

DECISION MAKING FOR SALES OF  
URBANIZED NATURAL RESOURCE LANDS

by

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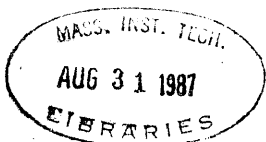
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ABSTRACT

This thesis examines the decision making process concerning the sale of urban real estate. It hypothesizes that a structured decision process captures the value of urban real estate. It utilizes examples from the Washington State Department of Natural Resources. For DNR, urban lands are those in transition from principal forest or agricultural uses to uses more characteristic of an urban environment such as residential, commercial, and industrial applications.

The Department has a history of concern for income production to benefit the trusts it administers. The past reliance on timber production and sales has shifted in recent years to include an appreciation of income producing potential on non-timber lands. While the Department does not see itself as a land developer, it does realize that urbanized lands are more valuable as properties to be developed and sold than as timber producing resources.

By structuring the decision process, property evaluations and decisions will be comprehensive and have continuity. Three case studies are reviewed to determine usage of any of three basic steps in the decision process. The thesis will examine whether other general guidelines, such as commonly accepted financial tools, were part of the decision process.

Standardization of the decision process allows it to be transferred from property to property. It ensures that all important factors are considered. The process must also remain flexible enough to allow decision makers to take advantage of new opportunities as they arise, but still provide guidance in determining how to package and sell an urban property.

Decision making guidelines could help DNR towards consistently successful outcomes. The thesis proposes a model process that will help agencies such as DNR decide how to best prepare lands, market them and deal with prospective buyers. It recommends using a structured decision making approach to capture value. It also recommends strategic alternatives for the construction of sale contracts which can be used to capture additional portions of a property's value.

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## I. INTRODUCTION

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This thesis examines the sale of urban real estate by the Washington State Department of Natural Resources (DNR). Real estate is not just sold but is marketed to a specific group of potential buyers. Therefore, astute preparations and structuring of the sale for those buyers will maximize the seller's profit.

The Department of Natural Resources has the fiduciary responsibility to produce income for the state's public school system and several other trusts by managing the state trust lands. It oversees almost three million acres of uplands and two million acres of aquatic lands.

Forestry is the heart and soul of the Department; its employees know and understand the farming of trees. Usually, the income for schools is generated through timber harvesting. Some lands, however, have become urban due to population increases and location shifts. This presents the DNR with the opportunity of selling this land for urban development and realizing a greater gain.

The lands in question are valuable because of their proximity to urban development. While these lands are currently not profitable from a forest management perspective, they can produce considerable revenue if sold for residential, commercial, industrial, or other urban uses. In other words,

their value as urban land has surpassed their value as a timber producing resource.

DNR has begun to view its real estate holdings that are in or impacted by urbanized areas as a portfolio of properties. In the last several years, the Department has recognized that its expertise in forestry has not prepared it to manage a portfolio of urban lands. While these lands are only a small percentage of the total DNR holdings, they demand special attention and expertise. The Department has responded to the challenge by forming a Real Estate Division to deal with these and other non-forestry issues.

The Real Estate Division reviews urban lands and those in transition to determine what can be done to create or capture the higher urban value. It determines whether the properties should be retained or sold. It also evaluates property exchanges and purchases. In essence, the Real Estate Division creates and manages a portfolio of investment properties for the Department from the existing, urbanizing parcels.

One way to capture the increased value of these lands is to sell the property. A professional, consistent approach to the sale of property will help the seller achieve the greatest potential profit. A comprehensive process is needed to identify the steps that must be taken for each property to be sold.

This thesis surveys real estate and financial literature to identify tools that may be useful in valuing a property and structuring a sale. It also presents three case studies as



examples of DNR's approach to the sale of urbanized natural resource land. The case studies are analyzed and compared. The case studies are then examined to determine whether a decision process and the tools described in the literature survey have been used. Conclusions are drawn and recommendations are made.

A matrix or checklist which can be reviewed at the beginning of a project will help develop a systematic decision making process. It should be applicable to both large and small sites. It should also be transferable to privately owned lands. This is particularly needed in Washington where tracts of forested land are surrounded by urban areas. Also, strategic alternatives for the structuring of a sale must be considered because government agencies such as DNR can not always respond to market opportunities as fast or as well as private development companies. They need to rely additional mechanisms to capture value.

The decisions on what to sell and how to present parcels to the market are important. The next chapter will discuss a framework for making these decisions.

## II. DECISION MAKING FRAMEWORK

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The hypothesis of this paper is that structuring the decision making process will ensure consistency and continuity. The variables to be considered and the sequence of the decisions to be made can be systematically analyzed and organized into a framework. The parts of the decision to sell can be identified and listed. For example, a market study, an appraisal, and development permit approvals are needed; which comes first? An organized pattern of decisions to be made becomes essentially a checklist to review for each new property to be sold.

Decisions made in a comprehensive manner ensure that all aspects of the question are reviewed and considered. Piecemeal, incremental and off-target decisions are avoided when an organization begins with a comprehensive perspective.

There are three basic steps involved in making a decision to sell urban land. The steps are as follows:

1. Define the objectives;
2. Determine a strategy for meeting the objectives; and
3. Develop an implementation plan to guide those who carry out the strategy. (Braun, 1975, p. 126)

Defining objectives identifies the important issues and provides goals to be met. For example, DNR, as a public

agency, has a wide variety of overseers to satisfy. Accordingly, its objectives must include the following areas:

1. Financial returns and value enhancement;
2. Community and political acceptance;
3. Agency efficiency and productivity; and
4. Trust land retention and income enhancement.

A strategy must then be developed to achieve the specific objectives.

"Very simply, a strategy is a set of instructions that so clearly define the action to be taken in response to every chance event that a third party or agent could act on a decision maker's behalf."  
(Raiffa and Thompson, 1985, p. 1)

A strategy will also address how much risk the decision maker should take. Reward is governed by the amount of risk that is taken. Because it sees itself in a fiduciary role, DNR as an agency wants to maximize profit; therefore, it must be prepared to take some risks.

The risks increase as one takes on more development activities. As the property is further improved, the seller moves along a continuum from "small risk" to "large risk." Development activities include the following:

1. Sell land as is;
2. Seek development approvals;
3. Undertake construction;

4. Get involved in marketing/leasing;
5. Assume operational management.

The rewards and benefits from undertaking these risks include the following and accumulate as more risks are taken:

1. Cash flow (revenue);
2. Fees for activities managed;
3. Residuals (future sales value);
4. Credit/publicity for doing the deal. (Bacow, 1987)

Tax benefits (shields) are another reward/benefit in a development deal but were not listed here because DNR is a non-taxed, government agency.

The final step after defining objectives and evaluating risks and rewards is to determine how those implementing the strategy will proceed. A good, workable plan requires carefully thinking through the sequence of events in order to anticipate what is going to occur. Successful developers are those who anticipate changes and respond to them in the course of completing a project. Using a decision tree, or similar vehicle for identifying options at various crossroads, will provide guidance.

Decision making rules are different than decision making processes. For example, the US Tax Code is a set of decision making rules. Rules govern and determine that decision making outcome. However, Washington's State Environmental Policy Act

(SEPA) defines a decision making process. SEPA provides a review of the environmental impacts caused by a proposal. It determines if there is significant impact. A project proponent then writes an Environmental Impact Statement. There is a public hearing and court review, as needed.

The Department of Natural Resources could use a set order of events or process for managing its portfolio of urban land. It faces four options. One possibility is to sell the urban lands outright. An alternative is to obtain land use permits and then sell the lands. A second alternative is to undertake some on-site development (i.e., obtaining permits and installing utilities). A third alternative is to hold the lands within the portfolio when the financial return is greater than sale of the developed or undeveloped land. DNR needs a structured way of approaching these options.

Structured decision making involves a framework which can be applied to many decisions. It allows for flexibility by requiring consideration of the options and consequences. It is a disciplined approach to achieving desired results.

The next chapter discusses the history of DNR. Then three case studies will be reviewed to determine if such a disciplined approach to decision making was used to identify objectives, develop strategies, and organize implementation plans. These case examples demonstrate the decision making process used by one government agency charged with selling urban lands.

### III. HISTORY

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The Department of Natural Resources has a history of concern for income production to benefit the trusts it administers. The past reliance on timber production and sales has shifted in recent years to include an appreciation of income producing potential on non-timber lands. The new focus on urban and transition lands as an additional source of income recognizes the population and urban area expansion that has occurred in Washington. It also reflects the Department's ability to persuade state lawmakers to adopt legislation to allow the new directions.

The approximately five million acres of land managed by the Department came from the federal government, Washington counties and gifts to the state. Approximately three million acres are managed as upland trust lands. The income generated supports the various state trusts while the land (seen as trust assets) is to be preserved for future beneficiaries. The largest of the 11 trusts is the public school trust and supports the construction of new schools.

DNR has a keen sense of being a trustee and is required to act on behalf of both current and future beneficiaries. Its fiduciary responsibilities have been defined through litigation. In United States v. 111.2 Acres of Land in Ferry County, Washington, the United States District Court declared: "Section 10 of the Enabling Act and Article XVI, section 1 of

the Washington Constitution constitute a declaration of trust, the United States is the grantor of the trust; the State of Washington acting through the Department is the trustee; the common schools (or other designated beneficiary) is the beneficiary; and the granted land (or proceeds from its sale) is the corpus of trust." (Marcus-Jones, 1985, p. 21)

The Department was established in 1957 after the concept of a single forest and land management agency for the trust lands became accepted. It is also responsible for the approximately two million acres of aquatic lands within the state. These are public trust lands also but are beyond the scope of this paper because they do not have a requirement to produce income for a trust.

An elected Commissioner of Public Lands oversees the Department. The Board of Natural Resources, a six member designated and appointed body, is charged with establishing policies governing the Department and enacting the necessary regulations to allow DNR to carry out its duties.

### Policy Development

A review of policy development by the Department demonstrates changes in philosophy over the years. For the majority of its existence, the Department viewed timber harvesting or farming as its primary purpose. Few of its lands were in urbanizing areas; those that were were considered problems. In the last few years more land has been urbanized. The Department now sees these sites as

opportunities. While it does not view itself as being in the land development business, it does see its role as expanded from solely forest management. The evolution in the Department's view of its duties is explained by the author of a thesis on the Department's urban and transition lands:

"Prior to 1968 the Department virtually ignored the problems with lands in transitory areas and performed management activities on these lands as if they were the same as any other forested land area." (p. 43)

"In 1968 the Department attempted to project future uses of its trust lands on a statewide basis. This was the first official recognition that some DNR lands did not fit neatly into a 'typical' forest management scheme. The policies for predicting these uses were adopted by DNR in August 1968 in the Resource Allocation Plan (RAP). In ensuing years this document would be revised substantially and finally supplanted by the Forest Land Management Program (FLMP)." (p. 44)

The 1979 FLMP "states, 'The primary measures of whether the Department has achieved its goal and fulfilled its trust responsibility must be an economic one in view of the overriding purposes of maximizing income to the trusts'...Income to the trusts was primarily expected to be derived from the sale and subsequent harvest of timber. The FLMP states that the Department manages its forest lands, 'to fully utilize the site and maintain optimum growth and productivity which will maximize income from these lands at the time of harvest.'" (p. 31)

Legal challenges to the first FLMP in 1979 and a change of administration of the DNR in 1980 led to a revised Forest Land Management Plan in 1984. The differences between these two documents represents a dramatic change in DNR's approach to management of its trust lands, as shown in the following quotation:



"Unlike the 1979 FLMP, the (1984)...program intended to guide the DNR for only ten years, 1984-1993, rather than 120 years. The (new) FLMP stressed a conservative approach to the management of the trust lands. Two themes were established as the focus of the document:...a) the forest lands should be managed as a whole, taking care to not only produce timber for revenue, but also protect non-timber resources as well...(and) b) to take a cautious view of the economic future by diversifying management practices and tree growing investments." (p. 35)

### Urban Lands

Urban lands are those lands in transition from principal forest or agricultural uses to uses more characteristic of an urban environment. These DNR lands were being surrounded by residential, commercial, and industrial development as cities and populated county areas expanded. One of the original federal land grants gave two sections of each township as school trust land. The scattered location of these sites increased their susceptibility to urbanization.

In the 1960's the Department exchanged 500,000 acres of its urban lands with private natural resource based development companies for the same amount of forested acreage. A windfall for the private companies, the Department did not recognize the value of these land then and tried to get rid of them at forestry values. As the population increased, migration occurred, and the public's environmental awareness increased, it became difficult for DNR to harvest timber on its urban lands. These problems steadily increased in the late 1970's. In 1976, DNR established a separate Urban Lands

Program. An inventory designated approximately 10,000 acres as urban.

"Unable to practice traditional forestry operations on these lands and experiencing pressure from the general public and local governments for other uses, DNR managers typically regarded these lands as a problem. The creation of the Urban Lands Program reflected DNR's recognition that an active and specific management program (for these lands) was in the agency's best interests." (p. 49)

In 1981 the inventory was updated and three categories of land were designated: Urban 10, Rural, and Special Uses. Approximately 16,300 acres were shown as Urban 10, of which about 1,600 acres were in active forest production. Urban 10 meant lands which would convert to urban uses within 10 years. In the 1984 FLMP, the Department said it would remove Urban 10 lands from its sustainable harvest base; this really meant only the 1,600 acres would be removed from active harvest.

In March 1984, the Transition Lands Act (Urban-Transition Bill/Second Substitute House Bill 181) was passed to give DNR increased flexibility in the management of urban and transition lands. "Primarily the bill amended the Land Bank legislation to allow the Department to acquire income producing as well as natural resource producing property. The bill also required the Department to not deplete the publicly owned land base nor reduce the publicly owned commercial forest base. In addition the department was directed to comply with local land use plans and applicable growth management principles." (DNR, 1986, p. 11) In July 1984, the

Board of Natural Resources formally designated 7,700 acres of trust lands as "Urban." The designated acreage was reduced from the number of acres previously considered urban after public hearings and consultation with local governments.

