well as guidance from staff and council, the consultant team recommends the following areas as appropriate for using TDR:

1. Regional Growth Centers (development in multi-family and mixed used projects)
   - » Downtown/central business district
   - » South Hill
2. RM-10 zone (development in townhome projects)
3. RM-20 zone (development in multifamily projects)
4. Future expansions and zoning changes
   - » Annexations
   - » Area-wide rezones

The city's vision encourages residential and commercial uses in the regional growth centers. This is a natural place for additional density as these areas already have provisions for incentive zoning that can be adapted to more effectively use TDR and are well-served by transit. In addition to designating these districts as receiving areas, the consultant team recommends other categories of receiving areas as well as specific policy and code changes to support TDR use.

The RM-10 zone currently sees high demand for moderately dense, multi-family housing – typically townhomes – and is projected to see continued growth. Owner-occupied housing is the predominant housing option in Puyallup and this will likely continue in the near future. A small amount of bonus density creates enough value to make TDR work in these zones and the consultant team sees this as an important component in the overall strategy for making TDR and LCLIP successful in Puyallup.

The RM-20 zone is intended for medium-density, multifamily residential uses. The amount of growth potential in this zone makes it a strong candidate for a receiving area. Similar to the RM-10 zone, the additional value that development incentives would create should drive use of TDR in the near to medium term.

While not yet identified, it is likely that in the future the city will annex portions of its urban growth area or pursue area-wide rezones. If these changes involve upzones, creating additional value for developers through legislated density increases, they create an opportunity to use TDR to gain a portion of the additional density established through the upzone. If and when the city pursues such land use changes, designating them as receiving sites would add another option for using TDR, further advancing city conservation and growth management objectives. In order to establish policy direction for these eventualities, the consultant team recommends that the city adopt comprehensive plan language that makes future area-wide rezones and annexations TDR receiving areas.

INCENTIVES

In order to ensure that a TDR program is providing the kinds of bonuses for which there is demand, it is important to establish incentives that are appropriate to the type of growth Puyallup desires and which a market will support. Based on a market analysis and input from staff and council, the consultant team recommends the following types of incentives in each category of receiving area:

- RM-10:
  - » Additional units
  - » Multifamily property tax exemption
- RM-20:
  - » Additional units
  - » Multifamily property tax exemption
- Regional growth centers:
  - » Additional floor area, expressed as density and building heights in the CBD, CBD-Core, UCX, RM-Core, LMX zones
  - » Multifamily property tax exemption
- Future receiving areas: to be determined

It is a common feature of successful TDR programs to offer bonus density in the form of additional units and floor area. A newer concept in Washington is to use TDR as a means for developers to access 8-year

multifamily tax exemptions (MFTE). Under this approach, a developer would be granted access to MFTE on a project conditional upon using TDR. For example, if a large project (200 units) would save $500,000 annually on property tax exemption using MFTE, the developer might spend $200,000 on TDR to access the savings.

For future receiving areas it is impractical to define at present what the incentives would be, however for annexations and area-wide rezones of low to moderate densities, additional units is likely the appropriate choice to offer. For rezones at medium and high densities, the range of options is greater and should be evaluated at the time based on need, market factors, and developer outreach.

The consultant team also recommends changes to the CBD and MX zoning regulations to increase the certainty that Puyallup will reach its TDR placement objectives should it pursue LCLIP. In the existing code the number of incentives from which developers can choose to gain bonus density in the mixed-use zones is a broad menu of options. Beyond TDR, these include structured parking, residential use, affordable housing, green roofs, solar power, and improved energy efficiency. Offering a wide range of choices reduces the likelihood that developers will use TDR. While all of the incentives currently offered provide public benefit, TDR is the only option that will directly drive new infrastructure revenue for the city through LCLIP. Therefore, in order to maximize the financial benefits of LCLIP, it is in the city's interest to maximize the certainty of using TDR in new construction.

Reflecting input from council and staff, as well as in consideration of incentives that are available beyond the realm of additional density to support other public benefits, the consultant team recommends Puyallup reduces the incentive choices in all proposed receiving areas to the following:

- TDR
- Affordable housing
- Multifamily tax exemption

Other bonus choices currently offered either have existing incentives available through other means, such as the federal solar tax credit, or are features that the city may wish developers to include regardless, such as residential uses or plazas. The city could shift these latter elements to design guidelines or development regulations. The incentive of additional density, especially when coupled with a property tax exemption, is a valuable enticement for developers. The powerful motivation for using such incentives is a policy tool that cities can use to provide the greatest public benefits for residents. In this situation, affordable housing, additional revenue for infrastructure, and conservation of resource lands meet pressing needs of the city and support Puyallup's community vision.

The State of Washington provides authority for cities to grant limited-term property tax exemptions as an inducement to developers to construct multifamily housing. This tool, multifamily tax exemption (MFTE) is available in two forms: 12-year and 8-year. Under the 12-year option, projects receive a property tax abatement for a period of 12 years if they include a certain amount of units that are affordable at a defined level over that timeframe. Under the 8-year option, multifamily projects receive a similar abatement for a shorter duration and without any affordability requirement. Cities have the discretion to attach other conditions to the 8-year MFTE. This could include use of TDR.

The analysis of Puyallup's real estate market shows that, by itself, bonus density through incentive zoning does not generate a high enough return to justify use of TDR at present, although this may change in the future if rents and home prices increase. By contrast, the combination of 8-year MFTE with bonus density makes the use of TDR not only feasibly, but highly attractive. The market analysis suggests that TDR in Puyallup would be successful if applied in conjunction with 8-year MFTE. The consultant team recommends that the city adopt both, stipulating that use of TDR is a condition for projects to access the abatement of 8-year MFTE.

