

**STAFF REPORT
C72**

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10/19/17
W 27135
K. Foster

**CONSIDER APPROVAL OF THE 2017 CATEGORY 2
SOLANA BEACH BENCHMARK RENTAL RATE**

INTRODUCTION:

Through this staff report, staff recommends the Commission approve the 2017 Category 2 Solana Beach Benchmark, which will inform recommended rents for leases authorizing the use and occupation of sovereign lands in the Pacific Ocean in the city of Solana Beach, San Diego County.

OVERVIEW OF BENCHMARKS FOR RENTAL RATES:

Benchmarks are used to establish uniform rental rates in specific geographic areas with large concentrations of similar facilities, mostly private recreational improvements within the Commission's jurisdiction. (California Code of Regulations, title 2, section 2003, subdivision (a)(5).) For proposed leases involving certain types of structures in regions where benchmarks have been approved, Commission staff will recommend a rental rate based on the applicable benchmark and the lease area. Benchmark rental rates are based on an analysis of similar land uses or substitute facilities in the local area. Generally, Commission staff updates the benchmarks for rental rates every 5 years. The use of benchmarks not only improves consistency and transparency throughout a geographic region, it also improves staff efficiency in setting and adjusting rent for large numbers of leases, saving time and money for both the applicant and the State.

The Commission has two types of benchmarks for rental rates:

- Category 1, which are generally applied to private docks, piers, and buoys.
- Category 2, which are generally applied to filled land, cantilevered decks, sundecks, or other non-water dependent uses.

A map showing all the Commission's current benchmark areas is attached as Exhibit A ([Benchmark Map](#)), and a list of all the Commission's current benchmark rental rates is attached as Exhibit B ([Current Benchmark Rates](#)).

Category 2 Benchmark Methodology

The Category 2 Solana Beach Benchmark has been used by the Commission since 2012. Category 2 benchmarks are based on and

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associated with nearby upland land values because the non-water dependent uses can represent an extension of the backyard, or as is the case in Solana Beach, protect the upland property from erosion and damage (primarily through seawalls and sea cave infills) – purposes unrelated to the docking and mooring of boats.

Commission appraisal staff uses the following general process to establish and update a Category 2 benchmark. First, staff conducts research to identify recent nearby upland property sales. The initial research seeks to identify only land value, rather than the value of improvements, because the property being leased is the underlying sovereign land and the area above sovereign land, not the privately-owned improvements. Next, staff analyzes the sales data and determines a per-square foot value representative of the area. The benchmark is calculated by applying a 9 percent annual rate of return to the appraised value of the leased land consistent with California Code of Regulations, title 2, section 2003, subdivision (a)(1).

The Category 2 benchmark may then be discounted to reflect that the sovereign land to be leased may not have the same utility or intensity of use as the upland properties from which the data were drawn, due to topography or other physical characteristics, the nature of the sovereign land use, certain legal constraints, or the upland owner's decision, but nevertheless still contributes to the value of the upland property.

Category 2 Solana Beach Benchmark

Using the methodology described above, Commission appraisal staff identified nine home sales on oceanfront lots in the city of Solana Beach. The sales occurred between 2013 and 2016, with a sales range of \$1,595,000 to \$8,750,000 (and a land value range of \$1,500,000 to \$8,000,000).

The undiscounted benchmark rate, with the 9 percent rate of return applied, is \$46.80 per square foot. The sovereign lands covered by this benchmark have no capacity to be used as residential living space, so a discount for a lower utility or intensity of use as compared to the upland land is appropriate. For features such as shoreline protective structures (primarily seawalls and sea cave infills in the Solana Beach area), staff recommends the application of a 75 percent utility discount.

