



## MEMORANDUM

To: Andrew Trippel, Planning Manager, City of Petaluma

From: Derek W. Braun, Principal  
Chris Holcomb, Associate II

Date: November 7, 2023

Project: Downtown Housing and Economic Opportunity Overlay

Subject: Downtown Overlay Market and Development Impacts Assessment and  
Fiscal Analysis of City Revenues Associated with the Proposed Hotel Project

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This memorandum describes the conclusions of Strategic Economics' assessment of the potential development and fiscal impacts associated with the proposed Downtown Housing and Economic Opportunity Overlay ("Downtown Overlay") and EKN Appellation hotel project. The City of Petaluma requested this assessment to inform community and decisionmaker considerations regarding the form and potential approvals of the Downtown Overlay and EKN Appellation hotel project.

The development impacts assessment focused on the Downtown Overlay's potential effects on the likelihood, timing, and magnitude of future residential, office, and hotel development activity within the overlay's boundaries. The assessment essentially considers how the Downtown Overlay may function as a regulatory incentive provided by the City to support preferred development at specific locations. As a regulatory incentive, the Downtown Overlay can potentially support the City's existing goals and policies while not requiring direct use of City budget resources for implementation.

Separate from the Downtown Overlay development impacts assessment, the fiscal impact assessment estimated potential ongoing Petaluma annual General Fund tax revenues associated with the proposed hotel project.

Strategic Economics completed a broad and qualitative assessment of the Downtown Overlay's potential impacts on development activity. The assessment was informed by analyses completed by Strategic Economics for the Petaluma General Plan update, as well as long experience conducting market and financial feasibility analyses in a variety of market contexts. The findings and conclusions of the General Plan analyses were described in two documents authored by Strategic Economics and attached to this memo via web links: the *Economic and Market Analysis* (November 3, 2021) and the *Residential Feasibility Analysis* (August 10, 2023). Strategic Economics is also continuing to conduct research and develop policy recommendations as part of the General Plan Update project.

This memorandum's contents include a brief description of the proposed Downtown Overlay and EKN Appellation hotel, description of findings and conclusions regarding the overlay's likely effects on development activity, and estimates of potential tax revenues associated with the hotel.

## DESCRIPTION OF THE PROPOSED DOWNTOWN OVERLAY AND HOTEL

The project applicant for the EKN Appellation hotel also submitted General Plan and Zoning Amendment applications proposing to change applicable development standards. These changes were necessary because the proposed hotel building exceeds current maximum floor area ratio (FAR), building height, and lot coverage allowed by the City of Petaluma's General Plan and Implementing Zoning Ordinance (IZO). Based on City staff's recommendations, the applicant proposed a zoning overlay to accommodate these exceptions.

The proposed EKN Appellation hotel at 2 Petaluma Boulevard South would involve the construction and operation of a 93-room, six-story hotel with below-grade parking for up to 58 vehicles, a rooftop event space and bar, and food service uses on the ground floor. The EKN Appellation hotel would exceed the site's current limit on Floor Area Ratio (5.6 proposed, versus 2.5 limit), building height (69-feet proposed, versus 45-feet limit), and lot coverage (100 percent proposed, versus 80 percent limit).

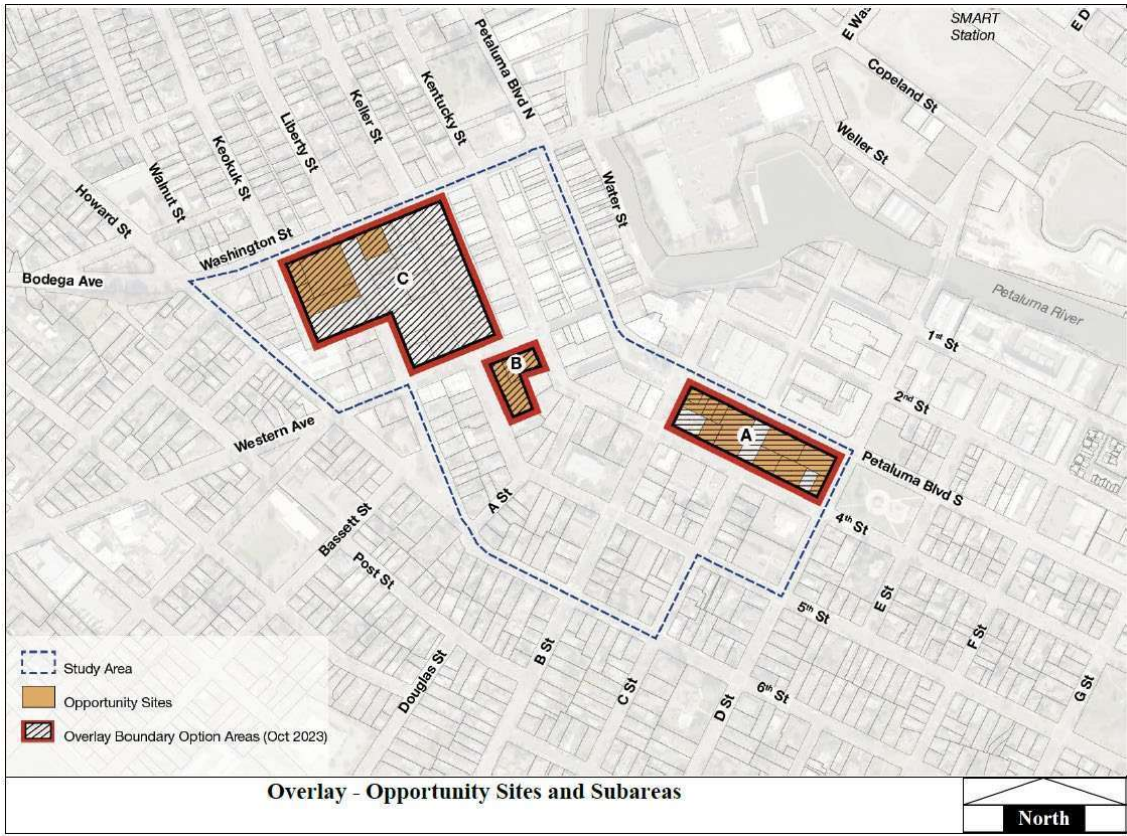
As currently modified based on Planning Commission and Historic & Cultural Preservation Committee feedback, the Downtown Overlay would cover three subareas within Downtown Petaluma, as shown in Figure 1. These subareas were selected to incorporate development opportunity sites while avoiding inclusion of historic resources.

