Report

Santa Rosa Downtown Specific Plan Market Demand Study

The Economics of Land Use

Prepared for:

City of Santa Rosa

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Table of Contents

List of Figures

List of Figures (continued)

1. INTRODUCTION AND KEY FINDINGS

This report provides an overview of real estate market conditions and trends relevant to the Santa Rosa Downtown Specific Plan Update. It has been prepared by Economic & Planning Systems, Inc. (EPS) as part of a multi-disciplinary team led by Dyett & Bhatia and retained by the City to update the 2007 Plan to reflect a revised boundary and better respond to current market conditions.

The Specific Plan area boundary is established to capture current and future uses within walking distance (½ mile) of the Transit Mall and the Sonoma Marin Area Rail Transit (SMART) station (see **Figure 1**). The current planning effort will focus on evaluating existing and potential land uses; analyzing circulation and infrastructure; and developing land use regulations, implementation strategies, and design guidelines to encourage economic development and real estate investment within the downtown area. As such, this market study is focused on select market trends and land uses most appropriate for the Specific Plan area.

Figure 1 Downtown Station Area Specific Plan Map

One of the challenges of this effort is that many of the higher density residential uses contemplated in the Station Area are not well represented in Santa Rosa at the current time. Consequently, the development feasibility analysis, slated for later in the process, will play a key role in the formulation of the Specific Plan Update, helping to optimize the amount and type of development as well as fashion an effective policy framework, development incentives, and public investment strategies. This market analysis will help inform the development feasibility work that follows, by identifying desired multifamily housing and commercial prototypes and reporting current market prices and rents.

Key Findings

The key findings are organized to highlight current conditions and trends by land use category, followed by implications for future market demand. Findings are informed by interviews with developers and other stakeholders. Preliminary conclusions may evolve with additional input from City staff and the development feasibility analysis that will follow as a later task.

Residential Market Conditions and Trends

1. ***The October 2017 Tubbs Fire exacerbated an already serious housing shortage in the region, generally, and the City, in particular.***

   The City's 2016 Housing Action Plan established there is a significant housing deficiency in Santa Rosa, worsened by the October 2017 Tubbs Fire, which destroyed more than 5,000 homes in the region, including entire neighborhoods in Santa Rosa. The loss of 5,000 homes eroded the County's gains of the prior decade and then some. Based on data reported by the Department of Finance, between 2010 and 2017, the County experienced a gain of nearly 3,500 units but lost 4,500 between 2017 and 2018 for net loss of approximately 1,000 units between 2010 and 2018. While the City gained 1,700 units in the seven years between 2010 and 2017, the fire contributed to a loss of approximately 850 units between 2017 and 2018. As a result, the City's residential stock expanded by approximately 870 in an eight-year period.

2. ***The City of Santa Rosa is taking meaningful steps to encourage and facilitate new residential development in the face of a decade-long production slow down and the aftermath of the fire, particularly in the Downtown Station Area Specific Plan study area.***

   The City Council is committed to supporting policies, efforts, and initiatives to bring infill development to the downtown and near transit. For example, the City's Housing Action Plan includes a goal of 5,000 new homes for very low and moderate-income households. To achieve this goal, the City has introduced the following incentive programs and implementation tools:

   - Eliminated development impact and utility connection fees for units that are 750 square feet or less.
   - Reduced fees for units between 750 and 1,200 square feet.

- Curtailed the discretionary action for design review and the use permit process for housing projects in the downtown and the City's four other Priority Development Areas (PDA).
- Implemented the Downtown High-density Residential Incentive Program, which reduces impact fees and defers water and wastewater fees.
- Created an "Express Permitting" process for downtown infill, designed to take an 18-month process down to approximately six months.
- Introduced a 100 percent density bonus in the Downtown Station Area Specific Plan study area.

The evaluation of other programs, financing mechanisms, and partnerships are underway and will be introduced as appropriate.

3. ***The Specific Plan area boasts a number of physical and community assets that have spurred higher density residential development in other Bay Area communities, including transit connectivity, a walkable grid, diverse commercial amenities, historic charm, and a variety of civic amenities.***

The community character, land use mix, and urban form in the Specific Plan Area include many of the core ingredients that have helped other Bay Area cities attract higher-density residential development in recent years. These include convenient auto and transit accessibility (e.g., direct access from Highway 101 and new SMART commuter rail station), a centrally located and aesthetically appealing town center, historic architecture, diverse retail offerings (e.g., local restaurants, breweries, and a regional mall), civic and cultural facilities (e.g., City Hall, museums, performing arts), and other amenities. Continued efforts to leverage and build on these core assets will likely contribute to making the Specific Plan increasingly attractive to residents and housing developers.

4. ***While Santa Rosa's housing market has long been dominated by single-family housing, the Specific Plan Area is significantly more dense and both geographies have a high proportion of renters relative to the County and other suburban markets in the Bay Area.***

Approximately 70 percent of Santa Rosa's 64,700 occupied residential units are either single-family detached (60 percent) or attached (10 percent) structures. While the Specific Plan Area accounts for a relatively small proportion of total City housing, with about 2,100 residential units (roughly 3 percent of the City's total) primarily located on the periphery of the commercial core, it is significantly more dense with more than 40 percent of the housing units in multifamily structures. Meanwhile, rental units account for about 70 percent of total residential units in the Specific Plan area and close to 50 percent Citywide, significantly higher than the County (40 percent) or Bay Area (42 percent). Taken together this data suggest that unlike many other more suburban markets, rental products have been accepted by a large proportion of Santa Rosa residents (either as a lifestyle choice or out of necessity). Additionally, it appears that small investors rather than institutional capital are currently responsible for providing and managing much of the rental product in the City, either in single-family structures or relatively older and smaller apartment complexes.

5. ***While both residential rents and sales prices have increased steadily in Santa Rosa since 2010, mirroring broader Bay Area housing trends, the City's for-sale sector has consistently out-performed the rental sector, reinforcing the City's profile as a strong single-family market. Meanwhile, the Tubbs fire appears to have created some short-term fluctuations in rental market indicators (e.g., pricing and vacancy) but less so for the for-sale market.***

   Single-family home sales prices increased at a robust 7.6 percent each year between 2010 and 2018, reinforcing the City's profile as a strong single-family market. During the same period, however, Citywide average rents increased at an annual rate of 4.4 percent, while average rents in the Specific Plan increased by just 2.4 percent per year despite persistently low vacancy rates (at about 4 percent). While low vacancies and strong home sales appreciation would normally put upward pressure on rents, this relationship has been less pronounced in Santa Rosa. In fact, residential rents in Santa Rosa stabilized in the past year and declined in the Specific Plan area. More specifically, in 2010 Santa Rosa's average rents were $1,131 per unit, while the Specific Plan Area's average rents were $1,327 per unit. By 2017, rents in the Specific Plan Area had increased to an average of $1,700 per unit but fell to an average of $1,600 per unit in 2018. Rents Citywide had risen to an average of approximately $1,600 per unit by 2017 and stayed level in 2018. Housing pressures immediately following the Tubbs Fire may have contributed to the 2017 highs and the 2018 softening.

6. ***Given current market fundamentals and the difficulty of distinguishing between the demand and supply constraints in the Specific Plan area, prospective housing absorption going forward cannot be technically derived. Rather, demand for quality housing at prices affordable to the area's households is nearly unlimited but primarily supply constrained due to development financial feasibility considerations.***

   While strong recovery from the "Great Recession" has been transforming many of the older suburbs of the Bay Area with new housing supply, to date this trend been less pronounced in the North Bay, Sonoma County, or Santa Rosa. A key constraint appears to be achievable rents or sale prices, which in Santa Rosa remain below the level needed to justify the cost of higher density construction. At the present time there is little or no higher density residential development as envisioned, in the *Specific Plan* evident in Santa Rosa or Sonoma County. Given the predominance of single-family housing throughout the County, it is unclear how much market-rate, higher density housing could be absorbed, although the high proportion of renter households in Santa Rosa is often positively correlated with higher demand for this product type.

   Typically demand for housing is the result of household formation related to population and employment growth in industries that support head-of-household wages. Sonoma County has not shared in the economic expansion, particularly in higher wage sectors such as tech that has occurred elsewhere in the Bay Area. Consequently, of the City's rental households, approximately 53 percent are considered to be "overpaying," which is defined as paying more than 30 percent of household income for housing.

   Achieving affordable prices/rents in the larger context of rising construction costs remains the primary hurdle for multifamily residential developers. Currently residential rents are below the threshold needed to attract developers and the required institutional capital. In addition, average rents in the Downtown compared with citywide are so similar that there is no compelling reason for a developer to incur higher development costs associated with parcel consolidation and higher density product types compared to elsewhere. This will be further explored through the feasibility testing work, but it appears that the Downtown will need to more effectively leverage its core assets and urban amenities to command higher prices and the City must do everything possible to provide incentives and ease development costs and risks associated with the higher density multifamily and mixed-use building types.

Despite these market conditions, given the inherent strengths of the Santa Rosa's downtown area (e.g., location, vehicular access, transit, services and amenities, walkability, historic charm), it should be able to attract higher density multifamily development given the right context. In order to facilitate this transformation, the City will need a multifaceted strategy that includes:

- Promoting economic development (job creation) in industries that provide higher average wages.
- Assuring that land use regulations and development review processes are streamlined and provide adequate assurance that planned development will be approved.
- While development costs will remain dominated by construction costs, doing everything possible to keep City-imposed costs (impact fees, exactions, and development conditions) within a market-reasonable range.
- Seeking opportunities through public-private partnerships to create "pioneer" multifamily residential projects that otherwise would not be financially feasible without public subsidy and support.
- Seeking opportunities for "transitional density" projects at the periphery of the downtown where appropriate given the existing built environment that take advantage of lower cost development prototypes (e.g., townhomes, stacked flats, etc.).

7. ***Going forward it is not unreasonable to expect that there could be approximately 1,000 new residential units permitted per year citywide, especially in the wake of the Tubbs Fire, and the Specific Plan area should be able to accommodate an increasing share of these units given the area's locational attributes.***

A reasonable forecast of demand for residential units in the Specific Plan area is informed by the City's historical production trends and assumptions about the share of units that can be accommodated in the Plan area. A housing needs assessment conducted as part of the City's Housing Action Plan concluded that housing supply needs to increase by approximately 1,000 units per year. The Housing Action Plan also concluded that with the income profile of newly formed (or relocating) households, roughly half of the needed units should be affordable to households with incomes below the area's median income level. It is important to note that the city's Growth Management Element and Ordinance would need to be revised to accommodate this amount of annual growth.

Retail and Commercial Market Conditions and Trends

8. ***The performance of the City's retail market in general, and Downtown in particular, is affected by national changes in consumer behavior (e.g., online sales), as well as regional competition. The existing retail concentrations within the Specific Plan area include an enclosed, regional shopping mall (Santa Rosa Plaza), historic Railroad Square, and Courthouse Square. These retail nodes are experiencing varying levels of success, and present both opportunities and risks for future expansion.***

   The Specific Plan area is particularly susceptible to competitive trends due to a predominance of large format retailers elsewhere in the City, the presence of a traditional mall, and well-amenitized, visitor destinations in the County (e.g., Windsor and Petaluma)***.*** While Santa Rosa Plaza is the single largest retail center in the County, commanding strong lease rates and several high performing tenants (e.g., Apple, Forever 21), it has been affected by the national trends related to the decline of traditional department store anchored malls, as indicated by the recent loss of one of its anchors (Sears). Just east of the mall, a retail cluster focused around Courthouse Square in the Downtown appears to be struggling, with average lease rates that are roughly half the citywide average. By contrast, the relatively small cluster directly west of the Plaza appears relatively vibrant, benefiting from a unique blend of local establishments with proximity to the SMART station, new hotels, and Railroad Square.