In 1985 the Department began writing a Transition Lands Policy Plan (TLPP). The purpose was to define the role of transition (urban) lands in the trust portfolio, to identify a management process to accomplish a change from lower to higher valued uses, and to maintain environmental quality. The document identifies changes in land use patterns as a means of capturing value for the urban DNR sites. The TLPP has not yet been adopted.

In late 1985 the Department reorganized and formed the Real Estate Division. Its immediate predecessor was an intradepartmental "Urban Lands Working Group" which was to "bring to successful completion specific urban land projects assigned to it." (McElroy, 1985) The formation of the Division gave formal recognition to the different management requirements for urban lands. The Division is responsible for selling lands no longer profitable for DNR, buying income producing property and managing the urban lands. It also is shepherding the draft Transition Lands Policy Plan through the approvals process. The TLPP comments on the benefits of urban lands:

"Viewing the scattered...holdings of the trust portfolios as potential income producing opportunities results in two direct benefits:

1. The value of underutilized or vacant property can be redeployed into more productive situations;

2. Purposefully diversifying the location and type of acquisition will allow the Department to generate greater income less subject to the cyclical income fluctuations from forest and agricultural lands." (DNR, 1986, p. 12)

### Legal Authority

The Department has five options for dealing with its urban lands and these are supported by several portions of the Revised Code of Washington (RCW) (the state laws). These include the following:

1. Sale of Public Lands: Public land could be sold at auction. The land has to be platted if it is within an incorporated city. Previously, there was no mechanism for purchase of replacement property. Also, proceeds of a sale went into the Permanent Common School Fund. The interest from the proceeds goes into the Common School Construction Fund.

2. Leasing of Public Lands: Ground leases can be awarded through public auction. However, there was a lack of market acceptance for ground leases associated with single-family residential uses. The maximum return was not usually obtained.

3. Resource Management Land Bank: DNR can borrow funds to purchase income producing land. Originally, DNR could only buy natural resource lands. The process is as follows: newly purchased land is held in the Land Bank, trust land which is deemed unproductive or not suitable is put

into the Land Bank and stripped of its trust designation, the trust designation is placed on the land purchased earlier, land is removed from the Land Bank and added to DNR inventory, and former trust land is sold and the funds used to reimburse the Land Bank. There is a \$3 Million limit per transaction. This is an awkward mechanism, although an Attorney General opinion now finds land can be sold first. It is suitable for small parcels, not large urban parcels.

4. Simultaneous Land Exchange: State land can be exchanged for other land of equal value. There are restrictions on reasons for exchanges. There is also concern for the appreciation value of land to be exchanged and land received.

5. Deferred Land Exchange: This mechanism relies on DNR's exchange authority. It includes sale of DNR land to a buyer in return for a promise to exchange land and establishment of an escrow account for the dollar value of the DNR property. After DNR has identified property it wants, the buyer purchases it with escrowed funds. Title is transferred to DNR. The new property should produce revenue for the trusts immediately.

DNR's original authority was to lease lands. This was the basis for its preference for structuring deals with ground leases. As ground leases were found to be awkward for disposal of urban lands, new options were developed.

"The principal authority to lease is found in RCW 79.01 and provides up to 55 year lease terms for commercial, industrial, business or recreational uses and up to 99 years for residential uses...Leases which authorize commercial, industrial, or residential uses on state lands may be entered into by negotiation. ...At the option of the Department, these leases may be placed for bid at public auction." (DNR, 1986, p. 33)

"Prior to 1966 the proceeds from sales of state lands were placed in the Permanent Fund (the principal was not reinvested in land). In 1977 and 1984, statutory changes were made recognizing the need of the Department to sell lands that could not be managed effectively. The legislature also recognized the importance of replacing those lands to maintain the publicly owned land base. The 'land bank' (RCW 79.66) facilitates sale of trust land and purchase of replacement property with natural resource or income producing potential" (p. 34) by establishing a mechanism to buy and sell land.

In 1984 the Transition Lands Act was adopted. It was significant because it allowed the Department to purchase income producing property in addition to resource property (asset redeployment). Income producing property could be commercial, industrial or office property, preferably with existing long-term leases. The legislation also allowed the Department to enter into leases after one-on-one negotiations rather than through the public auction process.

Sales of lands are also affected by two additional provisions:

1. "All sales of trust lands are to be at public auction...When lands have not sold at public auction, sales by brokers, for cash or by real estate contract, may be authorized (RCW 79.01);
2. No public lands shall ever be disposed of unless the full market value...be paid to the state. Article XVI, sec 1 and 2, Washington State Constitution." (p. 34)

All purchases and sales must be approved by the Board of Natural Resources, acting as the State Board of Appraisers.

Other sections of state law (RCW 79.08 and 79.66) authorize the Department to exchange state land. Provisions of importance include:

1. The department may exchange property held in the land bank for property of equal or greater value...which has greater potential for natural resource or income production...;
2. Exchange of urban land for land bank land. County, city, town, or certain state agencies...are given the opportunity to acquire state-owned designated urban land at fair market value...prior to such land being proposed for exchange to private parties..." (p. 34)

### Conclusion

The history of the Department of Natural Resources demonstrates the changes in philosophy that have occurred over the years regarding administration of the Washington State trust lands. These changes include the view that urban land has income producing potential and that income for the trusts can be produced by urban lands as well as natural resource lands. Two documents, a thesis by Diane Marcus-Jones for the University of Washington College of Forest Resources and DNR's draft Transition Land Policy Plan, describe this history succinctly and are the basis for much of this chapter. It is important to understand DNR's overall mission and the manner in which disposal of urban property is viewed.

The next chapter will discuss the specific examples of sales of urban lands.

#### IV. CASE STUDIES

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The Department of Natural Resources is a relative newcomer to selling urban real estate. Its decision making processes are not always clear. It is educational to study them to learn where improvements can be made.

Three case studies are reviewed. Map 1 on page 25 shows the location of the three sites. Activity in all three began before the Real Estate Division was formed. However, most of the activity on Canterbury Court, the third study, has occurred since the Division's formation. Timelines for specific events are presented at the end of each case study.

Bucklin Ridge is the first case study examined. It is an example of a piecemeal approach to the development and sale of a property. Several sales opportunities were lost over the years. The desire to obtain as high a return as possible was a contributing factor. It will remain in the Department's portfolio until area land values or other changes occur to make the site and its accompanying utilities assessment charges attractive.

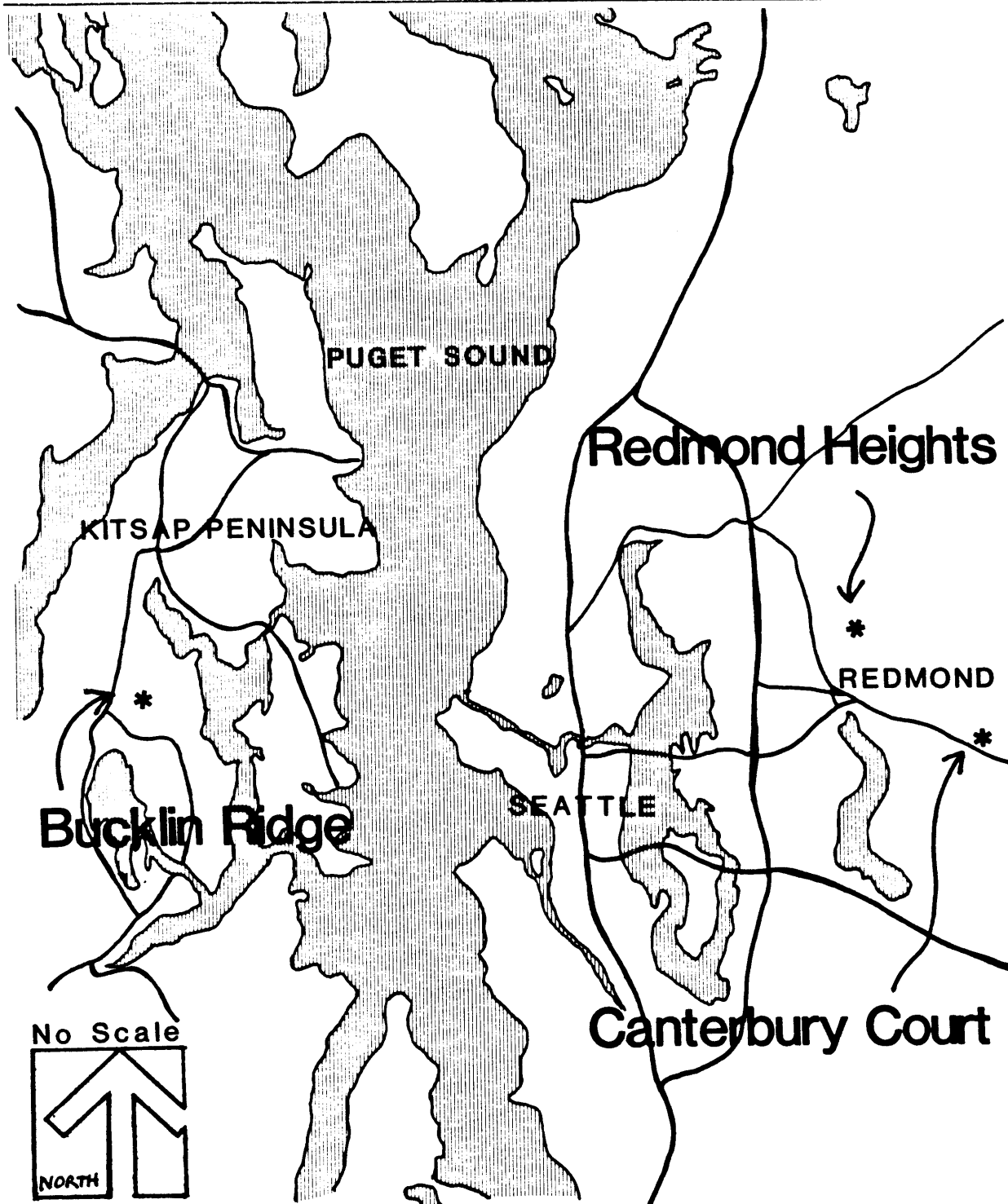
Redmond Heights is the second case study discussed. After four public offerings, a sale finally resulted in April, 1987. Uneven application of Department efforts over the years and lack of a comprehensive approach combine to demonstrate some pitfalls of urban real estate sales.



MAP 1

PUGET SOUND REGION:

CASE STUDY LOCATIONS



Canterbury Court is the third case study reviewed. Because it is the smallest site, the scope of the decision making process was less complicated. With the exception of the time involved, it has flowed smoothly. The first public offering should be made this year.

The methodology used to write the case studies consisted of interviews, a review of historical documentation, site visits, and discussions with various DNR staff members. Interviewees included former consultants, representatives from private natural resource based development companies and several Massachusetts Institute of Technology professors. DNR files yielded much information, and Real Estate Division personnel were very cooperative in discussing the cases.

Overall, the Department has always been committed to sell its urban lands, but it has floundered in its application and implementation of disposal mechanisms. This is due to the backwardness of some of the legislation governing it, and to the lack of a clear decision making process to determine which mechanism to use.

#### IV. CASE STUDIES

##### A. BUCKLIN RIDGE

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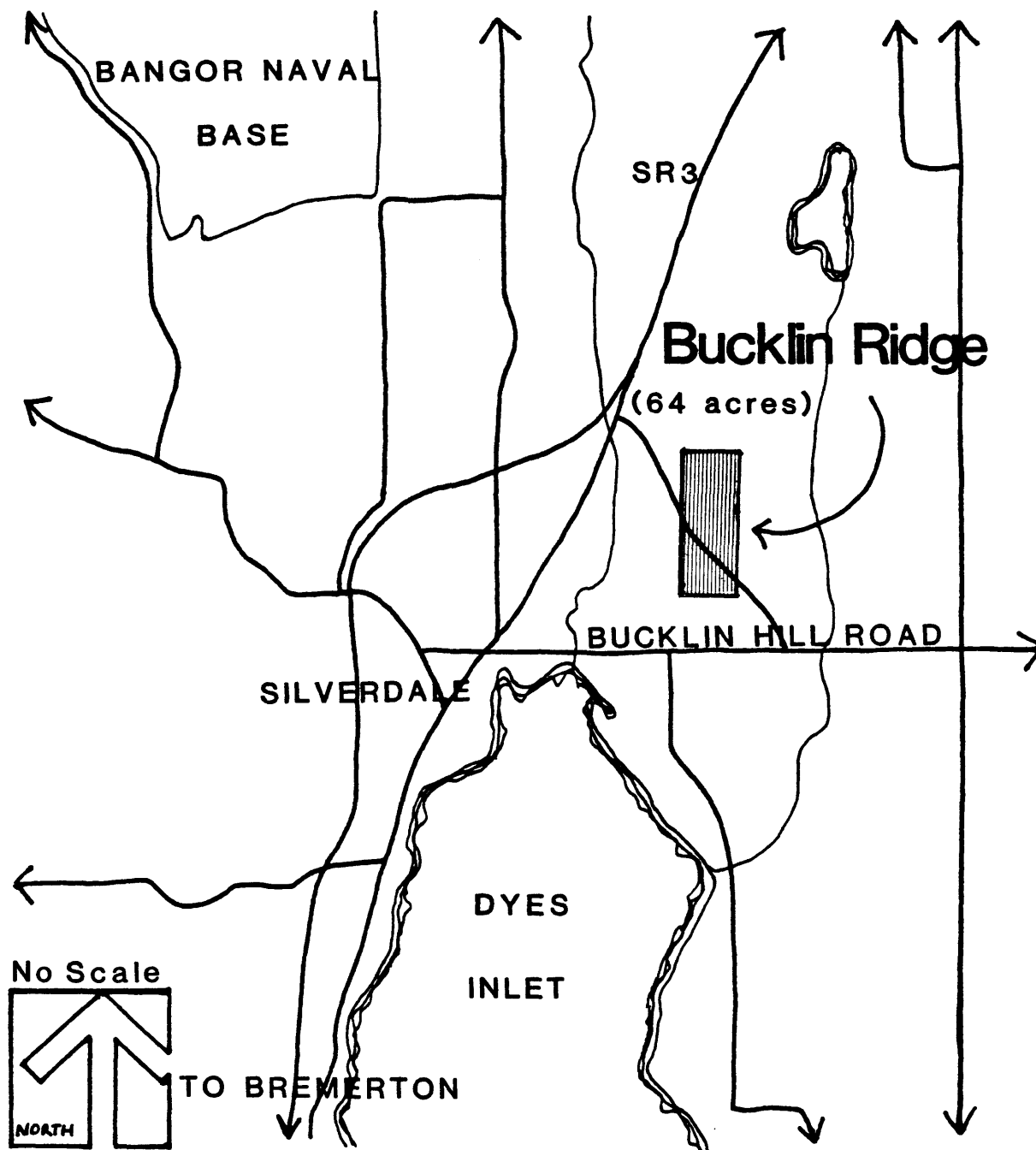
DNR's Bucklin Ridge property is one case study in the disposition of urban land. The approximately 64 acre property is located near the unincorporated community of Silverdale on the Kitsap Peninsula. Three US Navy installations are located on the Peninsula, which is across Puget Sound from Seattle. The DNR site is currently forested but split in two by a highway bypass.