The Downtown Overlay would increase the allowable FAR from 2.5 to 6.0, building height from 45 feet to 75 feet with a Conditional Use Permit (CUP), increase lot coverage from 80 percent to 100 percent, allow development of ground floor multi-family uses by right within portions of each subarea, and establish development and design controls for properties that would be subject to the proposed Overlay.

The development impacts assessment described in this memorandum was based on the Downtown Overlay's current proposed changes to development standards, as reviewed during a Planning Commission study session held on August 8, 2023. These development standards are comprehensively described in Figure 2, which was included with the August 8<sup>th</sup> study session staff report. The most relevant proposed changes for the purpose of this economic assessment are those that would expand development opportunities at sites within the Downtown Overlay beyond what is currently permitted by right (and subject to discretionary approval). These changes include:

- The maximum allowable height would increase to 60 feet with a conditional use permit or 75 feet with a conditional use permit and fulfillment of other design, public benefit, and use requirements. The maximum height permitted by right would remain at 45 feet. Additional stepback requirements would apply to floors above 45 feet.
- The maximum lot coverage limit would increase to 100 percent.
- The maximum FAR would increase to 6.0.
- Ground floor residential uses would be allowed by right, with exceptions.

FIGURE 1: DOWNTOWN OVERLAY OPPORTUNITY SITES AND BOUNDARIES, (AS SHOWN IN OCTOBER 3, 2023 HISTORIC AND CULTURAL PRESERVATION COMMITTEE STAFF REPORT)



Source: City of Petaluma, October 3, 2023.

FIGURE 2: CURRENT AND PROPOSED DEVELOPMENT STANDARDS: MU2 & CF + DOWNTOWN OVERLAY (AS SHOWN IN AUGUST 8, 2023 PLANNING COMMISSION STAFF REPORT)

	MU2 & CF	Overlay: June Study Session	Overlay: August and October Study Sessions
Lot Area (Min)	2,000 SF	No Change	No Change
Lot Depth (Min)	N/A	No Change	No Change
Lot Width (Min)	N/A	No Change	No Change
Height (Max)	45'	60' by right 75' w/qualifying criteria	60' w/Conditional Use Permit 75' w/CUP +qualifying criteria
Exceptions to height limit allowed?	Yes; Per Section <a href="#">12.020.D</a>	No, any building over 45' is limited to an overall Max of 60'/75'	
Setbacks	<b>When not abutting an R District</b>		
Front (Min/Max)	0-10'	0' <sup>1</sup>	
Rear (Min)	0'	0'	
Street-side (Min)	0'	0'	
Interior Side (Min)	0'	0'	
		<sup>1</sup> Change to not allow a front yard setback was made to reflect the historic building pattern in the downtown - see Exhibit 13	
Upper Floor Stepbacks?	None	Yes, See Exhibit 4.1 for details	
Lot Coverage (Max)	80% Maximum	No Limit - 100% Lot Coverage Allowed (change intended to reflect the historic building pattern in the downtown - see Exhibit 13)	
Floor Area Ratio (Max)	2.5	6.0	
Parking	Per <a href="#">IZO Chapter 11</a>	The parking and loading standards contained in IZO Chapter 11 will not be modified by the Overlay.	

Table is excerpted from Exhibit 1 of the Staff Report for the August 8, 2023 Planning Commission meeting / study session. The complete exhibit (with other referenced materials) can be downloaded at:

<https://cityofpetaluma.primegov.com/meeting/attachment/28717.pdf?name=Attachment%20A%20-%20Exhibits%201-12>

Source: City of Petaluma, August 8, 2023.

## MARKET AND DEVELOPMENT IMPACTS OF THE DOWNTOWN OVERLAY

Because the proposed Downtown Overlay is a regulatory incentive only, any future development in areas subject to the Downtown Overlay will depend on the actions and motivations of private developers. These developers make market-driven investment decisions based on the financial performance of potential development opportunities.<sup>1</sup> Therefore, the development impacts assessment focused on how additional height, additional lot coverage, and additional FAR may influence developer decisions regarding whether to pursue residential, office, and hotel projects in the area.

The following discussion of the Downtown Overlay's development impacts consists of two sections. The first section explains general critical context for understanding the developer perspective regarding the factors influencing the financial feasibility of a development project in a given location. The development impacts assessment in the subsequent section of this memo focuses on current market demand for locations in Downtown Petaluma and whether the Downtown Overlay's regulatory changes will beneficially impact the revenues, construction costs, and building efficiency for potential development projects.

### General Development Considerations

The following findings explain several critical factors considered by developers as they decide whether to pursue a new project in a specific location. This explanation provides a framework for the subsequent assessment of whether and how the Downtown Overlay would impact development activity by providing helpful regulatory incentives for developers.

**Developers will only seek to build a new project when they believe the project is financially feasible to construct.** Although all development projects involve risk, developers will only pursue new projects when they believe that reasonable certainty exists that the project will be financially feasible, or “pencil.”

**The financial feasibility of a development project depends on achievable rents or sales prices covering the costs of construction, land, and project financing while providing a competitive return on investment.** The costs of construction include “hard” costs for labor and materials, and “soft” costs such as municipal fees, and architecture, engineering, legal, project management, and marketing services. Land costs vary depending on what can be built on a site given development market conditions and the site's zoning. Project financing costs are determined by project lenders based on current interest rates and their assessment of the project's investment risk. Ultimately, the developer must be able to pursue a project that covers all these costs while still generating a return on investment that competes with all other investment options. Or, in the case of an affordable housing project, the developer must be able to compete for outside funding sources that reduce development costs to a level that allows the project to pencil while generating below-market rate revenues.

**Achievable rents or sales prices are a function of market demand for a given use, the attractiveness of a specific location, and the compatibility and desirability of the building with prospective occupants'**

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<sup>1</sup> Similar considerations apply to non-profit developers, such as builders of affordable housing. These developers must also consider construction costs, ability to compete for project financing, and the ability to construct a development project that is efficient to operate.



**needs.** A developer has little control over the market rate rents or sales prices that are achievable for a specific development project in a specific location. Instead, rents and sales prices are determined by demand for the development product within the broader market area and the desirability of a specific location for prospective tenants or buyers. A developer can, however, maximize achievable rents or sales prices within this market-determined range by designing a project that best aligns with demand.

**Building design factors—such as height, configuration, and uses—drive significant differences in construction costs per square foot of building area.** New buildings must meet local and state building code requirements. Among other issues, the requirements specify fire protection and life safety standards and related construction materials and design requirements for different building configurations and components. Each of these requirements and materials is associated with different construction costs—for example, costs for concrete and steel construction are significantly higher than wood framing. As a result, the construction cost per square foot of a building can vary significantly depending on applicable requirements. Many more stringent requirements are triggered based primarily on the height and usage of a building; the following Downtown Overlay assessment discusses specific applicable examples.

