

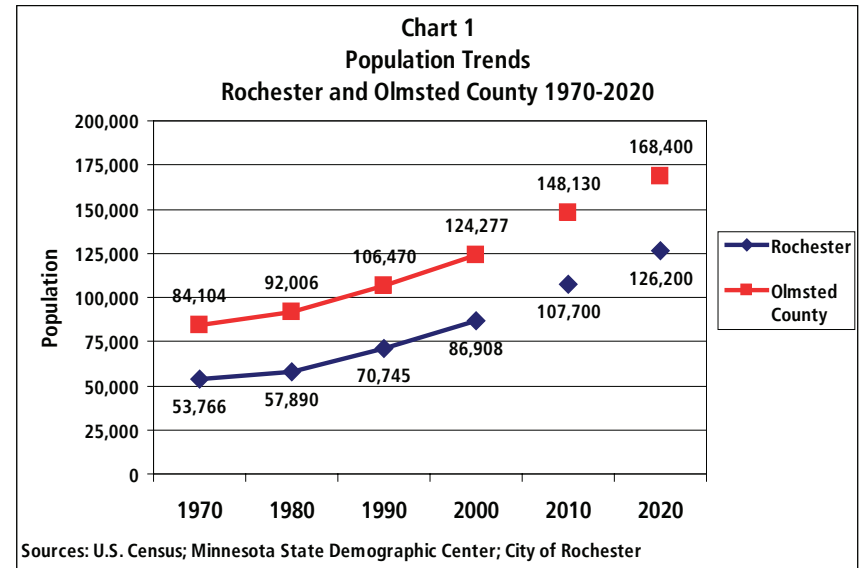
Appendix C: Second Street Corridor Market Analysis

INTRODUCTION

This report is a technical memorandum that summarizes findings from a market analysis conducted by Bonestroo in October and November of 2007. The market analysis is part of a larger planning effort to create a neighborhood plan for the 2nd Street Corridor in Rochester, Minnesota. The Corridor extends from 6th Avenue Southwest on the east to Highway 52 on the west. The market analysis was conducted during an early phase of the planning process and was intended to provide participants and stakeholders an understanding of the market conditions that will impact the potential for future development or redevelopment along the Corridor. Findings from this analysis were presented to the Plan's steering committee on November 14, 2007.

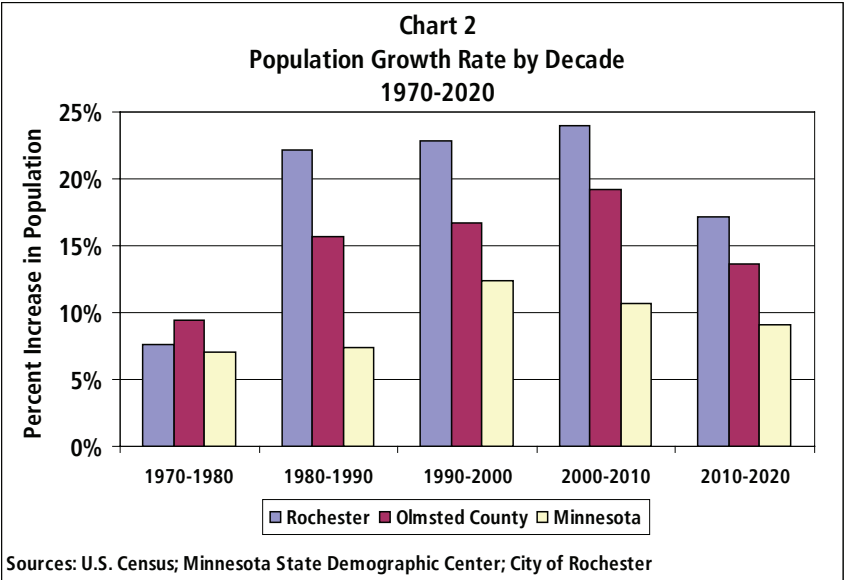
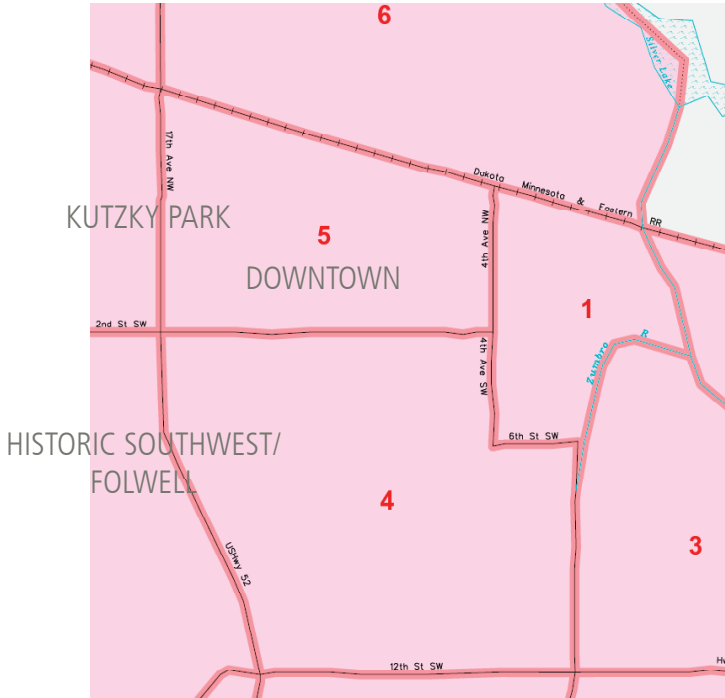
REGIONAL POPULATION GROWTH TRENDS

Rochester is a rapidly growing community. According to Chart 1 on the following page, Rochester had a population of just under 54,000 in 1970. By 2000, the City's population had increased to nearly 87,000. This impressive growth is anticipated to continue into the near future. The City's population is forecasted to approach 108,000 by 2010 and then exceed 126,000 by 2020. Although annexation of surrounding jurisdictions will contribute to future population growth of the City, the vast majority of this growth will be the result of natural increase and in-migration. This can be seen in Chart 1 in how the population of Olmsted County not in Rochester (i.e., one must subtract the Rochester figures from the Olmsted County figures) will have increased from about 30,000 in 1970 to more than 42,000 by 2020.