   Going forward, the existing competitive supply in the broader Santa Rosa market, combined with national trends in the consumer behavior, represents a significant market hurdle for any new retail development in the Specific Plan Area. While additional retail space as part of new, mixed-use buildings may enhance vitality at selected locations, a ubiquitous requirement for ground floor retail is likely to hinder the development feasibility of new projects.

   Improved performance in the Downtown retail sector is likely to be the result of incremental and fine-grained improvements to existing properties with a focus on creating a differentiated experience that provides shoppers with a unique sense of place (similar to what is already occurring around Railroad Square). Continued urban design improvements that enhance connectivity between and within the various sub-districts could also improve its functionality, appeal and regional draw of the Specific Plan retail sector. Targeted public investments that improve the overall attractiveness of the Downtown along with the infusion of demand from new housing has the potential to improve the overall performance of the retail sector.

9. ***Nearly two-thirds of the County's office space is located in the City of Santa Rosa, but despite this concentration and stable rent and occupancy rates, there has been little office development activity in the City.***

   Office rents in the Specific Plan area are above the City and County averages due to its position in the core node of activity; however, the Specific Plan area vacancy rates are slightly higher than the surrounding region. Vacancy improved significantly in the past five years while lease rates remained fairly constant. Currently, rents are between $21 and $23 per square foot per year in the region and vacancies are between 3.5 percent (Santa Rosa) and 5 percent (Specific Plan Area). The most recent office development in the Specific Plan area is Hugh Futrell's 4-story, 34,000-square foot development at the corner of Fourth and Davis Streets in 2005. It is fully leased, anchored by Charles Schwab.

10. ***Demand for office space is closely tied to employment growth in those industry sectors that typically require office space, and demand for office space in the Specific Plan area will depend on the business location decisions of employers.***

Plan Bay Area projects there will be about 86,200 jobs in Santa Rosa by 2020, increasing to 92,100 by 2040, or 6.8 percent (or 0.3 percent per year). The projected annual growth rate is slightly below the rate being projected for the County as a whole (0.4 percent per year). At the same time, the Santa Rosa area is struggling to capture a meaningful share of the growth in those industries that are driving the Bay Area economy and that support head-of-household jobs, which translates to weak demand for commercial office/flex space (and new housing, as described earlier). An analysis of the current and projected distribution of jobs in the County indicate that much of the employment growth will be in the visitor-serving sectors of accommodations and food services rather than office-using sectors.

While a full analysis of the root cause of the slowing job growth in the region is beyond the scope of this analysis, the availability of appropriate housing for employees certainly contributes to decisions about where businesses choose to locate.

This study evaluates the share of job growth in the County that typically requires office space and estimates that between 2020 and 2040, nearly 10,000 new "office" jobs will be created. Assuming "capture" shares for the City and the Specific Plan area which are based on current ratios, EPS estimates that the City may capture nearly 40 percent of total job growth within the County, or approximately 3,700 office employees. If the Specific Plan area were to capture 13 percent of the City's office-related job growth, the Specific Plan area would need to support nearly 480 new office employees by 2040, requiring approximately 143,000 new square feet of office inventory. This estimate does not account for a build-to-suit user who wants to locate his/her business in the downtown area to offer locational and transit amenities for employees.

2. RESIDENTIAL MARKET CONDITIONS AND TRENDS

Santa Rosa is the largest city in Sonoma County and home to more than one-third of the County's population. It is well established that the City is grappling with a significant housing shortage that was exacerbated by the October 2017 Tubbs Fire that destroyed more than 5,000 homes in the region. The current update to the Station Area Specific Plan presents an opportunity to better align the regulatory framework and market fundamentals to support TOD in the Specific Plan area.

Current Supply

Amount and Tenure

As shown in **Figure 2**, there are approximately 64,700 occupied residential units in Santa Rosa and approximately 2,100 occupied units in the Specific Plan area, representing approximately 3 percent of the City's occupied residential supply. Close to 50 percent of the City's housing is occupied by renters compared to more than 70 percent in the Specific Plan area. Santa Rosa has a much higher percentage of rental units compared with the County as a whole, where 40 percent of total units are rental units.

Figure 2 Housing Tenure

	Specific Plan Area [1]		City of Santa Rosa		Sonoma County	
Tenure	Occupied Households	% of Total	Occupied Households	% of Total	Occupied Households	% of Total
Owner	587	28.4%	34,381	53.1%	114,608	60.3%
Renter	1,483	71.6%	30,328	46.9%	75,450	39.7%
Total	2,070	100.0%	64,709	100.0%	190,058	100.0%
Percent of Citywide Total	**3%**		**100%**		**294%**	

[1] Estimate from ESRI Business Analyst, 2018.

Source: U.S. Census Bureau, 2013-2017 5-Year American Community Survey.

Figure 3 illustrates that of the City's residential inventory, 60 percent of the City's units are single-family detached units and another 10 percent are single-family attached. Meanwhile, roughly one-fourth (24 percent) of the units are part of multifamily structures consisting of three or more units. Available data published by ESRI Business Analyst based on 2012-2016 American Community Survey data suggests that the Specific Plan area is significantly more dense than the

City overall, with nearly 60 percent of the units part of multifamily structures. Only about 40 percent of the housing is single-family detached.[1]

Figure 3 Citywide Housing Stock by Tenure and Type / Size of Structure

Units in Structure	Total Occupied Units Number	Total Occupied Units Percent	Renter-Occupied Units Number	Renter-Occupied Units Percent	Rental Units as % of Total
Citywide					
Single Family (Detached)	38,590	60%	9,964	33%	15.4%
Single Family (Attached)	6,769	10%	3,941	13%	6.1%
2 Units	1,269	2%	1,174	4%	1.8%
3 or 4 Units	4,123	6%	3,755	12%	5.8%
5 to 9 Units	2,874	4%	2,641	9%	4.1%
10 to 49 Units	2,526	4%	4,834	16%	7.5%
50 or More Units	6,296	10%	3,582	12%	5.5%
Mobile Home	2,262	3%	437	1%	0.7%
Other (RVs, Vans, Boats, etc.)	0	0%	0	0%	0.0%
Total	**64,709**	**100%**	**30,328**	**100%**	**46.9%**
Specific Plan Area [1]	**2,070**		**1,483**		**71.6%**
Share of Citywide	3.2%		4.9%		

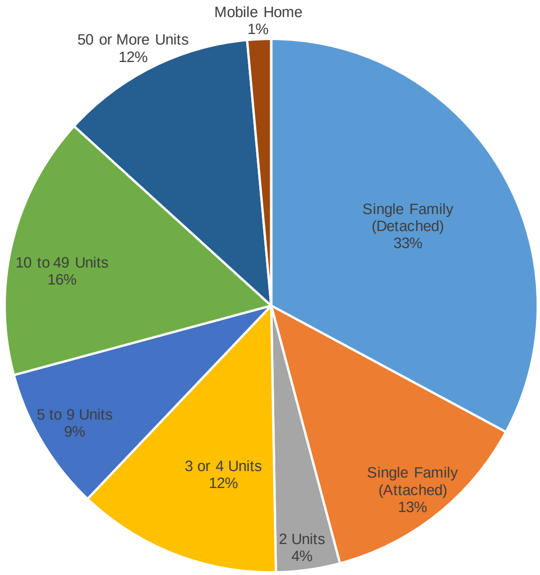
[1] Estimate from ESRI Business Analyst, 2018.

Source: U.S. Census Bureau, 2013-2017 5-Year American Community Survey.

Looking more closely at the rental market, a relatively large proportion is accommodated within single-family units. Specifically, single-family units make up about 46 percent of the rental stock (33 percent in detached and 13 percent in attached), as illustrated in **Figure 4**. This suggests that small investors rather than institutional capital are currently responsible for providing and managing the bulk of rental product in the City.

[1] Based on 2012-2016 American Community Survey data, ESRI Business Analyst reports that of the Specific Plan Area's 2,183 total housing units (occupied and unoccupied), 847, or 39 percent, are single-family detached units.

Figure 4 Composition of the Rental Housing Market in Santa Rosa



Source: U.S. Census Bureau, 2013-2017 5-Year American Community Survey.

Age and Class of Inventory

The age and vintage of the residential stock can also provide useful insight into the state of the market. Available data suggest that Santa Rosa's housing stock is relatively old. Specifically, approximately 86 percent of the City's units were built before 2000, and 35 percent of the City's housing units were built between 1960 and 1980, indicative of an aging housing stock (**Figure 5** and **Figure 6**).

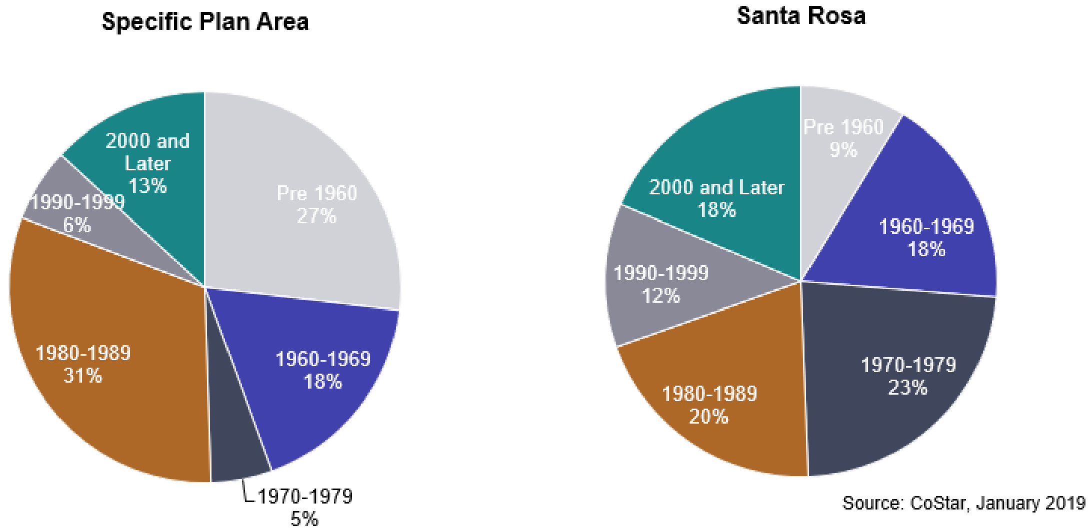
Figure 5 City of Santa Rosa Housing Stock by Year Built

	City of Santa Rosa		
Year Built	Number	% of Total	Accumulated Percentage
1939 or Earlier	3,520	5.4%	5.4%
1940 to 1959	8,516	13.2%	18.6%
1960 to 1979	22,578	34.9%	53.5%
1980 to 1999	20,872	32.3%	85.7%
2000 to 2009	8,205	12.7%	98.4%
2010 to 2013	811	1.3%	99.7%
2014 or Later	207	0.3%	100.0%
Total	64,709	100.0%	

Source: U.S. Census Bureau, 2013-2017 5-Year American Community Survey.

