COMMISSION STUDY SESSION

Item No: 10A

Meeting: 9/24/21

DATE: September 1, 2021

TO: Port Commission

FROM: Eric D. Johnson, Executive Director

Sponsor: Jason Jordan, Director, Environmental and Planning Services

Project Managers: Tony Warfield, Environmental Senior Project Manager and Mark Rettmann, Environmental Project Manager II

SUBJECT: STUDY SESSION: Mitigation Bank Pricing Policy

A. SYNOPSIS

Staff seek Commission input on establishing a pricing policy for the use and potential sale of mitigation credits from the Port's mitigation bank. Staff will return later in the fall to discuss a broader update to the Port's adopted 2014 Mitigation Strategy.

B. BACKGROUND

The Port of Tacoma's Upper Clear Creek Mitigation Bank was certified June 24, 2020. Thus far the Port has received 6.24 of its total 12.56 wetland credits. Staff anticipate receiving another 2.82 wetland credits in 2022 for a total of approximately 9.06 wetland credits, with the remainder being released by 2027. These credits can be used for Port projects, NWSA projects or sold to other parties.

Commission held a study session at the November 19, 2020 meeting to discuss policies surrounding the use of bank credits. Commission directed staff to 1) ensure we will have enough credits to cover our own needs, 2) focus potential sales on cargo logistics and transportation partners and 3) seek third party expert advice on how to value/price our credits. Even if the Port chooses to never sell any credits, the Port will need to know how to value credits used to support the NWSA.

C. STAFF FINDINGS

Port of Tacoma/NWSA Credit Needs

When looking at potential projects within the visioning work being conducted by the NWSA for the Coordinated Course to 2035, in addition to supporting the Port's 2021-2026 Strategic Plan, staff has projected a likely need of approximately 16 wetland credits. However, a more intense re-development scenario may require as much as 20.5 wetland credits. The Port's current mitigation credit portfolio includes an estimated 26 wetland credits produced by 2027 from our

current advance/bank mitigation sites (Place of Circling Waters, Upper Clear Creek Bank, and Lower Wapato Creek Habitat Project) for a potential surplus of 5.5 to 10 wetland credits.

Bank credits could be sold to support business partners and projects that support the Port's mission and goals. Proceeds from these sales could be used to create new mitigation sites to restore or maintain a balance of mitigation credits. In the forthcoming habitat mitigation strategy update staff will discuss how the Port can maintain the mitigation credit portfolio balance to most efficiently meet the needs of the Port and NWSA, and/or bank credit sale opportunities. Currently, the Port owns numerous properties where future mitigation sites have been contemplated such as Parcel 129/Bank expansion, Gog-Le-Hi-Te III, Saltchuk, etc.

External Party Demand for Credits

There is no doubt as to the demand for Port mitigation credits. Pierce County would likely buy out our entire bank to support the Canyon Road Expansion Project. The Washington State Department of Transportation has also expressed interest in Port credits to support SR 167 expansion. Sound Transit has expressed interest in the past, and representatives from warehouse developers write monthly with fairly urgent requests.

Third-Party Pricing Models Evaluation

The Port contracted with Jacobs Engineering to provide an evaluation of pricing methodologies and provide a recommendation for the Port to consider. Jacobs has several local staff with expertise in the establishment and management of wetland mitigation banks in Washington State including mitigation specialists and a resource economist. The Port included three criteria that any model must achieve. The model must be auditable, transparent, and accountable. Jacobs completed their evaluation in July and a summary of their work is provided below. The full text of their work is attached to this memo.

Jacobs narrowed their review to two options, market value with a replacement cost floor and recouping net present value (recouping the cost of obtaining the credits (land, design, construction cost, site stewardship) in today's dollars.

- **Market Value** –This approach involves setting a credit price based on market conditions. Those conditions are determined by comparison of other regional bank and in-lieu fee (ILF) program prices such as King and Pierce Counties' ILFs, Keller Farm, Spring Brook, and Blue Heron Slough banks and other comparable regional programs. Additionally, the Port will set a minimum price that is sufficient to cover the expected costs to replace the mitigation credits in the future. This ensures the Port does not sell credits for less than it would take to replace them.