Rochester is an important growth center in the State of Minnesota. Chart 2 displays how Rochester's population growth rate has substantially outpaced the State growth rate since 1980 and is anticipated to continue to do so through 2020.

MAP 1: CENTRAL ROCHESTER CENSUS TRACTS



Charts 1 and 2 emphasize the importance of Rochester as a growing community in which new places of employment and new housing will need to be created in order to meet forecasted growth trends.

CENTRAL CITY DEMOGRAPHIC TRENDS

In analyzing the market potential of redevelopment along the 2nd Street Corridor between 6th Avenue SW and Highway 52, Bonestroo reviewed a number of demographic characteristics of neighborhoods surrounding the Corridor. Fortunately, Census Tracts 1, 4, and 5, as defined by the U.S. Census Bureau, closely align with what are generally considered the neighborhoods of Downtown, Historic Southwest/Folwell, and Kutzky Park. The location of these Census Tracts are displayed in Map 1.



Chart 3 displays population trends for the three central Rochester neighborhoods. According to the Chart, Folwell and Kutzky Park experienced a substantial decline in population from 1970 to 2000, while Downtown experienced a substantial increase. Looking forward, though, it is forecasted that the population in Folwell and Kutzky Park will grow modestly through 2020 and that Downtown will continue its recent trend of population growth as well. The turnaround for Folwell and Kutzky Park is based on new housing development that has occurred in those neighborhoods since 2000. If new housing development were to cease or, conversely, far exceed recent trends, then the population forecasts would need to be revised.

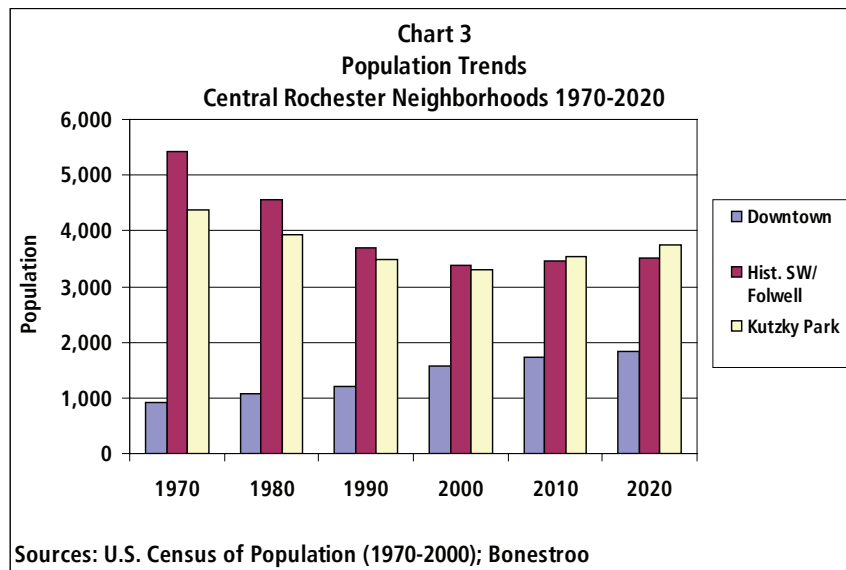


Chart 4 presents trends in the median age for each of the three neighborhoods analyzed and for Rochester, Olmsted County, and Minnesota. From the chart, we can see that the median age has increased every decade since 1970 for each neighborhood analyzed as well at the regional and state level. Therefore, regardless of the geographic scale, the overall population appears to be aging. This is important because an aging population will affect commercial development through the types of retail stores demanded. It will also affect the demand for housing as older households often prefer housing units with lower-maintenance and better accessibility to goods and services.

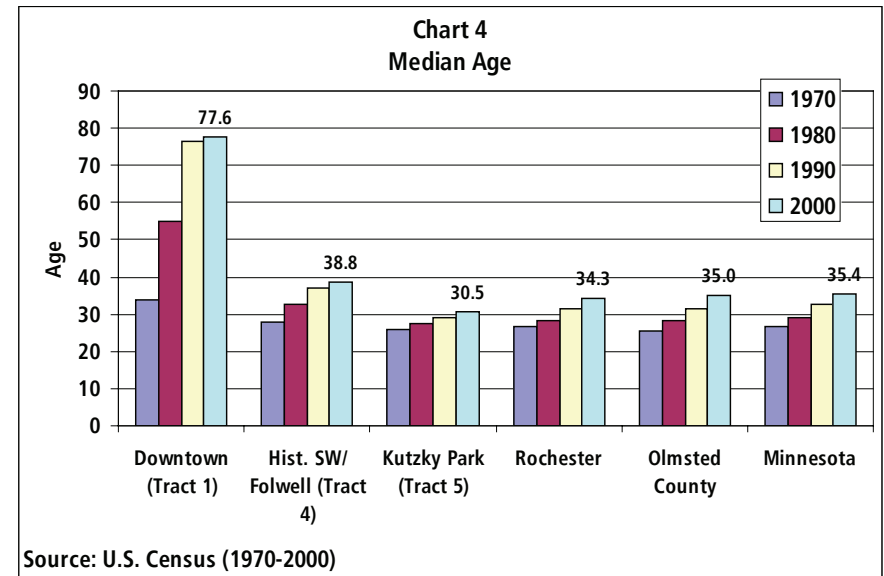


Chart 5 depicts the average household size. According to the chart, there is a clear trend toward decreasing household size. Like Chart 4, this trend can be found among central Rochester neighborhoods as well as throughout the Rochester region or the State. Decreasing household size is the result of several factors. First, the population is aging, and older households tend to have fewer persons. Second, birth rates have declined since the 1960s. Therefore, families with young children, which often bolstered the average size of households, have been declining not only in numbers but also the number of children per household. Third, the relative affluence of the typical household has increased substantially since the 1960s and this affluence has translated into greater demand for housing desired by single-person or two-person households, who otherwise would have lived as boarders or part of an extended-family situation.