In conclusion, a TDR framework for the City of Puyallup would maximize utilization of the program by:

- Offering the appropriate incentives in the areas where it desires growth,
- Reducing the number of incentives to maximize public benefit and certainty of using TDR – along with provision of affordable housing,
- Calibrating those incentives to the real estate market and reflecting stated conservation priorities, and
- Adopting an 8-year MFTE program that includes use of TDR in order to access the tax savings.

MARKET MECHANISM

A real estate market attribute that TDR programs must account for is the difference in marginal value of additional development between sending areas and receiving areas. For example, a developer will make a bigger return on a large, single-family home on a 10-acre parcel in unincorporated Pierce County than on one additional apartment in a multifamily building in downtown Puyallup. In other words, the value of development potential in sending areas is typically greater than it is in receiving areas. In order to make

a TDR transaction financially viable for both parties, a market mechanism is necessary to normalize values across the landscape. In TDR programs this is called an exchange rate. An exchange rate defines how much bonus a developer gains for purchasing one TDR credit and it is expressed in terms of a ratio.

Using assumptions for TDR credit pricing based on Pierce County and regional transaction data, as well as a market analysis of real estate and development pro forma costs, the consultant team proposes the following exchange rates for the recommended Puyallup receiving areas:

Recommended TDR Exchange Rate Table			
Receiving Area	Bonus Awarded	Sending Areas	Additional Development per Credit
Regional Growth Centers	Floor area (square feet)	Near-city farm	1,300 sf
		Countywide farm	1,100 sf
		Countywide forest	1,100 sf
		Regional (King, Snohomish)	1,300 sf
RM-20 Zone	Dwelling units	Near-city farm	1 unit
		Countywide farm	1 unit
		Countywide forest	1 unit
		Regional (King, Snohomish)	1 unit
RM-10 Zone	Dwelling units	Near-city farm	2 units
		Countywide farm	2 units
		Countywide forest	2 units
		Regional (King, Snohomish)	2 units

At first glance there is not much variation in the exchange rates across different sending areas. How does this reflect the city's conservation priorities of placing a greater emphasis on nearby farms, for example? The answer is in the wide range of prices that TDR credits take across the landscape. As market data show, prices for TDR credits in the Alderton-McMillin Community Plan area (farm land close to Puyallup) are relatively low in comparison to those elsewhere in the county and region. This is because Pierce County already incentivizes protection of farm land in this area by awarding landowners additional credits to sell than in other parts of the county. Credits elsewhere in Pierce, King, or Snohomish Counties all cost more. From a developer's perspective, the cost per additional bonus increment will be lower if purchasing credits from farm lands near the city. While the numbers in this table may not appear to favor one category of sending area over another, the practical result will be to incentivize the protection of lands that reflect the city's conservation priorities while retaining eligibility of all lands required for inclusion under LCLIP.

These exchange rates are calculated to make the use of TDR attractive to developers in receiving areas while providing enough value to sending area landowners to incentivize their participation in the program. They are also calibrated to the concurrent use of the 8-year MFTE program as a condition of using TDR. These exchange rates will not work for every conceivable development or every potential property, but they are calibrated to be financially viable for most situations. Exchange rates should not be static and if Puyallup pursues TDR/LCLIP, it should update them periodically to reflect changes in the market.

ADMINISTRATIVE MODEL

A program's administrative model is the mechanism by which TDR transactions occur. It defines the city's role in the process, which can vary from hands-on to light touch. An administrative model should make transactions simple for the buyer and the seller, as well as provide certainty and transparency on how the program works. The types of administrative model Forterra evaluated for Puyallup include simple buyer-seller, private market with public support, and public-private partnership. A brief overview of each follows.

Simple buyer-seller
Under this model buyers and sellers of TDR credits find each other and negotiate private real estate deals to effect transactions. The city's role is limited to recording the use of credits when applied to a project as part of the development permitting process.

Private market with public support
This is a variation on the simple buyer-seller model with key differences. Elements that remain the same are that the buyers and sellers of credits negotiate private deals to transact TDR credits while the city processes and records the use of TDR credits. This model takes the city's role further, however, by augmenting the resources available to support a private market. Foremost among these is providing program and market information to help participants understand how the program works, how to find each other, and what is involved in a transaction.

Public-private partnership
In this model the city would retain responsibility for essential administrative tasks (processing and recording use of TDR credits) while a private partner would market the program, recruit users, and facilitate transactions. In this approach the city would retain responsibility for central administrative functions that it already performs while the private partner would pursue deal-making that can be time-intensive and requires real estate expertise.

TDR bank
The consultant team did not explore the TDR bank option for Puyallup because Pierce County already operates one and creating another bank specific to the city would be duplicative. Choice of an administrative model is a policy decision based on the city's level of interest in operating a TDR program. Based on feedback given by council, planning commission, and staff, the consultant team recommends the city pursue either the private market with public support approach or a public-private partnership. A primary consideration might be the amount of staff time and city resources that Puyallup wants to invest in program operations.

Regardless of the administrative model Puyallup chooses, Pierce County will be an important partner in the implementation of a TDR program. The county serves several key roles, including:

- Certifying TDR credits from sending areas,
- Operating the county's TDR bank, which buys credits from landowners and sells them to developers, reducing uncertainty and transaction costs, and
- Tracking TDR use across the county and in other cities.

Puyallup would share program activity information with Pierce County, such as the use of TDR credits in new construction projects, and the two jurisdictions may wish to coordinate efforts in pursuing shared conservation objectives. Pierce County and Tacoma signed an interlocal agreement to establish the terms and conditions of cross-jurisdictional TDR credit transfers. Should Puyallup adopt a TDR program, the county may wish to enter into a similar agreement with the city.

