



JULY 2015

IN FOCUS:
**SONOMA COUNTY CALIFORNIA
HOTEL MARKET**

Anurat Rojanapairat
Senior Associate

Ester Wan
Analyst



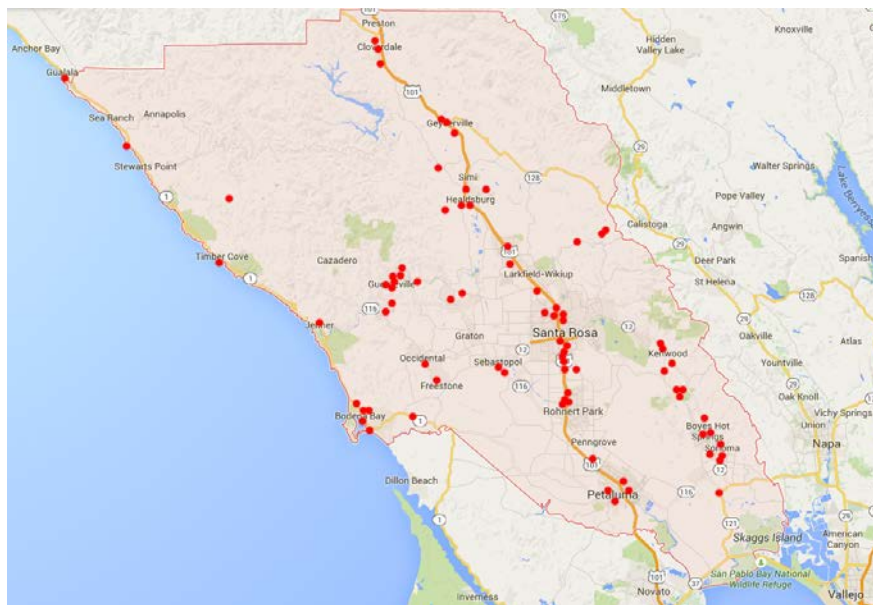
As one of Northern California's major recreational and tourist destinations, the Sonoma County hotel market is flourishing. With more available land than neighboring Napa, lower barriers to entry, and healthy demand levels, hotel supply is increasing.

Less than an hour's drive north of San Francisco, Sonoma County offers nearly 60,000 acres of vineyards, 400+ wineries, rest and relaxation along the Russian River, numerous hot springs, a NASCAR raceway, and ample outdoor recreation opportunities. Bound by miles of rugged Pacific Coast along the west and Napa County to the east, the area has a long history of tourism and wine production dating back to 1812. Most hotel development occurs in the population clusters located along U.S. Highway 101 and the Valley of the Moon/CA State Route 12, and will be the focus of this article.

LODGING MARKET

MAP OF SONOMA COUNTY HOTELS

Sonoma County continues to grow as a premier leisure destination, welcoming more than 7.5 million visitors in 2014. Tourism spending reached \$1.6 billion in 2014, or a 2.4% increase over the previous year.¹ Roughly 90% of the County's visitors are domestic; however, with an increase in tourists from Asia and Europe – and from China specifically – Sonoma County is poised to take advantage of rising international California wine-country tourism.² Napa Valley's reputation as a world-class wine region as depicted in popular media, has shifted China's emerging middle-class population to choose California over other destinations like France, with neighboring Sonoma County also benefitting from this increase in tourism.³ Compared to Napa, Sonoma County has a more casual character, with coastal scenery, less traffic, and access to wine tasting rooms without an appointment.



In terms of tourism hot spots, Healdsburg has the highest amount of visitors, followed by Santa Rosa. Most annual large-scale cultural events showcase food and winemaking. Popular events include VinOlivio, Savor Sonoma Valley, Russian River Valley Pinot Classic, Sonoma County Hot Air Balloon Classic, and the Sonoma County Harvest Fair.

Sonoma County has approximately 100 lodging properties totaling just over 6,100 rooms. These figures reflect a large inventory of smaller, independently-operated hotels; over 75% of the properties contain less than 100 rooms. Most of the larger, branded properties are located in metropolitan areas such as Santa Rosa and Rohnert Park.

¹ Eloísa Ruano González, "Sonoma County Tourism Continues to Surge," *The Press Democrat*, May 7, 2015.

² Sonoma County Economic Development Board, *2014 Sonoma County Annual Tourism Report*.