Although Chart 5 reveals broad changes in household size, it also reveals that neighborhoods in central Rochester have markedly lower household sizes than those found at the regional or State level. The dramatically low figures in the Downtown are explained by a high percentage of housing that is targeted to seniors. The other two neighborhoods marked by a higher percentage of rental housing and a general shift in preference among families with young children to live in larger, more affordable housing units further away from central Rochester.

Chart 6 displays the homeownership rate since 1970. Generally, homeownership has been on the rise since 1970. Among central Rochester neighborhoods, the experience has been more varied. Within Downtown, homeownership has always been very low and as of 2000 was at only 12 percent. In Kutzky Park, homeownership declined from about 35 percent in 1970 to nearly 30 percent by 1990. However, it elevated slightly during the 1990s to 33 percent. Historic Southwest/Folwell is in stark contrast to Downtown and Kutzky Park in that its homeownership rate has over 10 percent since 1970 and is much closer to the rate found throughout Rochester.

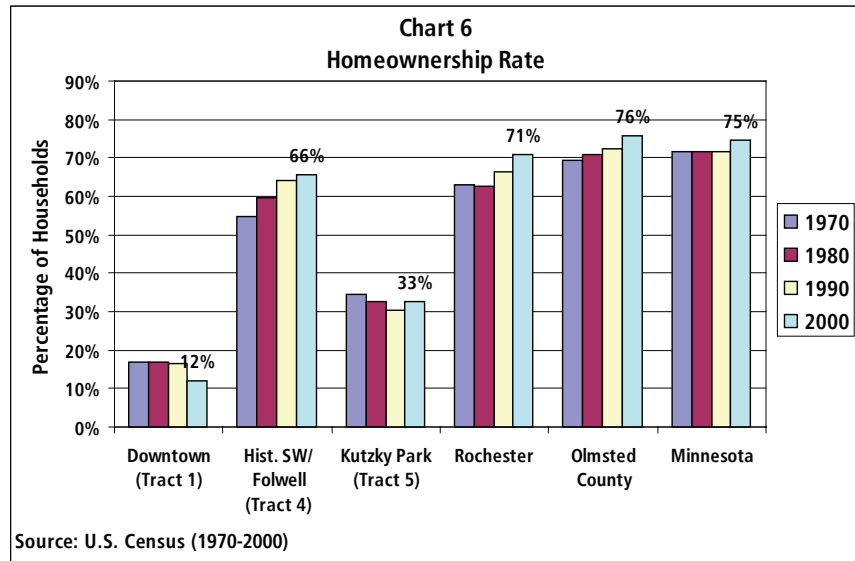
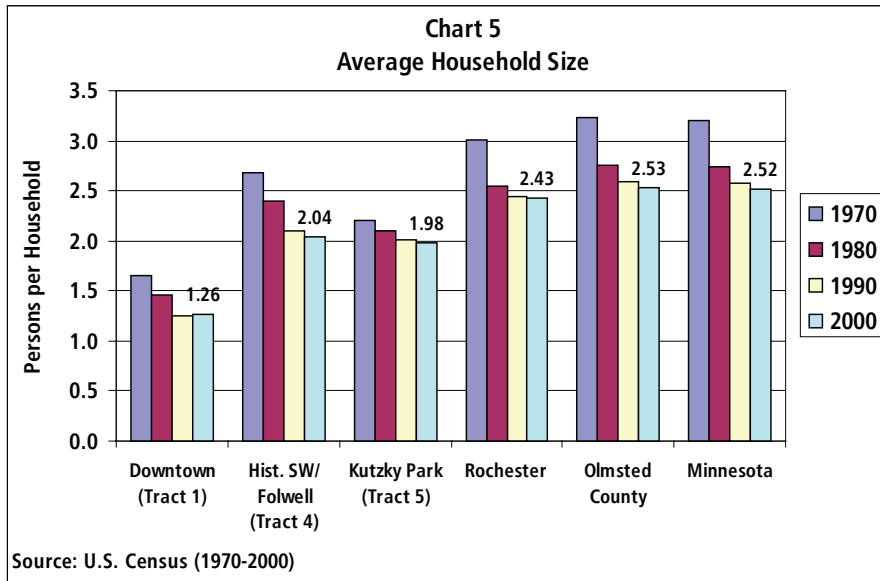


Chart 7 presents data on median household income. Downtown and Kutzky Park have decidedly lower median household income than compared to the regional or State median income. Interestingly, though, Historic Southwest/Folwell, has a median income substantially higher than the Rochester or Olmsted County median income.