**Building design also plays a role in determining the building's operating efficiency for the owner/operator and the building's attractiveness for tenants.** A building's overall size, configuration, and design can impact its ability to attract buyers and tenants by improving or diminishing its operating efficiency. For example, an apartment building with a high percentage of leasable private living area (versus unleasable circulation and common areas) can operate more efficiently; an office building with large floorplates can better serve large businesses seeking to keep their employees together; and a larger hotel can spread fixed operating costs across a larger number of revenue-generating rooms.

## **Downtown Overlay Impacts on Residential, Office, and Hotel Development**

As suggested by the general development considerations described above, the impact of the Downtown Overlay on development activity will primarily depend on 1) overall demand for a specific use and location, and 2) whether the overlay's revised requirements allow developers to better attract businesses or residents, achieve higher rents or sales prices, generate greater revenues overall, reduce construction costs per square foot, or design a building with greater operating efficiency.

The following findings describe the Downtown Overlay's likely impacts on residential, office, and hotel development activity within the overlay's boundaries. For each of these uses, the findings first describe current development conditions and context, followed by the likely impacts on development feasibility and activity associated with providing additional height, lot coverage, and FAR.

### **IMPACTS ON RESIDENTIAL DEVELOPMENT ACTIVITY**

#### **RESIDENTIAL MARKET AND DEVELOPMENT CONDITIONS APPLICABLE TO DOWNTOWN PETALUMA:**

- **Strong demand exists for a wide range of housing products in Petaluma.** The *Economic and Market Analysis* prepared for the Petaluma General Plan update estimated potential growth in housing demand for an additional 5,570 to 6,460 new housing units in Petaluma through 2050. The study also found new housing unit permits in Petaluma were nearly evenly split between multifamily housing and single-family housing from 2010 to 2020. Long-term

increases in rents and sales prices in Petaluma further support ongoing demand for housing in the community.

- **Relatively tall and dense midrise housing products are rarely financially feasible to build in Petaluma (and the North Bay generally).** The *Residential Feasibility Analysis* completed for the Petaluma General Plan update found that the analyzed higher-density 3-story, 5-story, and 8-story multifamily building prototypes were unlikely to pencil in Petaluma.<sup>2</sup> The 5-story and 8-story prototypes performed especially poorly, as these products require a costly concrete parking structure or parking podium, respectively.
- **Midrise housing products are infeasible in Petaluma due to higher construction costs for these products and relatively low achievable rents / sales prices compared to the Bay Area's strongest market locations.** Market rate rents and sales prices in Petaluma are currently insufficient to cover the higher construction costs per square foot of such taller, higher-density housing products. Construction costs vary little throughout the Bay Area region, whereas achievable rents and sales prices are set by local market conditions. As a result, these midrise and higher-density housing products are most often built in communities that command high rents and sales prices per square foot, such as San Francisco, Berkeley, Downtown Oakland, Fremont, San Jose, and some Silicon Valley communities. Such products are also often built in transit-oriented locations that enable units to be marketed despite reduced parking ratios, thus saving construction costs or foregone revenue for space dedicated to parking.
- **A greater diversity of housing products may become financially feasible in Downtown Petaluma in the future—especially if transportation, placemaking, and private amenity improvements enhance the area's desirability as a residential neighborhood.** These improvements support future housing development in Downtown Petaluma in two ways. First, the improvements further increase the rents or sales prices that prospective renters or buyers would be willing to pay at new development projects. Second, the improvements and amenities (including day-to-day retail needs) allow for more trips to be completed on foot, bicycle, bus, and SMART—thus gradually enabling reductions in the amount of costly structured parking a developer would need to build to attract renters and buyers.

#### IMPACTS OF ADDITIONAL HEIGHT, LOT COVERAGE, AND FAR ON RESIDENTIAL DEVELOPMENT FEASIBILITY:

- **All else being equal, additional lot coverage will enhance the financial performance of otherwise financially feasible multifamily residential development projects and potentially accelerate housing development.** Additional lot coverage will allow developers to construct projects with greater revenue-generating area per floor while not triggering the significant increases in construction costs per square foot that occur at different height thresholds. Therefore, the additional lot coverage will generally benefit the financial performance of any housing products that generate positive net revenues per square foot of built area.<sup>3</sup> The additional lot coverage also allows greater flexibility to design buildings that are more efficient to operate.

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<sup>2</sup> The feasibility analysis examined the financial feasibility of four housing development prototypes, assuming the need to acquire a site and build a speculative project. The analysis provided policy-level insights as to why taller, higher-density housing products are not being built in Petaluma. The report also used the analysis to recommend potential policy changes to support development of the housing products.

<sup>3</sup> The benefit will vary depending on specific site configuration and size, since in some instances a project with a larger footprint may trigger new life-safety measures such as additional emergency egress requirements.

- **The Downtown Overlay's increased maximum height is likely to have little initial impact on residential development activity, as projects built between 45 feet and 75 feet require higher-cost construction materials and techniques.** Residential buildings above 45 feet—or four stories—in the Downtown Overlay area will likely need to consist of “podium” products in which residential units are built over a parking structure. Podium housing products are an efficient way to accommodate density in infill settings and smaller sites, such as in Downtown Petaluma. However, the first one or two floors of these structures require costly concrete construction. Podium products are not currently financially feasible in Petaluma, as found in the *Residential Feasibility Analysis*. As a result, the greater total cost per square foot to build podium products means that the Downtown Overlay's impact on residential construction activity would be limited until achievable prices and rents increase to a level enabling this housing product to be built.
- **Despite this challenge, the Downtown Overlay will provide greater long-term flexibility for housing developers and will increase the likelihood that a residential product would be built when development conditions improve.** The Downtown Overlay would expand the types of housing products that could be built in Petaluma. This greater flexibility would increase the likelihood of capturing future housing development and growth as market and development conditions—which are always dynamic—change over time.