Bucklin Ridge is still in DNR ownership although the effort to plan, install improvements, and sell it has been going on for over seven years. It has been designated "Urban-10" (likely to come under urban development within 10 years). (Probst, 1982) In 1982, a DNR official described the property to the Kitsap County Board of County Commissioners:

"The DNR can no longer manage the Bucklin Hill site for timber production. The Silverdale area is rapidly urbanizing. The existing homes abutting the south and the proposed (adjacent) residential development make timber production no longer viable. The DNR site has been designated as urban property in a recent report to the Legislature." (Cahill, 1982)

The Bucklin Ridge site is within the area covered by the Bucklin Ridge Community Plan (BRCP). The BRCP is a planning document identifying approved land uses and densities that was developed by the property owners in conjunction with the

MAP 2  
BUCKLIN RIDGE:  
VICINITY MAP



County. It allows 4,000 dwelling units in a 655 acre area. A DNR draft brochure for the property describes what is permitted on the site:

"The Bucklin Ridge Community Plan Planned Unit Development has an overall designation of 'semi-urban.' The approved plan allows 382 total units, or about 5.9 units per acre (on the DNR site). Also provided is a mix of single-family and multi-family units. These may be separated at the builder's discretion as follows: 38 single-family and 124 multi-family units north of Waaga Way (the highway that divides the DNR site) and 86 single-family and 144 multi-family units on the south...The site supports superior access. It is located at the intersection of Waaga Way and the Ridge Top Boulevard Road...(which forms) the primary north-south connector on the Bucklin Ridgetop." (DNR, November, 1985)

After the BRCP was adopted, the owners formed several Local Improvement Districts (LIDs) and Road Improvement Districts to install and finance the water systems, the sanitary sewer systems, the road network and some storm drainage for the planning area. These efforts led to assessments of approximately \$10,000 per acre. In 1985, a potential buyer investigated the site but backed out upon learning he would be responsible for payment of the assessments.

DNR decided it could enhance the value of the site through community planning efforts and installation of on-site improvements. At this time the site was managed by DNR personnel whose primary background was in timber production and forest management. The DNR was unfamiliar with urban real estate sales. Development and sale of the site was not

considered a high priority. (The Real Estate Division, which would provide the expertise in the future, had not yet been formed.)

There were several points during this process of value enhancement at which the property could, or maybe should, have been sold. While DNR tried to do "the right thing" by cooperatively participating with adjacent landowners and the County staff in the planning process, it did so without identifying the market for its end product or defining what the end product would be. The decision making was segmented. Little, if any, time was spent evaluating the costs and real increases in property value. The private sector landowners/developers who were DNR's partners in writing the BRCP chose a similar path even though they were more experienced in the development field.

The Reagan Administration has continued to funnel money to the area's Navy facilities. The Bangor base has received all the assigned Trident submarines. The base at Bremerton did go through a recession in the shipyards. However, in late 1987, 1500 new hires are expected due to the arrival of the aircraft carrier USS Nimitz. The market has been saturated with lower cost land for development by property owners not involved in the BRCP. The Real Estate Division is waiting until the situation improves before attempting to sell the site, according to the current project manager.

The following paragraphs present a history of the Bucklin Ridge property. Exhibit 1, page 44, is a project timeline.

## History

In 1977, the Kitsap County Board of Commissioners adopted a County-wide Comprehensive Plan. In this document, the Commissioners identified areas where further study was needed on a more detailed basis. They also called for citizen participation in the formation of plans for these areas. The "Bucklin Hill Ridgetop" was identified as "a place where special care and creativity must be applied as development takes place." (Palmer, 1979)

To accomplish this, a specific plan for the area was to be developed. The County initiated a meeting between all the property owners in the area in early January, 1980 to begin this process. A week later the property owners gathered to discuss "a unique opportunity whereby property owners within a defined planning area would pool their financial resources and hire a consultant to develop a Master Plan and an Environmental Impact Statement." (Probst, January, 1980) The major property owners endorsed the project and it began in Spring 1980.

The planning area started with 757 acres and 25 property owners. Several owners did not want to participate. The BRCP eventually covered approximately 650 acres. The property owners group was led by a representative of one of the three major landholders, Pope Resources (part of Pope and Talbot, a forest products firm). DNR was another of the major landholders. The property owners, their consultants, and the County staff worked on the Community Plan and the

Environmental Impact Statement over the next two years.

The property owners group (both public and private entities) displayed a remarkable willingness to work together over the years. Self-interest played a part, as did knowing that the County was more likely to adopt a plan worked out by the property owners. Also, they understood that the Commissioners wanted a plan before allowing any development.

One DNR representative listed the following points as a rationale for participating in the joint planning process:

1. "It is a joint, unified effort of, hopefully, 25 property owners that has endorsement from Kitsap County Planning staff.
2. This effort follows the direction of the Kitsap County Board of County Commissioners for a site specific planning effort.
3. To go individually would be very difficult for DNR in light of our other planning efforts in Kitsap County.
4. This effort is a bargain compared to an individual effort (monetarily).
5. The opportunity exists whereby our land can be integrated into a total land use effort." (Probst, January, 1980)

In April, 1982, the County's Planning Commission recommended approval of the Plan. After a public hearing in May, the Board of County Commissioners approved the Plan in June. By November, though, the political winds seemed to have shifted. At the hearing to recommend zoning to implement the Bucklin Ridge Community Plan, the County staff proposed a zoning designation which allowed only half the density called for in the BRCP. DNR, along with the other property owners, protested. Eventually the higher zoning was adopted. Even



with the appropriate zoning designation, a more detailed development plan (conceptual and final PUD) was needed before actual building could start.

This is one point where DNR could have sold the property and realized an increase in value. In 1982 the economic picture in Central Kitsap County was rosy; this area missed the downturn which hit much of the rest of Puget Sound. Defense spending was high. Government money was directed to the Navy bases and the base at Bangor was receiving more nuclear-powered submarines. The area was growing and housing was needed. It was not sold because the Department was expecting greater returns later.

The current project manager suggests in retrospect that a study would have been needed to determine if the sales price that could have been obtained would have justified the development investment. Because the site was still raw land without improvements, the increased land value might not have been created at that time. The project manager noted DNR was still optimistic and believed its land was first in line to absorb future growth.

#### Site Improvements

The property owners, DNR among them, decided that they needed to plan for the area on an overall basis and then to provide the utilities to the site in order to make a sale of the site possible. In 1980, the Bucklin Ridge area was not served by sanitary sewers, water, or adequate roads. "It was

the consensus that a utility local improvement district would be the best way to pay for the water, sewer, and road." (Probst, August, 1980)

Three utility districts were formed, one each for sanitary sewer service, water service and the road network. Assessments for costs were divided among the property owners on a per acre basis. In May, 1983 DNR's initial assessment for the road improvements was approximately \$312,414. (Probst, 1983) During this time, the Department sold about two acres of its land to the County for use as street right-of-way in the BRCP area. This brought approximately \$30,000 in revenue and showed a land value of \$13,000 per acre.

The local water district was small and could not handle the financial requirements for the LID by itself. In order to sell the bonds necessary to finance the water system improvements, the water district required the property owners to contribute a total of \$300,000 plus two years interest on the bonds as a reserve fund. DNR's share was approximately \$52,540. "This money would be refundable at the end of the bond period or could be applied to the last assessment payment." (Monell, 1983) The property owners spent many meetings trying to arrive at a proposal acceptable to both the water district and them.

DNR's assessment costs for the water system were \$158,500. It also had to pay \$1,502 as its share of costs for a drainage study. The sewer assessment charges were \$165,800. In mid-1983, "current property values with the proposed sewer,

water and roads appear to be \$20,000 - \$25,000 per acre (from a recent appraisal for a school site). If all costs of roads, sewer and water are added together (for the DNR property) it comes to approximately \$10,000 per acre." (Monell, 1983)

### Property Valuation

In February, 1984 the Department had an appraisal completed for the property. The appraiser developed a value of \$13,000 per acre. DNR's own appraiser reviewed the report and agreed with the valuation numbers. "It is important to note that the value is \$13,000/acre as of January 14, 1984, with the purchaser to also be responsible for the approximate \$10,000/acre ULID costs. The overall benefit to us is \$23,000/acre." (Hoefer, 1984)

Selling the property before the assessments started to come due, but after the utilities were in, would have shifted the payment risks to the buyer. This is another point at which DNR could have sold the land with a satisfactory return to the trusts. A sale at this point would have allowed the ultimate developer to step in while the project momentum was still going.

DNR did begin an effort, which was not sustained, to sell the property in July, 1984. A brochure was drafted but not completed. Schools, local governments and other public entities were notified of the opportunity to purchase the land, as required by state law, but no offers were received. By Fall 1984, the Department was discussing selling the

Bucklin Ridge site to the highest bidder through a Land Bank exchange. Several timetables were laid out showing sales by mid-1985. It was anticipated that the utilities would be in place by the time a sale occurred.

In March, 1985 the property owners' engineering consultant found a Florida pension fund advisor who was interested in the Bucklin Ridge property. Another timeline for the sales process was initiated; it projected awarding the winning bid in early July. Due to the interest in the site, the Department obtained an update on its January, 1984 appraisal. The update found the "market value indication for 64.05 acres - \$15,000 per acre." (Benchmark, 1985) However, the appraiser also added:

"At the present time, it appears that there is a greater supply of developed single-family lots and new and used single-family homes available in Kitsap County and around the Silverdale/Bremerton area than the market can absorb." (Benchmark, 1985)

The Department was beginning to be concerned by the large assessment costs in light of the perceived shrinking property values.

#### Public Offerings

In April 1985, a potential buyer, a Florida pension fund, submitted an "Application to Purchase" the Bucklin Ridge property at a public auction. In May the pension fund advisor asked for the minimum price DNR would accept. He had not

realized the \$10,000 per acre assessments would be his responsibility. DNR's minimum was \$970,500 based on \$15,000 per acre; the advisor was not interested in meeting this figure.

Those managing the property at that time found the number of people willing to pay \$1 Million for the property was small. They realized the market was soft and it would be difficult to sell the property.

Department representatives discussed valuation of the existing timber on the site and how to include it in the asking price. One representative discussed the issue with private timber company resource people. He noted in a memo to other department personnel:

"The (private) real estate company pays the timber resource company for the timber on the land they are managing before it is sold or developed, or else the parcel is logged. This would suggest that we are not alone in our thoughts that perhaps 10 - 15 percent of the timber is amenity value with the land, but the rest should be a separate part of the appraisal. After all it is a source of ready cash for the developer while plans are going through the long approval process. With this in mind we should raise the initial price on Bucklin to \$1,070,000 total or \$100,000 for timber." (Monell, 1985)

In September, 1985, there was more department discussion concerning disposal of the Bucklin Ridge property because another developer had expressed interest in the site. Three options were reviewed:

1. Sell through the Land Bank;

2. Lease multi-family portions and sell single-family portions;
3. Lease both multi- and single-family portions with option to purchase at a later date.

Arguments for and against the second and third plans show what DNR thought was important. In a memo dated September 20, 1985 and a reply to it, two Department personnel discussed the advantages and disadvantages of options 2 and 3. Plan 2 advantages were described as:

1. Site specific plan is completed with market analysis;
2. Immediate income stream is possible;
3. Land base is retained on multi-family areas;
4. No upfront capital is needed to buy land;
5. Site plan is reviewed by DNR so best sites are not all multi-family;
6. Single-family value land is put in Land Bank.

The disadvantages to leasing were listed as follows:

1. LID payments are made by DNR for single-family dwelling portion until disposal;
2. Single-family land disposal timetable is unknown;
3. Quality of construction and buildout time could result in potential default by lessee; builder would build to low market due to military influence;
4. Absorption of units is expected to take a long time; lots of substitute land is available in direct competition.

Plan 3 (lease with option to purchase) also had advantages. They included the following:

1. Combined multi- and single-family plan will be developed;
2. Advantages of later purchase could increase competitive bidding;
3. Site is attractive to lenders;
4. No large upfront capital is needed to buy land;
5. Lessee is responsible for all LID payments;
6. Land value will increase due to development.

The DNR managers listed the disadvantages of this option:

1. Ability to sell at later date without public auction is under legal cloud;
2. Lessee may not take option to buy when due; DNR would be left with half finished improvements;
3. Market is speculative; there are lots of substitutes. (Probst, 1985)

The decision was to proceed with a sale of the site (Plan 1) before the end of the calendar year. The decision was made by the Assistant (Lands) Division Manager. Notes by the new project manager indicate the price of the timber was added to the site price. It was to be listed as \$1,070,000.

