

Marin-Sonoma commercial real estate: 2017 will be much like '16

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Pondering the North Bay commercial real estate in 2017 my mind drifted back to 1975 and the song Willin' by Lowell George and his wonderful band, Little Feat and the lyrics: "If you give me weed, whites and wine, and you show me a sign, I'll be willin,' to be moving."

The song and its main lyrics, ostensibly about truck drivers, is just one substance shy of describing the North Bay commercial real estate market, It is driven in large part by the emerging business of cannabis as well as a booming wine industry, along with one of the latter's derivatives, hospitality.

Let's take a look at where the commercial real estate market has been lately, because in 2017 it will be much of the same. The keywords are "investment sales" (large and small), "Fireman's Fund" and "pot."

PROPERTY SALES

Out-of-town investors "discovered" Marin County commercial property a few years ago. They came here seeking better investment yields as the

competition to buy commercial property in core markets went from cold to warm to hot to frothy in the last five years, making it difficult to get good returns in San Francisco, LA, Chicago, etc. Some 40 percent of Marin's Class A office buildings were sold in the last three years. This trend is continuing.

In November, **Haden Ongaro, Mac Cranford and Mark Carrington with Newmark Cornish & Carey** sold the Belvedere Place office complex in Mill Valley to a partnership comprised of Portland, OR-based ScanlanKemperBard Companies LLC – a privately held merchant bank, and New York-based Angelo, Gordon & CO., a privately held investment advisor. Newmark C&C reports that the Class A, 103,375-square-foot property sold for \$452 per square foot.

Yet it is not just institutional investors buying and selling commercial real estate. The so-called “Mom and Pop” buildings have been trading ownership with routine frequency – especially since the economy has recovered. For example, **Meridian Commercial's Matt Brown, Mike Lieberman and Samuel Ko** were involved with the sales of 514 Fourth Street in San Rafael.

FIREMAN'S FUND

Fireman's Fund Insurance Co. left Novato for Petaluma, leaving a 700,000-square-foot, three-building campus in favor of about 85,000 square feet of space on N. McDowell Blvd. in Petaluma.

Everyone knew it was coming so it wasn't a shocker when Jeff Quackenbush from this paper reported on Dec. 28, 2015, that it was official. Fireman's Fund's exit remained newsworthy in 2016 for a couple of reasons. Rumors swirled on-and-off again that Google was eyeing the campus for a North Bay outpost.

A riveting idea, yet the main reason Fireman's Fund was a catalyst for the news is that it caused the overall Marin County office vacancy rate to spike from 15 percent at the close of the fourth quarter of 2015 to 19.1 percent by the beginning of 2016, **according to Newmark Cornish & Carey**. The vacancy rate has remained the same, more or less, ever since.

I know there are many people that remain hopeful that the Fireman's Fund commercial space could be re-occupied by an office user but I am a skeptic. In part because I was the commercial real estate beat reporter for the Silicon Valley Business Journal in the early and mid-1990s and reported on the trials and tribulations of a similar campus back then – Borland Software, which was in Scott's Valley and just over the hill from San Jose toward Santa Cruz. Borland (which was to software in its day what Twitter is to social media today) built a one-of-a-kind campus in 1993 at a reported cost of \$120 million

It was in such an out-of-the-way place that when the company faltered, the campus quickly got the handle of "white elephant" because the software company, property investors and the like could not find a long-term occupier. After a few different owners tried to resurrect the real estate, the sprawling 24-acre, 370,000-square-foot property finally sold at auction in July of 2013 for a little more than \$12 million – a price that was barely a tenth of what it cost to build.

In my opinion, the Fireman's Fund property should be converted to housing, preferably senior housing with some great community space. The reason for this point-of-view is demand driven, or more accurately, the lack of demand for Marin office space.