#### IMPACTS ON OFFICE DEVELOPMENT ACTIVITY

##### OFFICE MARKET AND DEVELOPMENT CONDITIONS APPLICABLE TO DOWNTOWN PETALUMA:

- **Modest growth in office demand is anticipated for Petaluma, likely leading to gradual development activity over the coming decades.** The *Economic and Market Analysis* projected that Petaluma can potentially capture an additional 299,000 to 349,000 square feet of demand for office space through 2050.
- **Office demand in Petaluma is primarily driven by a combination of small professional services that can be accommodated in a variety of locations and larger employers that more often seek combined light industrial/flex/office spaces on greenfield sites.** Most new office development in Petaluma is driven by build-to-suit projects for large employers, often in conjunction with R&D, distribution, or manufacturing uses. Downtown Petaluma has historically attracted smaller increments of demand from smaller professional services tenants. This pattern could shift over time if additional employers follow the lead of Amy's Kitchen, which recently opted to renovate and expand an existing approximately 20,000 square foot building in Downtown Petaluma for their headquarters rather than pursue a larger project elsewhere.
- **Although development of new office space in Petaluma is likely to occur slowly, Downtown Petaluma does have potential to capture future demand based on its transportation (SMART Downtown Station) and retail amenities.** Downtown Petaluma offers assets not found elsewhere in Petaluma or most North Bay locations, including regional public transit access and numerous dining, entertainment, and retail amenities. As a result, the area is poised to continue attracting ongoing demand for office space, as exemplified by Amy's Kitchen.



#### IMPACTS OF ADDITIONAL HEIGHT, LOT COVERAGE, AND FAR ON OFFICE DEVELOPMENT FEASIBILITY:

- **Infill office development projects must be customized for the needs of targeted tenants; the Downtown Overlay would provide greater flexibility to accommodate evolving demand and opportunities.** Development of new office space in Petaluma is likely to occur at a slow and uneven pace, with much of this demand being captured at larger greenfield sites. The flexibility provided by the Downtown Overlay would complement Downtown Petaluma's public transit and amenity offerings to help the area better compete for office development. Developers and prospective businesses would have more freedom to customize office projects for their needs within the larger total building envelope enabled by the overlay.
- **Additional lot coverage and height create new opportunities to attract office-based businesses seeking a larger total increment of space.** The Downtown Overlay will make it possible to more readily attract businesses that either desire a larger floor plate to consolidate workers on a single floor or that need a larger total building to accommodate their operations. While it is not possible to anticipate how many businesses will have these needs or when they will seek space, the Downtown Overlay provides an option for attracting businesses that might not otherwise seek space in Downtown Petaluma.

#### IMPACTS ON HOTEL DEVELOPMENT ACTIVITY

##### HOTEL MARKET AND DEVELOPMENT CONDITIONS APPLICABLE TO DOWNTOWN PETALUMA:

- **The Petaluma hotel market primarily serves a combination of leisure travelers visiting Wine Country on vacation and business travelers seeking regional access via Highway 101.** Both visitor segments are positioned for ongoing growth as wine country tourism expands and businesses continue to grow in the North Bay.
- **Petaluma and the North Bay are anticipated to continue capturing long-term growth in demand for additional hotel stays, in line with the gradual but consistent growth in room supply during the past twenty years.** The *Economic and Market Analysis* found that hotel development trends in Petaluma and Sonoma County show consistent long-term growth rates in hotel room inventory as the economy has expanded. The analysis found that Petaluma is positioned to capture demand for 244 to 383 additional hotel rooms by 2050. The EKN Appellation Hotel project's 93 rooms and the proposed addition of 18 rooms at the Hampton Inn at 450 Jefferson Street would add 111 rooms to Petaluma's inventory.
- **The overall hotel market in Sonoma County is undergoing a significant though uneven recovery compared to pre-Covid-19 pandemic conditions.** Data provided by Sonoma County Tourism<sup>4</sup> shows that countywide hotel occupancy rates continue to lag 2019 levels despite recovering significantly since 2020. Total revenue per available room exceeded 2019 levels in 2022, but performance has declined in 2023 thus far.

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<sup>4</sup> Recent hotel market performance data is available at <https://www.sonomacounty.com/partners/statistics>

IMPACTS OF ADDITIONAL HEIGHT, LOT COVERAGE, AND FAR ON OFFICE DEVELOPMENT FEASIBILITY:

- **Additional height, lot coverage, and FAR are especially likely to benefit hotel development in Downtown Petaluma, as construction costs per square foot of building area are likely to remain consistent or decline as infill hotel buildings increase in size.** A hotel built in an urban infill setting such as Downtown Petaluma is likely to be built as a steel and concrete building, including parking. This is among the most expensive construction types per square foot of built area. However, these costs per square foot would largely remain consistent or even decline if such a hotel were to be built to the allowable limits under the Downtown Overlay, since the construction type would remain the same for the taller building. As a result, the Downtown Overlay would enable a hotel to be built with additional revenue-generating rooms while not triggering major increases in construction costs per square foot.
- **The larger building size enabled by the Downtown Overlay also increases the likelihood of hotel development by enabling the creation of a hotel that may be more efficient to operate and more likely to attract different operators over time.** The Downtown Overlay provides additional design flexibility that enables a prospective hotel developer or operator to further customize the size and configuration of their property to maximize its operational efficiency.

# POTENTIAL ONGOING CITY REVENUES ASSOCIATED WITH THE PROPOSED EKN APPELLATION HOTEL PROJECT

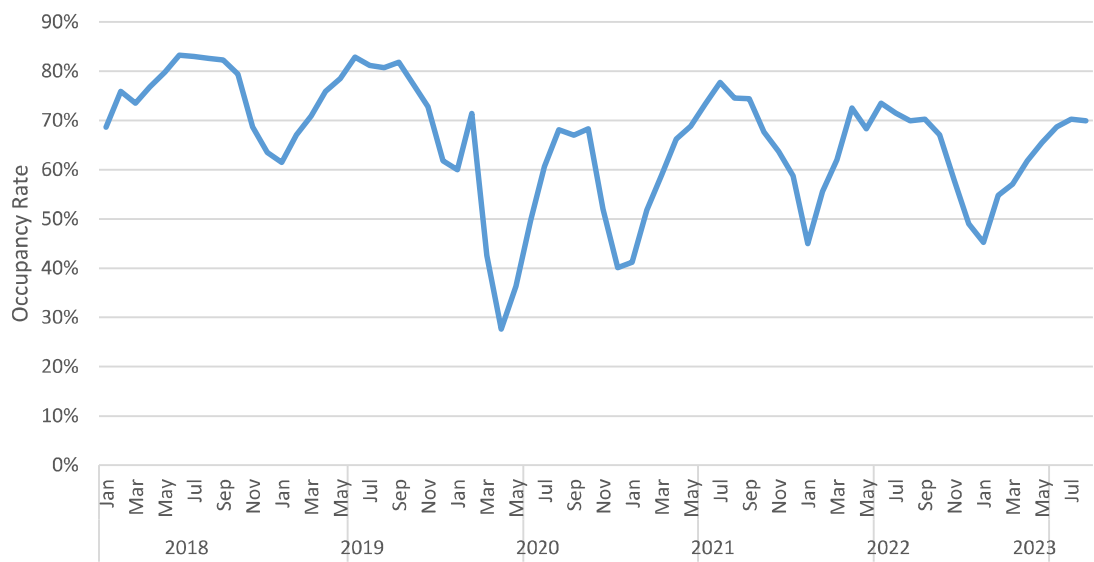
As part of the EKN Appellation hotel project applicant’s submissions to the City of Petaluma, the applicant completed estimates of the hotel’s projected economic impacts—including employment levels, projected new revenue, and the tax revenues associated with projected new revenue. This section of the memo describes the results of Strategic Economics’ estimate of the project’s expected impacts on the City of Petaluma’s tax revenue based on an independent market assessment and analysis of the project’s potential value and revenue generation. This section begins with an overview of relevant Petaluma hotel market indicators, followed by an analysis of expected value and revenue generation for the EKN Appellation project and analysis of associated Petaluma tax revenues. The section concludes with a comparison of overall findings to the applicant’s estimates of tax revenue.