During 1985, the County began to approve commercial and multi-family residential developments outside of the BRCP master planned area. It allowed development between Silverdale and the BRCP area even though a master plan to supplement the County's Comprehensive Plan had not been completed for the area. Examples included the Crestwood PUD (half retirement center, half multi-family project), two other multi-family Planned Unit Developments southwest of the DNR site, a Costco discount warehouse store, and small satellite commercial/retail facilities around the 600,000 sq ft Kitsap Mall.

These actions were significant to DNR for two reasons: a) high density residential and commercial development was now located adjacent to the south portion of DNR's property. DNR's site south of the Waaga Way highway bypass was zoned for medium and low density residential uses. An incompatible pocket of residential uses was created on DNR property; and b)

the County was implicitly saying that the rules under which DNR and the other Bucklin Ridge property owners operated in obtaining the master plan and installing the on-site improvements could be circumvented or avoided (no longer applicable). All the adjacent property became developable at a much lower price because there was no investment in planning or utilities and roads. DNR, on the other hand, had approximately \$10,000 per acre in improvement costs plus the investments in the planning process to recapture. Thus, the DNR property became less desirable and less valuable.

Also, during Summer 1985 the water district attempted to extend water services built and paid for by Bucklin Ridge property owners to other commercial and residential developments outside the assessment district boundaries. It announced that it might not be able to provide water to the Bucklin Ridge property owners when they developed due to over extending the water supply to users outside the district boundaries. Third, it advised that the \$300,000 plus two months interest payments paid by the property owners to start the LID would not be returned but would be used to secure other water district projects.

This was further evidence that the rules had changed for development in this part of Kitsap County. Growth had always been encouraged but now it was being achieved with fewer "hoops." DNR was caught in the middle of the loosening of restrictions.

In late 1985 another attempt to produce a brochure



advertising the property was made. By now the per acre assessments had increased to slightly over \$11,000. The three options the draft brochure offered to prospective bidders included the following:

1. Land exchange with leaseback;
2. Land exchange with leaseback and "boot" if the exchange did not equal the value of the Bucklin Ridge site; and
3. All cash.

Under the all cash option, the Department would independently find suitable replacement land. The bidder would participate only by paying the funds to the Department. This process would use the Land Bank to remove and reinstitute the "trust" designation. (DNR, November, 1985) The brochure was not finalized and the public offering was never made.

Investigations through contacts in the local market by Department personnel showed that these options were not considered realistic by the small number of parties in the market for a parcel of this price. Too much up front cash was required, and this is the hardest funding for a developer to raise. DNR realized now its property was no longer in position to receive the future growth first. It could not get "fair market value" for the land as required by state law.

According to the current project manager, DNR "did the right thing" from a community planning perspective by

participating in the cooperative planning effort between the private and public sectors. Residential densities appropriate to an urbanizing area, such as five to six units per acre, were achieved. However, three factors adversely affected selling the site: a) the \$19,000 per acre assessments (\$11,000 plus interest over the payment period), b) the economic recession during which the market closed somewhat, and c) the consequences of political changes whereby other developments were approved outside the master plan and could be sold more cheaply. (Harper, 1987)

The Department and the other members of the BRCP planning group tried to ensure rules requiring planning before development were established. Kitsap County Commissioners adopted resolutions calling for planning and site improvements before development in the region but then later violated them. The Commissioners do not appear to be recognizing the consequences of their actions and allowing changes to the BRCP to compensate for land use changes created by the "unplanned" development. According to the project manager, the Commissioners believe the Plan has a 20 year life. Allowing new commercial uses in the portion of DNR's property south of the Waaga Way highway bypass would recognize the new, existing land use patterns and encourage compatible uses. (Harper, 1987) It would also create a higher land value from which DNR could recover more of its front end costs and make the property more marketable.

## Conclusions

DNR representatives have spent years of effort preparing this property for sale. The sale might have been appropriate at any of several points along the way. It did not have to wait until all the planning and improvements were complete. It seems that Department personnel found developing more interesting than the end result of a sale and got caught up in the process.

The decisions were not made on a structured basis. The Department kept moving ahead without contingency plans for changing circumstances. However, the project manager believes that the value of the site has been enhanced and the Department will obtain a good return which is far in excess of forestry values. (Harper, 1987)

The next section of this chapter presents another case study in the disposition of urban property. This effort did result in a sale of property although the decision process was similar to the Bucklin Ridge example.

EXHIBIT 1

BUCKLIN RIDGE TIMELINE

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Prior to 1980 . . . . Site designated "Urban 10" by DNR.  
 January, 1980 . . . . DNR joined adjacent property owners,  
 County to discuss planning efforts.  
 March, 1980 . . . . Bucklin Ridge Community Plan started,  
 group hired engineering consultants.  
 August, 1980 . . . . Consensus of BRCP property owners to  
 put in utilities, roads.  
 June, 1982 . . . . Kitsap County Board of County  
 Commissioners approves BRCP.  
 November, 1982 . . . . Zoning hearings held for BRCP area,  
 staff calls for low density zoning.  
 December, 1982 . . . . Missed sale opportunity (had  
 Comprehensive Plan approval,  
 Preliminary PUD approval, and  
 zoning).  
 May, 1983 . . . . RID for road improvements formed.  
 June, 1983 . . . . Approximately 2 acres sold for road  
 right-of-way for \$30,000 (\$13,000 per  
 acre).  
 Summer, 1983 . . . . Water LID formed; \$300,000 deposit  
 and 2 year's interest.  
 Summer, 1983 . . . . Sewer LID formed.  
 July, 1983 . . . . DNR staff found current values of  
 property with improvements to be  
 \$20,000 to \$25,000 per acre  
 (unofficial appraisal).  
 December, 1983 . . . . Missed sale opportunity (utilities in  
 but assessments not yet started).  
 January, 1984 . . . . Appraisal for property; \$13,000 per  
 acre.  
 January, 1984 . . . . Per acre assessments estimated at  
 \$10,000.  
 Spring, 1984 . . . . State legislation change; DNR allowed  
 to buy income producing land and land  
 not adjacent to other DNR land.  
 July, 1984 . . . . DNR began sales effort; not  
 sustained.  
 October, 1984 . . . . DNR staff reviewed options.  
 October, 1984 . . . . Preferred alternative: Land Bank  
 exchange.  
 1985 . . . . Kitsap County began approving  
 development in area without planning,  
 site improvements (Costco, Crestwood  
 PUD, others).  
 March, 1985 . . . . Pension fund interested in site.  
 April, 1985 . . . . DNR began sales effort; not  
 sustained.

April, 1985 . . . . Appraisal update; \$15,000 per acre.  
 Comment: glut of residential property  
 on market.

May, 1985 . . . . Missed sale opportunity (pension fund  
 withdraws; not able to structure  
 better terms).

July, 1985 . . . . Price raised by \$100,000 to  
 \$1,070,000; timber value added.

Summer, 1985 . . . . Water District gives water service  
 outside assessment district  
 boundaries.

September, 1985 . . . . DNR staff reviewed options.

November, 1985 . . . . DNR began sales effort; not  
 sustained; draft marketing brochure.

November, 1985 . . . . Per acre assessments up to \$11,000.

December, 1985 . . . . Real Estate Division formed.

July, 1987 . . . . DNR waiting until commercial zoning  
 on site or better market for sales.

#### IV. CASE STUDIES

##### B. REDMOND HEIGHTS

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Another example of disposition of urban land by the DNR Real Estate Division is Redmond Heights. This 160 acre site is located north and east of Redmond High School in the Education Hill neighborhood of Redmond, Washington. The property is wooded and undeveloped. Single family residences of various urban densities and a senior high school surround the site.

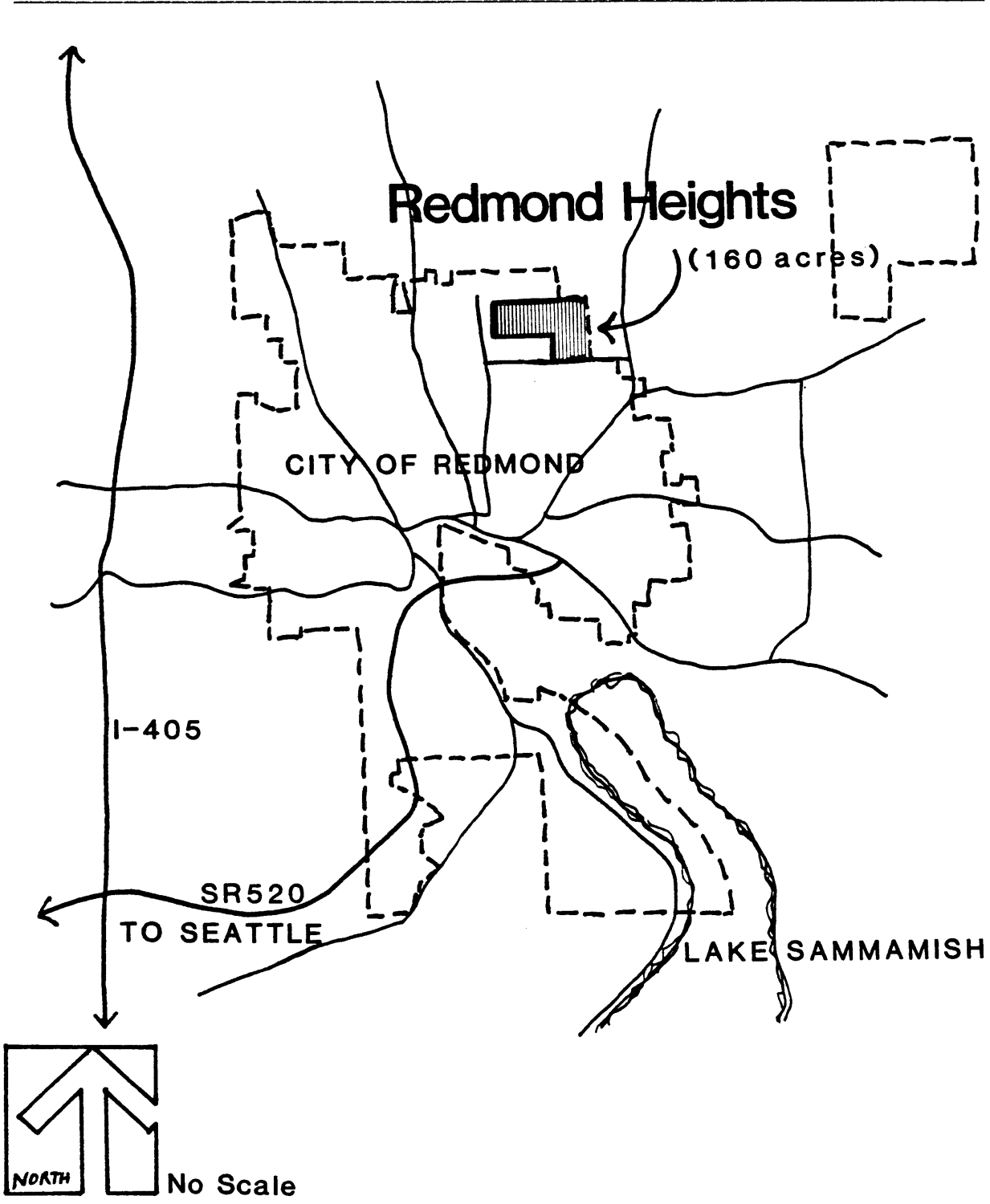
The site was sold to Kitchell Development Company of Arizona in April, 1987. The purchasers paid \$3.5 Million for the property (\$21,875 per acre). Included with the land were the City of Redmond approvals (Planned Unit Development and Preliminary Plat/Subdivision) for development of the site. Residential development of a total of 532 homes, including 100 units reserved for senior citizens, a day care center, and an equestrian center, was approved by the City.

Concentrated DNR activity concerning the future use of the site started in 1979. The City of Redmond Planning Department was revising the City's Comprehensive Plan and Zoning Code and combining them into one document. The City staff wanted to know what the Department was going to do with its property so that the City could apply the appropriate policies and zoning designations. (Vogt, 1987) The Redmond Heights property had been identified by DNR as "urban" prior

MAP 3

REDMOND HEIGHTS:

VICINITY MAP



to 1979 in recognition of its location in the middle of the City of Redmond and the inability of the Department to harvest the timber due to the encroaching urban uses.

The DNR decision process regarding disposition of the site was incremental and disjointed because it was a large site and one of the first to be reviewed for disposition as an "Urban" land. A plan was not developed nor was a target end-user or end-point determined in advance of any action. Rather, the Department took a step at a time, evaluated the results, and then took another step. The following paragraphs identify the steps and present the history of the Redmond Heights property. Exhibit 2, page 60, is a project timeline.

### History

In 1979, the Department published a press release announcing its intention to develop the Redmond Heights site. It realized that as more and more people moved into the area, pressure would mount to retain the site as open space. Retention of unproductive land as open space was not consistent with the Department's fiduciary responsibilities towards the trust lands. It had initially offered to sell the site to either the City or County as a park but had received negative responses.

In March, 1979, DNR commissioned an initial feasibility study of the site which included a social and environmental assessment. The authors, Robert Butts & Associates,



recommended that development permit approvals be obtained to enhance the value of the site prior to disposition.

Another consultant, Jones Associates, was hired and in March, 1980, issued a market and development feasibility study which included a financial summary of the options. An economist for the firm valued the land at \$3,850,000. One year later, the Department hired a third consultant (Subdivision Management, Inc.). This consultant prepared and submitted plans and development permit applications to the City of Redmond for the property in January, 1982. The initial proposal was to ground lease the property to a developer who would build and sell the homes with sub-leases.

The hiring of three different consultants was a disjointed way to manage the sale of the property. An end-user or purchaser was not identified and efforts were not directed toward developing a specific package for that market. At this time the site was managed by Department personnel whose primary background was in forest management and timber production, not the sale of urban land.

It took two years before the City issued development permit approvals. Two approvals became official on January 11, 1984. One was valid for one year with the possibility of approval extensions; the other was valid for three years. It was significant that during this time period DNR essentially had no out of pocket holding costs associated with the land. This fact distinguishes it from other "developers."