Looking more closely at the multifamily rental market, which represents 25 percent of the total market (and approximately 50 percent of the rental market), tells a similar story. Specifically, only 13 percent of the multifamily rental units were built after 2000, as shown in **Figure 6**. The largest surge in supply for these units (31 percent) occurred in the 1980s, a trend that mirrors national trends that were in part facilitated by federal tax laws pertaining to passive income.

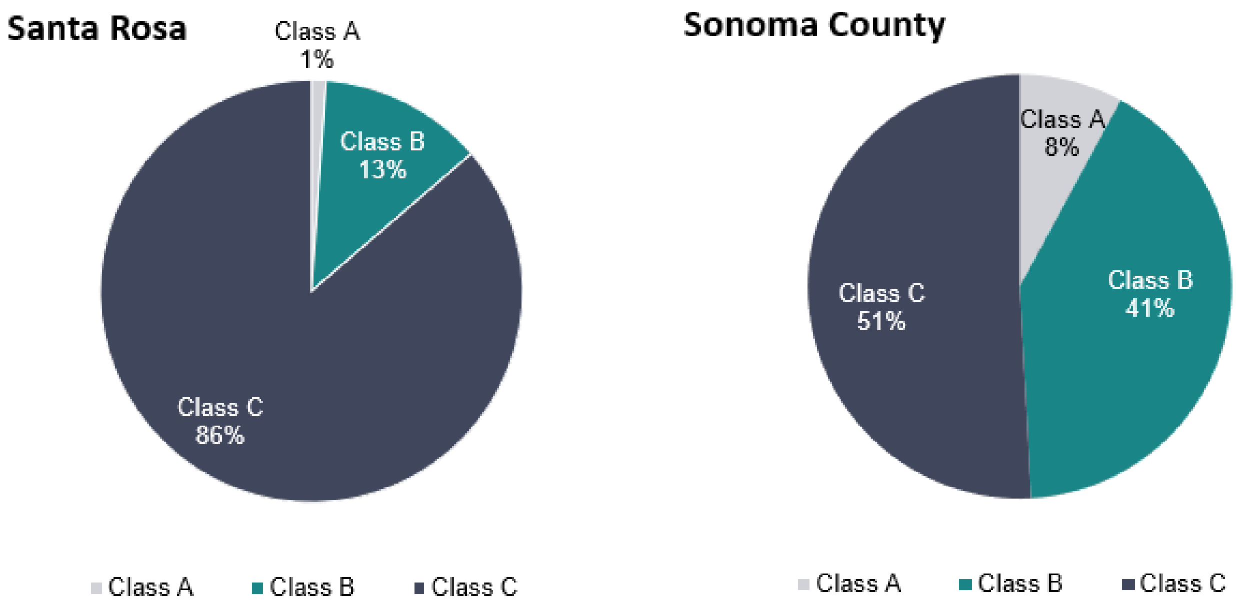
Figure 6 Age of Existing Inventory by Units



A related metric is a building's classification, which speaks to the age and quality of the building. Multifamily building classifications of A, B, and C are relative based on local comparisons of other multifamily buildings. According to data provided by CoStar, factors dictating the rating of a building include aspects of the building, location, rents, and local opinion. **Figure 7** illustrates the distribution of Class A, B, and multifamily complexes in the City.[2] With less than 15 percent of the inventory qualifying as a Class A or Class B building, it is apparent that the quality of residential inventory is lacking. This is relative to Sonoma County, where nearly 50 percent of the inventory is in a Class A or Class B building.

[2] CoStar is a private, third-party data source that tracks commercial real estate activity and trends. It is important to note that CoStar only includes large, multifamily rental units (i.e., single-family rentals, which are a significant portion of the housing market in Santa Rosa, are not included in the data). More specifically, there are 19,348 rental units in Santa Rosa tracked by CoStar. This figure represents about 64 percent of the rental housing inventory reported by the Census Bureau.

Figure 7 Composition of Housing Market by Building Classification



Source: CoStar as of January 2019.

Multifamily Unit Mix

The unit mix in Santa Rosa is fairly consistent with the unit mix in Sonoma County—it is composed of approximately 4 percent studios, 40 percent 1 bedrooms, and 46 percent 2 bedrooms. Less than 11 percent of the City's multifamily units are 3 bedrooms or larger (**Figure 8**). The Specific Plan area has a much higher proportion of 1-bedroom units (56 percent) than the City and County and fewer 2-bedroom units.

In Santa Rosa, the average unit size ranges from 540 square feet for a studio to 1,300 square feet for a 4-bedroom unit, which is also similar to the County. Studios and 4-bedroom units in the Specific Plan Area tend to be larger than similar units elsewhere in the City but the 1-, 2-, and 3-bedroom units are smaller.

Figure 8 Unit Mix in Specific Plan Area, Santa Rosa, and Sonoma County

Item	Unit Mix			Average Sq. Ft. / Unit		
	Specific Plan Area	Santa Rosa	Sonoma County	Specific Plan Area	Santa Rosa	Sonoma County
All	**100.0%**	**100.0%**	**100.0%**	**741**	**824**	**837**
Studio	5.6%	3.8%	4.5%	648	539	513
1 Bedroom	56.0%	39.6%	38.5%	635	634	647
2 Bedroom	34.0%	46.3%	46.7%	866	921	932
3 Bedrooms	3.9%	9.3%	9.0%	1,042	1,190	1,208
4+	0.6%	0.9%	1.3%	2,080	1,323	1,377

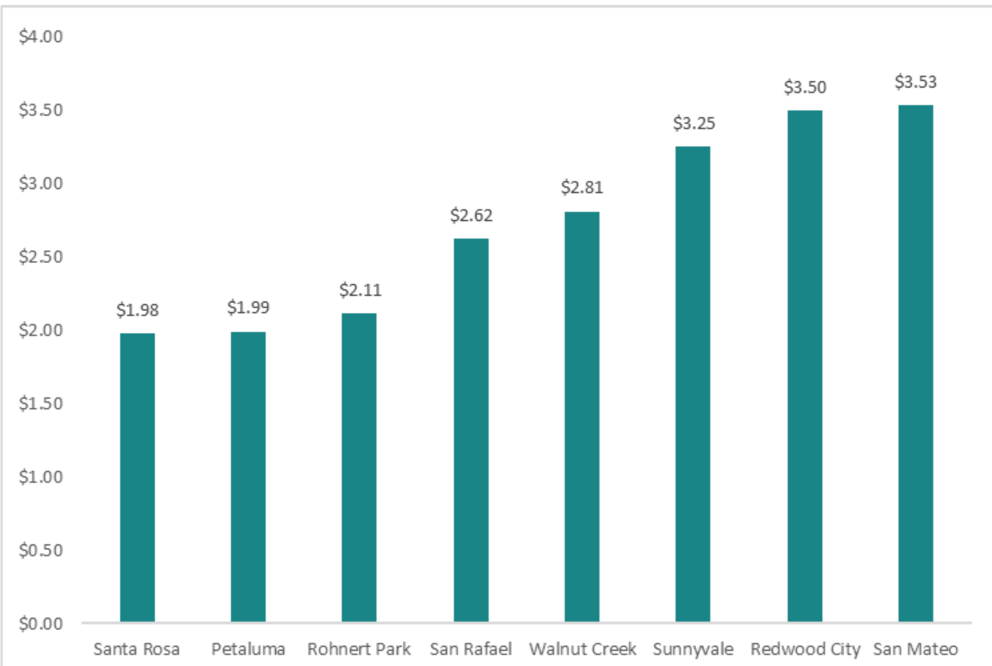
Source: CoStar

Rent and Occupancy Trends

Achievable rents are one of the major factors in evaluating the feasibility of new development, and the following section evaluates rents across a range of dimensions, including location in the City and size of unit. It is important to note that the rents shown in the following tables are reported by CoStar based on the inventory that CoStar tracks and may not reflect the rents that are being charged for units in smaller buildings or single-family homes.

A useful starting point is to compare rents in Santa Rosa, where very little new development has occurred to rents in other cities where development is occurring, including San Rafael, Walnut Creek, Sunnyvale, Redwood City, and San Mateo. **Figure 9** illustrates that while Santa Rosa has an average rent per square foot of $1.98, the other selected cities range from $2.62 per square foot (San Rafael) to $3.53 per square foot (San Mateo). Santa Rosa's nearby jurisdictions, Petaluma and Rohnert Park, have similar or slightly higher rents than Santa Rosa.

Figure 9 Average Rent per Square Foot by City



Source: CoStar (January 2019); Economic & Planning Systems, Inc.

The Alexandar Apartments

Drilling down to trends within Sonoma County and Santa Rosa, rent trends vary by unit type and unit size. Generally, rents per square foot are the highest for studios and the lowest for the largest units, as shown in **Figure 10**. At $1,611 per unit, average rent in the Specific Plan Area is higher than in the City as a whole but lower than in the County. Additionally, the rent in the Specific Area Plan is $2.26 per square foot whereas rent in the City and County is $1.98 and $1.96 per square foot, respectively. With 287 units, The Alexandar Apartments seems to be a large driver of the average rent and vacancy rate in the Specific Plan Area. Its average rent per unit is $1,676, or $2.28 per square foot. According to the project's website, concessions of six weeks of free rent are being offered for certain units.

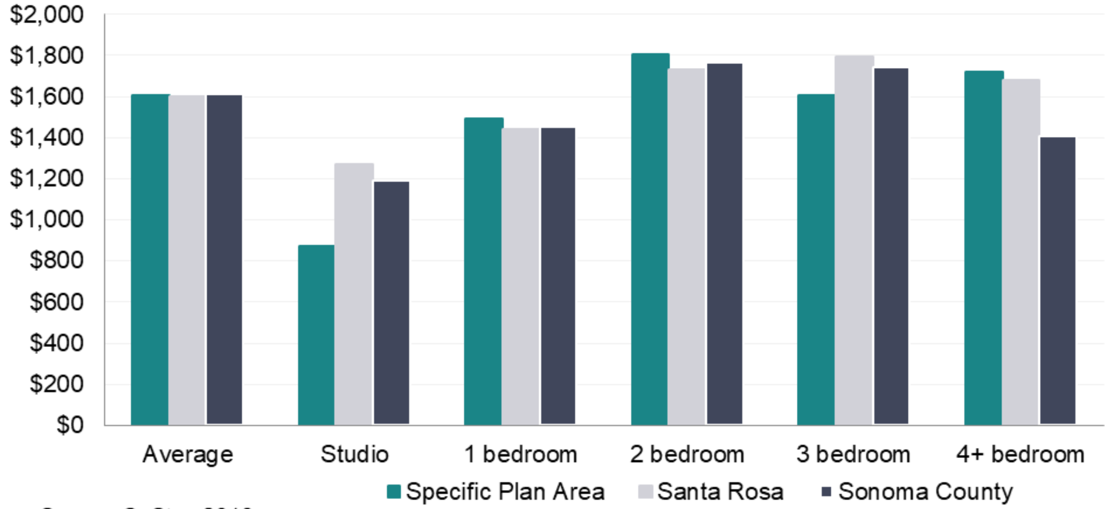
Figure 10 Rent Trends in Specific Plan Area, Santa Rosa, and Sonoma County

Item	Rent / Unit			Rent / Sq. Ft.		
	Specific Plan Area	Santa Rosa	Sonoma County	Specific Plan Area	Santa Rosa	Sonoma County
All	**$1,611**	**$1,599**	**$1,635**	**$2.26**	**$1.98**	**$1.96**
Studio	$874	$1,268	$1,193	$1.99	$2.52	$2.49
1 Bedroom	$1,476	$1,465	$1,454	$2.47	$2.31	$2.28
2 Bedroom	$1,835	$1,764	$1,769	$2.12	$1.89	$1.91
3 Bedrooms	$1,604	$1,793	$1,739	$1.43	$1.51	$1.45
4+	$1,722	$1,680	$1,406	$0.83	$1.27	$1.03

Source: CoStar

Figure 11 and **Figure 12** show the average rent by unit mix. As of 2019, studios in the Specific Plan Area rent for much less than studios in the City and County. The disproportionately lower rents for studios in the Downtown may be attributable to the Single Room Occupancy units that are skewing average rents. Within the Specific Plan Area and City, 4-bedroom units rent for more than the County. The other units (containing 1, 2, or 3 bedrooms) tend to have fairly similar rents across all three geographies. The demand for multiple-bedrooms/larger units in the Downtown and the relatively higher rents may be due to Santa Rosa Junior College students who share units and prefer the central location.