## Overview of Hotel Market Conditions in Petaluma

### PETALUMA HOTEL MARKET TRENDS

**Overall, the Petaluma hotel market is still recovering from the impacts of the COVID-19 pandemic.** Figure 3 shows monthly trends in occupancy rate from 2018 through August of 2023 for all Petaluma hotels. In addition to the seasonal trends shown in the figure, monthly occupancy rates in Petaluma declined significantly in March of 2020 and have only partially recovered in 2022 and 2023.

FIGURE 3: OCCUPANCY RATE TRENDS, ALL PETALUMA HOTELS, 2018 TO 2023

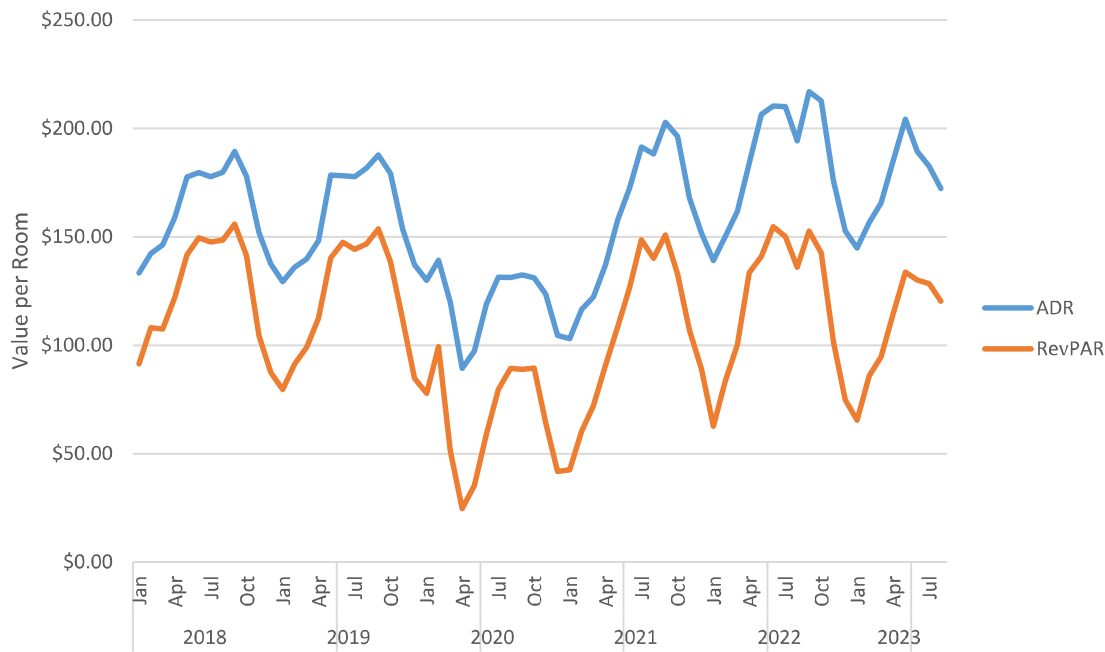


Source: CoStar, 2023; Strategic Economics, 2023.

**The average daily rate (ADR) for hotels in Petaluma has risen slowly to above pre-pandemic levels in 2022 and 2023, but these increases have not been accompanied by corresponding increases in total revenue.** After significant reductions in ADR during 2020 and 2021, ADRs at Petaluma hotels

increased substantially in 2022 and 2023. However, because occupancy rates remain low, revenue per available room (which is a function of ADR and occupancy rate) for Petaluma hotels has not returned to pre-pandemic levels for most months in 2022 and 2023. These findings are shown in Figure 4. CoStar projects that hotels in the Santa Rosa/Sonoma County market will not exceed 2019 levels for RevPAR on an annual basis until 2025.

**FIGURE 4: AVERAGE DAILY RATE AND REVENUE PER AVAILABLE ROOM TRENDS, PETALUMA HOTELS, 2018 TO 2023**



Source: CoStar, 2023; Strategic Economics, 2023.

### REVENUE ASSUMPTIONS

While overall market trends have a significant impact on each hotel's performance, individual hotel revenue is also influenced by each hotel's class, size, age or condition, amenities, and unique location. The analysis of hotel and restaurant revenue in this memo draws upon the following project description:<sup>5</sup>

"A 93 room, 6-story hotel on top of 1 level of sub-terranean, valet only parking (58 stalls). The parking is designed to include a stacker system to allow 2 parking stalls per bay. The hotel will have a full service, 3-meal restaurant on the ground floor, and a publicly accessible bar and event space on the occupied roof. The hotel when completed will be an upscale, boutique branded hotel, designed to embrace the history of Petaluma."

Based on these characteristics, Strategic Economics used the following assumptions to inform revenue calculations:

<sup>5</sup> EKN Development Group, 2022.

