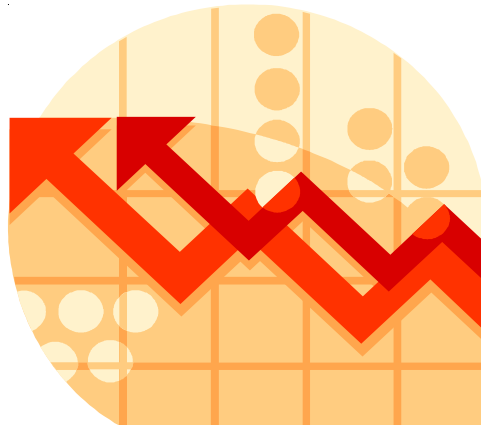


Economic Development Board

Volume 4, Issue 1, Fall 2005

Local Economic Report Series Fall 2005



Sonoma County
EDDB
Economic Development Board
www.sonomaedb.org

Presented By
Sonoma County Economic Development Board
in partnership with
Sonoma County Workforce Investment Board



Fall 2005

The Sonoma County Economic Development Board (EDB), in partnership with the Sonoma County Workforce Investment Board, is pleased to present the Fall 2005 edition of the *Sonoma County Local Economic Report*. In this edition, our research partner, Economy.com, provides an analysis on the local and the national economy, and Dr. Robert Eyles, chair of the Economics Department at Sonoma State University, provides his quarterly “Outlook for the Sonoma County Economy.”

Key highlights from Economy.com’s Local Economic Report include:

- The Sonoma County economy has experienced little change in employment over the last year, but the local unemployment rate remains well below the national average. While growth has slowed, the risks to the Sonoma County economy remain somewhat muted.
- Sonoma County is experiencing a rapid restructuring of its technology producers. Some firms, such as Agilent Technologies, have reduced local employment in favor of overseas operations, while others, such as Boston Scientific, Alcatel and Medtronic, have hired locally.
- Employment in the hospitality industry has been recently flat, but hotel occupancy rates and room rates have climbed through the midyear, indicating strong demand and potential for further growth.
- Sonoma County’s economy will lag the U.S. through the middle of next year, but there is potential thereafter to accelerate. Sonoma County is predicted to experience above average long-term growth.

Thank you for your continued interest in Sonoma County’s economy and the Economic Development Board’s research efforts. As always, if you have any questions or comments please feel free to contact me at (707) 565-7170.

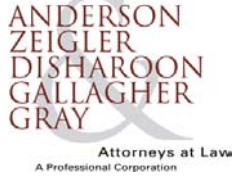
Yours sincerely,



Ben Stone
EDB Director



**With Acknowledgment and Appreciation to the Underwriters of the
Economic Development Board Foundation Research Initiatives Program**
 Sonoma County Permit & Resources Management Dept. ■ Sonoma County Office of Education
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Economic Development Board

Volume 4, Issue 1, Fall 2005

Section I:

Local Economic Report

Prepared for the Sonoma County Economic Development Board
by: Steve Cochrane of Economy.com

SONOMA COUNTY

EMPLOYMENT GROWTH RANK

Best=1 Worst=387

2004-06

218
3rd quintile

2004-09

76
1st quintile

LIFE CYCLE PHASE

Growth/Mature

Best=1 Worst=387

VITALITY

306

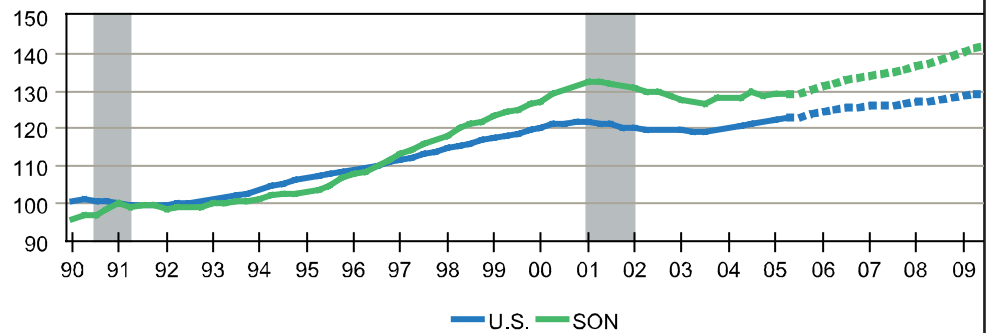
COST OF DOING BUSINESS

U.S.=100% **124%**

COST OF LIVING

U.S.=100% **139%**

Relative Employment Performance (1991=100)