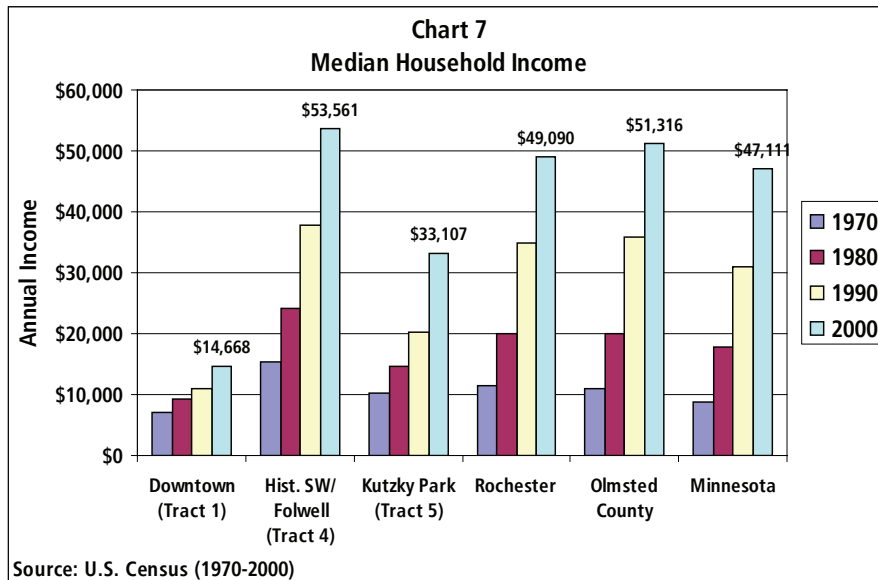
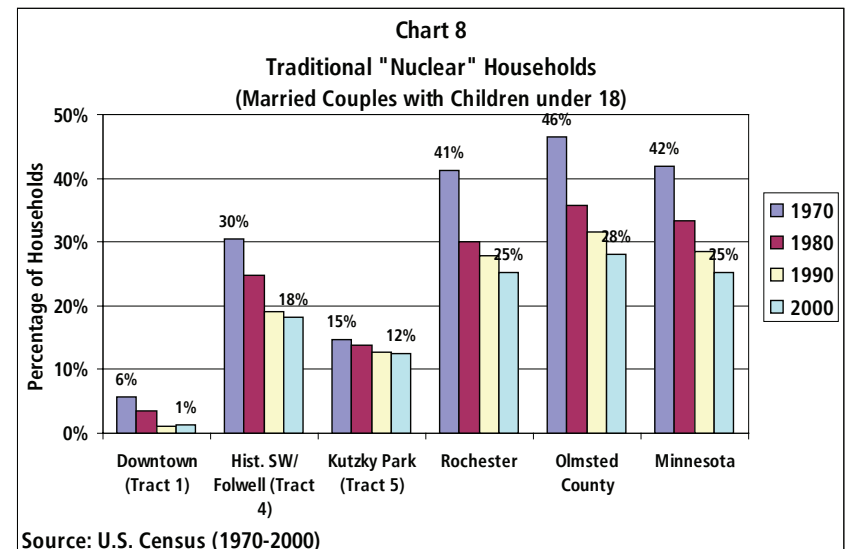


Chart 8 depicts how traditional "nuclear" families, married couples with children under 18, have declined in prominence since 1970. Such households constitute about one-quarter of all households in Rochester. Within the central Rochester neighborhoods, the lack of traditional nuclear families is even more pronounced. Less than one out of five households in such neighborhoods are traditional nuclear families. This demographic change will have a profound impact on the built environment since it suggests that most new homes desired over the foreseeable future will need to be designed to meet the needs of non-traditional families as opposed to traditional families. This will likely result in greater demand for lower-maintenance housing, single-level living, and more access to amenities such as parks, trails, restaurants, and shopping.



In summarizing the demographic trends of central Rochester neighborhoods, we can conclude several important findings. One, the demographic profile of these neighborhoods mirrors the profile of central city neighborhoods in other large cities. Namely, such neighborhoods are characterized by a growing population attracted to the convenience of being accessible to jobs and numerous amenities. This group is made up of a disproportionate number of young and old persons who primarily rent their homes, though there is a significant sector of affluent households who live in highly desirable owner-occupied homes as well.

REGIONAL EMPLOYMENT TRENDS

Since 1990 the unemployment rate in Olmsted County has consistently remained below the state and national rate (see Chart 9). A low unemployment rate is typically characteristic of a growing region with a healthy economy. It suggests that employment growth continuously outpaces the available supply of labor, which results in-migration as well as upward pressure on wages.

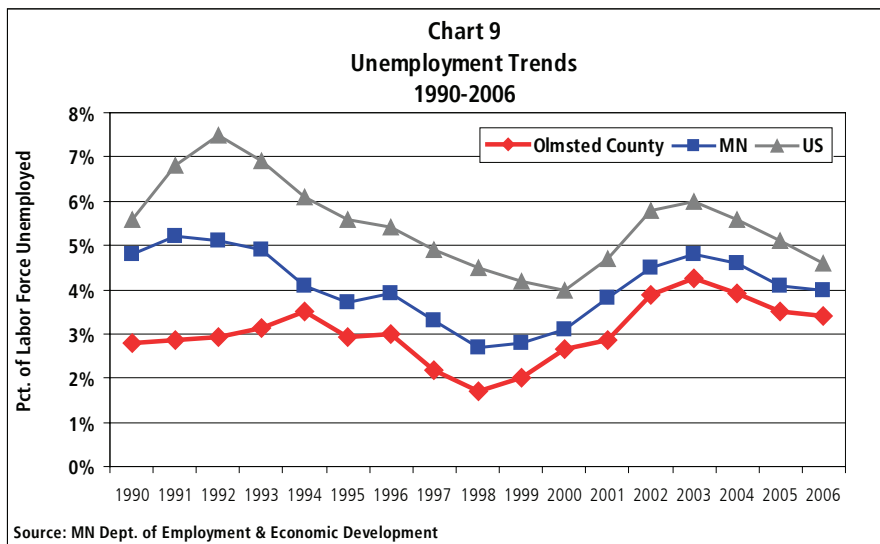


Chart 10 compares the distribution of jobs by industry in Rochester to the state and nation. According to the chart, Rochester has a very high percentage of jobs (46%) in the Healthcare/Education sector compared to Minnesota (22%) and the United States (13%). This is not surprising given the prominence of the Mayo Clinic. Nonetheless, it clearly demonstrates how important Healthcare is to Rochester's economy.