Figure 11 Average Rent by Unit Mix

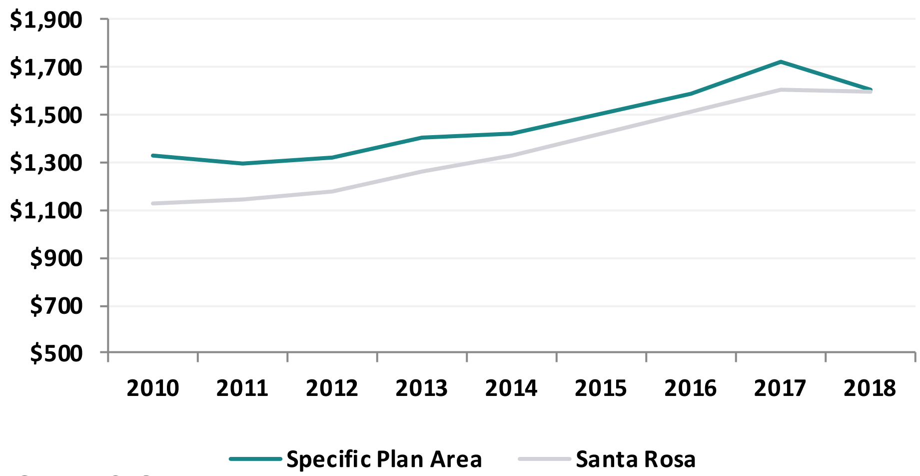


Source: CoStar, 2018

The Specific Plan area and Santa Rosa have experienced similar multifamily rental trends in the past nine years, although the Specific Plan Area has slightly higher rents than the City as a whole. For example, in 2010 Santa Rosa's rents were $1,131 per unit, while the Specific Area Plan's rents were $1,327 per unit. In 2018, rents in Santa Rosa increased to an average of $1,600 per unit and rents in the Specific Plan Area rose to $1,602 per unit (**Figure 12**). Notably, rents in the Specific Plan Area reached a high of $1,725 per unit in 2017, but decreased to $1,607 as of January 2019. The fires in Sonoma County likely caused rent spikes in 2017.

Average rents in the Downtown compared with citywide are so similar that there is no compelling reason for a developer to incur higher development costs Downtown (e.g., building type, infrastructure, etc.) compared to elsewhere. This will be tested through discussions with real estate developers and feasibility analyses, but it appears that either the Downtown has to become much more desirable to command higher rents, or City policy needs to be directed to ease the development burden associated with higher development costs of more TOD-appropriate building types.

Figure 12 Comparison of Average Rents, All Units (2010 – YTD)



Source: CoStar

As noted previously, the rents shown in the preceding tables are reported by CoStar based on the inventory that CoStar tracks and may not reflect the rents that are being charged for units in smaller buildings or single-family homes. As an alternative data point that includes the broader rental market, the median rent listed on Zillow for single-family homes and condominiums was around $2,600 per unit per month in 2018.[3] For multifamily apartment complexes, the median listed rent was $2,100 per unit per month.

While this analysis is focused on multifamily product types in recognition of the intended intensification of the Specific Plan area, there is recent single-family home construction underway. Located just outside of the Specific Plan Area, adjacent to Highway 12, Village Station is a new 110 single-family home project under construction with pricing in the low $500,000s, ranging from 1,195 square feet to less than 2,000 square feet.

Rental occupancies throughout the County are very high and have been high for some time, leaving little inventory to support efficient turnover. As shown in **Figure 13**, Santa Rosa and Sonoma County have a strong occupancy rate of just over 96 percent; the city with the highest occupancy rate among the selected jurisdictions is Cloverdale (97.3 percent), while Petaluma has the lowest occupancy rate, which is 94.6 percent. However, as with the rental data, occupancy decreased between 2017 and 2018, which could be “noise” in the data or could identify an inflection point in the market and the beginning of some softening.

[3] Zillow is an online resource that tracks the buying, selling, renting, financing, and remodeling of more than 110 million U.S. homes. Zillow’s database includes homes for sale, homes for rent and homes not currently on the market, as well as home values, rents, and other home-related information.

Figure 13 Occupancy Rate Comparison

City	Average Occupancy
Specific Plan Area	***96.1%***
Petaluma	94.6%
Healdsburg	95.7%
Santa Rosa	96.3%
Rohnert Park	96.6%
Sonoma	96.6%
Sebastopol	97.0%
Windsor	97.0%
Cotati	97.2%
Cloverdale	97.3%

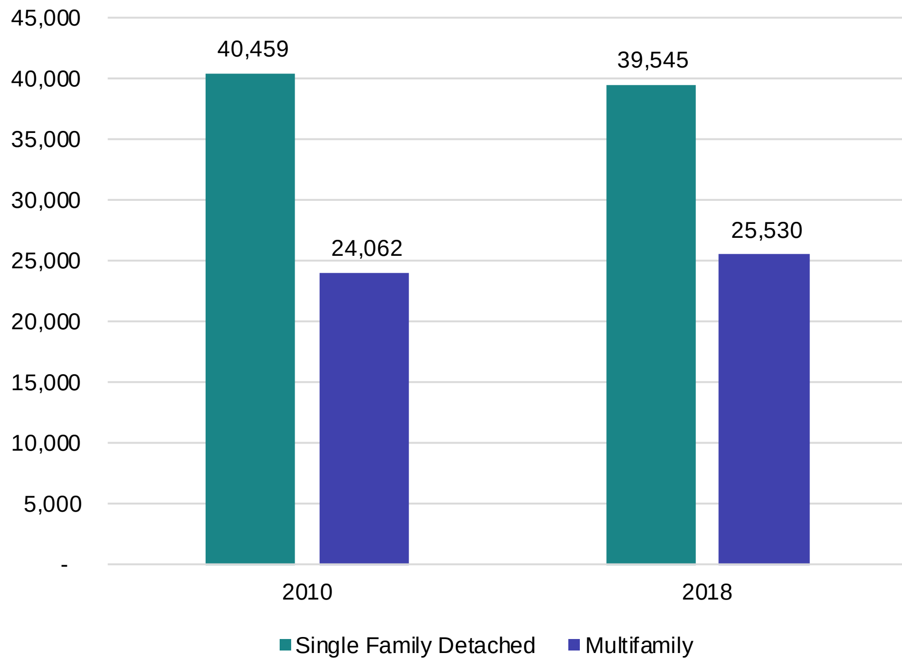
Source: CoStar, January 2019

Production Trends

In 2017, the Tubbs Fire destroyed about 5,000 homes in the Santa Rosa area. According to CalFire, the Tubbs Fire was ranked second among the most destructive California wildfires in history, after the Butte County 2018 Camp Fire, which destroyed nearly 14,000 homes.[4] The fire eroded much of the slow housing production progress that had been made during the preceding years, and, according to data reported by the California Department of Finance, the total number of units in 2018 was only 550 units higher than had been reported in 2010. Much of the loss from the fire was in the single-family home category. **Figure 14** illustrates 2010 units broken down by single-family and multifamily compared with 2018 units.

[4] http://www.ktvn.com/story/39446732/deadly-camp-fire-now-135000-acres-still-35-contained1

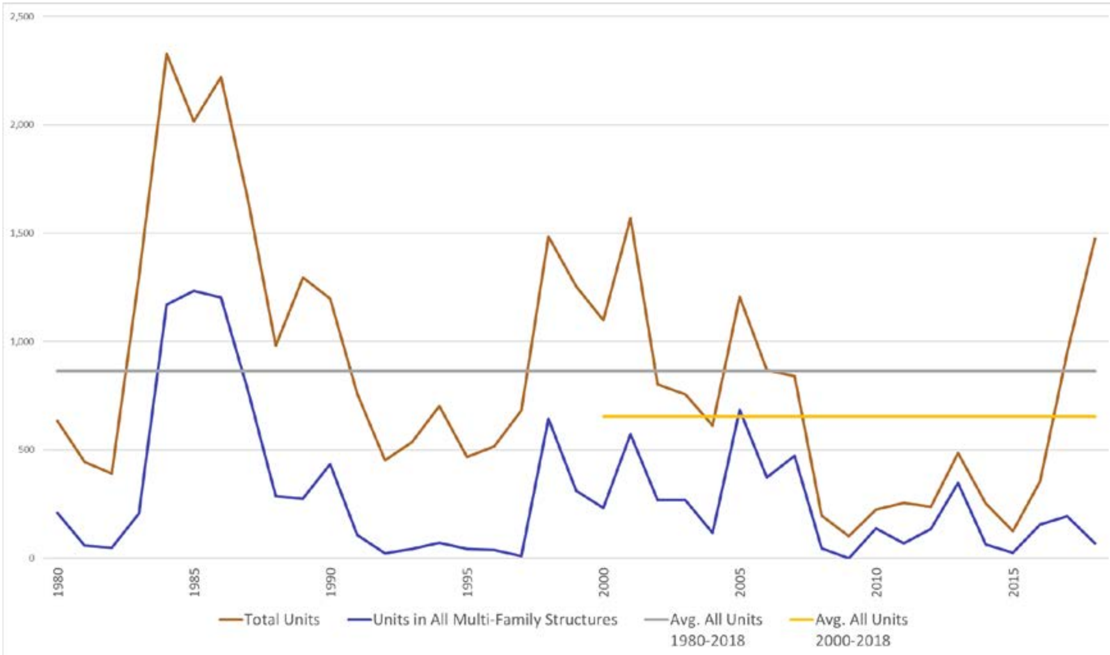
Figure 14 Santa Rosa Housing Units 2010 v. 2018



Source: California Department of Finance.

While total building permit issuance is still below historical norms (effectively zero in 2015), it has been increasing following the City's efforts to implement the Housing Action Plan and in the face of pressure to support post-fire rebuilding efforts. **Figure 15** shows total residential permit activity in the City over time and also highlights that multifamily permits remain low, falling in 2018, even as single-family permit issuance is increasing. Specifically, the 2018 uptick in building permit activity is limited to single-family homes outside of the Specific Plan area and is due to post-fire rebuilding activity and a renewed commitment on behalf of the City to improve development regulations and the entitlement process. Note **Figure 15** tracks housing unit building permit activity, not necessarily net new units. For example, some of the recent building permit activity is replacing units lost in the fire, not adding new units to the City's inventory.