- **Recoup Net Present Value (NPV) Costs** – This approach relies on calculations to determine Net Present Value (NPV), Internal Rate of Return (IRR), and Return on Investment (ROI) of the current bank. It includes all Bank costs to date and the current and future costs to manage the investment until all credits are sold (except for any credits that the Port wants to hold in reserve for our own use).

Jacobs concluded, and Port staff concur, of the two approaches evaluated, the market value approach based on future bank replacement costs is recommended because it meets the Port's accountability requirement to sell credits not less than fair market value, and it provides assurances that the Port will be able to meet and not overpay for its own credit obligations in the future. The second approach to simply recover the costs of building and operating the existing Bank was considered but rejected as this approach risks selling credits below the Port's cost of replacing the credits, and/or the price may be below fair market value. The Port will only sell credits at a price that meets or exceeds our future cost of credits. The Port would gain considerable benefits from the market value approach that provides greater financial confidence and is auditable, transparent, and accountable.

The Port's Finance Team can use the selected model and determine a price in the case of the sale of credits to a third party or place a value on the Port's credit in the case of a NWSA South Harbor project needing mitigation credit.

D. LEGAL REVIEW

The Port is a special purpose district, and so its authority is limited to those powers expressly granted in RCW 53.08. A special purpose district may also exercise powers that "are 'necessarily or fairly implied in or incident to the powers expressly granted,' " and those that are " 'essential' " to its " 'objects and purposes.' " *King Cty. v. King Cty. Water Districts Nos. 20, 45, 49, 90, 111, 119, 125*, 194 Wn. 2d 830, 840, 453 P.3d 681, 686–87 (2019) (internal citations omitted).

With respect to property, the Port has express statutory power to:

> … sell and convey any of its real or personal property valued at more than ten thousand dollars when the Port commission has, by resolution, declared the property to be no longer needed for district purposes, but no property which is a part of the comprehensive plan of improvement or modification thereof shall be disposed of until the comprehensive plan has been modified to find the property surplus to port needs.

RCW 53.08.090(1).

A wetland mitigation bank credit is considered intangible personal property for legal and accounting purposes. Because RCW 53.08.090(1) provides the Port with authority to sell either real or personal property, the Port has express authority to sell wetland mitigation bank credits with Port Commission approval provided that the credits are (1) surplus to the Port's needs and (2) the Port receives fair market value.

Port staff recommends selling surplus mitigation bank credits using the market value pricing method. This is within the Port's statutory authority found in RCW 53.08.090(1).

As noted below, implementation of a Port mitigation bank credit sale program will require Port Commission review and approval of updates to the Master Policy Resolution incorporating Port policy and procedures for such sales. In addition to the items described in the Staff Recommendation below, Port Legal Counsel recommends that Commission include policy guidance directing the reinvestment of proceeds from the sale of surplus credits into development of other Port wetland and fish habitat mitigation projects in support of Strategy

EL-4 from the 2021-2026 Strategic Plan. Port Legal Counsel will work with Port staff to develop recommended updates to the Master Policy Resolution for Port Commission review and approval.

E. RECOMMENDATION

Staff recommends:

- Sell surplus credits as approved by the Commission on a case-by-case basis.
- Credit sales only to entities whose projects are consistent with the Port's mission and goals as expressed in the Strategic Plan. Those would primarily be customers, cargo logistics and transportation partners.
- Credit price/value determined by market value methodology.

F. ATTACHMENTS

- Attachment 1: Credit Pricing
- Attachment 2: Project Impacts Figure

G. NEXT STEPS

- Write specific pricing policy language to be included in the next Master Policy update (with substantial help from Legal).
- Finance builds market based model.
- Present draft update to the 2014 Port-Wide Mitigation Strategy incorporating the above recommendations in study session Q4 2021.

Jacobs

Technical Memorandum

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Bellevue, Washington 98004
425.453.5000
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Subject:	**Task 2 Evaluation of Wetland Mitigation Credit Pricing Approaches Technical Memorandum, Revised Final (v3)**
Project Name:	Mitigation Support Services
Attention:	Tony Warfield, Senior Manager/Port of Tacoma Mark Rettmann, Environmental Project Manager/Port of Tacoma
From:	Hans Ehlert, Mitigation Lead, PMP, PWS/Jacobs Mary Jo Kealy, Resource Economist, Ph.D./Jacobs
Reviewed by:	Jennifer Thomas, Mitigation Advisor and QC Reviewer/Jacobs
Date:	July 19, 2021
Copies to:	File

1. Purpose

The purpose of this memorandum is to summarize two credit pricing approaches in support of the Port of Tacoma's (Port) Upper Clear Creek Mitigation Bank (Bank). Our team has also identified data gaps and/or additional information and recommendations that further support credit pricing for the Bank. This technical memorandum is the final deliverable for Task 2 (Perform Evaluation of Wetland Mitigation Credit Pricing Approaches for the Port's Bank).