Where shoreline protective structures provide a purely private benefit to the lessee, no public benefit discount is warranted. However, rock falls due to undercutting and sea cave collapses along the 50- to 80-foot-high

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sandstone bluffs that characterize the Solana Beach shoreline represent a hazard to the beach-going public which those structures help to mitigate. While shoreline protective structures in Solana Beach are primarily for private benefit, some do provide a limited public safety benefit; therefore, staff has applied, and recommends continuing the application of an additional 33 percent public benefit discount for those shoreline protective structures that provide a public benefit in the area covered by this benchmark. California Code of Regulations section 2003, subdivision (e)(4), provides that “Rent may be discounted or waived for use of sovereign lands if the Commission, at its sole discretion, determines that a significant regional or statewide public benefit is provided or accrues from such use.” Staff considered an appropriate discount to apply for the portion of recognized public benefit the seawalls provide in Solana Beach, and concluded that 33 percent was reasonable based on the circumstances.

Although not considered as part of this methodology, adverse impacts that may be caused by shoreline protective structures both in Solana Beach and throughout California are addressed through conditions imposed through Commission leases, Coastal Development Permits, and various beach nourishment programs conducted by city and regional governing bodies.

Table 1 summarizes the comparison between the 2012 and 2017 benchmark rental rates, expressed on a per square foot (sf) basis.

TABLE 1

Benchmark		2012	2017
Category 2 Solana Beach	Undiscounted	\$49.50/sf	\$46.80/sf
	Discounted*	\$12.38/sf	\$11.70/sf

*Represents a 75 percent utility discount.

STAFF ANALYSIS AND RECOMMENDATION:

Authority:

Public Resources Code sections 6005, 6216, 6301, 6321, 6321.2, 6501.1, and 6503; California Code of Regulations, title 2, sections 2000 and 2003.

Public Trust and State’s Best Interests Analysis:

Article XVI, section 6 of the California Constitution specifically prohibits the Legislature from making or authorizing any gift of public money or thing of value to any individual, municipality, or corporation. A thing of value

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includes the use of State-owned land for private benefit with no rent or compensation for such use.

Under title 2, division 3 of the California Code of Regulations, and the Public Resources Code, the Commission has broad discretion in all aspects of leasing state lands, including the method or amount of rent that is most appropriate, and how rent should be adjusted during the term (Cal. Code Regs., tit. 2, § 2000, subd. (b)). Rents must be in the best interests of the State, and may be based on one or more of the following methods, including, but not limited to: 9 percent of appraised land value; a percentage of annual gross income, where the percentage is based on an analysis of the market for like uses and other relevant factors; a comparison to rents for other similar land or facilities; benchmarks for regions with large concentrations of similar facilities, with benchmark rental rates to be based on analysis of similar or substitute facilities in the local area; and other such methods or information that are based on commonly accepted appraisal practices and principles. (Cal. Code Regs., tit. 2, § 2003, subd. (a).) The Commission may consider the amount of rent the State would receive under various rental methods, and whether relevant, reliable, and comparable data is available concerning the value of the leased land in determining which rent method should apply. (Cal. Code Regs., tit. 2, § 2003, subds. (d)(1), (2).)

Approval of the new benchmark rental rates will not result in a change in the use of Public Trust resources or the impacts thereto, and taking into account the requirements discussed above, provides a reasonable method for determining rents in the geographic regions covered by the benchmarks. Staff believes approval of the new benchmarks does not have an impact to the common law Public Trust Doctrine and is in the best interests of the State.

OTHER PERTINENT INFORMATION:

1. In 2016, the Commission reviewed and approved updates to the 2016 Category 1 Southern California Benchmark and Category 2 Huntington Harbour Benchmark rental rates ([Item 65, October 13, 2016](#)).
2. In 2017, the Commission reviewed and approved an update to the 2017 Category 1 Colorado River Benchmark rental rate ([Item 68, February 7, 2017](#)).
3. This action is consistent with Strategy 2.1 of the Commission's Strategic Plan to optimize returns for the responsible development and use of State lands and resources, both onshore and offshore.

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4. Approval of the 2017 Category 2 Solana Beach Benchmark rental rate is not a project as defined by the California Environmental Quality Act because it is an administrative action that will not result in direct or indirect physical changes in the environment.

Authority: Public Resources Code section 21065 and California Code of Regulations, title 14, section 15378, subdivision (b)(5).