Figure 15 Housing Unit Building Permits for Santa Rosa



Source: Census Bureau Building Permit Survey

Affordable Housing Project at 670 7th Street

As a result of this permit issuance activity, there are more units under construction in the City (year to date) than the market has seen since 2014. As shown on **Figure 16** and **17**, there are more than 250 units under construction in the City (none of which are located in the Specific Plan). Since 2010, 1,165 units have been constructed in the City. Apart from 2017 and 2018, absorption (defined as the rate at which units are sold or rented and taken off the market) in the City has been positive, with peak absorption of 412 units in 2015.

Market Rate Housing Project at 615 Healdsburg Avenue

The most recent activity in the Specific Plan area was a 51-unit affordable housing project delivered in 2013 located at 670 7th Street. In addition, in 2007, a 79-unit market rate project was delivered at 615 Healdsburg Avenue. Other than these projects, the amount of new development in the Specific Plan Area has been negligible over the last decade.

Figure 16 Construction and Absorption in Santa Rosa Over Time

Year	Units Under Construction	Total Units	Occupancy Rate	Occupied Units	Net Units Absorbed
2010	-	18,913	94.8%	17,931	2
2011	-	18,913	95.2%	18,020	90
2012	51	18,913	95.8%	18,125	105
2013	-	18,964	96.0%	18,209	84
2014	458	18,964	96.1%	18,224	15
2015	68	19,354	96.3%	18,636	412
2016	112	19,422	96.4%	18,724	88
2017	222	19,183	97.4%	18,691	-33
2018	254	19,348	96.3%	18,628	-64

Source: CoStar

Figure 17 Construction and Absorption in Specific Plan Area Over Time

Year	Units Under Construction	Total Units	Occupancy Rate	Occupied Units	Net Units Absorbed
2010	-	993	94.0%	934	-16
2011	-	993	95.1%	945	11
2012	51	993	95.5%	948	4
2013	-	1,044	95.8%	1,000	52
2014	-	1,044	95.7%	999	-2
2015	-	1,044	96.4%	1,006	7
2016	-	1,044	96.5%	1,007	1
2017	-	1,044	97.1%	1,014	7
2018	-	1,044	96.1%	1,003	-12
YTD	-	1,044	96.1%	1,003	0

Source: CoStar

Sometimes, units are approved by the City but construction does not move forward. A variety of factors contribute to this situation, as will be explored further in subsequent phases of the Specific Plan process. This market analysis suggests the following factors as contributing to the lack of development in the Specific Plan area:

- Prices/rents remain below the necessary threshold to achieve feasibility
- Development financing is challenged due to increased equity requirements

- Relatively high costs of impact fees and other mitigation requirements add to development costs
- A number of real estate professionals report that the City's entitlement and building permit processes can be slow and arduous

It is worth noting that the City is making significant progress on streamlining the entitlement process and has initiated an "Express Permitting" process designed to take an 18-month process down to approximately six months. As part of this, the City has curtailed discretionary action for design review and the use permit process for housing projects in the downtown and the City's four other PDAs.

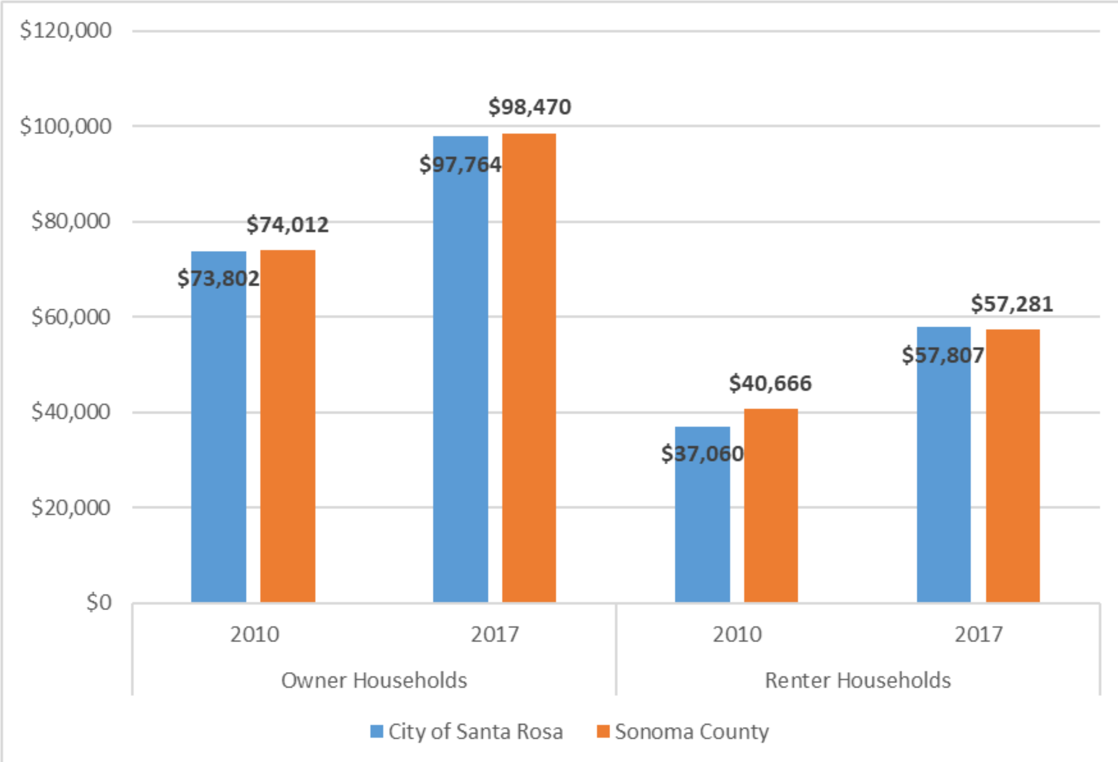
Household Incomes and Housing Affordability

Housing markets in general, and rental housing in particular, are heavily influenced by household incomes, particularly the wages and salaries of the working population. The median household income in Santa Rosa is $67,600 compared to $71,800 in the County and $67,200 in the State.

Household incomes for Santa Rosa homeowners increased by approximately 33 percent between 2010 and 2017 (not adjusted for inflation) and by 56 percent during the same period for Santa Rosa renters, as shown in **Figure 18**. When adjusted for inflation, household incomes for renters increased by 29 percent between 2010 and 2017, while incomes for homeowners increased by 10 percent.[5] The median household income in Santa Rosa is comparable to the median income in the County.

[5] This is in October 2018 dollars, adjusted for inflation using the Bureau of Labor Statistics Consumer Price Index for San Francisco-Oakland-San Jose.

Figure 18 Median Household Income in Santa Rosa and Sonoma County



Source: U.S. Census Bureau, 2013-2017 5-Year American Community Survey.

In Bay Area jurisdictions where new residential development is occurring, the median household incomes are higher and residents can afford to pay more for rent. Using the selected cities from **Figure 9**, household income in San Rafael and Walnut Creek is approximately $86,000 per year and household income in Redwood City and San Mateo is close to $100,000 per year. Household income in Sunnyvale is $118,000 per year.

According to the California Department of Housing and Community Development, an “overpaying” household is a household that pays 30 percent or more of its household income on housing costs. As seen in **Figure 19**, approximately 41 percent of Santa Rosa households are “overpaying” for housing (31 percent of owners and 53 percent of renters). In 2015, about 47 percent of households were “overpaying.” Not surprisingly, of renter households earning less than $35,000 per year, about 83 percent of households are overpaying.

Figure 19 City of Santa Rosa Overpaying Households

	Owner Households		
Household Income	Total Households in Income Category	Overpaying Households	Overpaying Households as a % within Income Category
Less than $20,000	2,314	1,577	68.2%
$20,000 to $34,999	2,973	1,741	58.6%
$35,000 to $49,999	2,925	1,669	57.1%
$50,000 to $74,999	6,366	2,790	43.8%
$75,000 or More	19,803	2,865	14.5%
Total	**34,381**	**10,642**	**31.0%**

Note: An overpaying household is a household that pays 30 percent of more of its household income on housing costs.

Source: U.S. Census Bureau, 2013-2017 5-Year American Community Survey.

Development Feasibility Conclusions

Achieving appropriate prices/rents in the larger context of rising construction costs remains the primary hurdle for multifamily residential developers. Currently residential rents are below the threshold needed to attract developers and the required institutional capital. In addition, average rents in the Downtown compared with citywide are so similar that there is no compelling reason for a developer to incur higher development costs in the Downtown (e.g., building type, infrastructure, etc.) compared to elsewhere. This will be further explored through discussions with real estate developers but it appears that the Downtown must become much more desirable from a variety of perspectives to command higher rents and the City must do all possible to provide incentives and ease development costs and risks associated with the higher density multifamily building types.

Despite these market conditions, given the strengths of Santa Rosa's downtown area (e.g., location, vehicular access, transit, services and amenities, walkability, historic charm), the area should be able to attract higher density multifamily development as market conditions become more favorable. In order to facilitate this transformation, the City will need multifaceted strategy that includes:

- Promoting economic development (job creation) in industries that provide higher average wages.
- Assuring that land use regulations and development review processes are streamlined and provide adequate assurance that planned development will be approved.

- While development costs will remain dominated by construction costs, doing everything possible to keep City-imposed costs (impact fees, exactions, and development conditions) within a market-reasonable range.
- Seeking opportunities through public-private partnerships to create “pioneer” multifamily residential projects that otherwise would not be financially feasibility without public subsidy and support.
- Seeking opportunities for “transitional density” projects at the periphery of the downtown where appropriate given the existing built environment that take advantage of lower cost development prototypes (e.g., townhomes, stacked flats, etc.).

Demand Forecast

A reasonable forecast of demand for residential units in the Specific Plan area is informed by the City’s historical production trends and assumptions about the share of units that can be accommodated in the Plan area. A housing needs assessment conducted as part of the City’s Housing Action Plan concluded that housing supply needs to increase by approximately 1,000 units per year citywide. However, it is important to note that the city’s Growth Management Element and Ordinance would need to be amended to allow this rate of growth.

The Growth Management Ordinance notwithstanding, the Specific Plan area should be able to accommodate an increasing share of these units given the area’s locational attributes. The Housing Action Plan also concluded that with the income profile of newly formed (or relocating) households, roughly half of the needed units should be affordable to households with incomes below the area’s median income level.

3. COMMERCIAL REAL ESTATE CONDITIONS AND TRENDS

This Chapter provides an overview of Santa Rosa's commercial real estate sector, focusing on the types of uses that currently exist or might be developed in the Specific Plan Area. Nonresidential development, including both visitor-serving (e.g., retail and hotel) and employment-serving (e.g., office and industrial or flex space), will play a critical role in the economic development of the Specific Plan area. These land uses can also be highly synergistic with the residential market, helping to create a vibrant mixed-use district where the community can live, work, and play.

Overview

The commercial real estate sector represents a physical manifestation of the local economy. The success of the commercial real estate market will depend on the City's ability to capture future job growth, which itself hinges on a range of conditions, including housing that is attractive and affordable to a growing work force. It is also linked to a district's ability to attract residents and visitors who seek shoping, dining, and cultural amenities.