## Options

The possibilities for disposing of the property at the outset of this process were somewhat constrained by the State Constitution and the Revised Code of Washington (RCW). These legislative documents allowed the following options:

1. Sale of public lands;
2. Leasing of public lands;
3. Simultaneous exchange of land;
4. Use of Resource Management Land Bank.

Traditionally, DNR issued ground leases for property on which it did not harvest timber; the leases were usually initiated by the lessee. Initially, DNR personnel thought of disposition of this property in terms of a ground lease. A newspaper article discussed DNR's new transition lands policies and used the Redmond Heights property as an example:

"The department eventually will look for a firm interested in developing the property according to the site plan. That developer could be a master lessee who would lease the property from the state, build the homes, and then sell long-term sub-leases." It also editorialized: "It's extremely difficult, though, to arrange financing for a single-family housing development on leased land." (Seattle Post-Intelligencer, 1982)

Another management option for the Department was selling the land outright to a developer. The same newspaper article quoted Commissioner of Public Lands Brian Boyle (head of DNR) as saying " 'But if we sell the land, that land base is lost

forever.'" At this point in time the proceeds from a sale were placed in the Permanent Fund for securities investments and not reinvested in land. Reduction in the trust land base was not acceptable to the Department.

In 1983, the preferred alternative shifted from a ground lease to an exchange of the Redmond site for another property of equal or greater value. This shift occurred because of three factors: a) advice given by the second and third consultants regarding the unwillingness of single family home buyers to accept a ground lease; b) opposition by neighborhood groups to the leasing of the land (Sammamish Valley News, 1983); and c) a City condition of approval requiring sales instead of sub-leases for the lots (DNR, July, 1986, p. 11).

At the time the Redmond Heights development permit applications were submitted to the City of Redmond (1982), the Department could exchange school trust land only for land that adjoined existing state land ("block up" existing DNR land). In 1984, however, the Transition Lands Act was enacted by the State Legislature. It allowed for the acquisition of income producing property and property not adjacent to existing DNR ownership. Department personnel took the exchange one step further and developed deferred exchanges. A fifth option for Department use was added to the first four (sale, lease simultaneous exchange and land bank) and that is:

##### 5. Deferred Exchange.

At this point there were many discussions in the Department regarding strategy. The preferred choice shifted again, this time to a deferred exchange. One Department manager discussed the options under consideration. First, dividing Redmond Heights into smaller pieces and selling them over time would "maximize the sales price DNR would receive" and no sale would go over the \$3 Million Land Bank limit. Second, "an exchange is overly complicated which will narrow the range of buyers and take more time." An exchange through "blocking up" or buying land adjacent to existing DNR ownership would narrow the range of acceptable trade properties. Third, a form of deferred exchange called for buyers to bid a dollar amount, acquire a parcel designated by DNR of equal value, and then exchange it for Redmond Heights. The manager noted this had the advantage of "enhancing the bidding and including people who may not otherwise go to the trouble to tie up a parcel;" this is a way to expand the market. (Vogt, 1984) Deferred exchange was chosen as the preferred option because it was the most likely to result in property desired by DNR.

### Property Valuation

As the City review process began to wind down in 1983, DNR staffers realized they "needed a plan to establish the fair market value of the property there...(It is) complicated by the fact that we are selling development rights as well as raw land. We need to be sure that our appraisal fully

reflects these investments in ...(the consultants) to carry the plan through to completion." (Vogt, 1983) On October 24, 1983, the Department's own appraiser prepared an appraisal which indicated the fair market value to be \$4,600,000 (first appraisal). This was \$28,750 per acre.

With only this appraisal as a basis, the Department expected to sell the property for at least \$4.5 Million. Commissioner of Public Lands Brian Boyle noted that the appraised value of the site had climbed about 45 percent since 1980. The "Planned Unit Development plan significantly enhanced the value of this Redmond Heights site." (DNR, 1984) "'Without the approved plan, (Doug) Webb (third consultant to DNR) said, any private buyer would have required substantial discounts because of the risk and time involved in trying to get permits for developing such a large piece of land.' Webb estimated DNR spent \$160,000 on the two years of planning, permits, studies and tests but will be repaid many times over when the bids for purchase are submitted." (Daily Journal of Commerce, 1984) No bids were received.

To clarify the value of the property, the Department obtained an appraisal by a third party (private firm outside the Department). It was commissioned and dated January 25, 1985 (second appraisal). It presented a market value of \$2,055,000 for the property. This was \$15,000 per acre based on 137 of the 160 acres (23 acres were subtracted due to the power company easement over them). This appraiser suggested DNR allow the buyer the ability to revise the City permits to

obtain standard sized lots rather than the approved clustered lots. One interdepartmental memo offers the following analysis:

"The Department has successfully improved the value of this property (by obtaining City permits)...(to at least) \$15,000 per acre (amount shown in second appraisal). This shows a benefit in having completed the permit acquisition process. In as much as market indications show that the extent of requirements and costs for the parcel are in excess of those for similar sites, it would appear this could be directly attributable to the fact that state government was dealing directly with city government...A conscious decision was made to offer the property initially at a high value principally because of the high degree of interest indicated...The fact that no bids were received at minimum identifies the high end of the market."  
(Otto, March, 1985)

The Department received advice that "the existing preliminary plat does not provide for the reasonable highest and best use use of the property, as compared to other plat approvals within the same market area. There is an inference that the Department's acceptance of (the) conditions (was) not in the best interest of the trust since highest value can not be realized." (Otto, March, 1985) This caused a great deal of concern in the Department as it prepared to offer the property a second time.

Another "third party" appraisal was completed on September 6, 1985 in an attempt to reconcile the previous appraisals and determine a value for the site (third appraisal). It indicated a value of \$4,650,000. The value per acre was \$29,062. This appraisal also noted the County

Assessor valued the site at \$1,701,700 or \$10,635 per acre. Finally, the last outside appraisal was completed on October 15, 1986 (fourth appraisal). This report developed a value of \$2.75 Million for the site. It looked at the land and the permits and found a value of \$17,188 per acre.

### Public Offerings

After the City approvals were obtained, DNR tried three times to dispose of the property but was unsuccessful. At the first offering in November, 1984, the Department solicited exchange proposals for the property with a minimum bid of \$4.6 Million based on the in-house appraisal findings but received no offers. Marketing consisted of assembling a long list of those in the local real estate industry and mailing out brochures advertising the property.

In early 1985, the Department realized it was targeting a narrow market due to the following characteristics of the property:

1. High value;
2. State governmental process;
3. Large acreage; and
4. High holding costs for a private developer because of multi-year absorption period. (Otto, November, 1985)

During 1985, several estimates of Departmental options were made. The following is a compilation of the options and alternatives suggested:

1. Reoffer the site at a value based on one or the other of the first two appraisals: a) the third-party appraisal value of \$2,055,000, or b) the \$4,600,000 figure recently re-endorsed by the Department's appraiser. (Hoefer, September, 1984)

2. Meet with City officials to achieve reduction in plat requirements. "The probability of requesting fewer plat restrictions from the City of Redmond appears to be quite low..." (Otto, March, 1985)

3. Redesign and resubmit the site plan for new City approvals. The optimum plat could be designed as one with the best yield. This would result in the highest and best use from the private (buyers') perspective.

4. Reoffer on a phased basis for cash or an exchange for improved property with a lease. This would involve renegotiating with the City and restructuring the approvals to allow phased development. "The Department would be requesting some changes that would allow the property to be marketed on a phased basis which would reduce the holding cost to a purchaser. Since the Department's holding costs are minimal this would increase probability of disposal at a higher value." (Otto, November, 1985)



5. Let the City permit approvals lapse. This would mean placing the site in the land bank and selling it in smaller parcels without approved plans and permits.

After evaluating the options, the Department obtained an extension of the City permit approvals and the third appraisal. It offered the property a second time (November, 1985) "on the basis of a 'Request for Proposal' format, and solicited proposals (simultaneous exchange) for other commercial property (and) property under existing ground lease..." (DNR, July, 1986, p. 11) Also, this offering entertained the possibility of "deferred exchange" or accepting all cash without a property exchange. The Department believed it could deposit cash from a buyer into the Land Bank and then withdraw it to buy land it found later, a reversal of the previously described Land Bank process.

This time five proposals for exchanges of property were received; no one proposed a deferred exchange. These bidders valued the DNR site at between \$2.1 and \$3.5 Million and offered exchange property they valued up to \$5 Million. Three of four sites were vacant land with development permit approvals; only one was improved property. After extensive review of one bid, none of the proposals were accepted.

Over the Summer 1986, the new Real Estate Division personnel met "with various financial institutions, private developers, and other interested investors to negotiate a proposed exchange or sale through the Land Bank mechanism of

the Department." (p. 11) In October, 1986 the fourth appraisal was obtained. It established a value of \$2.75 Million for the site. The property was reoffered a third time in December, 1986 on a deferred exchange basis. Sealed offers with a \$2.75 Million minimum were requested but none were received.

Finally, in March, 1987, activity in the real estate market picked up. Several buyers expressed interest in the site but wanted a conditional sale so that they could buy the property only if they were successful in obtaining amendments to the previously issued City of Redmond permits. They wanted DNR to assume the risk of obtaining the changes. Eight offers to negotiate for the property were submitted with values ranging from \$1.8 Million to \$3.5 Million.

When the competition was known, some buyers decided to forego the conditional sale and offered to buy the property outright. Kitchell Development Company was the successful bidder because its bid had the highest net present value for the Department; it offered all cash (\$3.5 Million) and closing within 90 days. DNR agreed to deed the property to Kitchell in return for a promise to buy replacement property designated by the Department. An escrow account for \$3.5 Million was established which Kitchell will use to buy property DNR wants and then transfer ownership to the Department. This will provide replacement, income producing property for the trusts.

## Conclusion

As was mentioned at the beginning of this case study, the Department's decision process was fairly disjointed and incremental. It made the next decision after it saw the results of the previous decision. This was one of DNR's first attempts to enhance the value and dispose of urban land. The efforts took several years and several tries but resulted in a successful sale.

The next section will present a third case study. This study shows DNR has learned some but not all of the lessons from its previous experiences.

EXHIBIT 2

REDMOND HEIGHTS TIMELINE

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Prior to 1979 . . . . Site identified as "urban" by DNR.  
 1979 . . . . City began "Development Guide;" asked  
 used of DNR site.  
 March, 1979 . . . . First consultants hired; feasibility  
 study (Robert Butts & Associates).  
 November, 1979 . . . . Second consultants hired (Jones  
 Associates).  
 March, 1980 . . . . Market and development feasibility  
 study issued by second consultants.  
 March, 1981 . . . . Third consultants hired (Subdivision  
 Management, Inc.)  
 January, 1982 . . . . Plans, permit applications submitted  
 to City of Redmond.  
 January, 1982 . . . . Preferred alternative: ground lease.  
 1983 . . . . Preferred alternative changed:  
 exchange of property.  
 October, 1983 . . . . First appraisal; in-house by DNR;  
 \$4.6 Million value/\$28,750 per acre.  
 January, 1984 . . . . City approves permits.  
 January, 1984 . . . . DNR staff reviews options.  
 Spring, 1984 . . . . State legislation change; DNR allowed  
 to buy income producing land and land  
 not adjacent to other DNR land.  
 May, 1984 . . . . DNR staff reviews options.  
 May, 1984 . . . . Preferred alternative changed:  
 deferred exchange.  
 November, 1984 . . . . First public offering; property  
 exchange; no bid received.  
 November, 1984 . . . . City approves one year extension on  
 permit approvals.  
 January, 1985 . . . . Second appraisal; \$2.055  
 Million/\$15,000 per acre.  
 February, 1985 . . . . DNR staff reviews options.  
 March, 1985 . . . . DNR staff reviews options.  
 June, 1985 . . . . Second public offering; simultaneous  
 exchange/RFP; 5 proposals received;  
 none accepted.  
 September, 1985 . . . . Third appraisal; \$4.65  
 Million/\$29,062 per acre. Assessor's  
 value shown as \$1.7 Million.  
 November, 1985 . . . . DNR staff reviews options.  
 December, 1985 . . . . City approves one year extension on  
 permit approvals.  
 December, 1985 . . . . Real Estate Division formed.  
 October, 1986 . . . . Fourth appraisal; \$2.75  
 Million/\$17,188 per acre.  
 December, 1986 . . . . City approves one year extension on  
 permit approvals.

December, 1986 . . . . Third public offering; deferred  
exchange; no sealed offers received.  
March, 1987 . . . . Fourth public offering; negotiated  
RFP, deferred exchange; 8 offers  
received.  
April, 1987 . . . . Sale to Kitchell Development Company  
for \$3.5 Million.

IV. CASE STUDIES  
C. CANTERBURY COURT

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A third example of DNR's disposition of urbanized land is Canterbury Court. This approximately 38 acre site is located in unincorporated King County and about 3.5 miles from the center of the City of Redmond, Washington. Redmond is a suburb east of Seattle and Lake Washington.

The DNR property is divided by a two-lane state highway, the Redmond-Fall City Road. It is a major transportation corridor for the fast growing east county area. There is a paved county road abutting the east side of the portion of the site north of Redmond-Fall City Road.