2. Review of Existing Information

The following documents provided by the Port were reviewed to understand the type of credits created and available, cost information, and limitations on sale of credits that may have implications on credit price:

a. Mitigation Bank Instrument for the Bank (February 2020). The Port's approved bank produces two types of environmental mitigation credits including 12.56 acre-credits (the currency for wetland credits) and an associated 273.16 discounted service acre year (DSAY) credits (the currency of fisheries credit under the Endangered Species Act) when all performance standards are met and credits are released over the next 7 years.

b. Commission Study Session: Mitigation Banking Policies (November 2020). This included a summary of four mitigation credit pricing models that included: Cost Plus Model, Peg to Pierce County's In-Lieu Fee (ILF) program, Set Price by Open Market, and Set Price as Replacement and Management Cost.

c. Pierce County ILF Program basis of credit pricing, prepared by Mark Rettmann on April 23, 2021. This confirmed a price of $1.4 million and a range of approximately $1 to $3.2 million per credit, depending on the "temporal loss factor" used in the Credit/Debit method for the impact site. Note that per the federal rule on compensatory mitigation

(U.S. Army Corps of Engineers 2008), ILF programs require full-cost accounting, including land cost.

d. Breakdown of nominal cost information for the Port to establish the Bank. These nominal costs have not been compounded to reflect current year dollars and do not include the opportunity cost for forgone earnings.

3. Critical Questions

The following critical questions were identified during this evaluation. The Port provided responses during the kickoff meeting on May 5, 2021, and during subsequent follow-up.

a. What is the Port's biggest risk/concern about credit pricing for the Bank?

- The Port is concerned about selling more credits than they should, based on the Port's anticipated needs for credits to meet regulatory requirements, without replacing the credits sold.
- The Port's finance/accounting staff team indicated that the sale of credits should not be less than fair market value, similar to the sale of real property (Revised Code of Washington [RCW] 53.25140 and Port of Tacoma Master Policy Resolution 2021-08-PT). In case of an audit, the Port needs to ensure that they can document that credits are not sold less than fair market value. Furthermore, the process for deriving the credit price must be auditable, transparent, credible, defensible, and accountable.

b. What is the Port's financial objective(s) for credit pricing? (e.g., recoup their costs or profit motive?)

- A major difference in the Port's Bank versus a private bank is that a goal of a private bank would be to sell all the credits and be appropriately priced. The Port will continuously need credits in the future and does not need to or have a goal of selling all their credits. Any credits sold should consider what the cost would be to replace the credits in the future, should the Port need the credits. Credits could be replaced in the future through purchasing credits (if available) or by the Port developing new mitigation sites/credits. Developing new credits takes time to acquire land (if necessary), and to plan, permit, design, construct, and monitor a mitigation site.
- It is important that the credit price covers the Port's costs. Two tiers should be considered to establish credit price: (1) recoup all costs and (2) sell credits no less than fair market value. One point of reference for fair market value is the Pierce County ILF price. There are also other relevant comparable banks with credit sales in King County and the King County ILF program to provide additional points of reference.
- The Port could just set a high price for credits and thereby create a "floor" below which they would not sell credits. This price would be high enough to cover the Port's future replacement costs after accounting for uncertainty.

4. Credit Pricing Approaches Evaluated

Our team identified and evaluated two general credit pricing approaches for the Port to consider, as follows:

a. **Market Value** – This is the approach generally followed to determine fair market value. It involves setting a credit price based on market conditions with the expectation that the Bank will earn at least the Port's target internal rate of return (IRR), which measures the annual growth rate of the investment. The goal is to charge a price that is more than sufficient for covering the expected costs to replace the bank credits in the future such that the revenue received from the sale of credits could be safely invested to develop future mitigation sites should the Port have a future need for more credits. This is accomplished by setting the target IRR for the Bank sufficiently high to cover uncertainty related to future development costs to establish a new mitigation site for credits.