EXHIBITS:

- A. Benchmark Map
- B. Current Benchmark Rates
- C. 2017 Category 2 Solana Beach Benchmark Memorandum

RECOMMENDED ACTION:

It is recommended that the Commission:

PUBLIC TRUST AND STATE'S BEST INTERESTS:

Find that approval of the benchmark will not result in a change in the use of Public Trust resources or the impacts thereto, does not have an impact to the common law Public Trust Doctrine, and is in the best interests of the State.

AUTHORIZATION:

1. Approve the 2017 Category 2 Solana Beach Benchmark rental rate of \$46.80 per square foot, effective October 19, 2017.
2. Approve the application of a 75 percent discount to this benchmark rental rate to adjust for any reduced utility or intensity of use of the sovereign land occupied by shoreline protective structures subject to this benchmark, effective October 19, 2017.
3. Approve an additional 33 percent discount to the discounted benchmark rate to adjust for the public benefit provided by those shoreline protective structures subject to this benchmark that provide a public benefit, effective October 19, 2017.

State Lands Commission Benchmarks

Location	Rental Rate (\$/SF)	Last Updated	Proposed Update
Category 1			
Colorado River	\$ 0.171	February 2017	2022
San Francisco Bay Area	\$ 0.198	June 2016	2021
Lake Tahoe Berths	\$ 0.79	July 2012	2017
Lake Tahoe Buoys*	\$ 377	July 2012	2017
Sacramento River	\$ 0.214	March 2015	2020
Delta Area	\$ 0.165	March 2015	2020
Southern California	\$ 0.374	October 2016	2021
Tomales Bay Berths	\$ 0.114	December 2015	2020
Tomales Bay Buoys*	\$ 125	December 2015	2020
Category 2**			
Sandy Beach	\$ 2.16	May 2013	2018
Corte Madera	\$ 5.40	March 2014	2019
Black Point	\$ 0.35	May 2015	2020
Huntington Harbour	\$ 31.50	October 2016	2021
Solana Beach	\$ 49.50	September 2012	2017

*per each

** The Category 2 Benchmark may be discounted to reflect that the sovereign land being leased may not have the same utility as the upland property.

Note: Benchmarks are generally updated every five years.

EXHIBIT C

State of California

State Lands Commission

Memorandum

Date: September 1, 2017

To: Brian Bugsch, Chief **RBB**
Land Management Division

Grace Kato, Assistant Chief
Land Management Division

From: Chaun Wong **CW**
Associate Property Appraiser
Land Management Division

Subject: Solana Beach Category 2 Benchmark 2017 – Rental rate for non-water dependent use areas extending onto and over sovereign land in Solana Beach, San Diego County, California

As requested, I have conducted research relevant to establishing the fair market rent for non-water dependent use areas extending onto and over sovereign land in Solana Beach, San Diego County, California. These non-water dependent uses consist of shoreline protective structures, encroachments, and/or other residential-related improvements that extend onto and over sovereign lands and essentially represent extensions of the usable area of the adjoining residential lots.

This research is an attempt to establish a "benchmark" value to be used as the basis for developing annual lease rates. The research is intended to be used by Commission staff in negotiations with lessees.

Introduction

The California State Lands Commission is responsible for leasing sovereign lands at Solana Beach. Solana Beach is an oceanfront community located in northern San Diego County. The coastline is characterized by high bluffs and narrow shelf beaches. Over the years, the tops of the bluffs have been developed with high-end single-family residences and condominium projects. Due to wind and wave action, the bluffs are subject to erosion. Many of the upland property owners have attempted to prevent further erosion of the bluffs by constructing shoreline protective structures such as seawalls and filling notches in the base of the bluffs. Some of these shoreline protective structures, as well as some private stairways leading down to the beach, are on sovereign land.

Methodology

The Commission's authority to lease lands and charge rent comes from the California State Constitution, the Public Resources Code, and the California Code of Regulations.

The Commission's mandate to charge rent comes from the Gift Clause of the California State Constitution, which states in part that:

"The Legislature shall have no power to...make any gift or authorize the making of any gift, of any public money or thing of value to any individual, municipal or other corporation whatever..." Cal. Const. Art. XVI -6.

Section 6503 of the Public Resources Code states that:

"The Commission shall appraise the lands and fix the annual rent or other consideration thereof."

The California Code of Regulations¹ provides the Commission with broad discretion in all aspects of leasing.