On a good year the county is lucky to have 200,000-250,000 square feet of positive net office absorption, and in 2016, net absorption was negative 240,999 square feet, **according to Newmark Cornish & Carey's Fourth Quarter Office Market Report.**

There may be some feasibility issues to overcome but the sooner everyone comes to grips with the obsolescence of the Fireman's Fund property as an office complex, the faster we can utilize the real estate, help solve the housing shortage crisis and keep from repeating the mistake of a Borland Software campus that was mostly empty for a decade. If I end up wrong on this take, I will be happy to have been wrong.

POT

Moving north into Sonoma County, the medical marijuana industry has been the primary driver of industrial space for several years now. The county's overall industrial vacancy rate is hovering around an ultra-low 5

percent compared to the 15 percent or so that it was as recently as early 2012, **reports Paul Schwartz, a commercial broker with Terra Firma Global Partners. By way of example, Schwartz was involved** in the Southwest Santa Rosa sale of a six building, 147,000-square-foot campus on 11.7 acres to Care by Design, a cannabis operator that is awaiting a use permit to grow marijuana at the property. The property had been occupied by JDS Uniphase, which previously did business as Optical Coating Laboratory Inc.

In another deal last year that demonstrates the impact of marijuana on the commercial real estate business, in November **Nick Egide with Meridian Commercial represented** Petaluma-based Hyrdrofarm Inc. in the lease of a newly constructed, 80,000-square-foot industrial building at 1470 Cadar Lane in Petaluma from New York Life Real Estate Investors. The deal brings Hydroponics' Petaluma footprint to 195,000 square feet, including its headquarters on South McDowell Blvd. Hyrdrofarm is one of the nation's oldest wholesaler and leading manufacturer of hydroponics equipment and grow lights with over 39 years in business.

The passage of Prop. 64 in November, which legalized the recreational use of marijuana, will undoubtedly fuel more demand for industrial space but perhaps more significantly, alter the retail real estate industry as cities open dispensaries for over-the-counter pot sales.

Yet at a broader level, legal pot is going to increase demand for all types of businesses. The Marin Independent Journal ran a story in mid-January after San Rafael's economic development director, Danielle O'Leary made a presentation to her City Council. "Cannabis businesses will need everything from lawyers and architects to builders and markets," O'Leary told the council.

Beyond the topics of property sales, what might become of the vacant Fireman's Fund property and marijuana's impact on commercial real estate, probably the biggest thing happening in the North Bay this spring is the completed reunification of Santa Rosa's Courthouse Square. When completed, the reunified square will create an outdoor plaza that is designed to host events while inviting residents and visitors a place to shop, dine and enjoy.

Terra Firma's Schwartz says it is much bigger than that.

“There is a renaissance going on here that is not only going to change the way some of us live in Sonoma County, but it is impacting the visitor industry. The catalyst was the reunification of the Courthouse Square but the area is being repositioned as the hub of the wine industry. There is an energy here that has been missing for 15 years and some real estate development and redevelopment projects that have been on the books for 20 years are coming to fruition now that the market is strong enough to support them,” Schwartz said.

He cited the addition of 90 hotel rooms to The Hyatt Vineyard Creek hotel as well as the conversion of the 1908 Empire Building to a 62-room Old Courthouse Square Hotel, a project by local developer Hugh Futrell Corporation, as just two of a handful of hotel projects underway in Santa Rosa.

Lastly, SMART Train's service start this year will begin to make commercial property along its route and specifically near its stops more valuable. It will take time but it will happen.

For example, after the recent sale of Northgate Mall from LA-based Macerich Co. to San Francisco-based Merlone Geier, **Newmark Cornish & Carey's Ongaro** cited the SMART train station across the street of the mall as one of the reasons Merlone Geier's newest property could increase in value – it can bring shoppers to Northgate that may not have otherwise shopped there.

Likewise, Schwartz noted that SMART's stop right in Railroad Square in Downtown Santa Rosa is one other reason for the renaissance that is underway in Sonoma County's biggest city.