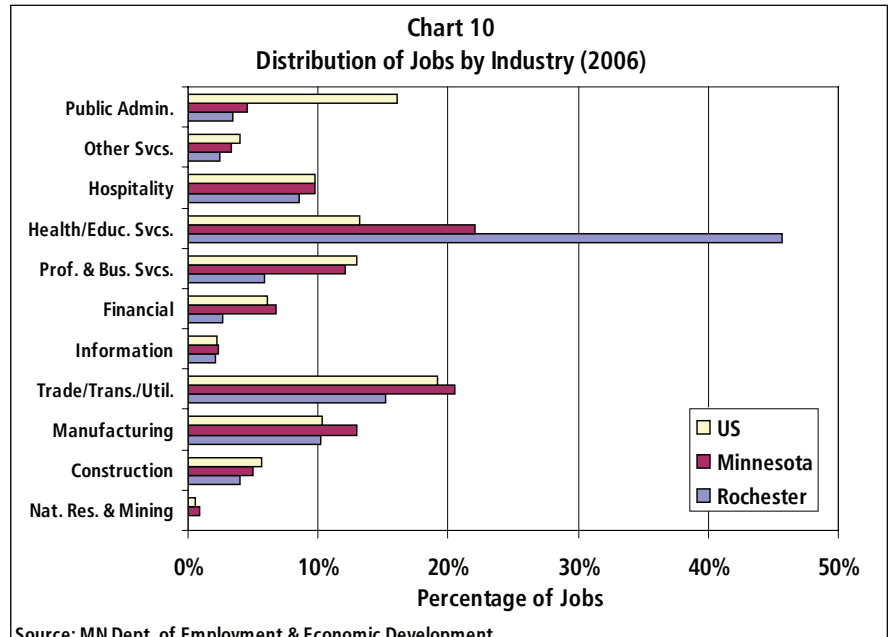


Chart 11 displays the percentage change in jobs by industry from 2000 to 2006 in Rochester, Minnesota, and the United States. The chart illustrates which industries have been growing the most since 2000. In Rochester, the biggest growth in jobs has been in the Hospitality (13%), Healthcare/Education (25%), and Information (94%) sectors. The remarkable growth in the Information sector has been primarily due to a large phone center expansion at a local cable provider. At the state and national level, the biggest percentage growth has been in the Healthcare/Education sector (19% and 18%, respectively). This bodes well for continued growth of the Rochester economy since it indicates that the Healthcare/Education sector is a key driver of growth nationally and that Rochester's economy is strongly tied to that industry sector.

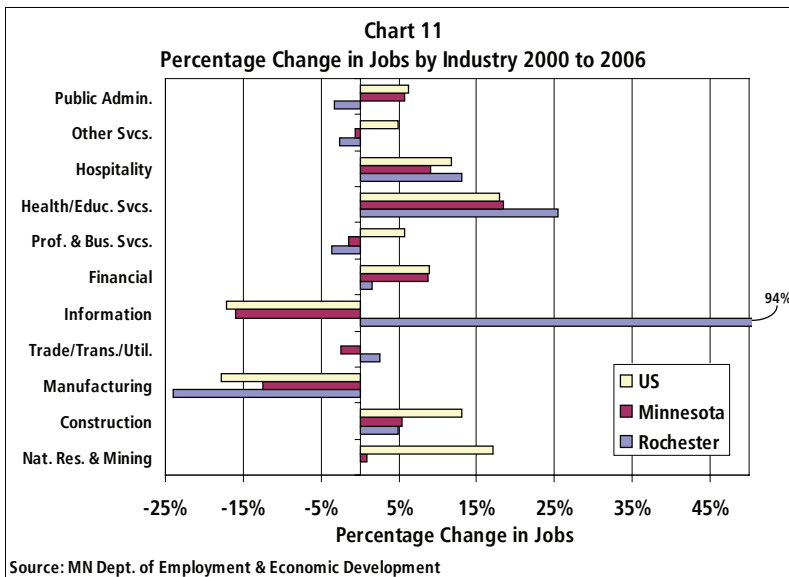


Chart 12 displays the numeric change in jobs by industry sector from 2000 to 2006 in Rochester. This chart emphasizes the importance of the Healthcare/Education sector to Rochester's economy. In the seven year span, the sector accounted for the overwhelming majority of new jobs. Without the jobs generated by this sector, losses from other industry sectors would have resulted in net job decline during the time period displayed.