1998	1999	2000	2001	2002	2003	2004	Indicators	2005	2006	2007	2008	2009
13.3	14.6	16.2	16.2	16.5	16.7	17.3	Gross Metro Product, C\$B	17.7	18.4	19.2	20.1	21.0
8.0	10.0	10.7	0.5	1.6	1.4	3.3	% Change	2.3	4.3	4.2	4.5	4.5
173.0	179.3	186.1	189.8	186.6	183.2	184.9	Total Employment (000)	186.1	190.2	193.7	198.2	203.6
4.6	3.6	3.8	2.0	-1.7	-1.8	0.9	% Change	0.7	2.2	1.9	2.3	2.7
3.3	2.7	2.6	3.0	4.5	5.0	4.5	Unemployment Rate	4.3	4.2	4.2	4.0	3.8
8.4	5.8	14.8	1.1	-0.3	0.7	5.4	Personal Income Growth	5.8	6.5	5.6	5.6	5.9
445.9	453.4	460.4	465.7	465.9	467.3	468.5	Population (000)	477.5	486.7	496.3	504.9	514.4
2,098	2,348	2,013	1,717	1,350	1,503	1,359	Single-Family Permits	1,892	1,975	1,840	1,818	1,811
964	688	492	866	578	749	583	Multifamily Permits	685	592	603	693	693
210.8	239.9	317.2	384.6	430.7	510.4	611.2	Existing Home Price (\$Ths)	744.5	768.8	788.7	806.2	824.6
5,207	4,064	3,817	8,948	10,209	13,047	10,692	Mortgage Originations (\$Mil)	9,176	7,258	7,151	7,377	7,617
7.2	6.0	5.5	3.7	-1.5	-0.3	-0.7	Net Migration (000)	7.2	7.2	7.6	6.3	7.2
2,173	1,627	1,158	1,183	1,223	1,300	1,267	Personal Bankruptcies	1,264	924	996	1,068	1,054

STRENGTHS & WEAKNESSES

STRENGTHS

- Highly educated workforce and attractive environmental quality.
- Tourism and wineries are oriented toward middle- and upper-income households.
- Active public/private partnerships that support economic growth and quality of life initiatives.

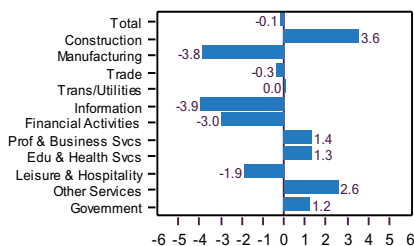
WEAKNESSES

- Very high cost of living and cost of doing business.
- Much congestion on transportation links to rest of Bay Area.
- Complex environmental regulations.

CURRENT EMPLOYMENT TRENDS

August 2005 Employment Growth

% change year ago, 3 mo. MA



FORECAST RISKS

SHORT TERM ↓ LONG TERM ↓ RISK-ADJUSTED RETURN, '04-'09 **0.48%**

UPSIDE

- Dollar falls further versus Asian currencies, supporting SON's exports and international tourism.
- Extended period of lower interest rates supports housing and retailing longer than expected.

DOWNSIDE

- Elevated energy prices sap demand away from travel and wine.
- Further consolidation and downsizing of local tech firms.

ANALYSIS

Recent Performance. The Sonoma County economy is flat. While industrial production is rising, employment is essentially unchanged from one year ago, indicative of the mixed signals found in a number of indicators. For example, hiring appears weak across most industries, including the travel and tourism industry, a heretofore stalwart performer. And yet, the unemployment rate remains well below the national average. The housing market also emanates mixed signals with a slowing pace of construction but price appreciation still exceeding 25%. The good condition of household credit quality is more certain, with personal bankruptcy filings falling through the first quarter and a consumer loan delinquency rate that is below state and U.S. averages. So while growth has slowed considerably, risks remain somewhat muted.