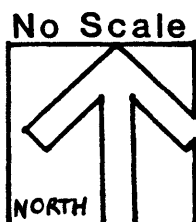
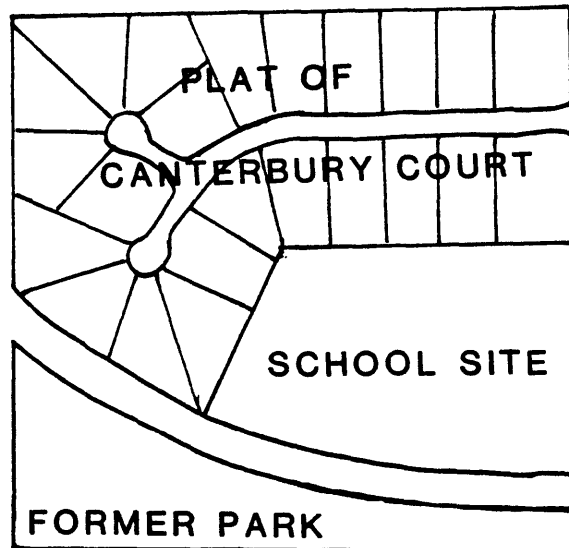
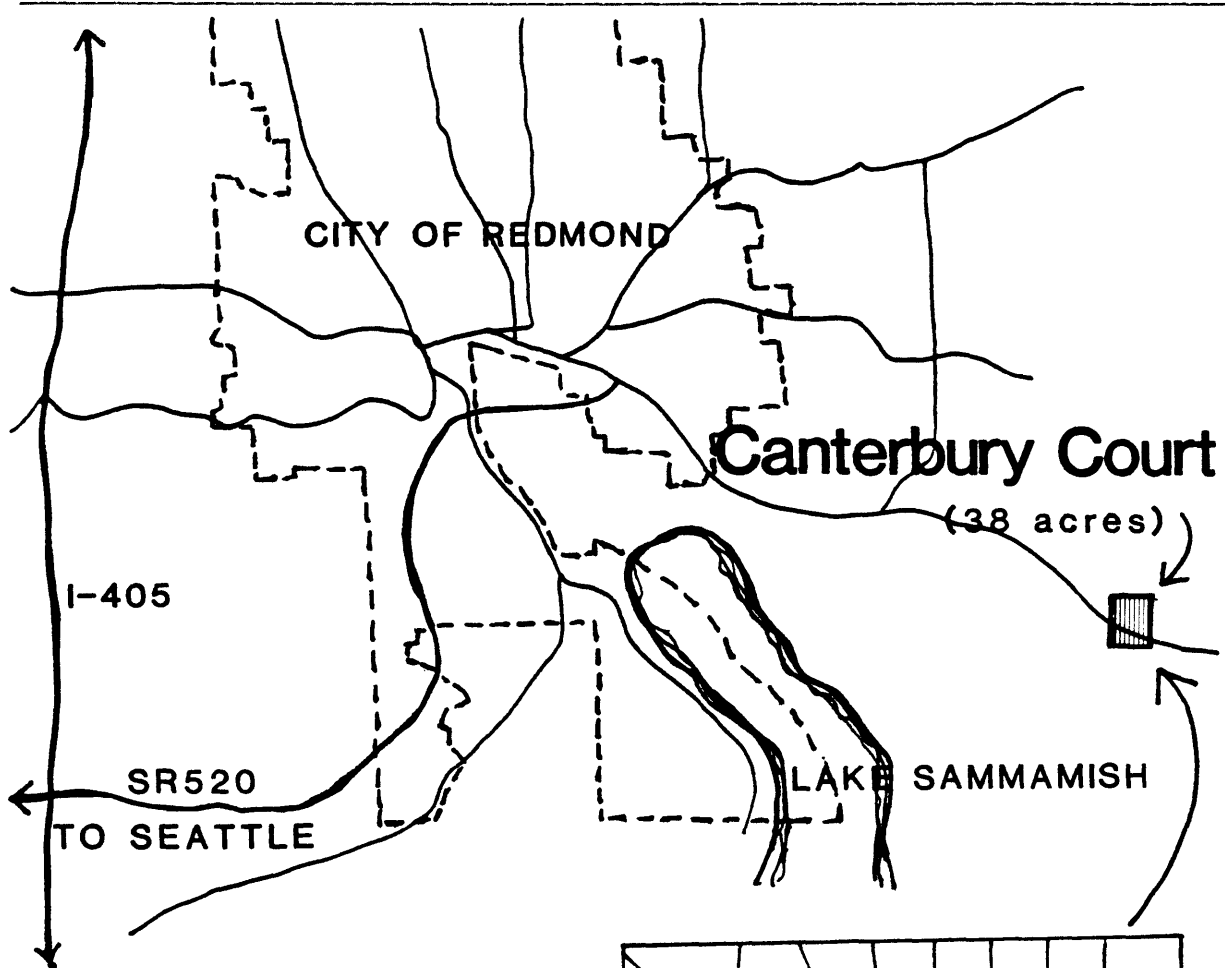
About one third of the site has been sold to Lake Washington School District #414 and the rest is still in DNR ownership. The school district purchased 11 acres of the site adjacent to Redmond-Fall City Road. It built an elementary school on the property. DNR's current ownership consists of two parts: 22 acres north and west of the school district site and five acres south of the state highway.

Prior to the school district sale, DNR obtained development permit approvals for the property north of Redmond-Fall City Road. King County approved 23 single-family residential lots on 22 acres and a school location on 11 acres.

MAP 4

CANTERBURY COURT:

VICINITY MAP



DNR activity on this site was initiated through a request from Lake Washington School District in 1983 to buy property for construction of a school. The District was preparing for the growth of the district enrollment. The population in this north east part of King County was growing and expected to continue to grow through the year 2000.

The DNR decision process for this site was much more organized and logical than it had been on the other two case study sites. A purchaser was identified for a portion of the site at the outset. DNR also decided it would determine what part of the site went to the school district after evaluating how it could use the remainder of the site. This was a much more proactive posture than was normally used for sites desired by school districts.

A history of the site and DNR's decision sequence is presented in the following paragraphs. Exhibit 3, page 72, is a project timeline.

### History

The property is the remaining portion of a section of land given to the State of Washington at statehood. The rest of the section has been sold in pieces over the years. The road connecting the City of Redmond and the rural town of Fall City has bisected the property since the 1920's. Farming was the predominant land use in the area before the 1970's.

In 1967, the five acre portion of the site south of Redmond-Fall City Road was leased to the State Parks



Department for recreational uses and named Harry Osborne Park. Funds from the state's Interagency Committee for Outdoor Recreation (IAC) were used to improve the site. Picnic tables, nature trails, cooking shelters and parking areas were some of the improvements placed there.

Because IAC funds were used, the site was limited to recreational uses for 55 years. This restriction was lifted in the last several years after alternative DNR property was funded and the park transferred. The value of the site had increased over the years due to population migration and homeowners' desires for "rural" lifestyles. DNR wanted the ability to sell the site and capture its increased value.

The whole Canterbury Court site was included in the list of lands proposed for "urban" designation in 1984. Another state agency, the Department of Game, recommended the designation process be halted for this property in order to investigate fully its value for fish and wildlife habitat. Identification as significant fish and wildlife habitat would mean no development on the site. This advice was not followed and the site was designated as urban by the Board of Natural Resources.

In the early 1980's, the planning staff of King County wrote a new county-wide development guide. It identified land uses which were appropriate for the unincorporated areas. It also tried to promote the philosophy that density should be adjacent to existing activity centers, rather than in

isolated, new locations. The DNR site was listed as "encouraged for urban uses" by the 1985 Comprehensive Plan.

The Plan specifically called for single family residential uses on the site. In the zoning hearings that followed adoption of the Plan, a zoning designation of "G" or General was assigned. It allowed residential lots of at least one acre in size (defined as 35,000 sq ft minimum).

The Lake Washington School District triggered DNR's review of the site and its future when it selected the site as the location of a future elementary school in 1983. The District wanted to buy surplus state land in order to accomodate the increasing school aged population.

In 1984, DNR hired a consultant to develop a site plan which would allow DNR to have a useable portion of the site remaining after the school district purchased its 11 acres. In December, 1984, another consultant was hired to assess the onsite sewage disposal capacities and prepare a report for submittal to King County. DNR personnel made a conscious decision to plan the use of the site before agreeing to sell a portion of it to the school district. This proactive approach demonstrated a sophistication gained from the lessons learned in the other case studies.

The first Canterbury Court consultant determined that 23 lots plus a cul-de-sac road located on the 22 acres DNR would retain optimized the use of the site. The lots and road were designed to fit the site and stay as far from the Redmond-Fall

City Road as possible. They were located in order to be compatible with the adjacent large-lot developments.

Applications to subdivide the 22 acres, known as the plat of Canterbury Court, and create the school district lot were submitted to the County in early 1985. After a delay caused by the need to obtain permission for water service from the local water district, the County gave final approval to the development on February 18, 1986.

### Options

The adjacent land uses were rural uses, small farms and large lot residential subdivisions when DNR began the permitting process. Use of the DNR site for a school and for single family residences was uncontested.

In October, 1985, DNR representatives began to discuss alternative mechanisms for disposal of the site. A deferred exchange was suggested with the options of selling while the permit approvals were pending or selling after the approvals were finalized. One DNR manager said:

"By far the most attractive way to dispose of this from a marketing point of view would be to do a 'deferred exchange' for cash. We could conceivably sell now with the final permit pending. Or if we are in no hurry we can await final action." (Vogt, 1985)

In late 1985 the Real Estate Division was formed. Another review of disposal options occurred in early March, 1986. The preferred alternative appeared to be disposal

through a Land Bank purchase. This meant that land would have to be purchased through the Land Bank, trust designations exchanged, and the Canterbury Court site sold through the Land Bank.

In late March, members of the Division tried again to look at options for disposition. A Land Bank sale was the method discussed. The mechanics of having to buy land first slowed the process but it was suggested that the time could overlap with that needed by purchasers to arrange financing. A member of the Department said:

"Now that our plat is final,...we should think about selling this ASAP. The market is really hot right now. ...we need to buy something in the land bank before we can sell this? My suggestion is that we set our minimum bid, if we have to have one, and terms, as try to advertise for 60-90 days so people can get financing...arranged. I think a one page fact sheet and copy of the plat would suffice rather than a printed brochure. Do we have a date for a land bank purchase to close yet?...Also we need to reserve fund allocation or whatever is needed in the land bank." (Vogt, 1986)

Nothing happened for almost one year. In January, 1987, the Department held the public hearing necessary to exchange the Canterbury Court property for replacement property of equal value. It had decided to sell the site through a deferred exchange.

#### Property Valuation

In September, 1985, an appraisal was completed for the property by an outside appraisal firm. It found a value of

\$240,000 for the 22 acres contained in the Canterbury Court subdivision. This equaled \$10,984 per acre.

One of the subdivision requirements called for DNR to dedicate a small portion of land as a right-of-way for the local water district's new pipeline. DNR needed to determine a fair market value for the property so that it could be sold to King County. In early 1986, a DNR appraiser used the 1985 appraisal and determined a value of \$11,000 per acre or \$1,300 for the area needed for right-of-way. In July, 1986, the DNR appraiser concluded that the value of the right-of-way should be reduced to 10 percent of this figure, or \$130, because use of the right-of-way was only 10 percent of the value of the property.

In February, 1987 the appraisal was updated by the outside firm. At this time the appraisers found a value of \$278,000 for the 22 acre site. This was \$12,723 per acre. One section of the appraisal update noted the County Assessor valued the property at \$411,800, including the school site. This averaged \$12,478 per acre. The updated appraisal agreed with the Division members' assessment that the "market was hot." It stated:

"The immediate surrounding development to the...(Canterbury Court site) clearly demonstrates that the area is a rapidly developing bedroom community to the Bellevue/Redmond/(Interstate) 405 corridor of lower densities (35,000 sq ft or horse acre lots) with homes ranging from the high \$100,000 to the low \$300,000 range. The Bear Creek area is one of the fastest growing areas in the State of Washington. Between 1970 and 1980 population increased from 6,100 persons to 13,250 (persons) average annual. The...(County's growth report)

indicates growth will continue at the rate of approximately 53 percent between 1980 and 1990." (Yates, Wood, and MacDonald, 1987)

Division members had estimated a sale price of between \$275,000 and \$350,000 in 1986 because the market was "hot." The 1987 appraisal update's growth in value substantiated this estimate and promised the possibility of more.

### Public Offerings

DNR has not had a public offering for Canterbury Court. It had the appraisal updated in early 1987 to reflect a current value which could have been used to determine a minimum bid. It has also developed a marketing notification flyer in the form of a postcard with an aerial photograph of the site on one side and information about the property on the reverse. It will be mailed to developers, banks, and other members of the real estate development community.

A target date for a marketing effort and a preferred alternative for disposal have not been determined. As a result, the Department missed a window of opportunity for the sale of Canterbury Court in Spring 1987 when interest rates and the inventory of platted land were low.

### Conclusion

The time period of DNR's involvement on Canterbury Court is much shorter than those involving the other case studies. The approach has been much simpler and less complicated. This

may be a function of the Real Estate Division's involvement. The market for this site is substantially different than that for the other two sites; the buyer of Canterbury Court will probably be a small homebuilder who puts in the streets and other utilities him or her-self or subcontracts them to a small contractor. However, the decision structure is still disjointed. The Department wants to sell the property but has spent too much time deciding on which method to use.

The next chapter will use the examples presented in the three case studies to discuss ideas on the sale of land found in the real estate and financial literature. It will address several ways to analyze property and the value it may represent.

EXHIBIT 3

CANTERBURY COURT TIMELINE

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1967 . . . . 5 acres of the site designated Harry Osborne Park.

Early 1980's . . . . County staff designate site for urban uses in draft Comprehensive Plan.

1983 . . . . Lake Washington School District asks to buy 11 acres for school site.

1983 . . . . Park designation transferred to another site.

1984 . . . . Site designated "urban" by DNR.

Summer, 1984 . . . . First consultant hired (plans and permits); design useable site before school portion removed.

December, 1984 . . . . Second consultant hired (on-site sewage report).

1985 . . . . County adopts new Comprehensive Plan; single family residential uses for site.

January, 1985 . . . . Plans, permit applications submitted to King County.

September, 1985 . . . . Appraisal; \$240,000 for 22 acres/\$10,984 per acre.

October, 1985 . . . . DNR staff reviews options.

December, 1985 . . . . Real Estate Division formed.

December, 1985 . . . . Preferred alternative: Land Bank exchange.

February, 1986 . . . . County approves permits for subdivision on site.

March, 1986 . . . . DNR staff reviews options.

Spring, 1986 . . . . Missed sales opportunity: DNR staff thought market was "hot."

Spring, 1986 . . . . 11 acres sold to School District.

July, 1986 . . . . DNR appraiser finds value of waterline right-of-way is 10 percent of value of one acre.