Puyallup can take a range of steps to achieve greater transparency, visibility, and usability for its TDR program. These are addressed as responses to questions from the perspective of program users.

How do prospective participants learn about the program?
The city can:

- Create a page on its website dedicated to TDR that
  - » Explains the program and benefits to buyers and sellers, including a walk-through of the entire process for both sides of the transaction
  - » Links to the code chapter
  - » Shows maps of receiving areas
  - » Includes a FAQ section
  - » Lists staff contact information
  - » Has downloadable electronic application forms
- Reach out to prospective developers and inform them of the opportunity to use TDR in the city. This can take the form of phone calls, a developer workshop, a webinar that the city posts on its website, mailing program summaries, or partnering with industry groups (realtors, Master Builders Association, chamber of commerce, etc.)
- Pursue media coverage.
- Spread the word through community hubs like farmers markets and civic organizations.

What does a TDR credit get me?

- As a result of the ECONorthwest market analysis for this study, the city should adopt exchange rates to define what density bonus a developer gains for purchasing a TDR credit. This is information that should be included on the city TDR website program overview and FAQ.

How do buyers and sellers find each other?

- As part of the TDR web page, the city can provide resources for participants to connect. This can include contact information for the Pierce County TDR program administrator or private partners who can serve as sources for TDR credits.

What is a TDR credit worth?

- This is a simple question with a complicated answer, but for the purposes of encouraging program activity it is important to make market data publicly available. Each developer will calculate a willingness to pay that varies depending on individual project factors and each landowner will have a unique price expectation. To help provide context for price negotiations between parties, Pierce County can publish sales data of transactions. This should include general information about the sending site (number of credits sold, acreage, land type – i.e. farm, forest – and location), prices paid, and any special attributes of the transaction.

What does the city have to do?

At minimum, the city's responsibilities in administering the TDR program involve:

- Establishing a review process for the use of TDR credits in receiving area projects. This includes setting a point in the development process at which an applicant must furnish certified TDR credits (or a substitute, such as an option agreement), such as at issuance of building permit or prior to certificate of occupancy.

- Tracking TDR credits used in receiving area projects, sharing credit use with Pierce County so it can extinguish credits applied to new construction.

Additional responsibilities may include:

- Making an annual report to planning commission and city council on TDR program activity.

- Marketing the program, recruiting participants.

What are the steps in a transaction?

This needs to be spelled out both in code and in program overview materials that the city publishes, including on its website. Some programs, like Snohomish County, have drafted visual flow charts to illustrate the process. The basic elements include:

For the buyer –

1. Developer holds pre-application meeting with city.

2. Developer and city discuss use of TDR and other incentive components as a way to achieve bonus density.

3. City calculates number of TDR credits developer needs to achieve desired project density based on exchange rate and other program elements.

4. Developer seeks TDR credit seller, negotiates a price, closes a transaction, and furnishes necessary documentation to city (this can be an option agreement or original TDR certificates, as the city prefers) at the established point in the development process.

What happens after the transaction?

- The city tracks TDR credit use and communicates program activity to Pierce County so the two jurisdictions can coordinate their respective sides of the process.

SUMMARY OF RECOMMENDATIONS

Based on analysis and city input, the consultant team recommends that the City of Puyallup incorporate the following elements into a transfer of development rights program, should it wish to proceed with adopting and implementing one:

Conservation priorities

- Puyallup should make all regional resource lands of long-term commercial significance eligible for development right transfers into the city's receiving areas. This includes lands zoned and designated for agriculture and forestry in Pierce, King, and Snohomish Counties. This will meet the criteria for using LCLIP.

- Recognizing that the city has specific priorities for conservation that are a subset of the eligible lands, Puyallup can incentivize protection of certain types of lands through calibration of its TDR exchange rate. These particular priorities include:

  - Farm land in close proximity to the city, specifically in the Alderton-McMillin and Mid-County Community Plan areas, farm land in the Puyallup watershed, and local farms that sell produce in the city.

  - Farm land generally in Pierce County (Agricultural Resource Land)

» Forest land generally in Pierce County

Receiving areas

- Puyallup should designate specific zones within the downtown and South Hill Regional Growth Centers as receiving areas, within the parameters identified in the subsequent sections discussing LCLIP:
  - » CBD, CBD-Core, UCX, LMX, and RM-Core
  - » RM-20
  - » RM-10
  - » Future area-wide rezones or subarea plans

Incentives

Within the designated receiving areas, streamline the number of incentives available to achieve development bonus to two public benefits:

- Affordable housing
- TDR

This should be established through a prescriptive approach in which a project must provide both incentives to gain bonus density.

TDR incentives should take the form of additional density that is appropriate to the form of the receiving area project. For example, in the RM-10 and RM-20 zones the bonus is additional dwelling units, while in the CBD/core zones the bonus is additional floor area (expressed in square feet).

A third component, which complements the city's incentive zoning, is a multifamily tax exemption (MFTE). Puyallup should adopt an 8-year MFTE program in conjunction with TDR, structuring it so that use of TDR is a condition for projects to access the exemption.

Market mechanism

Puyallup should adopt exchange rates as proposed in the Exchange Rate Table on pg. 10. These values reflect the conservation priorities articulated by the city (see Conservation Priorities section). Puyallup should also plan for periodic reviews of the exchange rates as market conditions evolve. Updating them on a regular basis (every 3-5 years, for example) will make the TDR program function more effectively as the exchange rates will more closely reflect the market for growth as circumstances change over time. In respect of the city's desire to minimize operational complexity of a TDR program, revisions to exchange rates should be made as administrative decisions under planning staff discretion, following the policy direction of city council.

Administrative model

Puyallup should operate a TDR program using either the private market with public support or public-private partnership model. Both of these achieve the city's stated goals of administrative simplicity. Additional administrative recommendations include exploring an interlocal agreement with Pierce County and adopting the Commerce rule.