   The Port's cost represents one side of the market and sets the floor for the price. The demand for credits (what buyers are willing to pay for different quantities of credits) represents the other side of the market for determining a fair-market value, which may exceed the floor price (see below for further discussion of market demand).

   The Market Value approach lets the market determine the actual IRR, so long as it meets or exceeds the Port's target IRR. However, all past costs must first be converted to common current year dollars, and all future costs must be assessed in current year dollars.

   We recommend the following calculations for this approach:

   - Calculate the NPV of full costs to establish and manage a replacement mitigation site using a discount rate consistent with Port financial practices.
   - It is important to note that by IRR is meant an annual return such that each year the investment would earn the selected target percentage on the value of the previous year's investment. Because this investment is over many years, this is substantially different than simply multiplying the initial investment by a factor (i.e., the ROI).

   If Bank replacement costs are high, then this would result in a relatively high price that discourages some buyers and retains credits for the Port's use. Credits that are sold would generate revenue at least sufficient for obtaining or replacing credits in the future.

   The Market Value approach requires developing an estimate of the market demand for credits over time (i.e., the schedule of price a buyer is willing to pay per credit and the number of credits). This demand is influenced by the pace of demand, which includes both private sector development and public sector infrastructure projects. It also depends upon the costs associated with mitigating for one's impacts rather than purchasing credits from a bank or ILF program. A potential buyer may be willing to pay a premium for a bank credit over the cost of on-site permittee-responsible mitigation for the convenience/certainty factor. To meet the Port's requirement to avoid selling below fair market value, it is expected that documentation of the basis for the demand estimate

would be required and that it may be necessary to run more than one scenario to account for uncertainty in key parameters (such as, private and public sector mitigation needs, their mitigation costs, and the potential for competition from other banks).

To obtain information about the price buyers are willing to pay for credits, the Port will first examine market transactions for wetland credits within the Bank's service area. However, the relatively small number of potential transactions within this Bank's service area may not be sufficient for establishing a reliable estimate of fair market value. To bolster the evidence, it would be necessary to go outside the Bank service area to consider the representative service areas in comparable urbanized regions of Puget Sound and the Pacific Northwest (PNW).

This Market Value approach resembles the Port's typical process for establishing fair market value to determine asking price when selling Port property.

b. **Recoup Net Present Value (NPV) Costs** – This approach is similar to the first approach in that it would rely on financial models including calculations to determine NPV, IRR, and ROI, except that the costs would be related to the present bank only. It includes all Bank costs to date and the current and future costs to manage the investment until all credits are sold (except any that the Port wants to hold in reserve for their own use) and Bank management moves into long-term maintenance and monitoring (a required element of mitigation banks in compliance with the federal mitigation rule [U.S. Army Corps of Engineers 2008]).

   This second approach is not recommended because the Port is uncertain about its future need for credits, and it risks selling credits at too low a price that would not cover their cost of future credits. In addition, this approach does not include market information to justify selling credits for not less than fair market value, thus would not satisfy the Port's accountability objective.