Tech transfers. The restructuring of SON's technology producers continues unabated. The loss of 300 jobs at Agilent Technologies to overseas locations this quarter is the latest in a string of job losses. The sharp downturn in manufacturing employment and the limited expansion in professional services are further evidence of this. Thus, commercial property markets remain tepid; Keegan & Coppin reports an office vacancy rate hovering above 20%.

Finally, U.S. business investment spending, which still is rising at a greater than 10% rate, is beginning to be felt in SON. Alcatel is hiring again, at least for selected positions, to support demand for telecom equipment upgrades. This is indicative of future trends in which production of commodity products will shift away from this high-cost area, but new product R&D and manufacturing will take advantage of the clusters of SON-based expertise in telecom, electronics and medical devices. Boston Scientific has hired 300 over the past year and Medtronic will expand its payroll through mid-2006.

Tourism. While employment in leisure and hospitality industries has flattened, returns in

the industry are improving. Both hotel occupancy rates and room rates continued to climb through midyear, indicating strong demand and potential for further growth.

Construction. Nonresidential construction remains steady at a historically high level, although it is nearly entirely concentrated in new retail space. Income growth is estimated to exceed 5% now for the first time since the 2001 recession, generating revived demand for retailing, particularly for high-end retailers that currently are not in plentiful supply.

Agriculture. The fall grape crush looks to be larger than in the past few years, but downward pressure on pricing will be minimal since the industry has slowed the expansion of acreage, and domestic demand for wine has strengthened with the U.S. labor market.

Risks. The impact of higher energy prices following Hurricane Katrina shifts the risk factors for SON's economy toward the downside. Travel and tourism could easily falter if airlines are able to raise fares and gasoline prices remain elevated, generating a loss of both long-distance and local travelers. Further, demand for wine could be diminished by the loss of disposable income after energy bills are paid by households. This would likely hit lower income households first, and thus lower priced wine first, which would shield many SON vintners initially; risks will rise the longer energy prices remain high. On the upside, however, a slower U.S. economy should keep long-term interest rates moderate, lending additional support to homebuilding.

Sonoma County's economy will continue to lag the U.S. average through the middle of next year. There is potential thereafter to accelerate as long as domestic and international consumer spending and business investment remain healthy. SON is ranked above average for long-term growth.

Steven G. Cochran
September 2005

EMPLOYMENT & INDUSTRY

TOP EMPLOYERS

Santa Rosa Junior College	3,115
Agilent Technologies, Inc.	2,500
St. Joseph Health System	2,370
Sonoma State University	1,799
Kaiser Permanente	1,423
Optical Coating Laboratory	1,300
JDS Uniphase Corporation	1,200
Safeway, Inc.	1,218
Medtronic, AVE	1,200
Kendall-Jackson Wine Estates	900
Sutter Medical Center	859
State Farm Insurance Company	846
Albertsons, Inc.	770
Target Corporation	724
Amy's Kitchen	650
Hansel Dealer Group	650
Advanced Fibre Communications	600
SBC Communications, Inc.	600
Longs Drug Stores, Inc.	585
Cisco Systems, Inc.	550
Home Depot	550

Source: North Bay Business Journal, February 2004

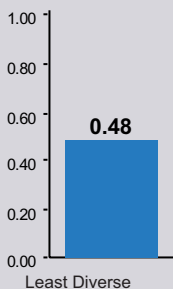
Public

Federal	1,691
State	5,569
Local	22,341

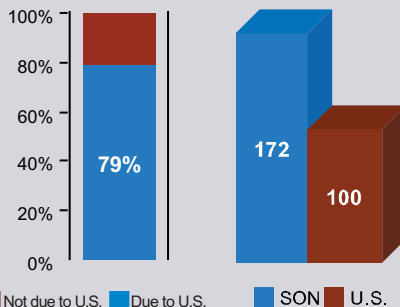
2004

INDUSTRIAL DIVERSITY

Most Diverse (U.S.)