- The hotel will have 93 rooms.
- The hotel will be an *upscale, boutique, full-service* hotel
- The hotel will contain a 3-meal restaurant, bar, and event space

Strategic Economics evaluated potential hotel revenue based on a combination of current revenue metrics for comparable hotels and forecasts of continued recovery in the Santa Rosa/Sonoma County hotel market. Figure 5 provides a summary of revenue references and final assumptions from a competitive set of similar hotels in Petaluma, Santa Rosa, and Napa. These revenue assumptions were based on a theoretical three-year market recovery, and a rebound in hotel occupancy rates that would be consistent with a stabilized hotel product.<sup>6</sup> The basis for ADR and occupancy rates came from a “competitive set” of hotels focused on upscale hotels that included restaurants, with between approximately 40 and 150 total rooms. The competitive set also focused on hotels in similar locations to that of Downtown Petaluma within other Sonoma County and Napa County communities. The final hotel revenue per available room (RevPAR) estimate of \$157 was based on assuming 75 percent occupancy and a \$209 average daily rate.

Assumptions of “gross other” hotel revenue (non-room and non-restaurant revenue) and overall operating expenses are also shown in Figure 5. These assumptions were based upon a combination of feedback from developers throughout the Bay Area about budget profiles for full-service hotels and hotel budget models for the Northern California Region, provided by CoStar.

**FIGURE 5: HOTEL REVENUE ASSUMPTIONS, PER ROOM**

	2019	2023	2024 Projected	2025 Projected
<b>CoStar: Santa Rosa Market, Upscale &amp; Upper Midscale</b>				
ADR	\$184	\$216	\$229	\$234
Occupancy	72%	60%	60%	61%
RevPAR	\$133	\$129	\$137	\$143
<b>STR Competitive Set</b>				
ADR	\$191	\$194		
Occupancy	79%	65%		
RevPAR	\$150	\$126		
<b>Final Assumptions</b>				
ADR		\$194	\$205	<b>\$209</b>
Occupancy		65%	70%	<b>75%</b>
RevPAR		\$126	\$144	<b>\$157</b>
<b>Other Revenue Assumptions</b>				
Non-Room & Non-Restaurant Revenue, as Share of RevPAR (Gross Other Revenue)				<b>18%</b>
Operating Expenses, as Share of Total Revenue				<b>62.5%</b>

Sources: Strategic Economics, 2023; CoStar, 2023; STR, 2023; Developer Interviews, 2023.

Notes: Competitive set based upon Hotel Petaluma in Petaluma; Courtyard Petaluma in Petaluma; Hilton Garden Inn in Napa; Cambria Hotel Napa Valley in Napa; Cambria Hotel in Napa; Courtyard Santa Rosa; Hotel La Rose in Santa Rosa; and Hotel E in Santa Rosa.

<sup>6</sup> This approach should produce a revenue estimate that is similar to the applicant’s decision to base revenue projections on year three of hotel operations. The three-year recovery forecast was based primarily on CoStar’s projections of market recovery for the Santa Rosa Market. However, for years beyond this three-year forecast, Strategic Economics did not assume that hotel revenue would increase at a rate higher than inflation.

Revenue estimates for the restaurant portion of the development were calculated by multiplying the hotel restaurant's total size by standard metrics for restaurant sales per square foot. This approach differed from a typical method of calculating hotel restaurant revenue, where food and beverage revenue is calculated as a share of total expected room revenue. Calculating restaurant revenue separately was intended to create a more nuanced estimate of overall restaurant revenue based on the restaurant's size. As shown in Figure 6, sales per square foot estimates were based on the average value for restaurants in California sales tax data provider HDL's "Dinner House" category, the highest sales category for sit-down restaurants. This figure, \$896 per square foot, was multiplied by the total square feet of the restaurant as shown in the applicant's plans, including kitchen, interior seating, and outdoor seating. The resulting revenue estimate was approximately \$4.5 million annually.

**FIGURE 6: RESTAURANT REVENUE ESTIMATE**

	Unit	Value
Restaurant Size, Including Outdoor Seating	Square Feet	5,041
<u>Annual Sales</u>	<u>\$ per SF</u>	<u>\$896</u>
Total Annual Restaurant Revenue	\$ per Year	\$4,517,151

Sources: Strategic Economics, 2023; HDL, 2019; BLS, 2023.

Note: Uses average estimate from 2019 for HDL's "Dinner House" category, the restaurant category with highest sales per square foot. Adjusts to 2023 dollars using inflation index for San Francisco.

Total revenue for the hotel and restaurant property was calculated as a product of hotel revenue, restaurant revenue, and typical full-service hotel assumptions for other revenue and operating expenses. Revenue calculations are shown in Figure 7. In addition to the restaurant revenue described in Figure 6,<sup>7</sup> annual hotel room revenue is expected to exceed \$5 million, and additional hotel revenue—or "Gross Other Revenue" is expected to total nearly \$1 million. This gross other revenue would include revenue from event rentals, front desk sales of retail or food and beverage products, or other miscellaneous revenue. In total, the hotel property was estimated to generate nearly \$11 million in revenue annually. Based on current market capitalization rates of eight percent, this means that the total hotel property value would be approximately \$50.7 million.

**FIGURE 7: HOTEL TOTAL REVENUE AND PROPERTY VALUE CALCULATIONS**

Hotel	Daily/room	Annual/room	Annual Total
Gross Room Income (RevPAR)	\$157	\$57,341	\$5,332,685
Restaurant Revenue		\$48,572	\$4,517,151
<u>Gross Other Revenue</u>	<u>\$28</u>	<u>\$10,368</u>	<u>\$964,266</u>
Gross Total Revenue	\$186	\$116,281	\$10,814,102
<u>Less: Operating Expenses</u>	<u>62.5%</u>	<u>-\$72,675</u>	<u>-\$6,758,814</u>
<b>Annual Net Operating Income</b>		<b>\$43,605</b>	<b>\$4,055,288</b>
Cap Rate	8.00%		
<b>Hotel Property Value</b>		<b>\$545,066</b>	<b>\$50,691,104</b>

Sources: Strategic Economics, 2023; CoStar, 2023; STR, 2023; Developer Interviews, 2023.

<sup>7</sup> Notably, the restaurant revenue calculation described in Figure 6 resulted in a much higher revenue than would be calculated by estimating restaurant revenue as a share of total room income based on typical full-service hotel budgets. Assuming that food and beverage revenue accounts for 14 percent of total hotel income, the total restaurant revenue would be approximately \$1 million. However, individual hotel approaches to restaurant revenue can vary widely from hotel to hotel.



## Estimated City of Petaluma Revenues Associated with Hotel Project

Based on the revenue the hotel, restaurant, and associated building uses are expected to generate, the project would generate tax revenue for the City of Petaluma via its transient occupancy tax (TOT), sales taxes, and property taxes. While most of these funds would be applied to the City's General Fund, the present analysis also counts tax dollars that would go to other City funds. For example, the City's Transient Occupancy Tax goes into a separate TOT fund, which is used in part to support the City's economic development activities, downtown beautification, and sidewalk repair, among other things. However, based on the City's most recent budget, approximately 75 percent of the direct TOT revenue in 2022 was transferred to the General Fund.<sup>8</sup> Because the exact percentage transferred to the General Fund varies from year to year, this analysis calculated the impacts of project revenues on all City funds, rather than isolating the General Fund impacts.