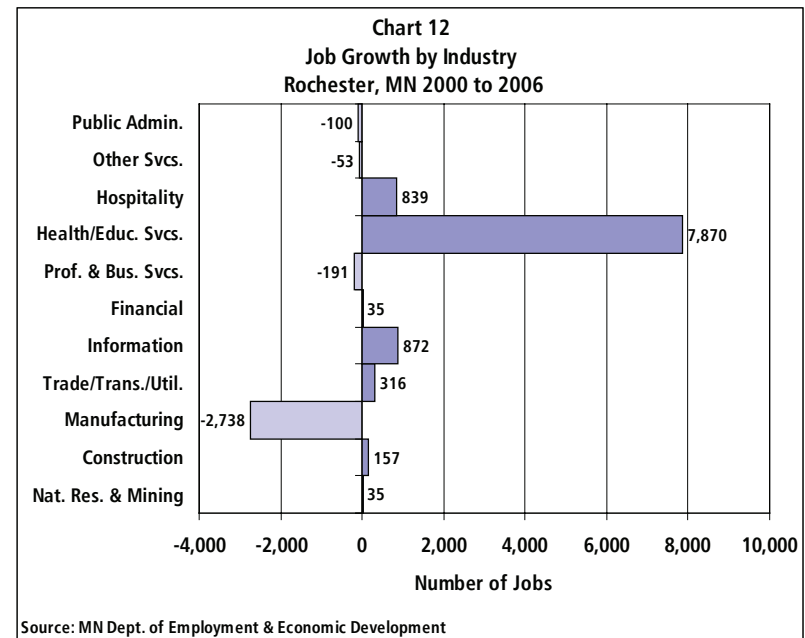
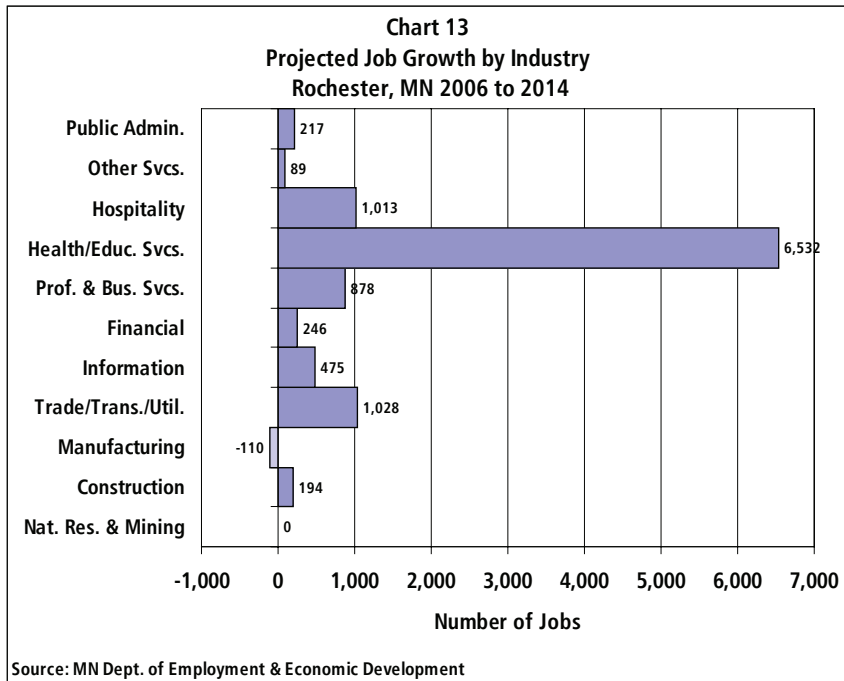
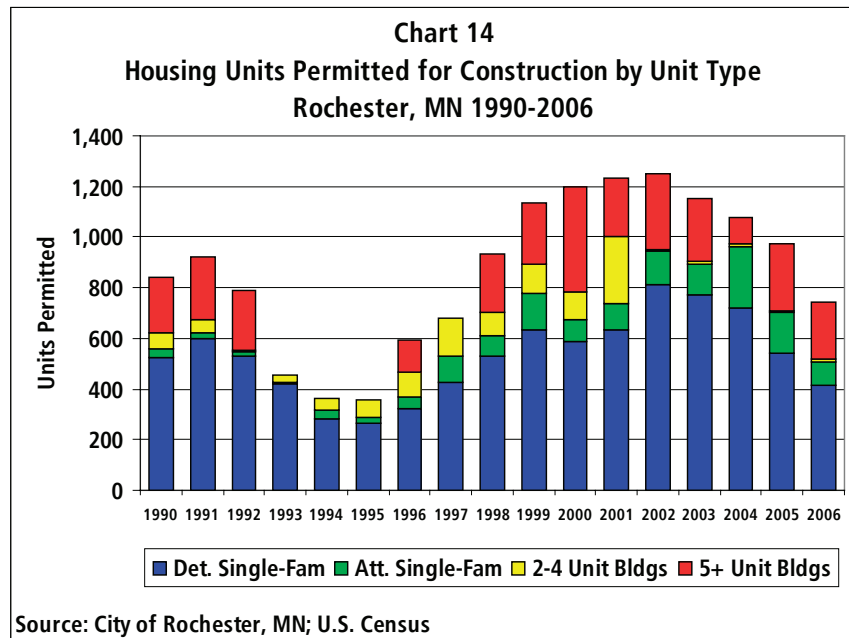


Chart 13 presents data on job growth projections prepared by the Minnesota Department of Employment and Economic Development. According to the chart, Rochester is anticipated to have a net increase of over 10,500 jobs from 2006 to 2014, nearly two-thirds of which will be in the Healthcare/Education sector. Again, this demonstrates the importance of the Healthcare industry to Rochester's economy, but the chart also indicates strong growth is anticipated in ancillary sectors, such as Hospitality, Trade, and Professional Services.



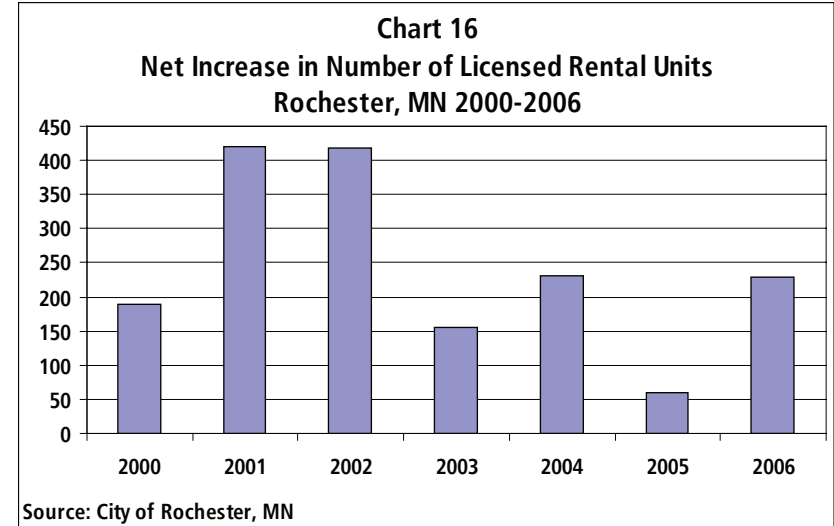
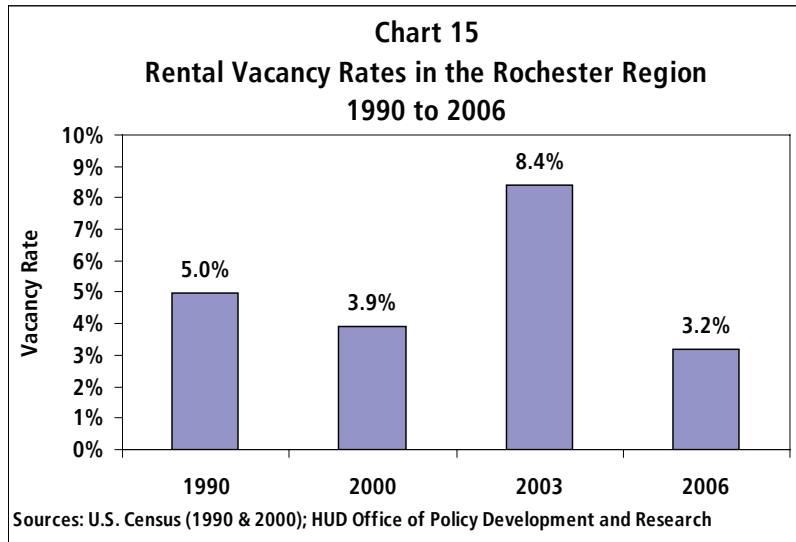
RESIDENTIAL CONSTRUCTION TRENDS