³ Jennifer Huffman, "Napa Valley Tourism on the Rise," *The Weekly Calistogan*, June 9, 2015.

Over the past 10 years, room supply shifted away from full-service hotels to limited- and select-service property types as land prices and development costs were generally high. Examples of hotels constructed during this time include two **Hampton Inn and Suites**, a **Hilton Garden Inn**, a **Super 8**, and a **Holiday Inn Express**. The only full-service luxury property to open was the **Hotel Les Mars** in Healdsburg in 2005. However, in the past few years, with the healthier economy, visitor demand surge, and more fluid bank financing, the market is seeing several new full-service hotel developments.

MAJOR DEVELOPMENTS

The **Sonoma-Marín Area Rail Transit (SMART)** is a passenger rail and bicycle-pedestrian pathway project that will serve a 70-mile corridor between Larkspur in Marin County to Cloverdale in northern Sonoma County. SMART, which is anticipated to take more than 1.4 million cars off U.S. Highway 101 annually, will provide an alternative transportation option for tourists and commuters.⁴ Phase I, the 42-mile rail section connecting San Rafael to Sonoma County Airport is currently set to be completed in December 2016. Full integration of the rail system will occur as future funding for the project becomes available.

Bell Village is a mixed-use project in Windsor that will include retail and office space as well as over 300 new residential town houses. Phase I is slated to be completed by end of 2015. Additionally, the new **Beverage District** will involve beer and spirits distilleries (as the name implies) and will be located just south of downtown Windsor.

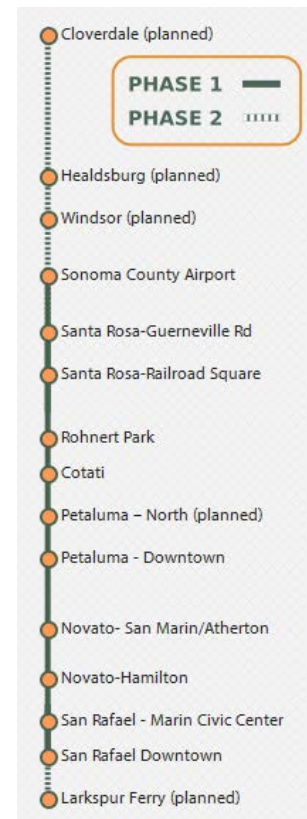
Construction on the **University District** near the Sonoma State University campus is currently underway, with three of 12 new neighborhoods anticipated to be completed by the end of 2015. The Specific Plan for the area includes 1,645 residential, commercial, and affordable housing units, plus two public parks.

The mixed-use development of the **Roseland Village Neighborhood Center** is part of a redevelopment project set to help revitalize the Roseland Community in Santa Rosa. The development will contain a plaza, library and community center, and mixed residential and commercial space.

HOTEL SUPPLY

Like other jurisdictions in California, new hotel development in certain areas of Sonoma County often faces substantial hurdles and requires a lengthy timeline due to limited community support and litigation. New development and redevelopment projects may also be subject to additional infrastructure improvements, which may notably inflate development costs, rendering a project infeasible. Nevertheless, as occupancy and average rate levels surpass prior peaks, development interest has increased, particularly in the cities of Sonoma and Healdsburg. As illustrated in the table below, supply is expected to increase by roughly 9% over the next 2-3 years.

SONOMA-MARIN RAIL TRANSIT STATIONS



⁴ <http://main.sonomamarintrain.org/traffic-relief/>

SONOMA COUNTY HOTEL DEVELOPMENT SUMMARY

Proposed Property	Product		Rooms	Est. Open Date	Developer	Development Stage
	Type	City				
Holiday Inn Windsor	FS	Windsor	100	Early 2016	Town Green Enterprises, LLC	Under Construction
h3 Guesthouse	B	Healdsburg	39	Dec-16	Piazza Hospitality Group	Seeking Entitlement
Saggio Hills	FS	Healdsburg	130	Mid 2017	Korman Development	Pending Approval
Cloverdale Rancheria Destination Resort	FS	Cloverdale	244	-	Sealaska Corporation	Early Development
Proposed Hotel West Napa Street	B	Sonoma	59	-	Kenwood Investments	Early Development
Total			572			

Key: FS=Full Service; ES=Extended Stay; SS=Select Service; B=Boutique

Source: HVS, Build Central, San Francisco Business Times, developer and city planning department websites.