It should be noted that the project would generate additional tax revenue benefits for other entities that were excluded from the scope of this study. The analysis did not include tax dollars from TOT, property, or sales taxes that would go to Petaluma Schools, Sonoma County, or other government entities. In addition, the analysis did not include any one-time revenue that would be generated by one-time development impact fees or potential property transfer tax if the property is sold. Each of these revenue sources were excluded because they do not represent annual recurring sources of revenue for the City.

### TRANSIENT OCCUPANCY TAX

**The hotel is expected to generate over \$550,000 of TOT revenue for the City each year, equating to \$2.8 million for every five years and \$13.8 million over the course of 25 years.** The City of Petaluma collects a 10 percent transient occupancy tax on all stays of 30 days or less in hotels, campgrounds, RV parks, or vacation rentals. In addition, the Petaluma Tourism Improvement District assesses a two percent tax on hotel and lodging activity within the city boundaries. Most of this revenue is managed separately by the Tourism Improvement District, but approximately 17 percent of revenue from the two percent tax is remitted to the City. In order to calculate City TOT revenue from the applicant's project, Strategic Economics multiplied annual hotel room revenue estimates times the combined transient occupancy tax rate of 10.3 percent. This calculation is shown in Figure 8.

FIGURE 8: ANNUAL TRANSIENT OCCUPANCY TAX (TOT) ESTIMATES, IN CONSTANT 2023 DOLLARS

	1 Year	5 Years	10 Years	25 Years
Total Room Revenue	\$5,332,685	\$26,663,423	\$53,326,846	\$133,317,116
TOT Rate	10.0%	10.0%	10.0%	10.0%
City Share of PTID	0.3%	0.3%	0.3%	0.3%
<u>Total TOT Rate</u>	<u>10.3%</u>	<u>10.3%</u>	<u>10.3%</u>	<u>10.3%</u>
Total TOT Tax Revenue	\$551,400	\$2,756,998	\$5,513,996	\$13,784,990

Sources: City of Petaluma, 2023; Strategic Economics, 2023.

Note: The Petaluma Tourism Improvement District (PTID) assesses a 2% tax on hotel and lodging activities in addition to the TOT. Approximately 17% of this 2% (or 0.3%) is remitted to the City for development projects and programs.

<sup>8</sup> This percentage applies to the ten percent TOT that goes directly to the City and does not include the share of two-percent Petaluma Tourism Improvement District (PTID) revenue that is remitted to the City. Similar General Plan revenue-sharing practices are used for the City's Measure U Sales Tax. Based on the City's 2023-2024 budget, approximately 86 percent of expected Measure U sales taxes for the next seven years are budgeted to be transferred to the City's General Fund.

## SALES TAX

In addition to its base Bradley Burns Sales Tax collection rate of one percent, the City of Petaluma adopted a one cent sales tax in 2020 that adds to its local sales tax collections. This ballot measure—Measure U—brought the City’s total sales tax collection rate to 9.5 percent. As shown in Figure 9, the City of Petaluma receives two percent of taxable sales tax revenue, while the remainder goes to other jurisdictions such as the State of California and Sonoma County. These tax rates were used alongside total restaurant and other sales estimates to estimate the total sales taxes raised for Petaluma from the hotel project. Results of this analysis are shown in Figure 10, which used typical budget distributions for full-service hotels to estimate revenue raised from non-room and non-restaurant activities. Strategic Economics also used California Department of Tax and Fee Administration sales tax policies to estimate the share of each revenue category’s sales that would be taxable.

FIGURE 9: SALES TAX COLLECTION RATE ASSUMPTIONS

	Rate
<b>Total Sales Tax Rate</b>	9.5%
<b>Petaluma Portions</b>	
Sales Tax Rate	1.0%
Measure U Sales Tax	<u>1.0%</u>
Total Petaluma Sales Tax	2.0%

Sources: City of Petaluma, CAFR, 2022; CDTFA, 2023, Strategic Economics, 2023.

FIGURE 10: ESTIMATED ANNUAL SALES TAX COLLECTIONS FROM RESTAURANT AND OTHER HOTEL REVENUE, IN CONSTANT 2023 DOLLARS

	Revenue	% Taxable	Petaluma Sales Tax	Total Sales Tax
<b>Tax Rate</b>			2.0%	9.5%
<b>Taxable Categories</b>				
<b>Restaurant</b>	<u>\$4,517,151</u>	<u>100%</u>	<u>\$90,343</u>	<u>\$429,129</u>
<b>Other Revenue</b>	\$964,266			
Other F&B	\$292,202	50%	\$2,922	\$13,880
Other Departments	\$387,168	75%	\$5,808	\$27,586
<u>Miscellaneous Income</u>	<u>\$284,897</u>	<u>75%</u>	<u>\$4,273</u>	<u>\$20,299</u>
<b>Total Taxable Sales</b>	\$5,481,417		\$103,346	\$490,894

Source: Strategic Economics, 2023; CoStar, 2023; CDTFA, 2023.

Notes:

Estimates for other revenue based upon overall hotel room revenue, and the share of total revenue comprised by those departments at typical full-service hotels.

All restaurant sales except pre-packaged takeaway items would be taxable. For other food & beverage, tax applies to 33% of vending machine sales of cold food products and 100% of carbonated beverages. Assumed 75% taxable for all other departments and income.

In total, the hotel project is expected to generate \$100,000 per year in sales tax revenue for the City of Petaluma, and nearly \$500,000 of total sales tax revenue for all government jurisdictions. Extrapolated over ten years, these totals would be over \$1 million, and nearly \$5 million, respectively. The full sales tax estimate results are shown in Figure 11.

FIGURE 11: ESTIMATED SALES TAX COLLECTED FOR 5, 10, AND 25 YEARS, IN CONSTANT 2023 DOLLARS

Years	Petaluma Sales Tax	Total Sales Tax
1 Year	\$103,346	\$490,894
5 Years	\$516,730	\$2,454,468
10 Years	\$1,033,460	\$4,908,935
25 Years	\$2,583,650	\$12,272,339

Source: Strategic Economics, 2023.  
Note: Does not adjust for inflation.