5. Recommendations

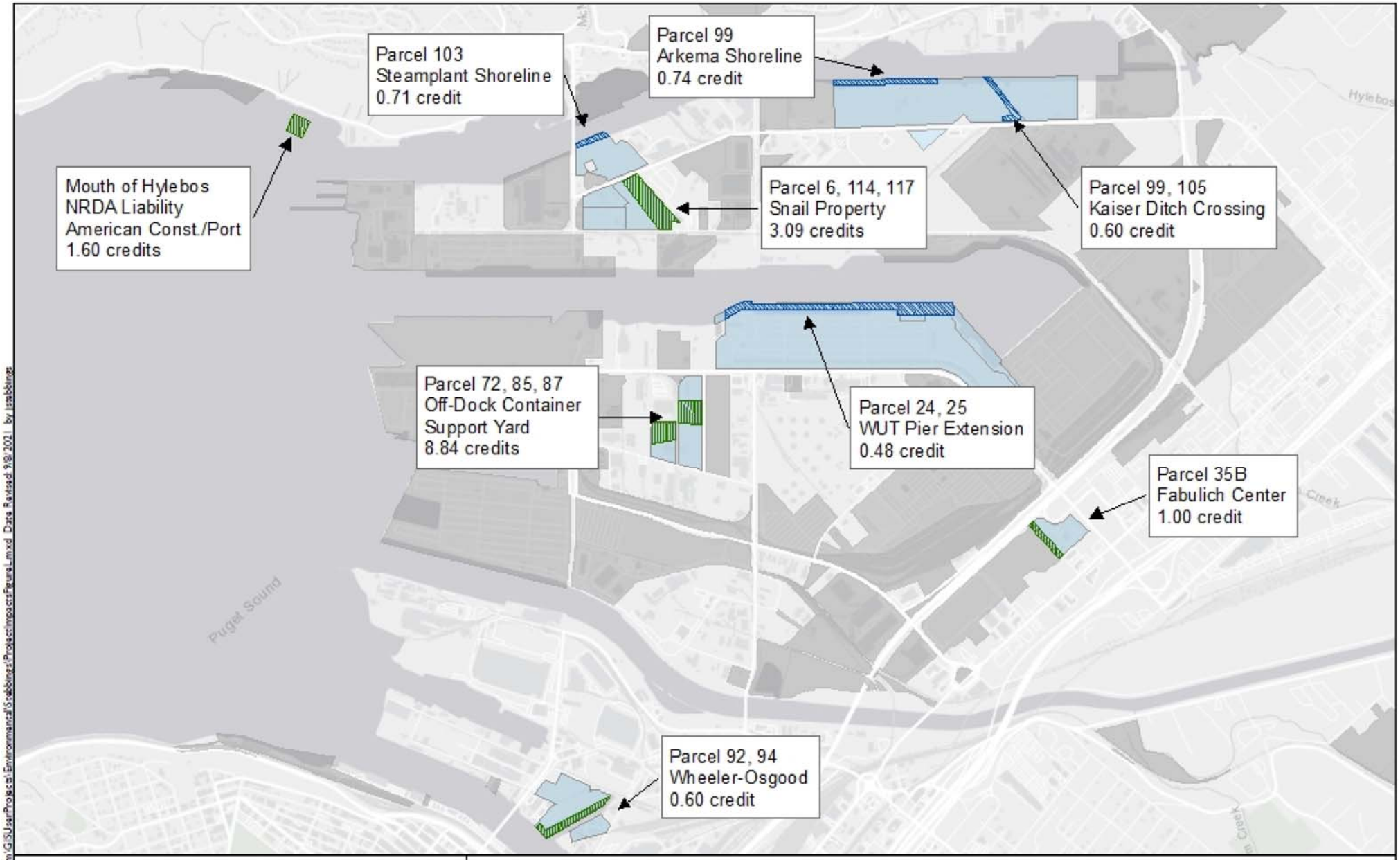
Of the two approaches evaluated, the Market Value approach based on future bank replacement costs is recommended because it meets the Port's accountability requirement to sell credits not less than fair market value, and it provides assurances that the Port will be able to meet and not over pay for its own credit obligations in the future. The second approach to simply recover the costs of building and operating the existing Bank was considered but rejected as this approach risks selling credits below the Port's cost of replacing the credits, and/or the price may be below fair market value. Under the Market Value approach, the IRR is based on fair market value, which depends both on the Port's future replacement costs and on what buyers are willing to pay for credits. That is, the Port will only sell credits at a price that meets or exceeds their future cost of credits. The Port would gain considerable benefits from the Market Value approach that provides greater financial confidence that is auditable, credible, defensible, transparent, and accountable.

For the Port to select a credit price, some additional analysis may be beneficial. This would allow for sensitivity testing and scenarios that evaluate different IRR rates with market analysis of comparable banks across the PNW that could consider key uncertainty factors affecting

replacement cost, demand for credits, and competition from other potential suppliers of mitigation (e.g., banks, ILF, and permittee-responsible).

6. Reference

U.S. Army Corps of Engineers. 2008. Final Rule for Compensatory Mitigation for Losses of Aquatic Resources, published in the Federal Register on April 10, 2008. Accessed from: https://www.gpo.gov/fdsys/pkg/CFR-2012-title33-vol3/xml/CFR-2012-title33-vol3-part332.xml.