Figure 20 provides an overview of the primary commercial real estate sectors in the Specific Plan Area in terms of total inventory. As shown, retail space represents the predominant commercial real estate product type in terms of square feet, followed by office, and industrial/flex space. A further description of the market dynamics in each of these real estate sectors is provided below.

Figure 20 Overview of Specific Plan Area Commercial Real Estate Sector

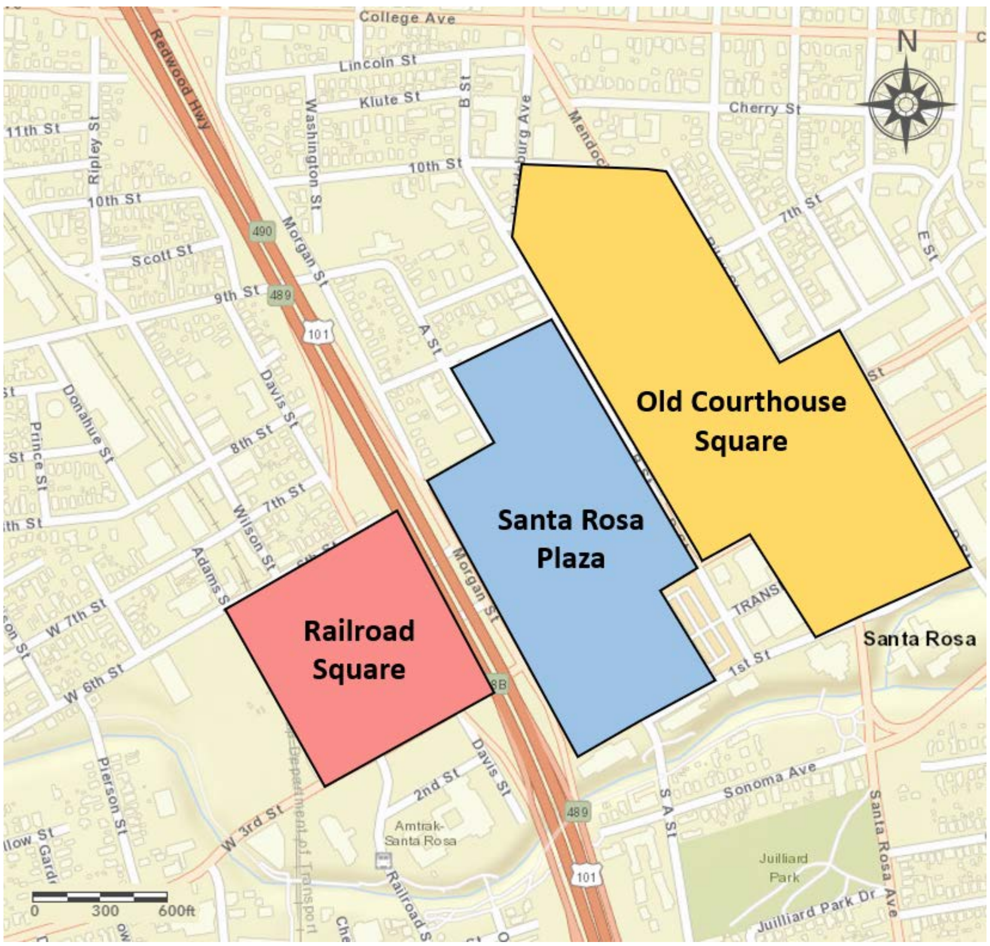
Real Estate Product Type	Total Building Square Feet in Specific Plan Area	
	Amount	% of Total
Industrial/Flex	788,180	17%
Retail	2,248,912	48%
Office	1,607,306	35%
Total	**4,644,398**	**100%**

Source: CoStar; Economic & Planning Systems

Retail Market

The performance of the City's retail market in general, and Downtown in particular, is affected by both national changes in consumer behavior (increasing online sales), as well as local dynamics. Santa Rosa is particularly susceptible to these trends due to a predominance of large format retailers as well as a traditional mall, the Santa Rosa Plaza Shopping Center, located in the Specific Plan area. **Figure 21** depicts the major retail clusters within the Specific Plan Area. The combination of a regional serving mall (Santa Rosa Plaza), the downtown area (loosely referred to as Old Courthouse Square in the Figure below, although the Square itself is a smaller area), and a smaller, slightly separated mixed-use node adjacent to the SMART station/Railroad Square area presents both opportunities and challenges for future success.

Figure 21 Santa Rosa Downtown Specific Plan



Relevant National Retail Market Trends

Retail is a dynamic industry that is constantly evolving. Over the last decade, traditional retail formats, in particular department store-anchored shopping malls, have struggled in most locations. A report by Green Street Advisors indicates that 800 department stores—about 20 percent of all anchor space in U.S. malls—will likely close over the next few years, and many malls will close with them.[6] Last year, the New York Times put the number of malls suffering vacancies of 10 to 40 percent at 15 percent.[7]

The decline of anchor stores and malls is linked to and compounded by the rise of the internet and e-commerce. Since 2000, the e-commerce share of retail sales advanced from just under 1 percent to about 10 percent in 2018.[8] The migration of retail sales from brick-and-mortar stores to the internet is beginning to show up in space-per-capita data in the United States. Since the 2008 recession, retail space per capita has declined to 34.5 square feet, the same level as 10 years ago. Major retailers like Target are downsizing the footprint of their stores. Even in regions with strengthening market fundamentals, recent demand for big-box retail space has significantly lagged behind improving job markets and increases in consumer spending.[9]

It should be noted that the top tier of luxury shopping malls is not suffering from high vacancy rates. Recently, consumer spending patterns have been bifurcated, with luxury and discount spending strong and outlays for mid-priced goods increasing slowly, if at all.[10] The remaining mall operators are increasing the dining and entertainment aspects of their retail centers in an effort to combat declining consumer spending in a nation that is oversupplied with retail. As of 2016, the United States has twice as much per-capita retail space as any other place in the world, leading industry experts to predict a swift decline in the country's retail footprint.[11]

Local Market Dynamics

Santa Rosa is particularly susceptible to the trends described above due to a predominance of large format retailers as well as a traditional mall, the Santa Rosa Plaza Shopping Center, located in the Specific Plan area. In 2014-2015, the list of Santa Rosa's top 25 sales tax generators was abundant with national retailers like Apple, Macy's, Costco, etc. (see **Figure 22** below). Of the top 25, three (3) are located in the Specific Plan Area but one of these (Sears) recently closed. Overall, the City has experienced relatively modest growth in retail space over the last decade (e.g. roughly 3 percent from 2007 through 2018).[12] This is in part attributable to the national decline in retail sales, but also at play is that the major national retailers are already located in Santa Rosa.

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[6] "Commercial Real Estate's Slow-Motion Slowdown: E-Commerce and Other Disruptors of the Seven-Year boom," *Urban Land Institute*, (2016).

[7] Schwartz Nelson, "The Economics (and Nostalgia) of Dead Malls," *The New York Times*, (2015).

[8] US Census Bureau, Quarterly Retail E-Commerce Sales, 3Q2018.

[9] "The New Model for Commercial Real Estate Demand," RCLCO Real Estate Advisors, (2013).

[10] "2016: The Year of the Consumer: Spending the Oil Dividend and Reaping the Wage Benefits," Cushman & Wakefield Research Publications, (2016).

[11] Close Kerry, "A Third of American Malls Will Close Soon," *CNBC Money*. (2016).

[12] City records indicate that close to 200,000 square feet of office and retail uses were constructed in the Downtown area since 2007. The CoStar data presented in this Report provide net increases in inventory and may mask redevelopment or tear-down/rebuild projects.

Figure 22 Santa Rosa Top 25 Sales Tax Generators, 2014-2015

Retail Name	Located within Specific Plan Area
Apple Stores	X
Best Buy Stores	
Chevron Service Stations	
Costco Wholesale	
CVS/Pharmacy	
Freeman Toyota	
Hansel Ford Lincoln Mercury	
Home Depot	
Honda of Santa Rosa	
JC Penney Company	
Jim Bone Nissan of Santa Rosa	
Keysight Technologies	
Lithia Dodge	
Macy's Department Store	X
Mead Clark Lumber Company	
Oliver's Market	
Pace Supply	
Platinum Chevrolet	
Prestige BMW/VW/Porsche	
Ross Stores	
Safeway Service Stations	
Safeway Stores	
Sears Roebuck & Company [1]	X
Smothers European Volvo	
Target Stores	

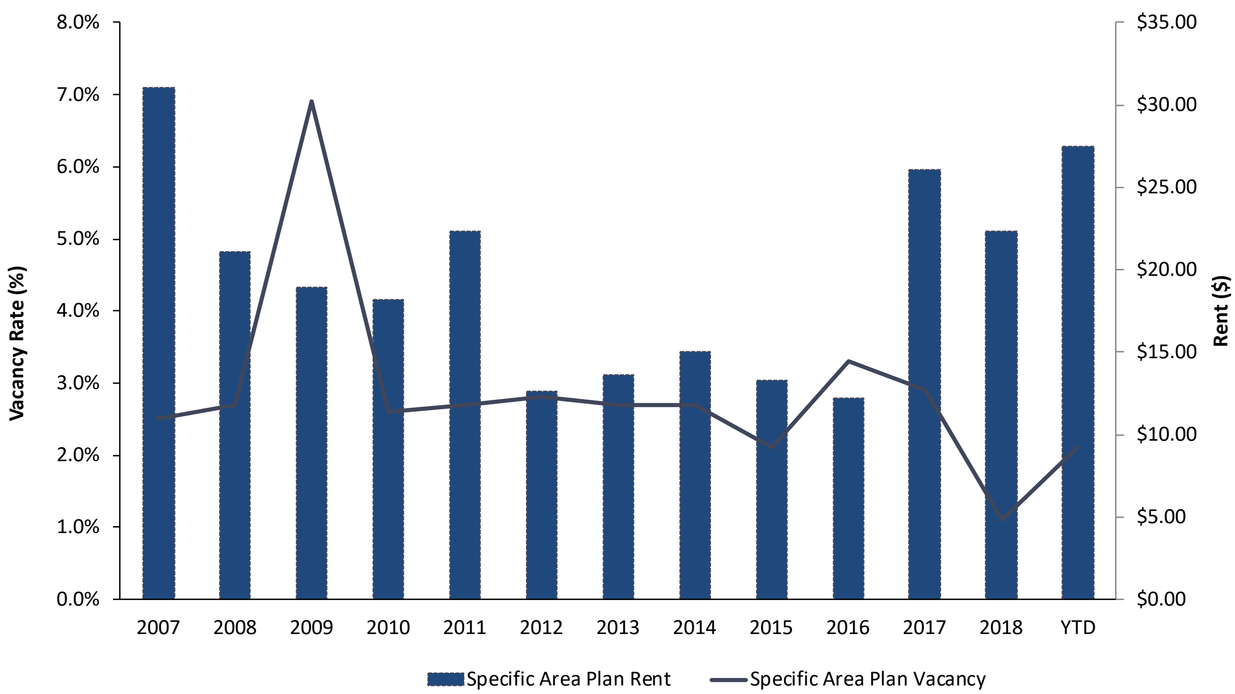
[1] Recently Closed.

Source: City of Santa Rosa Sales Tax Report; EPS.