EMPLOYMENT VOLATILITY DUE TO U.S. FLUCTUATIONS RELATIVE TO U.S.

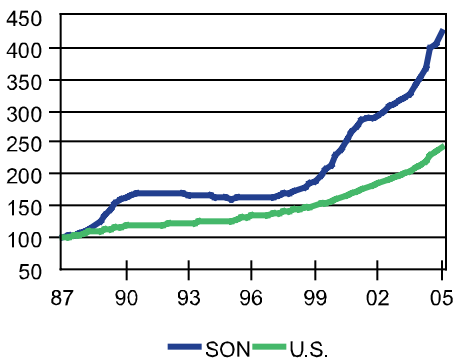


COMPARATIVE EMPLOYMENT AND INCOME

Sector	% of Total Employment			Average Annual Earnings		
	SON	CA	US	SON	CA	US
Construction	7.4%	5.8%	5.3%	\$53,490	\$54,018	\$44,373
Manufacturing	13.1%	10.5%	10.9%	\$62,321	\$70,640	\$63,129
Durable	52.4%	63.5%	62.3%	nd	\$78,393	\$65,880
Nondurable	47.6%	36.5%	37.7%	nd	\$57,502	\$58,627
Transportation/Utilities	2.1%	3.3%	3.7%	\$45,852	\$57,461	\$51,868
Wholesale Trade	3.5%	4.5%	4.3%	\$52,404	\$60,818	\$59,828
Retail Trade	12.7%	11.1%	11.4%	\$30,102	\$31,964	\$26,190
Information	2.3%	3.3%	2.4%	\$67,415	\$94,946	\$78,059
Financial Activities	5.4%	6.2%	6.1%	\$40,133	\$53,047	\$51,058
Prof. and Bus. Services	10.7%	14.4%	12.5%	\$37,240	\$50,601	\$47,411
Educ. and Health Services	12.2%	10.7%	12.9%	\$39,530	\$42,197	\$38,538
Leisure and Hosp. Services	10.9%	9.9%	9.5%	\$16,370	\$22,617	\$18,779
Other Services	3.5%	3.5%	4.1%	\$23,358	\$23,766	\$22,334
Government	16.0%	16.4%	16.4%	\$48,681	\$55,189	\$49,194

Source: Percent of total employment - Economy.com & BLS, 2004; Average annual earnings - BEA, 2003

HOUSE PRICES



Source: OFHEO, 1987Q1=100, NSA

LEADING INDUSTRIES

NAICS Industry	Employees (000)
GVSL State & Local Government	27.9
7221 Full-Service Restaurants	7.2
3121 Beverage Manufacturing	6.3
6221 General Medical and Surgical Hospitals	5.7
FR Farms	5.3
4451 Grocery Stores	5.2
7222 Limited-Service Eating Places	5.2
5613 Employment Services	4.1
2360 Construction of Buildings	4.0
7211 Traveler Accommodation	3.2
5617 Services to Buildings and Dwellings	3.0
3345 Nav., Meas., Electromed. & Ctrl. Inst. Manuf.	2.8
2383 Building Finishing Contractors	2.7
2382 Building Equipment Contractors	2.7
4521 Department Stores	2.6
High-tech employment	11.6
As % of total employment	6.0

Source: BLS, Economy.com, 2004

CREDIT QUALITY

FITCH	MOODY'S
N/A	Aa2

MIGRATION FLOWS

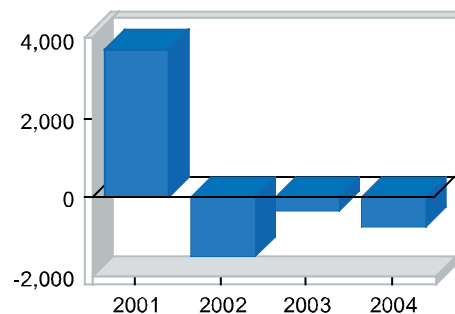
Into Sonoma County	Number of Migrants	Median Income
San Francisco CA	3,662	39,470
Oakland CA	1,233	31,625
San Jose CA	647	43,970
Sacramento CA	610	23,165
Los Angeles CA	527	19,558
Vallejo CA	439	33,552
Napa CA	395	29,999
San Diego CA	326	18,602
Riverside CA	245	22,626
Santa Ana CA	210	25,749
Total Inmigration	14,659	26,425