Legend

- Less Intense Development
- More Intense Development
- Development Parcel
- Port Parcel

0 2,000 Feet

Less Intense Development

8.84 credit - Parcel 72, 85, 87
3.09 credit - Parcel 6, 114, 117
1.60 credit - Mouth of Hylebos NRDA Liability
1.00 credit - Parcel 35
0.60 credit - Parcel 92, 94
1.20 credit - Contingency (EBC, Can-Am, etc.)
16.33 credits - Subtotal (6 projects)

More Intense Development

0.74 credit - Parcel 99
0.71 credit - Parcel 103
0.60 credit - Parcel 99, 105
0.48 credit - Parcel 24, 25
1.80 credit - Contingency (NMFS maintenance, etc.)
4.33 credits - Subtotal (5 projects)

20.66 credits - TOTAL (11 projects)

Item No.: 10A
Date of Meeting: September 24, 2021

Study Session: Mitigation Banking Policies

Tony Warfield

Environmental Senior Project Manager

and

Mark Rettmann

Environmental Project Manager II

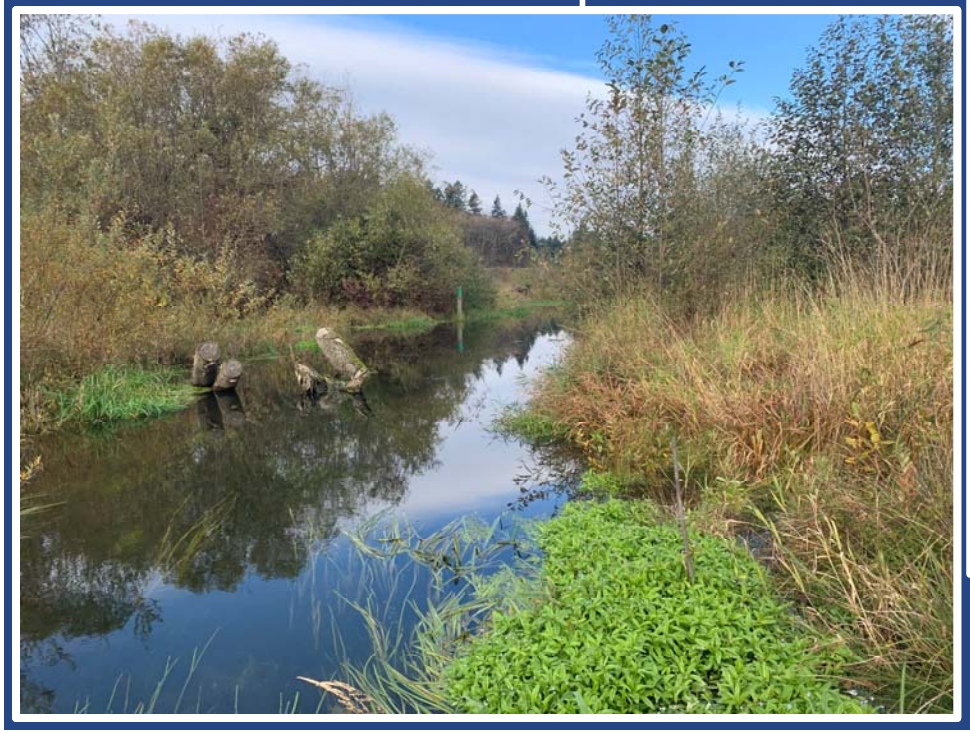
Port of Tacoma

People. Partnership. Performance.

Study Session
Mitigation Banking Policies

Staff seek Commission input on establishing mitigation bank pricing policies considering appropriate credit balances and potential customers.

No action is requested.



Background
Mitigation Banking Policies

Commission direction from November 19, 2020 study session:

1) Ensure we will have enough credits to cover our own needs,
2) Focus potential sales on cargo logistics and transportation partners, and
3) Seek third party expert advice on how to value/price our credits for sale or use for NWSA projects.