Chart 14 displays residential construction in Rochester since 1990. From the chart, it is evident that residential construction is cyclical nature with periods of peaks and troughs. Single-family construction peaked most recently in 2002 when nearly 800 units were permitted for construction. By 2006, that number had fallen to around 400. Multifamily construction, though cyclical in nature as well, is prone to larger variations from year-to-year. For several years during the mid-1990s it was almost non-existent. By 2001, over 600 multifamily units were permitted for construction, almost equaling single-family production. Like single-family homes, though, multifamily construction has been trending downward over the last three to four years. Despite the current slow down in construction, recent trends corroborate findings from the demographic analysis earlier in this report. Namely, increases in the number of older households and smaller households are driving demand toward more multifamily product types.



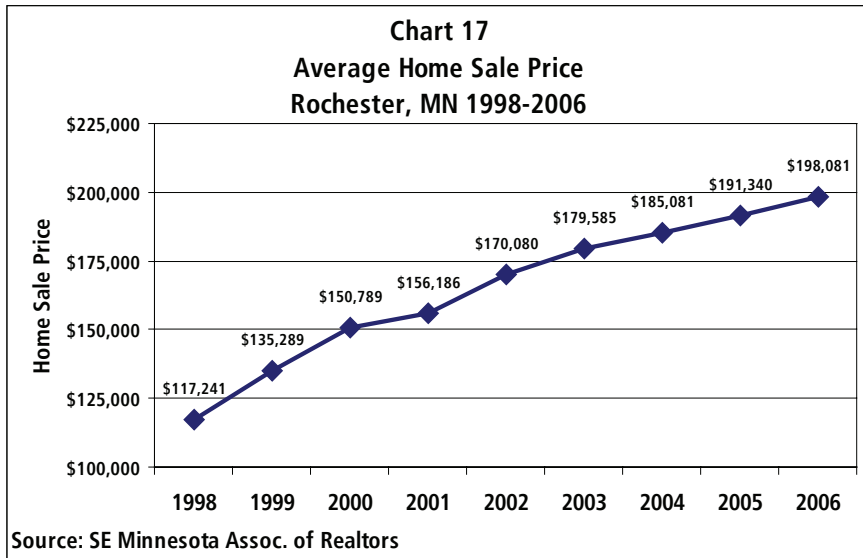
RENTAL MARKET TRENDS

In 2007, the regional HUD office in Minneapolis conducted a study of the Rochester housing market. The report presented data on overall vacancy rates among area apartments since 1990 (Chart 15). According to the report, the vacancy rate declined throughout the 1990s as the construction of new rental units failed to keep pace with job growth. However, several large apartment projects were completed in 2001 and 2002 (Chart 16), which resulted in a sharp increase in vacancies. Since 2003, though, continued job growth and a slow down in apartment construction allowed excess units to be absorbed by the market, which has resulted in this most recent decline of the vacancy rate.



FOR-SALE MARKET TRENDS

According to Chart 17 Rochester experienced rapid appreciation in home prices during the late 1990s and early 2000s. Between 1998 and 2002, the average annual increase in the sale price of a home was over 10%. Since 2002, the average annual increase has moderated to about 3.5% with indications that 2007 figures, which had not been released at the time of this research, may even represent a slight decline.



Between 2000 and 2005, annual sales increased from 1,900 to 2,400 (Chart 18). As price appreciation flattens, or even declines, sales activity has begun to slow down.