## PROPERTY TAX

The property is also expected to generate more than \$55,000 per year in property tax revenue for the City of Petaluma. This calculation, shown in Figure 12, is based on the City's "direct" property tax rate, and does not include taxes that go to other sources, such as Petaluma Schools, Sonoma County, or other tax levies. Based on the property's expected capitalized value of \$50.7 million, the 0.11% tax rate received by the City of Petaluma would equate to \$279,000 in tax revenue every five years.

FIGURE 12: ESTIMATED PROPERTY TAX IMPACTS, IN CONSTANT 2023 DOLLARS

	Unit	Value
Property Value	Capitalized Value	\$50,691,104
<u>Petaluma Property Tax Rate</u>	<u>% of Value</u>	<u>0.11%</u>
Total City Property Tax per Year		\$55,760
<b>Cumulative Total</b>		
5 Years		\$278,801
10 Years		\$557,602
25 Years		\$1,394,005

Sources: Strategic Economics, 2023; City of Petaluma, 2023.  
Note: Includes only the portion of property tax that goes directly to the City of Petaluma. Additional property tax revenue would be generated that benefits schools, Sonoma County, and other entities.

## CONCLUSIONS AND COMPARISON TO APPLICANT ESTIMATES

Overall, the project is expected to generate over \$700,000 in annual tax revenue for the City of Petaluma's budget—primarily from TOT revenues. A full 25-year projection of tax revenue for each tax category is shown in Figure 13. Approximately 75 percent of total expected tax revenue is expected to come from the hotel's TOT revenue, based on hotel room revenue. Over a 25-year period, the hotel would generate \$13.8 million in TOT, \$2.6 million in sales tax, and \$1.4 million in property tax revenue for the City of Petaluma. The General Fund would receive the majority of these funds. In comparison, the applicant's estimates of tax impacts from the projects are shown in Figure 14.

FIGURE 13: ESTIMATED CITY OF PETALUMA REVENUES ASSOCIATED WITH THE PROJECT, IN CONSTANT 2023 DOLLARS

	1 Year	5 Years	10 Years	25 Years
TOT Tax	\$551,400	\$2,756,998	\$5,513,996	\$13,784,990
Sales Tax	\$103,346	\$516,730	\$1,033,460	\$2,583,650
<u>Property Tax</u>	<u>\$55,760</u>	<u>\$278,801</u>	<u>\$557,602</u>	<u>\$1,394,005</u>
<b>Total</b>	<b>\$710,506</b>	<b>\$3,552,529</b>	<b>\$7,105,058</b>	<b>\$17,762,645</b>

Source: Strategic Economics, 2023  
Note: All revenue estimates for City of Petaluma only.

**FIGURE 14: APPLICANT ESTIMATES OF TAX REVENUES ASSOCIATED WITH THE PROJECT, FOR CITY OF PETALUMA AND “THE REGION”**

	<b>5 Years</b>	<b>10 Years</b>	<b>25 Years</b>
TOT (City of Petaluma)	\$5,100,000	\$11,400,000	\$37,100,000
Sales Tax (City of Petaluma)	\$549,000	\$1,200,000	\$3,800,000
<u>Property Tax (Region)</u>	<u>\$3,600,000</u>	<u>\$7,800,000</u>	<u>\$24,900,000</u>
<b>Total</b>	<b>\$9,249,000</b>	<b>\$20,400,000</b>	<b>\$65,800,000</b>

Source: EKN Development Group & Appellation Hotels, 2023

Note: The applicant indicated that TOT and Sales Tax revenue were estimated based on the City of Petaluma only. Conversely, property tax revenue was described as “for the region.” More explanation of how these estimates compare to Strategic Economics estimates is provided in the paragraphs that follow.

Strategic Economics’ tax revenue estimates cannot be directly compared to the project applicant’s estimates, which are shown in Figure 14. The following factors explain most of the differences between the estimates, although insufficient information was included with the project applicant’s estimates to fully understand the underlying approach and assumptions incorporated in the applicant’s analysis:

- Most critically, the applicant appears to have reported the full property tax revenue for the region, rather than just the City of Petaluma. This difference in property tax rate calculations would partially—but not fully—explain the difference in property tax estimates between Strategic Economics and the applicant.
- The applicant reported significantly higher revenue projections for both the hotel and restaurant than Strategic Economics’ forecasts.
  - The applicant projected \$9.5 million in annual hotel revenue and \$8.5 million in annual restaurant revenue. In comparison, Strategic Economics projects \$5.3 million in hotel room revenue, \$4.5 million in restaurant revenue, and nearly one million dollars in other hotel revenue.
  - The applicant reported revenue projections as “inflation adjusted to a 2023-dollar value.” However, the applicant’s ten-year estimates are more than twice as large as the five-year estimates, and 25-year estimates are more than what would be expected if trends from years five to ten were extrapolated to years 11 to 25. Since the applicant indicated that their revenues had been adjusted to constant 2023 dollars, their projections must have assumed that revenue will increase at an average rate faster than inflation. In contrast, Strategic Economics assumed that future revenue increases would match the rate of inflation.
- Both Strategic Economics and the applicant arrived at similar sales tax estimates, but likely through different methods of calculations.
  - As described above, the applicant reported larger annual revenue estimates for both hotel and restaurant sales than Strategic Economics. It is not clear how the applicant determined what percentage of revenue would be taxable, or what sales tax rate to apply to calculate total revenue.

## ATTACHMENTS:

1. *Economic and Market Analysis*, Petaluma General Plan update, November 3, 2021.  
Available online at:  
[https://static1.squarespace.com/static/5ea880f6d9a2075c7b7f54af/t/6184a9330fac8669df1bd3c4/1636084020825/PetalumaGPEconMktAnalysis\\_20211103.pdf](https://static1.squarespace.com/static/5ea880f6d9a2075c7b7f54af/t/6184a9330fac8669df1bd3c4/1636084020825/PetalumaGPEconMktAnalysis_20211103.pdf)
2. *Residential Feasibility Analysis*, Petaluma General Plan update, August 10, 2023.  
Available online at:  
[https://static1.squarespace.com/static/5ea880f6d9a2075c7b7f54af/t/64e52874f57ab9619673eef5/1692739701293/Petaluma\\_GP\\_5.3\\_Residential+Feasibility+Report\\_20230810+%281%29.pdf](https://static1.squarespace.com/static/5ea880f6d9a2075c7b7f54af/t/64e52874f57ab9619673eef5/1692739701293/Petaluma_GP_5.3_Residential+Feasibility+Report_20230810+%281%29.pdf)