Most of the proposed hotels are in or near Healdsburg as a result of being one of Sonoma County's major attractions. Healdsburg was ranked #2 of the 20 best small tourist towns to visit in the United States by *Smithsonian Magazine* in 2014.⁵ The city showcases renowned farm-to-table restaurants, luxury hotels, art galleries and boutique shopping around its historic downtown square. Healdsburg has actively encouraged hotel development because of continued growth in visitation and demand levels. In contrast, the city of Sonoma has only one proposed project, as gaining city and community approval can be difficult and due to development restrictions in the Valley of the Moon. However, anti-hotel development sentiment may be shifting. A ballot measure to limit hotel development in that city was defeated in 2013. Known as Measure B, it would have capped new or expanding hotels at 25 rooms unless the city of Sonoma achieved an annual occupancy of 80%.

Two new hotel developments are proposed in Healdsburg. The **h3 Guesthouse** will be a 39-room boutique hotel located downtown. The 4-story hotel will include meeting space, an indoor-outdoor rooftop lounge, a swimming pool and garden park. This hotel will be a sister property to the nearby h2 Hotel and the Hotel Healdsburg; according to the owners, h3 is anticipated to be more moderately priced in comparison. Construction is slated to begin in the spring of 2015 with an anticipated 2016 completion date. The **Saggio Hills** project is a long-delayed 258-acre development which contains a luxury hotel and residential component on the north fringe of Healdsburg. The LEED-certified resort will be a 130-room, five-star ultra-luxury hotel that includes a restaurant, spa, demonstration cooking facility, and conference facilities. Plans for the residential development include 70 "resort" residences and villas. The Saggio Hills project is currently under review by the city and it is tentatively scheduled to begin construction in 2016.

In Sonoma, a 59-room hotel has been proposed at **153 and 541 West Napa Street**, half a block away from the city's historic plaza. The site will include multiple courtyards, restaurant, spa, pool, and parking. The project will be LEED-certified. The hotel is still in the early planning stages as the environmental studies are pending approval and as the developer accommodates city and community concerns.

The proposed **Holiday Inn Windsor** will be the first full-service hotel in Windsor and will feature a 100-room hotel with a restaurant, bar, and meeting space. The developer, Town Green Enterprises, owns the Holiday Inn Express on the west side of Highway 101 in Windsor. The project is conveniently located near the U.S. Highway 101 intersection with Old Redwood Highway. Work on the hotel began in September 2014 and is expected to be complete in early 2016.

The Bureau of Indian Affairs is in the final stages of environmental review for the proposed **Cloverdale Rancheria Destination Resort & Casino**. The Rancheria plans to build a \$320 million casino resort on 70 acres of tribal land adjacent to Cloverdale. The proposed 596,000ft² site includes a casino, a 244-room hotel and spa, restaurant, bar, an entertainment venue, and a convention center.

⁵ "The 20 Best Small Towns to Visit in 2014," *Smithsonian Magazine*, April 2014.

In 2014, the California Green Building Standard Code (CALGreen) became effective for all new buildings and certain alterations/additions for construction projects throughout California. Sonoma County has adopted and amended CalGreen, and also mandates that all project applicants hire a third-party green building special inspector to verify compliance with CalGreen requirements.⁶

HOTEL MARKET PERFORMANCE

Demand patterns in Sonoma County are seasonal in nature with high occupancy in the summer and weekends during the spring through autumn. Occupancy during these times in 2014 ranged between 80-85%. During the winter months, this rate dipped to just under 60%, giving an annual average for the county of 74-75% in 2014. Based on an HVS survey of market participants, average rate levels follow similar trends as occupancy, with peak demand in the summer and fall allowing for higher rates. The average daily rate for 2014 was near \$135, with a RevPar of approximately \$100, an increase from the year prior and a new all-time high. The year-to-date period through April 2015 registered an approximately 15% increase in RevPAR over the previous period. The Sonoma County market has seen five consecutive years of RevPAR increases. Sonoma County draws a significant portion of demand from both residents of and visitors to the greater Bay Area (San Francisco, Oakland, Berkeley, Silicon Valley, and Marin County). The area's tech boom and associated economic impact has also played a key role in attracting visitors.