Looking more closely at the Specific Plan Area, rents rose significantly from $12 to $26 between 2016 and 2017, but decreased slightly in 2018 to $22 (see **Figure 23**). This volatility is more a reflection of the small market area and small sample of available space at specific points in time than a clear trend. As of January 2019, prices are nearly catching up to where they were before the Great Recession. Vacancies reached a high of nearly 7 percent in 2009 but have improved since, tracking rent escalation.

The Specific Plan Area's retail market inventory comprises 20 percent of Santa Rosa's inventory and 9 percent of the Sonoma County inventory, as shown in **Figure 24**. The average triple-net (NNN)[13] lease rate for retail space in the Specific Plan Area ($27.48) is higher than that of the City and County. However, this overall performance is heavily influenced by the presence of Santa Rosa Plaza, an 826,000 square feet enclosed mall, currently anchored by Macy's and Forever 21. With the closure of Sears, one of the three anchor spaces is currently vacant.

Figure 23 Retail Vacancy vs. Rent



Source: CoStar; Economic & Planning Systems

In looking at the three primary retail concentrations within the Specific Plan Area (Santa Rosa Plaza, Railroad Square, and Old Courthouse Square), these areas represent about 1.6 million square feet of the 2.3 million square feet in the Specific Plan Area, or over 70 percent (**Figure 24**). Santa Rosa Plaza an enclosed, regionally-serving mall that bifurcates the Downtown area, is the predominant player in the Specific Plan area. It has significantly higher rents than the other areas, at almost $58 per square foot. While the 6 percent vacancy rate exceeds the citywide average, this is primarily attributable to the loss of Sears.

[13]Triple-net (NNN) lease is a common lease structure for retail and other commercial uses (except Class A Office) where the tenant is responsible for paying all operating expenses associated with a property, including real estate taxes, building insurance, and common area maintenance.

At the other end of the spectrum, the Old Courthouse Square area appears to be struggling. The average market rents of $33 per square foot are roughly half the citywide average and the 6 percent vacancy rate is also well above normal. Various stakeholders have indicated that the district suffers from negative perceptions related to homelessness, safety, cleanliness, lack of free parking, and other factors.

By contrast, the relatively small Railroad Square district appears to be relatively vibrant with rents that exceed the City average ($33 per square foot) and low vacancy. The area appears to have evolved as a visitor destination, offering a unique blend of local establishments with a successful dining scene in a historic and walkable format. Its proximity to the SMART station, new hotels, and the historic Railroad Square provides a good foundation for future success. However, its expansion as a visitor-oriented "lifestyle" district will need to account for competition from well-amenitized and tourism focused destinations elsewhere in the County (e.g., Windsor, Healdsburg, and Petaluma).

Figure 24 Retail Building Space Trends

	Santa Rosa Downtown Specific Plan					
Item (as of Q1 2019)	Santa Rosa Plaza	Railroad Square	Old Courthouse Square	**Specific Plan Area (Total Area)**	**Santa Rosa**	**Sonoma County**
Performance						
NNN Rent per Sq. Ft.	$57.96	$33.16	$13.03	$27.48	$24.16	$21.07
Vacancy	5.8%	0.8%	5.9%	2.1%	1.7%	2.6%
Inventory						
Square Feet	826,037	178,725	581,879	2,248,912	11,174,890	25,021,358
Share of City	7.4%	1.6%	5.2%	20.1%	100.0%	
Share of County	3.3%	0.7%	2.3%	9.0%	44.7%	100.0%
Growth 2007 - Q1 2019 Including Pipeline						
Net New Inventory	0	0	0	10,000	320,979	1,228,169
% of Total Inventory	0.0%	0.0%	0.0%	0.4%	2.9%	4.9%

Source: CoStar; Economic & Planning Systems
P:\181000s\181138SantaRosa\Model\[181138 Comm Market Data.xlsx]TABLE-Retail

Going forward, the existing competitive supply in the broader Santa Rosa market, combined with national trends in the consumer behavior, represents a significant market hurdle for any new retail development in the Specific Plan Area. New growth in retail is likely to be the result of incremental and fine-grained improvements to existing properties with a focus on creating a differentiated experience that provides shoppers with a unique sense of place (similar to what is already occurring around Railroad Square). Continued urban design improvements that enhance connectivity between and within the various sub-districts could also improve its functionality, appeal and regional draw of the Specific Plan retail sector. While additional retail space as part of new, mixed-use buildings may enhance vitality at selected locations, a ubiquitous requirement for ground floor retail is likely to hinder the development feasibility of new projects.

Office Market

The Specific Plan Area office sector functions within a relatively mature and successful County market that is primarily anchored in Santa Rosa. Within this context, Santa Rosa has a relatively large market share, with about 62 percent of the inventory, as shown in **Figure 25**. Rents in the Specific Plan Area are above the City and County average due to its position in the core node of activity; however, the Specific Plan Area vacancy rates are slightly higher than the surrounding region. Currently, rents are between $21 and $23 in the region and vacancies are between 3.5 percent (Santa Rosa) and 5 percent (Specific Plan Area). Vacancy improved significantly in the past five years while lease rates remained fairly constant (see **Figure 26**).

The most recent office development in the Specific Plan area is Hugh Futrell's 4-story, 34,000 square-foot development at the corner of Fourth and Davis streets in 2005. It is fully leased, anchored by Charles Schwab.[14]

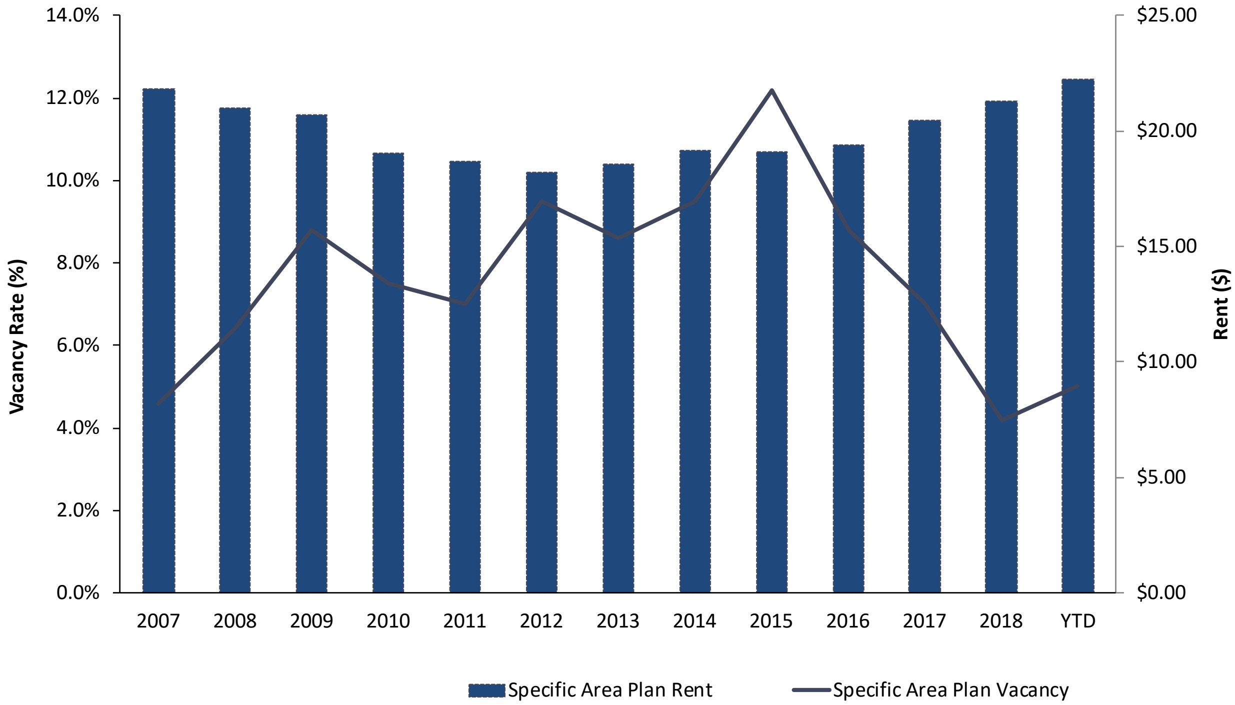
Figure 25 Office Real Estate Trends

Item (as of Q1 2019)	Specific Plan Area	Santa Rosa	Sonoma County
Performance			
Gross Rent per Square Foot	$22.25	$21.15	$21.80
Vacancy	5.0%	3.6%	4.4%
Inventory			
Square Feet	1,607,306	10,402,467	16,859,576
Share of City	15.5%	100.0%	
Share of County	9.5%	61.7%	100.0%
Growth 2007 - Q1 2019 Including Pipeline			
Net New Inventory	2,503	339,151	519,094
% of Total Inventory	0.2%	3.3%	3.1%

Source: CoStar; Economic & Planning Systems

[14] Ibid.

Figure 26 Office Vacancy vs. Rent



Source: CoStar; Economic & Planning Systems

Industrial and Flex Market

Industrial buildings include those that accommodate users that assemble, process, or manufacture products on-site as well as warehousing, distribution, and maintenance facilities. While flex space can include similar uses as industrial, it tends to be more adaptive, often accommodating office, medical, R&D, and even some sales.

The Specific Plan Area's 788,000 industrial/flex square feet, accounts for a small portion of the region's inventory, at about 6 percent of City inventory and 2 percent of County inventory. The City's industrial/flex inventory grew just 1 percent over the last 10 years, compared with 3 percent growth in the County (see **Figure 27**). While there has been no inventory change in the Specific Plan Area in the past 10 years, several existing industrial tenants in the Maxwell Court area have made significant investments in their properties, signaling a commitment to their current location. The industrial and flex market currently has vacancies of 3.4 percent, 2.4 percent, and 3.9 percent for the Specific Plan, City, and County, respectively. Rents steadily increased by about $3 in the City and County between 2012 and 2019, from around $7 per square foot to $10 per square foot.

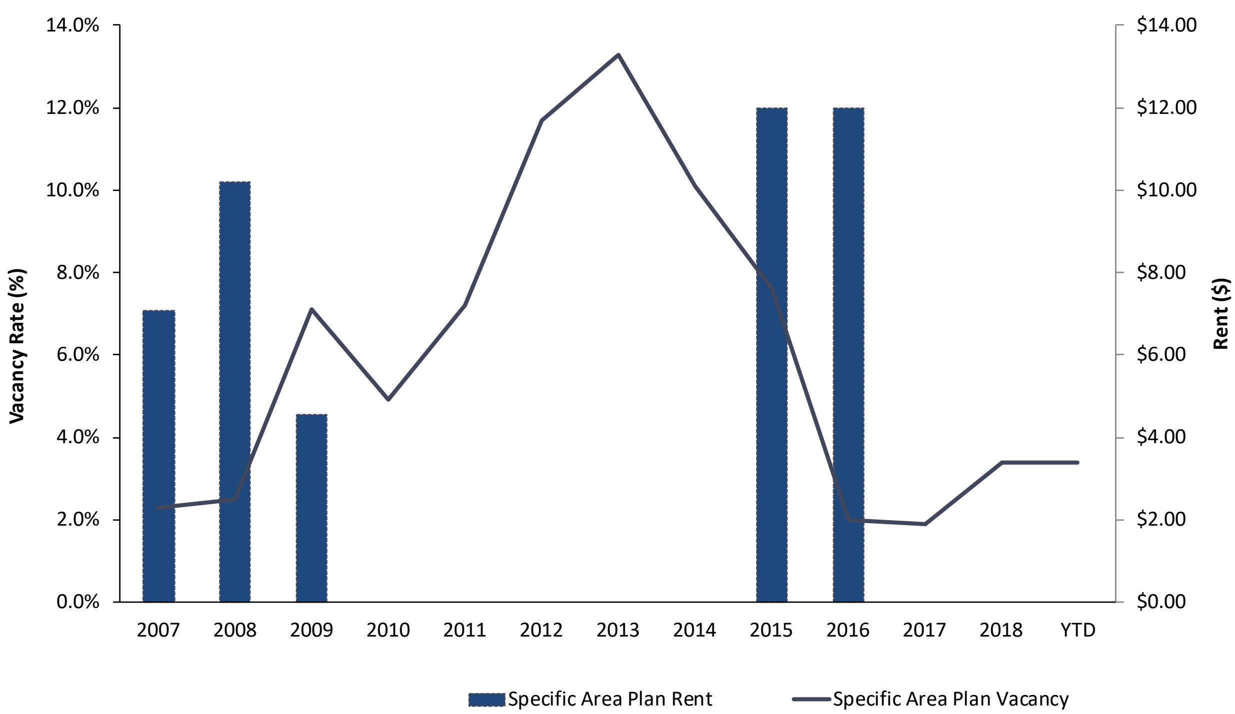
Industrial-type development does not tend to be associated with smart-growth, TOD principles, but there may be some smaller floor-plate spaces with retail components that are appropriate.