January, 1987 . . . . DNR holds required public hearing for exchange of land.

February, 1987 . . . . Appraisal updated: \$278,000 for 22 acres/\$12,723 per acre.

February, 1987 . . . . DNR staff reviews options.

Spring, 1987 . . . . Missed sales opportunity: DNR staff thought market was "hot."



## V. REAL ESTATE AND FINANCIAL LITERATURE

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This chapter will survey real estate and financial literature to identify ideas appropriate to a discussion of the sale of property. The literature is limited and the majority of it deals with the purchase of property. However, the ideas presented may be applied to a sale and its preparation. These ideas will identify tools which can be incorporated into the decision process for selling urban land.

The limited literature on the sale of urban real estate means that research on this topic has to be more broadly based. A review of other, related topics will provide additional perspectives. These include:

1. Description of DNR
2. Financial analysis
3. Portfolio management
4. Real estate marketing

A description of natural resource based development companies is important. Other research describes financial indicators that provide evidence of the profits which may be generated through a sale. Also, real estate is a commodity which can be held in a portfolio and managed as an investment. Fourth, real estate is not just sold but marketed to a specific group of players.

## Description of DNR

The Real Estate Division of DNR is essentially a public agency acting as a natural resource based development company. The case studies in Chapter IV show that urban encroachment triggered a move from timber production to transition/urban uses of DNR's "urban" lands. For example, the Redmond Heights site is surrounded by suburban density residential uses within an incorporated city. The Bucklin Ridge property is adjacent to the fastest growing commercial area in Kitsap County. Canterbury Court abuts a state highway which acts as the major transportation corridor for east King County.

Braun (1975) describes "natural resource based development companies" as having an inventory of, or access to, lands formerly used for natural resource production. Examples of uses include forestry, grazing, or mining. Braun attributes the rise in value of the natural resource lands to the urbanization of the area around them.

"Typically, land values lie dormant for a long period of time and then go through a period of rapid appreciation, often triggered by external factors such as highway construction, utilities extension, and population growth. Appreciation may also, or alternatively, be stimulated by capital investment, which creates a market for the property concerned."  
(p. 128)

A strategy is a disciplined way to meet objectives and obtain desired results. "In short, financial and strategic objectives should determine, via product/market analyses, the

use to which the land will be put - not the other way around."  
(p. 133)

Braun finds that utilizing a decision making strategy is important. Natural resource based development companies generally follow one of four basic strategies or approaches to the business.

1. The single segment strategy (focus on one end product; build strong skills through specialization);
2. The multi-product market strategy (capitalize on several profit opportunities at one time; requires strong management);
3. The functionally based strategy (capitalize on one strength in key area and apply to all segments of market; sophisticated management);
4. The vertical integration strategy (build on existing resource bases; go forward to where product starts as well as back to end-user; heavy demands on management). (p. 131)

DNR as an agency follows the fourth strategy, vertical integration. Separate divisions within the agency address different aspects of the cycle of resource development. The Real Estate Division, as one part of DNR, concentrates on the end of the cycle for the properties which no longer can produce the resource. Other natural resource based companies in Washington State follow the same strategy but use separate companies rather than divisions. For example, the Weyerhaeuser Company has several wholly or partially owned subsidiary real estate development companies: Weyerhaeuser Real Estate Company, Quadrant Corporation, and Cornerstone-Columbia Company. Pope and Talbot, another forest products

company, has established Pope Resources as its development company.

Braun also discusses the decision process in terms of the three basic steps identified in Chapter II. The decision making process appears to be the same regardless of whether the decision maker is a public or private natural resources based development company. In either case, the decision to sell urban lands should address goals and objectives, strategies for achieving them, and an implementation plan. An overall or comprehensive approach ensures that significant aspects are not left out or forgotten.

#### Financial Analysis

Financial indicators are important to understand a project. They should be used in conjunction with the other criteria listed in this document and not solely by themselves. Discounted cash flow (or net present value) is an accepted base indicator.

Hodder and Riggs (1985) discuss the use and misuse of discounted cash flow analysis, which they define as a framework for comparing cash flows occurring at different times. Cash flow comparisons are an integral part of the decision to hold or sell real estate. Hodder and Riggs cite three critical factors which must be taken into account in the cash flow analysis: inflation, the different levels of uncertainty (risk) in different phases of a project, and management's ability to mitigate risk.

DNR does not appear to have recognized the different levels of risk associated with the various stages of project development in each of the case studies. Also, it does not appear to have analyzed how it might mitigate some of the risk associated with each of the stages. For example, the Redmond Heights project has two stages: planning/permit approvals and marketing/sale to potential buyers. There is development risk with the first and marketing risk with the second. The degree of risk is different with each. The degree of riskiness of the cash flow is therefore different and should be reflected in any cash flow analysis completed for the project. Another example of the stages of a project are the three stages of the Bucklin Ridge project: planning (Bucklin Ridge Community Plan), installation of the site improvements, and sales efforts/external influences. The risk of each stage should be assessed independently. Discount rates which reflect individual stage risks should be used in the cash flow analysis.

Welter (1970) also discusses discounted cash flow analysis. He cautions that the main difficulties in calculating a discounted cash flow (i.e., collecting, handling and interpreting the data) are organizational. An implementation plan which identifies how the project objectives and strategy will be carried out, such as suggested by Braun (1975), is needed to ensure the cash flow estimates are realistic and the calculations are consistent with financial and growth objectives.

Hirschmann and Brauweiler (1965) discuss projecting trends in cash flows rather than making annual forecasts. According to the authors, this allows exploration of a range of options (sensitivity) and identifies anticipated rates of return under various assumptions and conditions. A specific, pinpointed rate of return can be affected by changes in the economy, inflation, sale price (residual), or any other assumption in the discounted cash flow analysis. Using a range of options allows decision makers to understand the judgments and uncertainties that are incorporated into it. An array of cash flow trends will visually display the information.

The Real Estate Division should derive a discounted cash flow when it evaluates each project. Although it is difficult to value raw land, "pro formas" (costs and anticipated revenues projection)s give an added dimension to the project. Assumptions concerning value are made and explicitly identified. The Division can use this mechanism to determine a likely range of rates of return. It will better understand what it is selling and who will buy it. The results may even convince Division representatives to keep the property in the DNR portfolio.

There are other financial indicators beside discounted cash flow which can be utilized. Neidich and Steinberg (1984) look at the real estate hold versus sell decision from a financial perspective. They find the decision depends on price, future value (property appreciation), and investment

alternatives. While the authors address corporate equity investment in real estate, the quantitative factors they use can be molded to apply to the Real Estate Division's actions.

Neidich and Steinberg develop a financial model that uses equity dilution analysis and present value analysis to determine whether a corporation should sell or continue to hold real estate it now owns. Equity dilution analysis is a method of quantifying the impact of a property sale on earnings. Present value analysis is a way to examine the long term view of a sale's capital budgeting implications.

The Real Estate Division finds itself facing the same decision to hold or sell its property as a corporation. These two analyses can be modified to use DNR's variables and can add financial data to the decision making process. While DNR does not have "earnings" as a private corporation does, it can still determine whether a particular property should be sold or held and its impact on the overall portfolio. Use of present value analysis could also help DNR examine the tradeoffs between retaining ownership of a property and the necessary capital expenditures over the expected life or holding period as compared to the returns from selling it now.

The case studies generally reveal little financial analysis on the part of DNR or the Real Estate Division. Rather, it appears that "gut instinct" and previous experience were used as guides through the development and sales processes. The financial tools described above are sophisticated ways to view the project and may possibly "over

analyze" a situation. They are, however, important indicators and do provide a means for comparison and evaluation. Matrix V-1 identifies whether any financial tools were used.

MATRIX V-1

Factor/ Influence	Redmond Heights	Bucklin Ridge	Canterbury Court
1. Discounted cash flow on cost, revenues	no	no	no
2. Range of rate of return determined	no	no	no
3. Assumptions identified	no	no	no
4. Other financial indicators used	no	no	no

Portfolio Management

When a person or entity owns two or more properties, they own a real estate portfolio. Management of a real estate portfolio is similar to that of a securities portfolio. With both types of portfolio management, risk and diversity are important factors. Diversification reduces the variability of returns among the items in the portfolio because it combines several types of real estate holdings, such as residential, commercial, industrial and office, within the portfolio. The total return to the owner or owners is not based on the return from one single property, which can vary each year, but on the combined returns from many properties. The total amount of



combined returns is generally more reliable. As a result, risk is reduced overall.

Diversification in the way real estate is held is one way a portfolio can be managed to mitigate risk. Hayes and Harlan (1967) investigate how investors can participate in profit potentials through equity (ownership) participation. They use residential and commercial development as examples. By looking at raw land instead of developed property, equity participation can be applied to situations such as those presented by DNR.

Retention of land ownership through a joint venture with a developer-partner is a way to participate in the profit potentials and not deplete the trusts' land base. The deal could be structured so that the developer-partner assumed all the construction and lease/marketing risk while DNR contributed or leased the land to the joint venture and assumed the development/permits risk. As a partner, DNR could participate in some of the "upside:" the future cash flows, residuals if the property is sold, and property appreciation. At this time, state law does not permit such partnerships but education of the legislature regarding the benefits could result in changes to the law.

Several other ideas that can apply to DNR are seen in the following quotation. These include maximization of profit/return, degree of completion of the development process, and development risk.

"The profit returns from development of commercial and industrial property have generally been somewhat lower than those from housing ventures. This is because construction is often undertaken against firm leases for all or part of the space developed, thus removing that part of the market risk that involves the variability of the future revenue stream. It should also be emphasized that the returns from holding already-developed real estate as an investment have not been as large as those accruing from developing real estate, where the risks are somewhat higher because of uncertainty surrounding both the costs of development and the size of the revenues flowing from the property once it is developed." (p. 9)

DNR's goal is to maximize the amount of profit it can realize on a sale of property in order to return as much as possible to the trust beneficiaries. To date it has concentrated on developing real estate to the point of obtaining land use permit approvals and then selling the property. The Department has told the State Legislature it will not go as far as building speculative end-user improvements such as offices, industrial plants, or homes. This is a policy constraint rather than a legal constraint, but it does affect the kind of return DNR can expect.

Another factor is the amount of risk DNR is willing to assume. Generally, DNR will minimize risk because it is a public agency and because it has fiduciary responsibilities for the trust lands. Determining policies and constraints is part of the decision process. These factors influence what DNR believes it can achieve with a particular site. They also affect the marketing of the site as well as the basic hold/sell decision.

Risk acknowledgement and understanding are important in portfolio management. Hertz (1979) discusses the importance of knowing the risks involved when making capital investments. Although he was speaking to buyers of real estate, sellers should also identify risks. DNR, as a seller, should be aware of the risks it is taking and those it is asking the buyer to take. DNR should take those risks which are the least consequential. For example, DNR may be able to obtain permit approvals for development of a site with less risk and cost than the future buyer of a site because DNR is a government agency. The buyer would be willing to pay DNR more for the site with the approvals in place. As long as the cost of the approvals to DNR is less than the additional return or purchase price it receives, it should take the development/permit approvals risk.

Hertz promotes using simulation as a method of risk analysis which measures a multitude of risks (risks in combination with each other). For example, each variable that makes up the financial statistic called rate of return is subject to a high level of uncertainty. Simulation estimates the potential odds of occurrence for each combination of variables. It shows that a specific rate of return depends on a specific combination of values of a large number of variables. As another example, simulation can be used to assess the probability of each of several outcomes, such as the sale of the whole site, the sale of portions of the site, and no sale. The outcomes depend on the combination of

variables that influence them. Using simulation techniques forces the user to identify and quantify the variables that make up an outcome and, in the process, see the causes and effects. While a specific computer program is needed, very little time is involved in the mechanics of the operation.

Diversity of the type of real estate within the portfolio is also important. A review of the case studies indicates little risk assessment was undertaken. However, the studies do show sensitivity to diversity of product. They have differing sizes (64 acres, 160 acres, and 38 acres), differing potential markets (institutions, developers, and small home builders), and differing degrees of improvements (utilities and road improvements). The diversity appears to reflect the individual situation rather than a predetermined strategy.

Matrix V-2 identifies whether the factors involved in portfolio management were addressed by DNR. A review of the case studies indicates there were mixed results.

MATRIX V-2

Factor/ Influence	Redmond Heights	Bucklin Ridge	Canterbury Court
1. Diversity of projects, investments	within site	within BRCP	recognize different size, mkts
2. Alternative ownership structures used	dropped orig. ground lease	no	no
3. Risk identified & measured	no	no	no
4. Risk assignment	no	no	no

## Real Estate Marketing

Marketing consists of identifying potential buyers, determining deal structures, and packaging the property to make it attractive to buyers. The scope of these activities is determined at the beginning of a project.

Hayes and Harlan (1967) identify publicly held corporations and tax-exempt institutional investors as groups which are increasing their holdings of real estate. This is still true today and presents an opportunity for marketing urban sites. Other "buyers" include private investors and institutions, local developers, large or small scale home builders or other groups of players, such as doctors or dentists. Targeting a buyer at the beginning of a project is key to determining how to position the property. The case studies indicate that DNR has not actively identified potential buyers at the outset of projects. In most cases this led to confusion about the product and who would buy it.

Hayes and Harlan (1972) also wrote an article on the syndication of real estate as a means of sale. The authors caution that there can be many pitfalls with syndication. The amendment to the federal tax code in 1987 has affected syndications which are based primarily on tax benefits or shields.

However, syndication is still an option which a purchaser of DNR property can exercise. It may be particularly appropriate because of the way DNR is required to operate. All property must be sold at a public auction with a minimum

bid. DNR can accept only all cash or a property exchange. The ability to obtain immediate payments from syndication investors in return for a piece of the property (in essence, reimbursement) may make the requirement to pay all cash acceptable to more potential buyers. Such immediate resale through syndication would lessen the incidental holding costs such as interest and fees.

DNR can suggest ways such as syndication for a purchaser to finance the deal. Obviously the buyer makes the decisions, but DNR can present alternatives in its discussions with potential purchasers. The Bucklin Ridge project manager suggested that buyers were disenchanted with DNR's sales structure; this is one way to offset it.