Interlocal agreement (ILA)

Pierce County currently has an ILA in place with Tacoma to establish the roles and responsibilities between the two jurisdictions for TDR credit transfers from the county into the city. Pierce County may wish to negotiate a similar arrangement with Puyallup.

Commerce rule

The Washington Department of Commerce drafted a rule (WAC 365-198) defining terms and conditions for interlocal TDR credit transfers. Jurisdictions that adopt this rule by reference may conduct interlocal credit transfers without needing separate interlocal agreements. This introduces greater efficiency from an administrative standpoint and is advantageous for using TDR within a regional marketplace. Puyallup should adopt this rule as part of a TDR enacting ordinance.

TDR framework conclusions

Transfer of development rights is an innovative land use tool that helps to steer growth into areas where it's desired and away from areas where it's not. By itself, TDR doesn't drive growth. It harnesses the demand for new development to create multiple public benefits for both urban and rural communities. The City of Puyallup expressed a desire to explore a simple, market-based approach to conserving lands important to the community while balancing other priorities. Adoption and implementation of an effective TDR program will give the city the option to pursue LCLIP, an infrastructure financing tool (described in the following section) that can help the city to grow with grace. Recommendations in this report lay out a path to streamlining the city's existing incentive zoning structure that already includes TDR, making successful implementation of the tool a more likely outcome. Taken together, this set of recommendations will position Puyallup to have a functioning TDR program that will provide community benefits as the city gains greater access to regional transit and remains an attractive place to live in close proximity to major employment centers.

IV. LAND CONSERVATION AND LOCAL INFRASTRUCTURE PROGRAM (LCLIP)

OVERVIEW

Puyallup is eligible to use LCLIP, a state program (RCW 39.108) enacted in 2011 that creates a financial incentive for cities to use TDR. LCLIP is the first program of its kind in the nation and works on a regional scale, spanning Pierce, King, and Snohomish Counties. The goal of LCLIP is to give cities more resources to pay for infrastructure investments that support growth while also conserving resource lands. In exchange for agreeing to accept a specified number of TDR credits, cities can retain a portion of the county's share of property tax revenue on all new construction for a period of up to 25 years. The revenue must be spent on public improvements in the same areas where new construction uses TDR. The program is essentially a form of tax-increment financing combined with transfer of development rights.

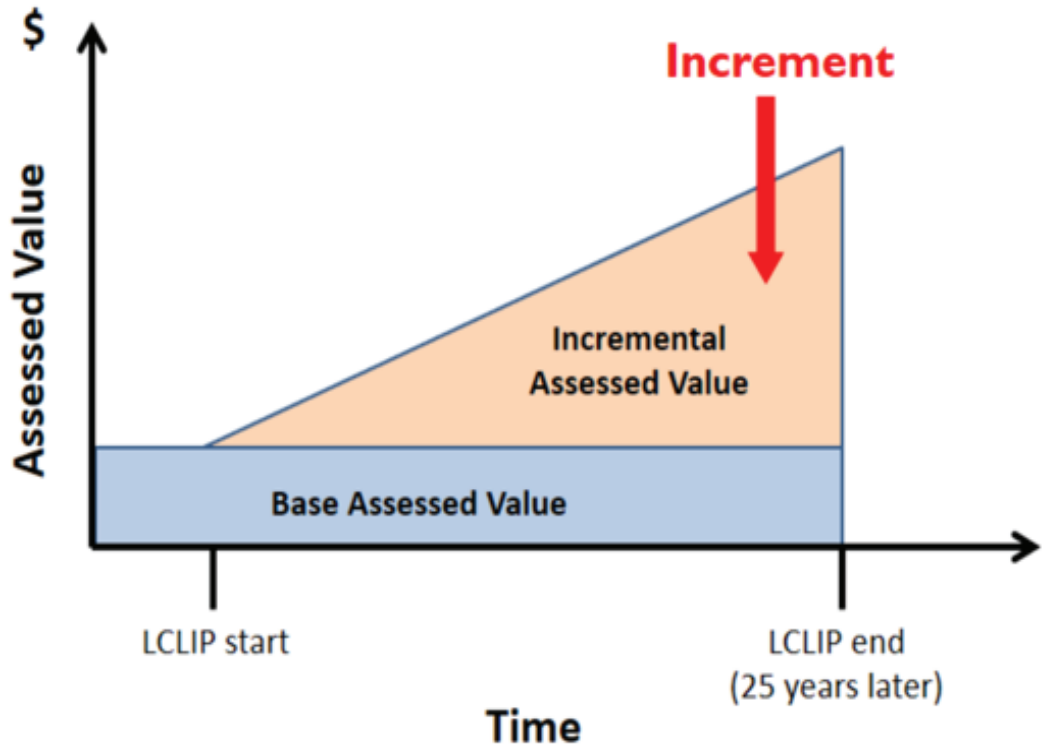

FIGURE 2: *Assessed value over time*

LCLIP involves only a portion of the incremental property taxes generated from new construction. This is not a new tax to residents or businesses, rather it is a temporary redistribution of existing tax revenues. The remaining portion of the property tax still accrues to the sponsoring city and to the jurisdictional county. Existing and incremental revenues flowing from sales, business and occupation, and utility taxes still accrue to the city, as well as other capital restricted revenues. **FIGURE 1** and **FIGURE 2** illustrate how LCLIP works.

In order to implement LCLIP, a city needs to have a TDR program in place (or commit to creating a mechanism to use TDR) and must make a series of decisions about how it wants to use the tool. This section of the report identifies what those decisions are, analyzes the choices, and makes recommendations for how Puyallup can optimize the program for greatest benefit.