Background
Mitigation Banking Policies

Mitigation Bank certified June 24, 2020:

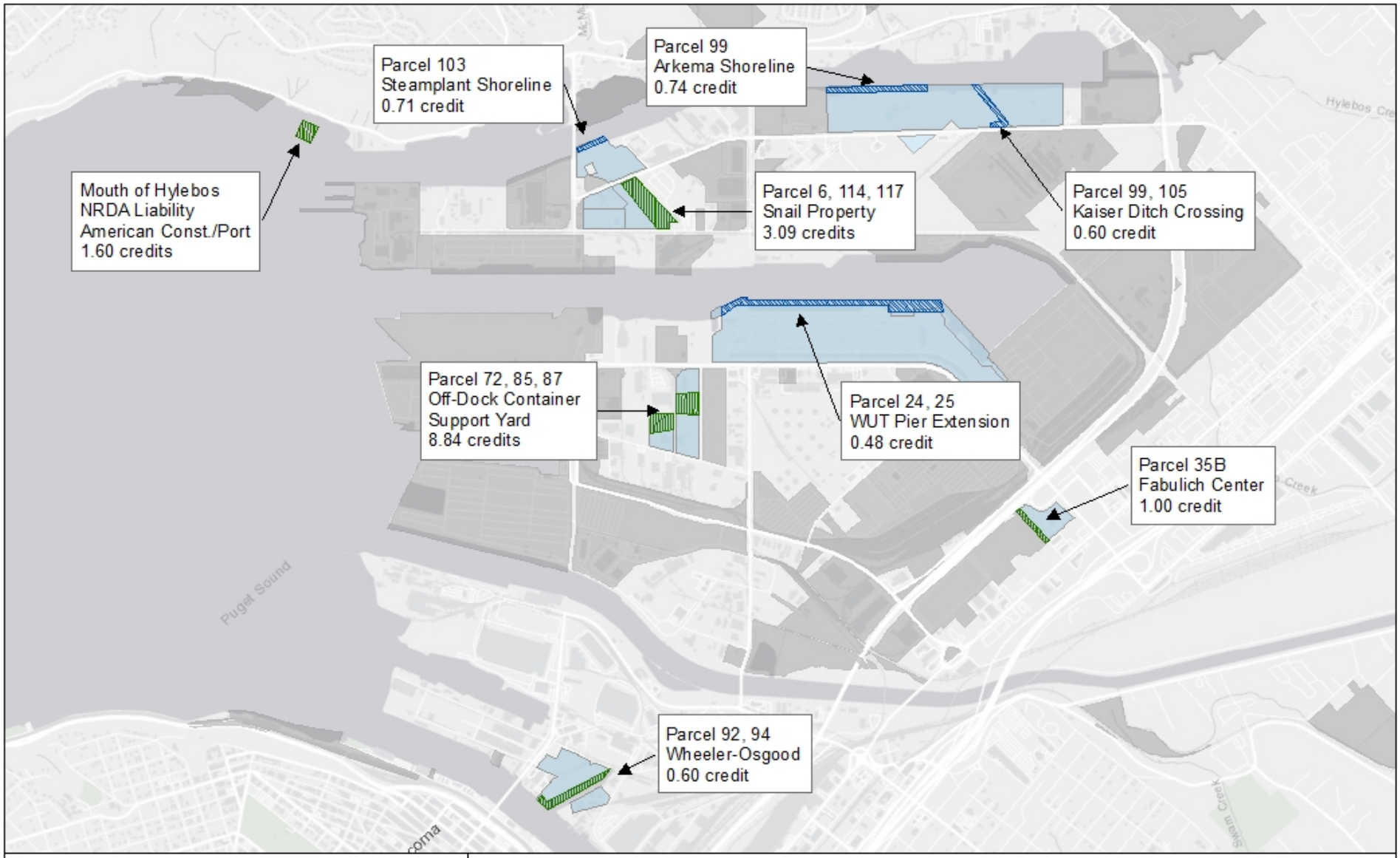
- Received 6.24 wetland credits of 12.56 total
- 2.82 credits in 2022 for a total 9.06 credits
- Remainder released by 2027 (12.56 total)
- Bank credits can be used for Port projects, NWSA projects or sold to other parties

Background
Mitigation Banking Policies

Port of Tacoma / NWSA Credit Needs

Credit Needs (Port's 2021-2026 Strategic Plan & NWSA Coordinated Course to 2035):

- Need ~16 to 20.5 wetland credits (includes ~15% contingency for unforeseen projects/regulatory uncertainty).
- ~26 wetland credits obtained by 2027 (from 3 advance/bank mitigation sites).
- Potential surplus of 5.5 to 10 wetland credits (depending on intensity of Port re-development).