"Leases or permits may be issued to qualified applicants and the Commission shall have broad discretion in all aspects of leasing including category of lease or permit and which use, method or amount of rental is most appropriate...based on what it deems to be in the best interest of the State"

The Code of Regulations then goes on to outline the types of leases and the methods of setting rent for each. Of these, the "9% of the appraised value of the leased land"² method is considered the most directly applicable. For purposes of this analysis, the land to be leased is sovereign land located waterward of the ordinary low water mark. Since there is not an active real estate market for sovereign land, the basis for the annual rent is the adjoining upland property. At Solana Beach, the adjoining upland property generally consists of single family homes on residential lots. The rent to be set is based on the value of the underlying land and does not include the value of any improvements. Thus, for valuation purposes, the value of oceanfront residential lots at Solana Beach is the basis of the rental rate.

The market value of residential land is typically estimated through use of the Sales Comparison Approach. In this approach, recent sales and current listings of similar properties are compared to the subject on the basis of pertinent factors such as location, size, shape, etc. Oceanfront residential lots are typically valued on either a per-lot or on a per-oceanfront-foot basis. However, because the lease areas generally do not represent a full residential lot, the unit of comparison used is the price (or value³)

¹ Title 2, Administration, Division 3, State Property Operations, Article 2 Section 2000, General (b).

² Title 2, Administration, Division 3, State Property Operations, Article 2 Section 2003(a)(1).

³ The terms "price" and "value" will be used interchangeably hereinafter generally depending on whether the sale

per square foot of land area. An indication of value is then concluded based on a comparative analysis of these factors. Per the California Code of Regulations, rent is then set based on 9% of the concluded value of the leased land.

Market Value of Upland Property

A search was made for recent sales of vacant residential lots fronting Solana Beach in San Diego County. However, due to its built-up nature, no comparable sales of vacant oceanfront lots were found. Rather than use comparable sales that do not front the ocean, which would necessitate adjustments for location, an allocation technique is employed. In this analysis, residential land values are allocated from recent sales of single family houses in the Solana Beach area through use of the improvement percentage assigned by the San Diego County Assessor's Office. For instance, if a house sold for \$1,000,000 and had an improvement percentage of 40%, then the allocated value of the land is 60%, or \$600,000. For analysis purposes, the unit of comparison used is the price per square foot of land area.

Summarized in the table on page 6 are the pertinent details of nine sales of single family residences in Solana Beach. The sales took place between November 2013 and March 2016. All of these sales involve oceanfront lots. The lot sizes range from 3,100 to 9,100 square feet, with a mean of 5,789 square feet and a median of 5,700 square feet. The sale prices for the oceanfront lots ranged from a low of \$1,595,000 to a high of \$8,750,000, with a mean of \$3,763,333, and a median of \$2,750,000. According to the Assessor's allocations, the value of the land in these transactions accounted for between 58.42% and 96.92% of the total price. Based on these percentages, the value of the unimproved land lies between \$421 and \$976 per square foot. The mean unit value is \$560 per square foot, while the median is \$484 per square foot.

Analysis of the sales revealed no recognizable trends relating to typical lot area and land value relationships (i.e., unit prices decreasing as sizes increase). The lack of a size/price relationship is illustrated in the following table. The presentation of the sales is based on the lot area (SF) of the sales, going from smallest to largest.

price was allocated, or not, to arrive at land value. Unlike price (which is the amount asked, offered, or paid for a property), value is an opinion of worth of a property. In terms of the improved sales used in this report it is recognized that land value per square foot depends on the assessor's market allocation of land after a change of ownership occurs. Essentially, it depends on the ratio of land value to total property value established by the assessor's appraiser. Therefore, price becomes an opinion of value after the assessor's allocation is applied.

Solana Beach Category 2 Benchmark

Lot Area (SF)	Land Value Per SF
3,100	\$483.87
3,200	\$590.62
3,600	\$722.22
4,400	\$424.87
5,700	\$421.05
5,800	\$431.03
8,200	\$975.61
9,000	\$555.56
9,100	\$439.56

Similarly, analysis of the sales revealed no recognizable trends relating to typical ocean frontage and land value relationships (i.e., unit prices increasing as ocean frontages increase). The lack of an ocean frontage/price relationship is illustrated in the following table. The presentation of the sales is based on the ocean frontage (LF) of the sales, going from smallest to largest.