GEOGRAPHY

The first question about LCLIP is where to use it. Under the statute, cities define special districts where they want to use LCLIP. These districts have to meet certain criteria. They must:

- be TDR receiving areas,
- include no more than 25% of the city's assessed value, and
- be where the city will spend the collected revenue on public improvements.

The idea is that new construction and TDR use drive revenue, which is then spent on infrastructure to support the growth.

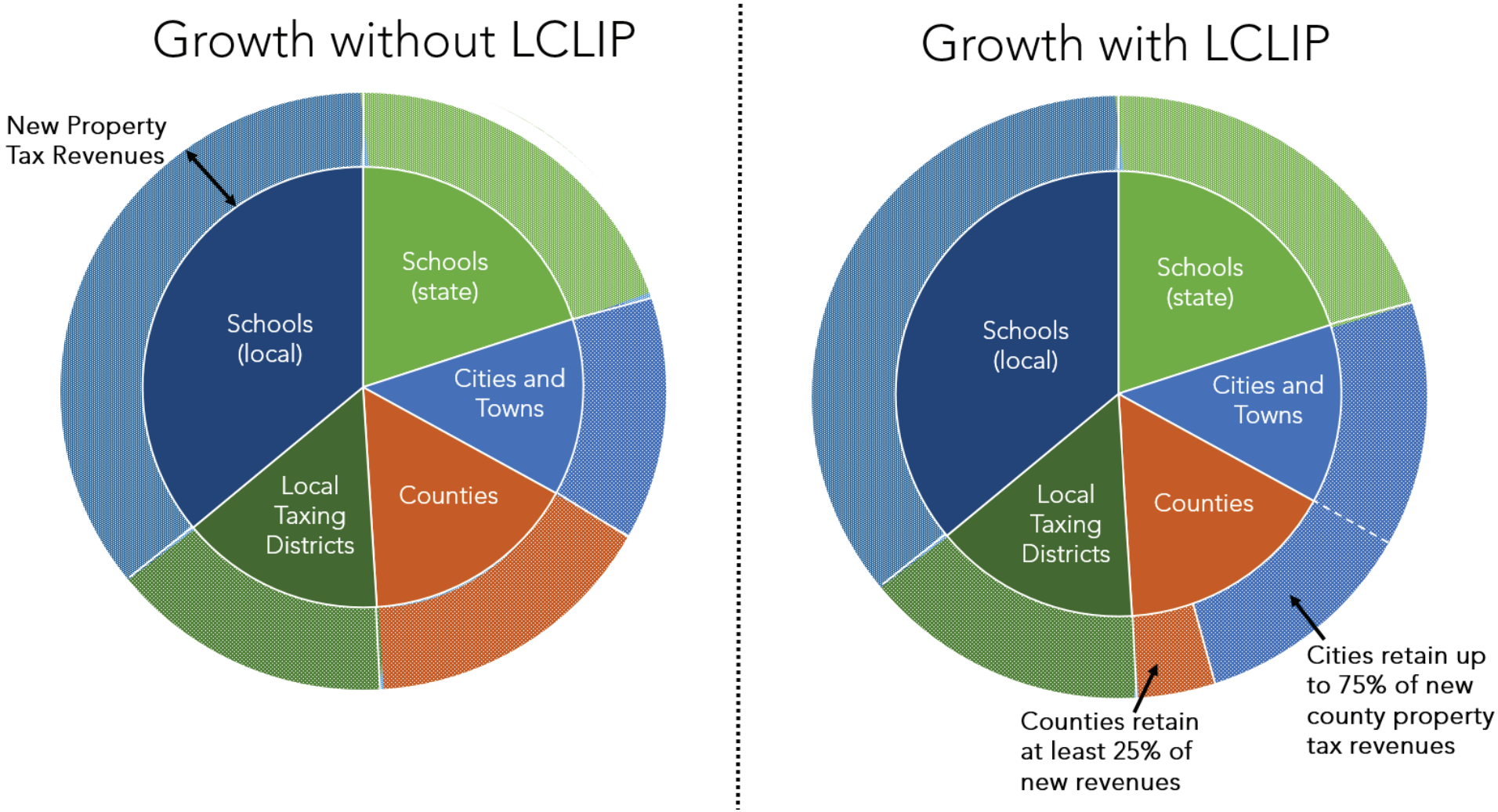

FIGURE 3: *Tax revenue with and without LCLIP*

The statute has a special name for these LCLIP districts: Local Improvement Project Areas, or LIPAs. In evaluating the zones and areas most likely to use TDR, resulting in the most revenue, and adhering to the program limitations, the consultant team identified portions of the regional growth centers to define as LIPAs including the following zones shown in **FIGURE 4** on the following page.

From these zones, it is possible to create the following six LIPAs. These LIPAs contain the assessed value from the table shown in **FIGURE 5** on the following page.

FIGURE 6 summarizes the assessed value by LIPA on the folllowing page.

USE OF REVENUES

Under the terms of LCLIP, cities can use revenues to pay for public improvements in the LCLIP district as follows:

- Street, road, bridge, and rail construction and maintenance;

- Storm water and drainage management systems;
- Water and sewer system construction and improvements;
- Sidewalks, streetlights, landscaping, and streetscaping;
- Parking, terminal, and dock facilities;
- Park and ride facilities of a transit authority and other facilities that support transit-oriented development;
- Park facilities, recreational areas, bicycle paths, and environmental remediation;
- Electric, gas, fiber, and other utility infrastructures;
- Expenditures for facilities and improvements that support affordable housing as defined by WA law;
- Providing maintenance and security for common or public areas; and
- Historic preservation activities authorized under WA law.

LCLIP is different from previous versions of TIF in Washington in that it provides more flexibility on how the funds can be used. Specifically, LCLIP enables funding for more than just capital improvements and can support certain operational activities related to the maintenance and security of public areas.

