DEPARTMENT OF NATURAL RESOURCES' LEASING OF STATE-OWNED AQUATIC LANDS

REPORT 08-7

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REPORT SUMMARY

At statehood, Washington State's Constitution declared state ownership of the 2.8 million acres of tidelands, shorelands, and bedlands within the boundaries of the state. Statute directs the Department of Natural Resources (DNR) to manage these state-owned aquatic lands. Statute also provides direction for leasing these lands.

In 2007, the Legislature directed the Joint Legislative Audit and Review Committee (JLARC) to answer a number of questions about the leasing of state-owned aquatic lands. This report answers these questions in two parts: Part 1 answers questions about current aquatic land leasing; Part 2 provides an assessment of the advantages and disadvantages of alternative approaches to setting aquatic land lease rates.

Part 1: Leasing State-Owned Aquatic Lands

Article XVII of the state's Constitution declared state ownership of aquatic lands. Until 1971, the state sold some of its aquatic lands. Of the original 2.8 million acres, 94 percent or 2.6 million is still state-owned aquatic land. *(A separate JLARC report "Management of State-Owned Aquatic Lands" explores the broad issues related to state-owned aquatic lands.)*

Statute establishes four main lease categories or use classifications and establishes a lease rate process for each use.

Use	How the Lease Rate is Set
Water-Dependent: A use that cannot logically exist in any location but on the water, such as a marina.	• Statute declares this a favored use. • Formula sets lease rate as 30% of the adjacent upland parcel value times a rate of return.
Nonwater-Dependent: A use that can operate in a location other than on or near water, such as a restaurant.	• Statute declares this a low-priority use. • Lease rate is fair market value determined by appraisal. • Must be more than water-dependent lease rate would be for the same parcel.
Multiple Uses: Water-dependent and nonwater-dependent uses occupy portions of the same leased parcel.	• Lease rate is pro-rated for each use.
Aquaculture: A water-dependent use that focuses on aquatic farming such as growing oysters.	• Lease rate established through competitive bidding and negotiation.

In Fiscal Year 2007, DNR collected $8.3 million for these various uses. The Legislature appropriates this money for the management of state-owned aquatic lands and for projects that protect, improve, or provide access to aquatic lands.

Part 2: Advantages and Disadvantages of Alternative Approaches to Setting Water-Dependent Leases

This study reviews 11 alternative approaches to setting lease rates for water-dependent uses of state-owned aquatic lands. The approaches link lease rates to:

- Upland assessed value (current approach);
- Modified upland assessed value;
- Negotiated fair market value;
- Net income;
- Gross income;
- 1990 rates;
- Matrix or flat rate;
- Averaged uplands assessed value;
- Zone;
- Averaged uplands assessed value by zone; and
- Residual model to estimate market value.

The assessment of the advantages and disadvantages of the approaches uses three criteria:

✓ *Payment of Market Rent*- Does the rent come close to what "the market" would charge?

✓ *Equitable Treatment*- Do uses of identical parcels pay the same rent?

✓ *Administrative Burden*- How many hours does it take to determine rent?

JLARC contracted with a firm with real estate valuation expertise to rank the 11 alternative methods against each of the three criteria.

Results

Exhibit 8 on page 15 in the body of the report provides the full results of the ranking exercise. No single approach ranked best against all three criteria. Using the first two criteria, Market Rent and Equitable Treatment, the negotiated fair market value and residual model approaches received the best rankings. The zone and upland assessed value approaches received the best ranking using the criterion of reduced Administrative Burden.

How Would the Private Sector Set a Lease Rate?

The JLARC real estate valuation expert selected the negotiated fair market value as the most likely private sector approach for setting lease rates for water-dependent leases. They noted that negotiation between informed parties is how market rents are developed, which leads to equitable treatment. This perspective assigns less importance to administrative burden. The expert also observes that, while methods based on a formula generally have less administrative burden, none of the formula-based approaches ranks well using the other two criteria of market rent and equitable treatment.

Conclusion

Statute prescribes how aquatic lands lease rates are set for various uses. Looking for alternatives, the Legislature and DNR have reviewed a number of methods different than those in statute, with the Legislature attempting a change in 2003.

With *this* analysis, the Legislature directed JLARC to review these alternative methods and describe their advantages and disadvantages. While it is ultimately up to the Legislature to choose its criteria for setting lease rates, based on the three criteria JLARC used—payment of market rent, equitable treatment, and administrative burden—the analysis in this report shows that:

- If the most important criteria is payment of market rent and equitable treatment, the Legislature would establish a negotiated fair market value approach to setting water-dependent lease rates;
- If the most important criterion is low administrative burden, then the Legislature would retain the current or some other formula-based approach;
- If the most important criterion to use is an approach that most closely resembles the private sector, the Legislature would establish a negotiated fair market value approach.