Ocean Frontage (LF)	Land Value
49	\$555.56
50	\$424.87
51	\$483.87
52	\$590.62
52	\$722.22
52	\$431.03
52	\$421.05
74	\$975.61
81	\$439.56

Furthermore, lease areas impacted by the Solana Beach Category 2 Benchmark are also of various lot areas, ocean frontages, locations, shapes, topographies, zonings, etc. Due to the uniqueness of each lease area and the lack of significant land value trends relating to typical lot area or typical ocean frontage; no particular sale is deemed a better indicator in concluding a land value benchmark. Therefore, an analysis of the overall dataset is warranted and deemed appropriate in concluding land value for the Solana Beach Category 2 Benchmark. Consequently, emphasis is placed on the mean and median unit prices (\$560 and \$484 per square foot, respectively). Therefore, a rounded market value of \$520 per square foot is concluded as reasonable for the upland residential property.

Market Value of Upland Property **\$520 per square foot**

Benchmark Rental Rate

Applying the 9% annual rate of return to the previously concluded market value of the upland property results in an annual rental rate of \$46.80 per square foot⁴.

Benchmark Rental Rate

\$46.80 per square foot

The concluded value is based on the leased land having the same utility as the adjoining upland. If the leased land does not have the same utility, then a lower benchmark rental rate may be warranted. A lower utility is generally expressed as a percentage of the full benchmark rental rate.

⁴ Calculated as $\$520 \times 0.09 = \46.80 .

LAND VALUE INDICATIONS
 Allotted Assessed Land Values from Recent Sales
 Solana Beach

No.	APN	Address	City	County	Sale Date	Lot Area (SF)	Beach Frontage (LF)	Sale Price	% Assessed Land Value	Land Value	Land Value Per SF	Land Value of Beach Frontage
1	263-312-10-00	249 Pacific Ave	Solana Beach	San Diego	03/21/2016	4,400	50	\$3,200,000	58.42%	\$1,869,442	\$425	\$37,389
2	263-051-01-00	475 Pacific Ave	Solana Beach	San Diego	04/27/2015	9,000	49	\$5,975,000	83.68%	\$5,000,001	\$556	\$102,041
3	263-312-01-00	325 Pacific Ave	Solana Beach	San Diego	01/16/2015	3,200	52	\$1,950,000	96.92%	\$1,890,000	\$591	\$36,346
4	263-041-16-00	509 Pacific Ave	Solana Beach	San Diego	12/01/2014	8,200	74	\$8,750,000	91.43%	\$8,000,000	\$976	\$108,108
5	263-021-04-00	629 W Circle Dr	Solana Beach	San Diego	10/21/2014	9,100	81	\$4,500,000	88.89%	\$4,000,000	\$440	\$49,383
6	263-312-03-00	311 Pacific Ave	Solana Beach	San Diego	09/12/2014	3,600	52	\$2,750,000	94.55%	\$2,600,000	\$722	\$50,000
7	263-041-02-00	529 Pacific Ave	Solana Beach	San Diego	02/05/2014	5,800	52	\$2,650,000	94.34%	\$2,500,000	\$431	\$48,077
8	263-312-02-00	319 Pacific Ave	Solana Beach	San Diego	12/27/2013	3,100	51	\$1,595,000	94.04%	\$1,500,001	\$484	\$29,412
9	263-323-06-00	141 Pacific Ave	Solana Beach	San Diego	11/18/2013	5,700	52	\$2,500,000	96.00%	\$2,400,000	\$421	\$46,154
Indications:												
						3,100	49	\$1,595,000	58.42%	1,500,001	\$421	\$29,412
						9,100	81	\$8,750,000	96.92%	8,000,000	\$976	\$108,108
						5,789	57	\$3,763,333	88.70%	3,306,605	\$560	\$56,323
						5,700	52	\$2,750,000	94.04%	2,500,000	\$484	\$48,077