TDR PLACEMENT SCENARIOS AND REVENUE

As part of the implementation of LCLIP, the Puget Sound Regional Council allocated the number of

Zone	Total Assessed Value	Share
CBD	$81,079,400	1.2%
CBD-CORE	$77,564,840	1.2%
LMX	$41,062,100	0.6%
RM-10	$98,549,100	1.5%
RM-20	$762,972,255	11.5%
RM-CORE	$208,694,310	3.2%
UCX	$287,927,700	4.4%
Sum of Zones	$1,557,849,705	23.6%
City Total	**$6,607,199,525**	**100.0%**

FIGURE 4: *Assessed value by zone (Source: Pierce County Assessor, City of Puyallup Zoning)*

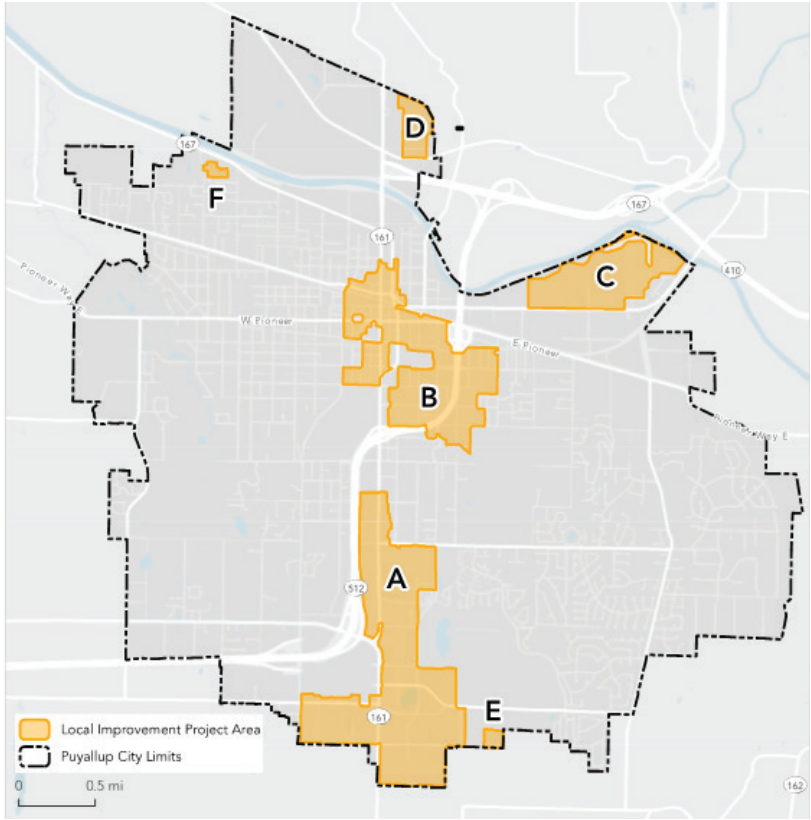

FIGURE 5: *Potential Local Improvement Project Areas (LIPAs) within Puyallup city limits*

eligible development rights available for transfer under the regional program (approximately 24,000) to the 35 cities that are eligible to use the tool. Each city received its own allocation of credits – a share of the regional total – that was scaled in proportion to its growth targets. The major metropolitan centers expecting considerable growth received the highest TDR credit allocations (Seattle, 3,440; Bellevue, 1,081; Tacoma, 1,843; and Everett, 1,491), while smaller cities expecting more modest growth (such as Mountlake Terrace and Covington with 92) received the fewest. Puyallup's allocation is on the lower end of the range, at 364, reflects its size, growth targets, and its two regional growth centers. The statute gives cities flexibility in choosing to what degree they wish to participate in LCLIP: they can commit to accepting any number of credits from 20% to 100% of their allocation.

In Puyallup's case, the city would commit to accepting anywhere between 73 and 364 TDR credits based on the growth projections that the consultant team modeled. The more credits the city commits to, the more revenue it earns, so there is a compelling financial incentive to take all 364 if the demand in the real estate market is strong enough and the city's TDR program mechanics are accurately designed to place them all. The market analysis for Puyallup shows strong enough demand to justify committing to all 364 credits. The main conclusion from the analysis is that LCLIP will succeed in Puyallup and can generate between $5.1 million and $9.2 million in new infrastructure funding (nominal year-of-expenditure dollars).

The consultant team evaluated two scenarios to project how many TDR credits the market would place and how much revenue the program would generate. These are:

- Status quo, in which recent historical growth trends are assumed to continue into the future, and
- Urban center, in which future demand for growth in Puyallup increases relative to the present market.

Status Quo – Current Market Absorption Scenario

- Sending area credit price assumption: $25,000
- Exchange Rate: 1 credit per 1,100 sf (with use of MFTE)
- Absorption: Averaging about 90 multifamily units a year (equivalent to 30 credits placed)
- Likelihood of reaching TDR placement goal of 364: 100% (market places 300 credits by year 10 of the program)
- LCLIP revenues:
  - » Net present value: $3.1 million (amount against which the city could bond today)
  - » Nominal: $5.2 million (amount the city would collect over 25 years)

Urban Center – Stronger Market Absorption Scenario

- Sending area credit price assumption: $25,000
- Exchange Rate: 1 credit per 1,100 sf (with use of MFTE)
- Absorption: Averaging about 120 multifamily units a year (equivalent to 40 credits placed)

LIPA	Total Assessed Value	Share
A	$765,469,690	11.6%
B	$469,143,780	7.1%
C	$205,104,550	3.1%
D	$109,901,385	1.7%
E	$1,248,900	0.0%
F	$6,981,400	0.1%
Sum of LIPAs	$1,557,849,705	23.6%
City Total	**$6,607,199,525**	**100.0%**

FIGURE 6: *Assessed value by LIPA (Source: Pierce County Assessor, City of Puyallup Zoning)*

- Likelihood of reaching TDR placement goal of 364: 100% (market places 400 credits by year 10 of the program)

- LCLIP revenues:

  » Net present value: $5.5 million (amount against which the city could bond today)

  » Nominal: $9.1 million (amount the city would collect over 25 years)

The amount of revenue LCLIP will generate is a function of two factors:

1. City TDR credit commitment. The more credits a city chooses to accept, the more revenue it will collect.

2. New construction activity. The greater the amount of new construction within the program period, the more revenue the city will collect.