Figure 27 Industrial/Flex Real Estate Trends

Item (as of Q1 2019)	Specific Plan Area	Santa Rosa	Sonoma County
Performance			
NNN Rent per Square Foot	-	$20.27	$12.52
Vacancy	3.4%	2.4%	3.9%
Inventory			
Square Feet	788,180	12,929,366	33,345,079
Share of City	6.1%	100.0%	
Share of County	2.4%	38.8%	100.0%
Growth 2007 - Q1 2019 Including Pipeline			
Net New Inventory	0	523,583	1,620,103
% of Total Inventory	0.0%	4.0%	4.9%

Source: CoStar; Economic & Planning Systems

Figure 28 Industrial/Flex Vacancy vs. Rent



Note: Rent data is not available for 2010 - 2014 and 2017 - present.

Source: CoStar; Economic & Planning Systems

4. EMPLOYMENT AND COMMERCIAL REAL ESTATE DEMAND GROWTH

More than any other factor, demand for commercial real estate is driven by job growth. Santa Rosa has a current labor force of 91,500 people, 89,100 of whom are currently employed, reflecting a very low unemployment rate of 0.026 percent as of December 2018. Santa Rosa is the jobs center in Sonoma County with nearly 40 percent of the County's jobs located within the City. The future of the City's commercial real estate market will depend on the City's ability to capture job growth, which hinges on a range of conditions, including having a supply of housing that is attractive and affordable to a growing work force.

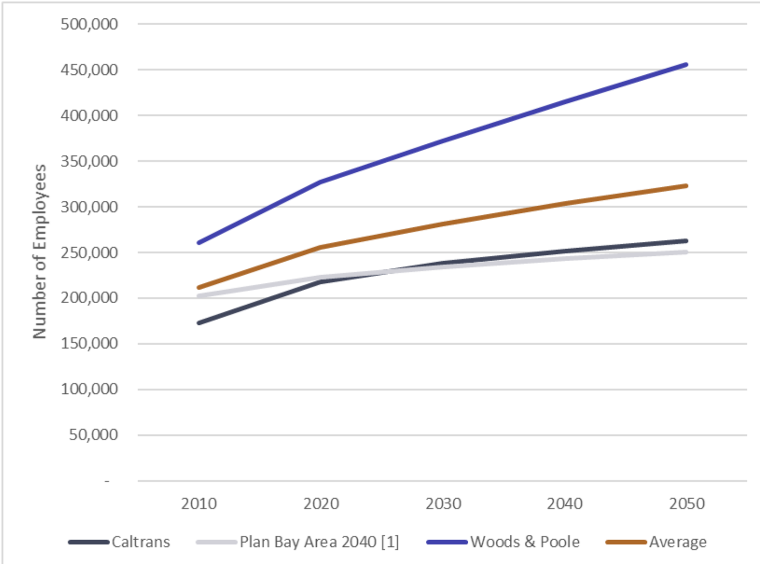
Employment Projections

EPS has relied on three data sources (Caltrans, Plan Bay Area 2040, and Woods & Poole[15]) to project job projections in Sonoma County through 2050 (**Figure 29**). Taking the average of these data sources, it is estimated that there will be approximately 255,900 employees in 2020 and 322,900 employees in 2050 for total growth of 47,400 jobs. This reflects an average annual growth rate of 0.85 percent.

Unlike the other sources, Plan Bay Area also tracks and projects jobs on a citywide basis. It estimates that in 2020 there will be about 86,200 jobs in Santa Rosa, and in 2040 there will be 92,100 jobs. Over twenty years, this suggests that there will be a 6.8 percent growth in the number of jobs, or 0.3 percent per year (compared with 0.4 percent per year for the County as a whole, using just Plan Bay Area projections). This suggests that job growth in the City will be slower than job growth elsewhere in the County.

[15] Woods & Poole Economics, Inc. is an independent firm that specializes in long-term county economic data and demographic data projections. Woods & Poole's database for all U.S. counties contains projections for every year through 2050 for more than 900 variables. Each year Woods & Poole updates the projections with new historical data.

Figure 29 Sonoma County Employment Projections (2010 – 2050)



[1] Data was extrapolated from Plan Bay Area 2040 for the year 2050.

Sources: Caltrans; Plan Bay Area 2040; Woods & Poole; Economic & Planning Systems, Inc.

Growth Projections by Industry

At the same time that job growth is projected to be slower in Santa Rosa than the County as a whole, the area is struggling to capture a meaningful share of the growth in those industries that are driving the Bay Area economy and that support head-of-household jobs, which translates to weak demand for commercial office/flex space. An analysis of the current and projected distribution of jobs in the County indicate that much of the employment growth will be in the visitor-serving sectors of accommodations and food services.

In looking at Plan Bay Area 2040 Santa Rosa projections, analysis of the data suggests that the Finance and Professional Services sector will decrease by 10 percent in the next two decades, along with Manufacturing and Wholesale decreasing by 15 percent. On the other hand, Plan Bay Area estimates Health and Educational Services to increase by 22 percent, and retail to increase by 13 percent. Thus, most employment is not expected to occur in office-oriented sectors, according to PBA.

Using an entirely different set of employment forecast data, the California Employment Development Department provides industry level forecasts, which were last prepared for the Sonoma County area for 2014 to 2024, as shown in **Figure 30**. From this dataset, it appears the construction industry, historically a strong sector in Sonoma County, is projected to expand by 25 percent between 2014 and 2024, based on state projections. Sub-sectors projected to grow the most in the County are in the health care related industries (e.g., a subcategory within Professional and Business Services) and the visitor-serving industries (e.g., Leisure and Hospitality). Mining and logging are combined to reflect the "Natural Resources" industry in Sonoma County.

Figure 30 Sonoma County 2024 Projected Employment Levels

Industry	Estimated Number of Employees		% Change
	2014	2024	
Construction	10,500	13,100	25%
Leisure and Hospitality	23,800	28,900	21%
Professional and Business Services	20,100	24,200	20%
Trade, Transportation, and Utilities	36,100	40,200	11%
Information	2,700	3,000	11%
Manufacturing	20,700	22,300	8%
Other Services	6,800	7,200	6%
Government	31,200	32,800	5%
Mining and Logging	300	200	-33%
Total	**152,200**	**171,900**	**13%**

Source: CA Employment Development Department, Occupational Employment Statistics, Santa Rosa MSA.

Implications for Office Real Estate Demand

The total County growth of approximately 47,400 employees from 2020 to 2040, as shown in **Figure 31**, was evaluated on an industry sector by sector basis to estimate growth by job sector. **Table 31** shows that there will be approximately 9,800 new employees in those sectors that typically require office space in Sonoma County, while the remaining 37,600 new jobs are expected to occur in other sectors, such as health care and social assistance, manufacturing, retail, and accommodation and food services.[16] The largest number of new office-requiring jobs are projected to come from the Professional, Scientific, and Technical Services sector, at 2,465 workers.

[16] Job sector estimates provided by Dyett & Bhatia, using Census figures from 2015.

Figure 31 County Employment Growth by Sector (2020 – 2040)

Jobs by NAICS Industry Sector	Job Sector % Share in County (2015) [1]	Distribution of New Jobs (2020 to 2040) [2]
Office Employment Sectors		
Information	1.6%	758
Finance and Insurance	2.6%	1,233
Real Estate and Rental and Leasing	1.7%	806
Professional, Scientific, and Technical Services	5.2%	2,465
Management of Companies and Enterprises	1.2%	569
Administration & Support, Waste Management and Remediation	4.9%	2,323
Other Services (excluding Public Administration)	3.5%	1,659
Subtotal	**20.7%**	**9,813**
Other Employment Sectors		
Agriculture, Forestry, Fishing and Hunting	2.9%	1,375
Mining, Quarrying, and Oil and Gas Extraction	0.1%	47
Utilities	0.5%	237
Construction	6.3%	2,987
Manufacturing	11.8%	5,594
Wholesale Trade	4.4%	2,086
Retail Trade	11.5%	5,452
Transportation and Warehousing	2.0%	948
Educational Services	8.2%	3,887
Health Care and Social Assistance	15.5%	7,348
Arts, Entertainment, and Recreation	2.0%	948
Accommodation and Food Services	10.1%	4,788
Public Administration	4.0%	1,896
Subtotal	**79.3%**	**37,593**
Total Job Growth in County (2020 - 2040)	**100.0%**	**47,406**

[1] Distribution of jobs by sector is based on 2015 Cenus data provided by Dyett & Bhatia. The definition of "office employment" vs. "other employment" sectors is EPS's distinction.

[2] The 2020 to 2040 job projections for Sonoma County are based on an average of Caltrans, ABAG, and Plan Bay Area data.

Source: Dyett & Bhatia; Caltrans; Plan Bay Area 2040; Woods & Poole; Economic & Planning Systems, Inc.

Using the 9,800-office employment projection in Sonoma County for 2020 to 2040, the City and Specific Plan shares of the growth are estimated (**Figure 32**). On average, the City may capture nearly 40 percent of total job growth within the County, or approximately 3,700 office employees. With the expectation that there will be 300 square feet per employee, this equates to approximately 1.1 million new square feet of office space in Santa Rosa within the 20-year period. If the Specific Plan were to capture 13 percent of those employees (based on the current ratio), the Specific Plan area would need to support nearly 480 new office employees by 2040, requiring approximately 143,000 new square feet of office inventory.

Figure 32 City and Specific Plan Allocation of Job Growth (2020 – 2040)

Item/Source	Share	Number of Office Employees (2020 - 2040)	Square Feet per Office Employee	New Office Square Feet (2020 - 2040)
Total County Office Employees [1]		*9,813*	*300*	*2,943,892*
City Share of County Employees				
ABAG 2040	38%	3,708	300	1,112,525
Specific Plan Share of City Employees				
D&B/Census 2015	13%	478	300	143,464

[1] See **Table 15**.

Source: Plan Bay Area 2040; Dyett & Batia; Economic & Planning Systems, Inc.