Jewett (1977) identifies seven steps to follow to market surplus real estate. Although he is specifically discussing marketing existing industrial buildings which a corporation no longer needs, the principles are equally applicable to sales of urban lands. The author begins by advocating the seller spend time studying the potential of the site. This includes potential uses and users, projected rents, size (space) needed by users, adaptability to multiple uses, and financial arrangements (lease or sale). The property should be made attractive to potential users/investors because:

1. It can be phased or subdivided if one user does not want all the space;
2. It has a price justified by identified and documented new users; and
3. It has been merchandised to move quickly and profitably;

4. It has been packaged and sized for the biggest market. (p. 4)

The case studies in Chapter IV show the DNR has had mixed success in applying these ideas. For example, Redmond Heights was not broken into smaller pieces and packaged for the biggest market. Canterbury Court, however, was sized to appeal to a broad market. Also, the anticipated price of Canterbury Court was probably right for the market due to the early 1987 appraisal update. However, none of the properties are merchandised to move quickly due to the cumbersome mechanisms DNR must use as sales vehicles.

The ideas presented by these articles can be compared with the case studies described in Chapter IV. The ideas and principles have not generally been incorporated in DNR's past actions. The following matrix (Matrix V-3) indicates the general status.

MATRIX V-3

Factors/ Influences	Redmond Heights	Bucklin Ridge	Canterbury Court
1. Target purchasers	only on 4th offering	no	no
2. Aid buyer with financial structuring	no	no	no
3. Study site potential (uses, price, market)	no	no	no
4. Marketing tools (brochure, etc)	limited	no	one, but not yet used

## Conclusion

The literatures indicate there are many ways to address financial analysis, portfolio management and real estate marketing. These topics are incorporated during the decision process and become integral factors in the evaluation of a project. The principles can be applied to any sale of urban land. The case studies indicate DNR has not consistently applied them to its projects. It appears, however, that as the Real Estate Division develops a track record and gains credibility, it is beginning to incorporate some of these principles in its approach to urban land sales.

The next chapter analyzes the case studies in detail and offers conclusions which apply to urban real estate sales.



## VI. ANALYSIS AND CONCLUSIONS

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Three case studies have been used to examine how a decision to sell urban property is made and executed. Each presents lessons in decision making. Bucklin Ridge represents several missed sales opportunities and evidence of the "greed factor." Redmond Heights exemplifies a sale with success based on coincidental market timing. Canterbury Court represents a less complex project that is still in the process of being sold.

### Comparing Case Studies With Each Other

Timelines have been developed to highlight the major events in each case study. The timelines are presented at the end of each case study (pages 44, 60, and 72). They serve as the foundation for identifying commonalities, as well as differences, among the cases which can be quantified. Matrix VI-1 on page 90 demonstrates the number of times each of the events listed in the left column occurs in each case study. The higher the number in each category, the more times the same process has been repeated for a single project. Maximum efficiency occurs when each event happens only once in the life of a project. For example, a review of all the options available should take place at the beginning of the project and not every few months during the project. Rather,

milestones should be established to demonstrate progress to the desired result.

MATRIX VI-1

Event	Bucklin Ridge	Redmond Heights	Canterbury Court	.
# Consultants (major)	1	3	1	.
# Appraisals	2 official 1 unofficial	4	2	.
# Public offerings	0	4	0	.
# Tries to have offering	3	0	1	.
# Missed sale opportunities	3	0	2	.
# Preferred alternative changes	0	3	1	.
# Marketing efforts	.5	3	1	.
# DNR staff involved	11	10	5	.
# Years elapsed	7	8	4	.

Qualitative factors are also important in comparing the case studies with each other. All three of the case studies deal with raw land located in areas of urban growth and development. The Department, and later the Real Estate Division, recognized the increases in value due to the location and tried to capture them through sales of the sites. Land use permits were obtained for each site as a way to lock in the increased value.

Each project is distinctly different in size. At the end of each project it has become apparent that each was designed for different markets and different groups of buyers. The per acre values are discrete. This is evidence of the variance between markets in which each site is located. The amount of effort expended by Department personnel and the portion of the development process completed for each project are also different.

It is evident from the timelines, Matrix VI-1, and the qualitative comparisons that DNR has not focused its efforts in any of these examples. The time spent administering these projects is fragmented, not concentrated. As a result, much of the effort is wasted and has to be reworked each time the project is brought back into the spotlight. Even though large numbers of personnel have worked on each project, it is clear that one person has not been given the responsibility and a clear calendar to get it sold or otherwise disposed.

#### Comparing Case Studies With The Decision Process

The decision process can be reduced to generic parts and ordered so that it can be applied to many different projects. The process has three basic parts: goals and objectives, strategy, and implementation. Each of these is needed in a decision to make it a cohesive unit.

Objectives, strategy, and implementation are discussed in Chapter II. The objectives provide goals to meet and identify areas that are important to the decision maker. A strategy is

then developed regarding how the objectives will be achieved. The scope of the decision is narrowed and more specificity is introduced about how objectives will be accomplished. The final step is to identify how those people implementing the strategy will operate. The anticipated sequence of events is determined and a "game plan" developed.

These three basic parts of a decision provide a framework for evaluating the examples provided by the Department of Natural Resources. The examples describe two levels of decision making: agency and individual project. Although the two are intertwined, it is the individual project decision making process which is of interest here.

The literatures discussed in Chapter V address the following topics: financial management, portfolio management, and real estate marketing. They are subsets of the implementation plan which is devised at the beginning of each project. As part of the implementation plan, it is determined how to gather the data, who will gather it, and when. The resulting financial, portfolio, and marketing tools are the mechanisms to assess individual portions of each project and are components of the total package of data assembled for the project. The decision maker uses all the information to evaluate and choose a course of action and to develop contingency plans.

Matrix VI-2 on page 93 compares the case studies with the basic parts of a decision discussed earlier. It incorporates tools from the literatures which should be addressed in the

process. Responses in the matrix cells identify what actions taken in the case studies, if any, correspond to the framework listed in the left column of the matrix.

MATRIX VI-2

Decision structure	Redmond Heights	Bucklin Ridge	Canterbury Court
1. Goals & objectives	general; trust needs	general; trust needs	property to school dist.
2. Strategy	work with community; not a park	follow County desires for planning	make remaining area useable, saleable
3. Implementation plan (control mechanism)	none; disjointed; as time permits	none; led by County desires	none; proceed after each action
A. Financial analysis	little effort	none; not realize value drop, costs	none
B. Portfolio management	no risk assessment; tried within site	no risk assessment; tried within BRCP	no risk assessment; recognize site, buyers different
C. Real estate marketing	4 offerings; disjointed effort	little effort	little effort

The case studies illustrate that project administrators on each project were part-time and uneven in their concentration. Objectives and goals, if any, were general and not site specific; bringing in money for the trust funds was predominant. Implementation plans were not developed. A strategy for approaching the project, determining the market and potential end-user, and timing was not decided before the work on each project began. Also, there was no risk

assessment or acknowledgement of the risks involved. There was little use of standard financial indicators of value, such as discounted cash flow analysis on costs and revenues. The conclusion is that in most cases the decision process used by DNR is not consistent with this framework or structure. There is little evidence that a systematic process was used by the Department or Division.

### Conclusion

The Department, and now the Division, has certain constraints on the actions it can take because it is a public agency. One of the project managers described the constraints as follows:

1. DNR's lack of a comprehensive business plan;
2. Need for streamlined statutes, to provide product (real estate) in a timely fashion to private sector clients not accustomed to government requirements for public notice and hearings before disposition of property;
3. Inability to negotiate for property;
4. Public exposure to developers who are typically reclusive in nature; and
5. Requirement for large up-front amount of cash by developer for purchase; private sector properties allow better terms. (Harper, 1987)

These constraints distinguish a public agency acting as a natural resource based development company from a private natural resource based development company. They effect the way the public agency might operate or pursue a strategy, but they do not preclude it from using a structured, defined decision process.

## VII. RECOMMENDATIONS

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This thesis explores the decision process with respect to selling urbanized real estate. The decision to sell property which has a higher urban value than timber producing value can be structured so as to capture that value. Three case studies from the Washington State Department of Natural Resources are used as examples.

There are two recommendations to be made. The first addresses structuring the decision making process. The second suggests ways for DNR to structure the sale to incorporate more opportunities to share in the value gained from the urban land uses.

### Structuring The Decision

The three basic parts of a decision should be undertaken at the beginning of a project, rather than at various times throughout the life of a project. It is important to determine the goals and objectives, strategy and implementation in conjunction with each other. How well these parts interact with and complement each other determines the effectiveness of the decision.

A structured approach allows repetition of the decision making pattern. It is transferable from one property to another and promotes comprehensive decisions. It is equally applicable to the decisions to sell urban lands made by

private natural resource based development companies and to those made by public agencies.

Completion of Matrix VII-1 by decision makers will evaluate a project before any action is begun. The matrix is a framework for viewing a project in order to determine goals and objectives, strategy, and implementation.

MATRIX VII-1

Stages of Production

Decision structure	Conception (planning)	Production (permits)	Distribution (marketing; sales)	Management (if hold property) .
1. Goals & objectives				
2. Strategy				
3. Implementation plan (control mechanisms)				
A. Financial analysis				
B. Portfolio management				
C. Real estate marketing				

The complete approach to the project is decided at the beginning. Flexibility is retained to take advantage of opportunities that present themselves after the project is



started. The decision makers can evaluate whether or not a new opportunity which arises really contributes to the desired result because they have determined the desired result and alternative ways to accomplish it. They are not in the position of grasping at a different "solution" or new method.

The decision makers also identify and understand project risks and their own risk profiles. Determination of what risks they are willing to accept and what rewards are desired as compensation is important. The analytical tools discussed in the literature review can assist with these assessments. The following checklist can be used:

1. Identification and occurrence of risk
  - a. probability
  - b. simulation;
2. Financial indicators
  - a. discounted cash flow of revenues/costs
  - b. appraisal
  - c. market analysis
  - d. equity dilution/present value analysis;
3. Anticipated outcomes
  - a. range of rates of return
  - b. land use permits
  - c. capital appreciation/residual value.

Those directing a sale of urban land decide how much of the development process to complete. This decision is based on a comprehensive understanding of the project. A limit or end-point is set. When that point or time is reached, the sale of the site should be completed. Determination of the level of involvement ahead of time and the ability to sell at the predetermined time affects the level of return anticipated and received.

There is certain basic information needed to sell urban real estate. It includes: a) the value of the site, b) the market, c) the external factors and possible effects, and d) the risks. Use of Matrix VII-1 will organize the approach to determine this information and serve as the basis for making decisions. The DNR case studies demonstrate some of the pitfalls which can occur and some of the lessons that can be learned.

Structuring the decision making process provides consistency and continuity. Decisions made in a comprehensive manner ensure that all parts of the decision are reviewed and considered. Piecemeal and incremental decisions are avoided. Consideration of all the elements captures the value inherent in the sale of urban real estate.

#### Participating In The "Upside"

The use of strategic alternatives is complementary to the use of an improved decision making process. Strategic alternatives are deal structuring options which provide various ways to participate in the increased value of the site. The constraints under which DNR, as a governmental agency, operates do not always allow it to move as quickly in decision making as might be appropriate even though it may have a structured process. It needs to establish ways to compensate for this. The use of new and creative methods of constructing a sale of property can lock in additional value.

It is hard to value raw land. The value seems to be what someone is willing to pay for it. Ideally, value increases over the life of the project. Because value is uncertain, however, the structure of a deal with a developer or other buyer can be written to allow participation in as many of the value creating steps as desired. Not only can it receive value when it disposes of the property, but DNR can participate in future value by retaining some ownership rights through a well negotiated contract with the purchaser. DNR's return is maximized. The way a disposition agreement is constructed determines how much profit DNR receives. Three strategic alternatives are suggested:

1. Through the Request For Proposal process, hire a real estate management company to sell the land. DNR receives a minimum amount of the "fair market value" determined by an appraisal. The amount of the sale price actually received that is above the appraisal figure is split on a predetermined proportional basis between DNR and the real estate management company. There is incentive for the company to obtain a high sales price and DNR participates in the increased values received.

The company decides how much of the developmental process to undertake based on its knowledge of the market. If it has not sold the property within a certain time period, the property returns to DNR and the company receives nothing. Risk is reduced to one factor: performance of the real estate company. Even with the Division's new attempts to negotiate bids for property, it still can not work the market as a private company can.

2. Capture the benefit of DNR's own positive externalities when it has large pieces of property for sale. It can develop and sell a portion of the site, wait for the value of surrounding property to rise due to the value created by the developed piece, and then sell the rest of the property at an even higher value. The risk is in market timing and property location.

A conceptual example is the location of a shopping center on 50 acres within a 150 acre site. The peripheral, satellite development on the 100 acres may generate more in profit than the shopping center because of its timing and location. A local example is the Alderwood Mall area north of Seattle.

3. Use contingent sales whereby the property is sold to a developer for the appraised fair market value contingent on DNR receiving a percentage of the future sales price obtained by the developer when the property is resold. The percentage can be written with a minimum dollar amount to mitigate downside risk. A competent developer is needed for this alternative to work. It allows DNR to receive money now and participate in the additional profit gained through property appreciation.

These three strategic alternatives can be used in addition to the joint venture and financing options discussed in Chapter V. Retained ownership and partial ownership situations are also possible. Imagination and creativity are needed. The point is to develop a mechanism in each disposal situation which maximizes the return DNR will receive.

### Conclusion

As the Real Estate Division matures, it should be more aggressive in seeking deal structures which provide minimal risks yet participation and sharing in the future values created as the property is developed. State laws can be changed as needed. Ideas can be tested on small properties first. Incentives can be created to produce returns and value.

As with the decision making process described above, participation in the "upside" while limiting the "downside"

exposure is transferable to any urban real estate sales situation. Creative use of strategic alternatives and an organized decision process will return value and profit.

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