The graph in **FIGURE 7** illustrates this relationship, showing how different levels of TDR placement and new construction affect LCLIP revenues.

LCLIP PERFORMANCE – CITY OBLIGATIONS

While LCLIP can run for a maximum of 25 years, the legislation requires participating cities to demonstrate performance on the use of credits within their designated districts. Cities using LCLIP must meet a series of performance thresholds tied to their commitment to use TDR. In order to meet these milestones either the private market should drive credit placement or, alternatively, cities may purchase the credits themselves to extend program revenues. These thresholds are as follows:

- Threshold #1: Placement of 25% of the specified portion of TDR credits is required to start the revenue stream. This is not a time-based milestone, but rather a performance-based milestone.

- Threshold #2: Placement of 50% of the specified portion of TDR credits is required by year 10 to extend it by 5 years.

- Threshold #3: Placement of 75% of the specified portion of TDR credits is required by year 15 to extend it by five years.

- Threshold #4: Placement of 100% of the specified portion of TDR credits is required by year 20 to extend it by five years to its conclusion.

FIGURE 8 illustrates the TDR credit placement milestones and how they relate to the extension of revenue collection.

The consequence of not meeting these placement thresholds is that Pierce County would have the option of discontinuing revenue and stopping the program.

In previous examples of LCLIP implementation, there has been some difference in interpretation from program partners as to what is required to start an LCLIP program. Briefly, the difference in interpretation is whether the placement of 25% of the specified portion is required to start the program or whether the creation of the LCLIP program through ordinance is the trigger. Should Puyallup adopt LCLIP, this question of timing would be resolved through an interlocal agreement with Pierce County. Precedent suggests that the program begins accruing revenue immediately upon adoption and the first payments would not occur until year two.

PROGRAM TIMING AND ADOPTION

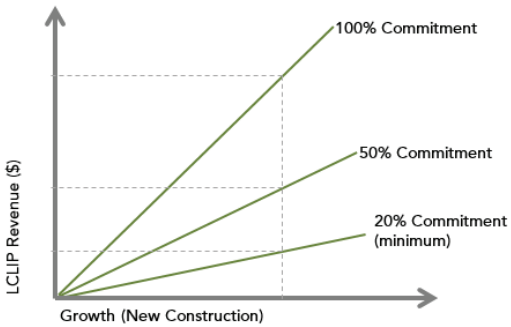

FIGURE 7: *LCLIP revenue across committment and new construction activity (Source: Pierce County Assessor, City of Puyallup Zoning)*

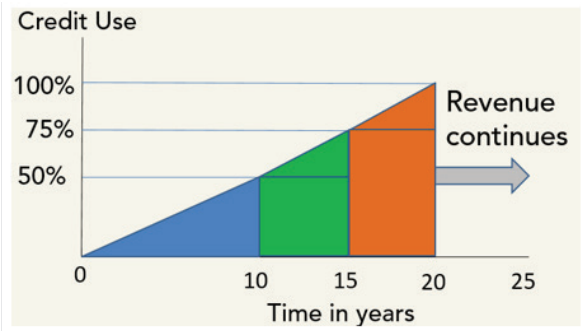

FIGURE 8: *TDR credit placement milestones*

STRATEGY

Another decision in LCLIP use is when to start the program. The 25-year clock starts when the city adopts the enacting ordinance. It is to the city's advantage to make the most of that time in terms of both revenue generation and TDR credit placement. This reduces the risk of the program ending early and increases the certainty of success. The consultant team recommends the city include the following approaches into an overall adoption strategy:

- Link adoption to launch project. By timing the start of the program to the construction of a project that uses TDR, the city is guaranteed to make progress towards credit placement and revenue generation from day one.
- Prepare legislation and documentation in advance to be ready for hearings. If the legislative package is complete and ready for introduction, the city can act quickly to adopt LCLIP when conditions are ideal.
- Define set of conditions for adoption. This will help the city to make an objective decision about when to move forward with adoption.
- Include WAC reference. To simplify regional TDR credit transfers, the city should incorporate by reference into the adopting ordinance the Washington Administrative Code rule (WAC 365-198) that sets terms and conditions for interlocal TDR transfers. This will eliminate the need to negotiate separate interlocal agreements with other counties.
- Adopt regulatory updates now, including 8-year MFTE as part of a TDR program, so the foundation of the program will be in place when conditions are prime for starting LCLIP.

RISKS AND TRADEOFFS

Cities considering LCLIP pose a common question: what are the risks to adopting the program and what happens if the private market doesn't place enough TDR credits to meet the performance thresholds? The short answer is that there is limited risk to the city. Should the city fall short of credit placement milestones the county has the option to end the program at that time. The consequences are that the city retains no further revenue from that point forward. Because the final years of the program generate the most revenue, the only loss is the opportunity cost of foregone income – although it's a large cost. There is no cancellation fee, no early withdrawal penalty, and cities can keep revenues already collected. The primary incentive to meet the TDR credit placement milestones is the prospect of higher revenues toward the end of the program.