RECENT TRANSACTIONS

Sonoma County records a few hotel sales each year, as most lodging properties are independently owned and not widely marketed. Branded properties in Santa Rosa are the most popular, and buyers tend to be California-based entities. The sale with the highest overall value and price-per-key was the **Fairmont Sonoma Mission Inn & Spa**, which is also the only full-service hotel to sell in over five years. The property transacted at \$97.1 million, or \$429,646 per key, in July 2013; however, the sale was not a true arms-length transaction and reflected an ownership structure change. The property had sold just a year prior in 2012 at \$88 million, or \$389,381 per key. The **Timber Cove Inn** also sold twice in this time frame, but the second sale was for an undisclosed price.

SONOMA COUNTY HOTEL TRANSACTIONS 2013-2015

Name	Location	Sale Date	Buyer	Rooms	Price	Price/Room	Est. Cap Rate
Hyatt Vineyard Creek	Santa Rosa	Mar-15	Thayer Lodging	155	\$29,100,000	\$187,419	-
Timber Cove Inn	Jenner	Dec-14	Ironstate Development	50	Undisclosed	Undisclosed	-
Motel 6 Santa Rosa South	Santa Rosa	Sep-14	Motel 6	104	2,800,000	26,923	-
Fern Grove Cottages	Guerneville	Jul-14	Sherman Tyler & Jennifer Lamarre	21	2,600,000	123,810	-
Fairmont Sonoma Mission Inn & Spa	Sonoma	Jul-13	Carey Watermark Investors, Inc./Fairmont Hotels & Resorts, JV	226	97,100,000	429,646	3.2%
Timber Cove Inn	Jenner	Aug-13	PRES Companies	50	10,300,000	206,000	-
Vagabond Inn Santa Rosa	Santa Rosa	Apr-13	Santa Rosa Motel Co., LP	100	4,750,000	47,500	-
Courtyard by Marriott Santa Rosa	Santa Rosa	Feb-13	Pacifica Companies	138	18,200,000	131,884	10.2%
Grape Leaf Inn Healdsburg	Healdsburg	Feb-13	539 Johnson Street, LLC (Kenneth C. Wilson)	12	2,000,000	166,667	-

Source: HVS and RCA.

CONCLUSION

Sonoma County is one northern California's major recreational destinations. Driven by strength of the Bay Area economy and surge in wine and "farm-to-table" tourism, lodging demand is expected to strengthen through the near term. The development of new supply over the next few years should further contribute to the market's attractiveness.

⁶ <http://www.sonoma-county.org/prmd/docs/grnbldg/index.htm>



About HVS

HVS, the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries, celebrates its 35th anniversary this year. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a network of more than 35 offices and more than 450 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry.

www.hvs.com

Superior Results through Unrivalled Hospitality Intelligence. *Everywhere.*

HVS CONSULTING & VALUATION in San Francisco, established in 1985 by Suzanne R. Mellen, performs numerous and varied consulting and valuation assignments. Our feasibility studies and appraisals have won wide acceptance among a broad base of developers, investors and the lending community.

About the Authors



Anurat Rojanapairat is a Senior Associate with HVS's San Francisco office. He performs hotel appraisals and feasibility studies across the United States and Mexico, with a special interest in Food & Beverage operations. He joined HVS in 2012 after working as the Assistant Director of Finance at the Ritz-Carlton in Half Moon Bay, California. Anurat graduated summa cum laude with a Bachelor of Science degree from the School of Hospitality Administration at Boston University. A native San Franciscan with deep roots in the restaurant industry, he also speaks conversational Thai and Indonesian. Anurat can be reached at +1-415-268-0358 or anurat@hvs.com.



Ester Wan joined HVS San Francisco in 2014 as an Analyst and brings with her a strong passion for the hotel industry. She has appraised resorts and hotels throughout California and nationwide. Prior to HVS, Ester earned her operations stripes at the SLS Hotel in Beverly Hills and W Hollywood Hotel in Los Angeles, and at the Portman Ritz-Carlton in Shanghai, China. She also worked in the Accounting and Finance department at Kimpton Hotels in Boston. She earned her Bachelor of Science degree magna cum laude from the School of Hotel Administration from the Boston University. Ester hails from Irvine, California, and speaks conversational Cantonese. Ester can be reached at +1-415-268-0370 or ewan@hvs.com.