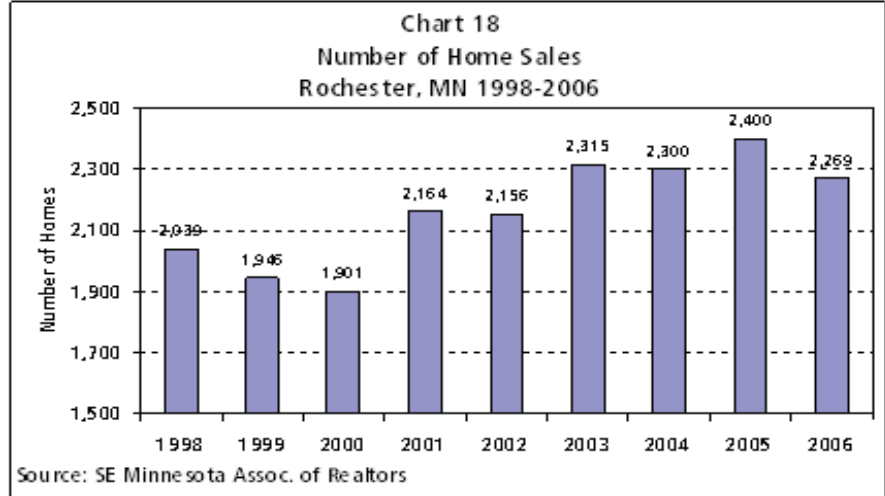
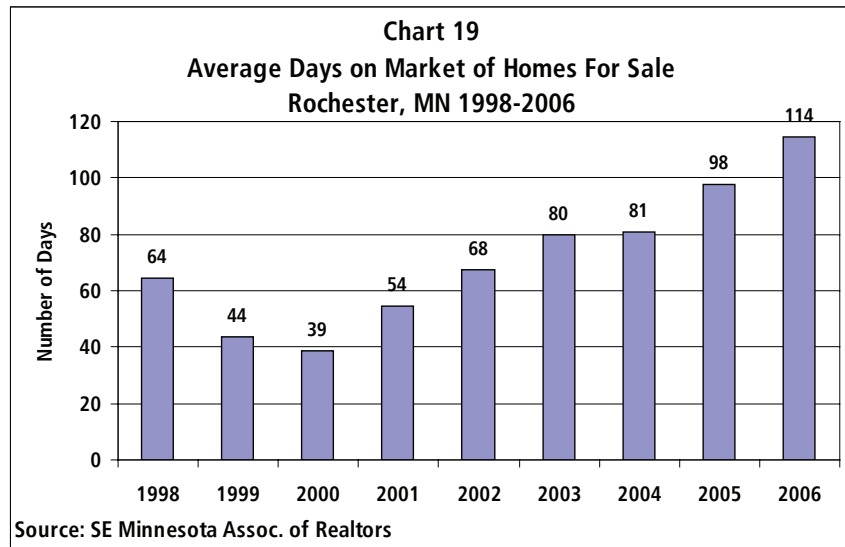
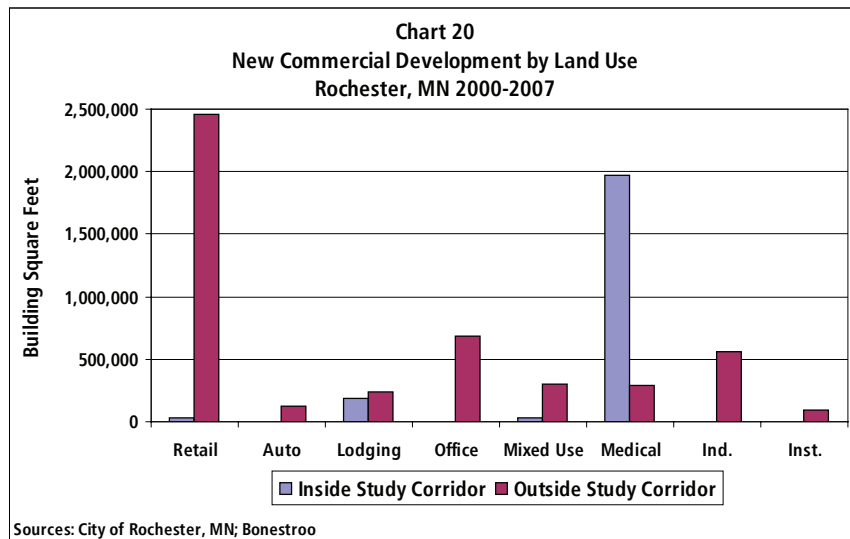


Chart 19 displays average days on the market. Between 2000 and 2006, the average time it has taken to sell a home in Rochester has increased nearly three-fold from 39 days to 114 days. The increased amount in time is a reflecti reflection of excess supply of homes for sale.



COMMERCIAL DEVELOPMENT TRENDS

Chart 20 displays data on the development of new commercial properties in Rochester since 2000. The chart further breaks down the data based on whether the development occurred within the 2nd Street Corridor Study Area, which is defined as the neighborhoods of Downtown, Historic Southwest/Folwell, and Kutzky Park, or outside of the Study Area. Based on building permit data provided by the City of Rochester, the chart shows that the land use categories of Retail and Medical have resulted in the most development since 2000. Because the Study Area is fully developed, it is interesting to note that a significant overall percentage of new development occurred in this area. The vast majority of this development, however, is the result of Mayo Clinic expansions and construction of new lodging facilities. Nonetheless, this is an important distinction in that projected job growth is projected to be strongest in these two industry sectors.



CONCLUSIONS

From an analysis of demographic and economic data, we can see that Rochester is a rapidly growing community. This growth is driven by the community's deep roots in the Healthcare industry. Although this strong growth has contributed to an impressive expansion of the metropolitan area, close in neighborhoods have been affected as well. Construction of new medical and lodging facilities are increasing the number of employees in such neighborhoods. Meanwhile, recent developments of new housing have stopped decades-long declines in population. Although the demographic composition of residents in Downtown, Historic Southwest/Folwell, and Kutzky Park consist mostly of young professionals or lower-income retirees, these are the household types that are fueling the strongest demand for new housing throughout the region and the nation.

Such trends bode well for the long-term prospects of development and redevelopment along the 2nd Street Corridor. However, if development is pursued in the short-term (i.e., within three to five years), the for-sale housing market is slow and any new development will need to recognize these conditions. Challenging markets do not always preclude any development, however. Projects that are well positioned and designed appropriately for the market may do well despite an overall market malaise.

Key market factors that will influence the timing and nature of development along the 2nd Street Corridor include the following:

- The 2nd Street Corridor is evolving into an important commercial corridor that is at the center of activities (medical & lodging) that drive the Rochester economy
- Nearly 50% of all jobs in Rochester are located within walking distance of the Corridor
- Growth in these key activities is projected to be very strong, which indicates demand will continue to increase along the corridor for new medical and lodging uses
- As important, though, demand will also increase for housing that is convenient to jobs along the corridor among both lower-skilled and higher-skilled employees (i.e., workforce and high-end housing)

- Retail along the western end of the Corridor will be dependent upon the increase in jobs as retail in this area primarily supports daytime workers instead of neighborhood residents
- The eastern end of the Corridor (i.e., CBD) will be able to support additional retail provided the pedestrian character of the environment is preserved and, especially, enhanced (e.g., streetscape improvements, re-use and adaptation of existing buildings, and in-fill of vacant parcels)