Consider a hypothetical scenario for illustrative purposes: Puyallup adopts LCLIP and commits to placing 364 credits, or 100% of its allocation. Under the terms of the program the city must place 182 credits by year 10. If, by year nine, the private market has only placed 162 credits, what will happen if it can't place the remaining 20? Possible outcomes include:

- The city acquires the final 20 credits to close the gap and meet the threshold. The city could hold these credits and re-sell them to developers in future projects to recoup the purchase price.
- The city could approach the county to request flexibility in the threshold if it can demonstrate that there are new construction projects in the pipeline that would drive continued use of TDR or that demand for credits will continue.
- The jurisdictions could end the program. This would be an undesirable outcome for both the city and the county, as both would lose out on the future benefits of revenue and conservation, respectively.

The biggest risk associated with LCLIP is if a city bonds against future revenue from new construction. If the anticipated growth doesn't materialize, or unexpected factors change demand for growth, the program won't generate as much revenue as projected. This in itself wouldn't be a significant problem absent the bond, however the city is responsible for servicing the debt regardless of what revenues the program generates. If the actual revenues are lower than expected then the city is still liable for that obligation. One way to mitigate that risk while still taking advantage of up-front revenue for infrastructure is to bond for an amount that is smaller than the projected revenue to hedge against uncertainty.

Predicting future trends in growth, construction, and the real estate market is difficult, especially across longer timelines. There are many unforeseen factors that could help or hamper a city's implementation of LCLIP. Part of successful use of the tool is managing for these factors – adjusting TDR exchange rates if demand for growth changes, for example – and knowing that the long timeframe of the program allows for mid-course adjustments to keep the city on track to meet its goals.

ROAD MAP

In order to begin using LCLIP, a city must take a number of steps to set the program in motion. This section outlines – at a high level – the sequence of actions needed to start the program. The final report will cover these steps in greater depth. The goal at this point in the project is to provide an overview of the adoption trajectory and highlight how this final phase

fits into the LCLIP implementation picture.

There are two main elements that a city needs to start LCLIP: a TDR placement mechanism and an adopting ordinance.[3]

In order to create a TDR placement mechanism the consultant team recommends Puyallup adopt a program based on the framework outlined in this memorandum. General steps include:

- Draft code and policy changes identifying sending areas, creating receiving areas, establishing exchange rates, and defining an administrative model. A TDR program will typically be a stand-alone chapter within the development code and policy changes to the Land Use element of the comprehensive plan will address future receiving area creation.
- Confer with Pierce County about an interlocal agreement defining development right transfers.
- Schedule public hearings for planning commission and city council to consider policy and code changes.

The LCLIP adopting ordinance must contain the following components:

- Define the geography in which the city will use the program (the LIPAs), which may not exceed 25% of the city's assessed value.
- Define the number of TDR credits the city will accept. This amount may be in the range of 73 to 364 credits.
- Identify the public improvements on which the city will spend LCLIP revenue within the program area.
- Provide the date when the use of local property tax allocation revenues will commence and a list of the participating tax districts (city and county).

The consultant team recognizes that Puyallup city council, planning commission, and staff will consider the benefits and choices outlined in this memorandum to inform a decision on whether to proceed with creation of a TDR program and use of LCLIP. Should the city wish to continue with putting one or both of these tools in place, the technical support to help craft the specific language needed is beyond the scope of the current project.

SUMMARY OF FINDINGS

There is a strong case for Puyallup to use LCLIP.
The analysis suggests that, even with historic growth rates continuing unchanged, there will be sufficient demand in Puyallup to place all of the city's TDR credit allocation within the program's timeframe – provided the incentives and zoning prioritize use of the tool. If growth rates increase in the future, the certainty of credit placement also rises.

A market-driven approach to TDR credit placement should make LCLIP viable.
The strongest market for housing development in Puyallup is for single family and medium-density, multifamily construction. Rising construction costs and current multifamily rents make new construction a more challenging economic investment. If the city streamlines its incentive zoning to emphasize use of TDR in conjunction with implementing 8-year multifamily tax exemption (MFTE), the economic benefits will provide a compelling motivation for the private market to use these tools.

LCLIP revenue can pay for capital facilities that support growth.
The range of revenues projected for Puyallup is between $5.2 million and $9.1 million (in nominal terms). A constraint affecting LCLIP's revenue-generating potential in Pierce County is the lower relative levy rate (as compared to King or Snohomish County). The result of this is lower LCLIP revenue yields adjusted for every dollar of new construction value. Regardless, development brings other, broader tax benefits to the city. First, the city collects retail sales taxes on the construction and retail sales taxes from residents as more and more retail spending migrates to e-commerce. Second, the new construction al lows the city to grow its levy collection more than the statutory limit of 1% (through new construction add-on value). The bottom line is that use of TDR and LCLIP should result in aggregate revenues higher than the projections estimated in this analysis, which are only directly related to LCLIP.

This revenue would otherwise be unavailable to the city and it is highly flexible in nature. While this sum may not single handedly finance a large public improvement, it could play an important role as part of a broader infrastructure funding strategy. Puyallup could leverage it as match for other funding opportunities, for example. One of the top infrastructure needs the city has identified is that of additional stormwater treatment capacity in the South Hill regional growth center. Revenues from LCLIP

3 From a practical standpoint, cities historically have implemented TDR through a private market using incentives to place credits in new construction, however other options exist for using LCLIP that do not involve the traditional TDR structure. These can include the city buying credits outright, or pursuing a density fee whose proceeds fund TDR acquisition, among other approaches in which the city plays an active role in credit placement. Feedback from city staff and council has indicated a preference for a lighter-touch approach to using TDR, relying on the private market to place credits.

could play a role in supporting such investments.

PHOTO: *Joe Sambataro*