From Sonoma County

San Francisco CA	1,940	31,988
Sacramento CA	1,524	30,729
Oakland CA	931	27,947
Vallejo CA	571	39,721
Los Angeles CA	474	18,297
Napa CA	465	30,520
San Jose CA	445	39,558
San Diego CA	434	17,673
Phoenix AZ	349	30,430
Riverside CA	317	24,758
Total Outmigration	17,318	27,050

Net Migration	-2,659	-625
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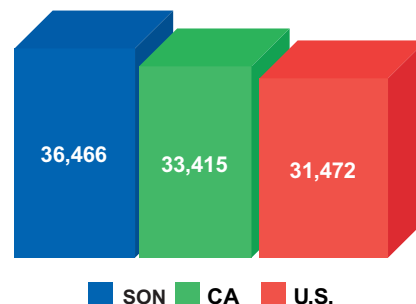
Net Migration, SON



	2001	2002	2003	2004
Domestic	1,056	-4,084	-2,871	-3,271
Foreign	2,683	2,613	2,540	2,542
Total	3,739	-1,471	-331	-729

Source: IRS (top), 2003; Census Bureau & Economy.com, 2004

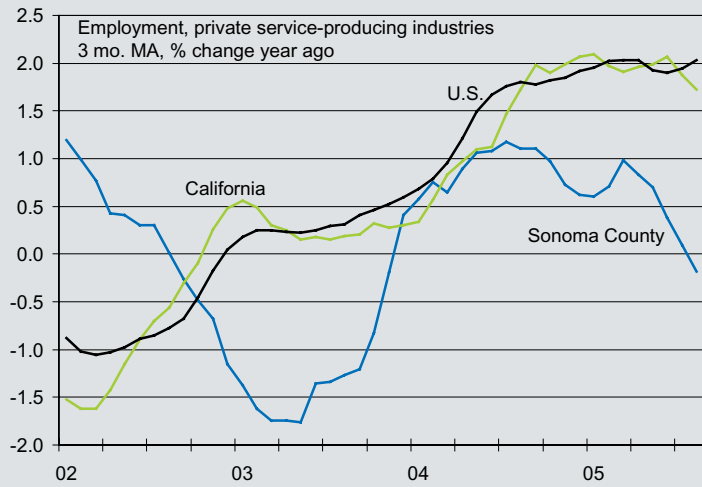
PER CAPITA INCOME



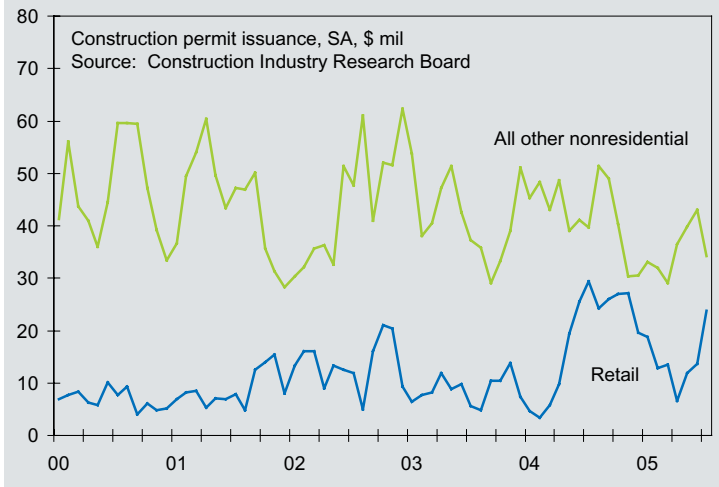
Source: Bureau of Economic Analysis, 2003