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1.80 credit - Contingency (NMFS maintenance, etc.)
4.33 credits - Subtotal (5 projects)

20.66 credits - TOTAL (11 projects)

Bank Credit Demand, Sales & Reinvestment

- Bank credits can be sold
- Demand for Bank credits is high
  - PoT/NWSA/Customers
  - Transportation partners
  - Logistics support businesses
  - Other non-Port related private entities
- Proceeds could be reinvested in new sites

Third-Party Pricing Models

- Jacobs Engineering (mitigation specialists and resource economist) conducted analysis.
- Evaluation criteria: auditable, transparent, and accountable.
- Two alternatives:
  - Market Value (with a replacement cost floor).
  - Recoup Net Present Value Costs (recoup cost of existing bank in today's dollars).

Third-Party Pricing Models

Market Value:

- Sets credit price based on market conditions
- Uses comparable sales in central Puget Sound region
- Set price floor to cover replacement costs of credits

Market Value Example: Scenario A

Port of Tacoma

Request for Purchase (outside entity)

1. Establish market value via comps of central PS bank/ILF transactions
2. Determine replacement cost of credits
3. If replacement cost less than comp market price take proposal to Commission for consideration
4. If replacement cost greater than comp market price confirm buyer willing to pay replacement cost
    a) If yes: take proposal to Commission for consideration
    b) If no: terminate sale discussions

Market Value Example: Scenario B

Offering Credits for Sale (Port initiated)

1. Establish replacement cost of credits
2. Issue RFP with minimum bid
3. Determine highest bidder with offer at least matching replacement cost and is consistent with Port's mission and goals as established in the Strategic Plan
4. Take proposed sale(s) to Commission for consideration

Market Value Scenario Comparisons

Scenario A) Request for Sale:

- Likely focuses most tightly on Port's mission, goals and highest priorities
- Likely does not achieve highest potential returns

Scenario B) Port Initiated Sale:

- More difficult to focus sales on Port's highest priority projects (highest bidder may meet Port's mission and goals, but be lower priority)
- Likely establishes the highest price point at any given time

Third-Party Pricing Models

Port of Tacoma

<u>Recoup Net Present Value (NPV) Costs:</u>

- Costs relate to the present bank (UCC) only
- Includes:
  - all Bank costs to date
  - future costs to manage the Bank
- Risks:
  - selling credits below fair market value
  - selling credits below future replacement cost

Recoup NPV Cost Example

1. At any point in time determine cost of existing bank credits.
2. Use that cost to determine the price to sell credits in either a outside party or Port initiated sale.
3. Take proposed sale to Commission for consideration with price set equal to the cost of building the Upper Clear Creek Bank.

Recommendation for Pricing Model (Jacobs & Port Staff)

Recommend Market Value approach:

- Transparent
- Accountable
- Auditable
- Prevents selling credits <FMV
- Port recovers cost of future credit needs
- Port's Finance Team use model to determine price/value for a credit sale or use by NWSA

Legal Review

- A wetland mitigation bank credit is considered intangible personal property for legal and accounting purposes.
- RCW 53.08.090(1) provides the Port with authority to sell either real or personal property, the Port has express authority to sell wetland mitigation bank credits with Port Commission approval provided that the credits are:
  (1) surplus to the Port's needs, and
  (2) the Port receives fair market value.
- Port Legal Counsel will work with Port staff to develop recommended updates to the Master Policy Resolution for this purpose for Port Commission review and approval.

Summary

- Bank credit sale policy gives Commission option to sell credits in the future
- No obligation to sell any credits
- Commission can review the Port's needs/credit balance and determine how many credits, if any, to sell
- Even if no credits are ever sold to an outside party, pricing policy will determine value of credits used by NWSA

Recommendations & Next Steps

Port of Tacoma

Recommendations:

- Sell surplus credits as approved by the Commission on a case-by-case basis
- Credit sales only to entities that support the Port's mission and goals as expressed in the Strategic Plan
- Credit price/value determined by market value approach

Next Steps:

- Draft pricing policy text for next Master Policy update
- Present draft update to 2014 Port-Wide Mitigation Strategy in study session later this Fall

Discussion
Mitigation Banking Policies