Sonoma County

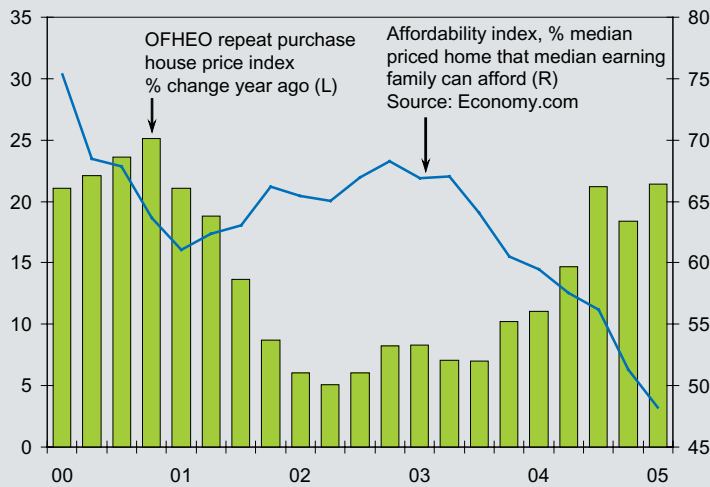
Service-Producing Industries Falter in Sonoma County



Nonresidential Construction Focused on Retail

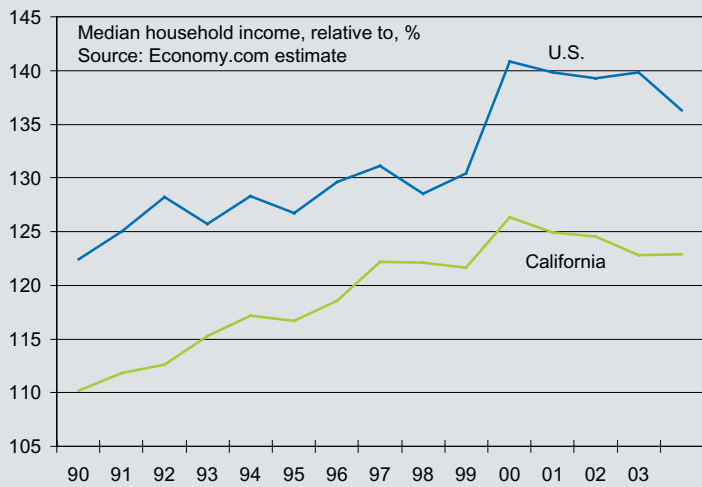


Rapid House-Price Appreciation; Affordability Plummets

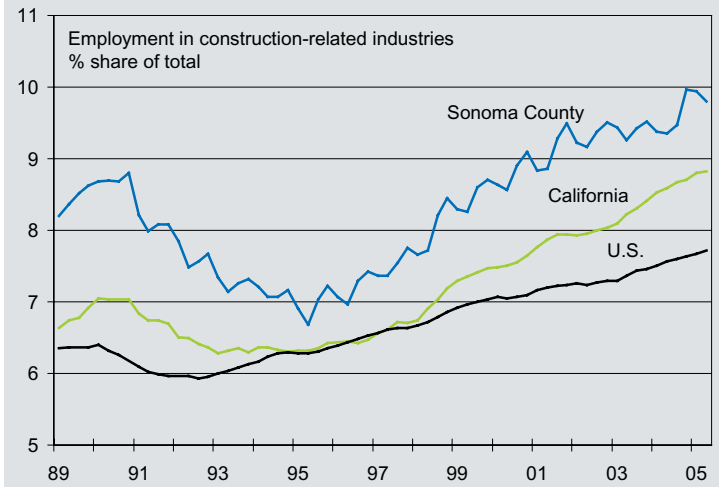


Nonresidential construction in SON is increasingly concentrated in retail space. Currently, there is little new demand for either office or industrial space. Moreover, until recently, there had been little new supply of retail space in the metro area, particularly high-end space. The addition of new space is beneficial for SON since it is a retailing center for much of northern California. Attracting more shoppers from outside of the metro area will generate higher tax revenues, income, and employment for SON.

Income Growth Has Faltered; Still Well Above Average



Labor Market Increasingly Concentrated in Construction



While homebuilding has slowed in recent months, the labor market remains unusually concentrated in construction. The share of construction-related employment, at 10%, is above the previous peak of 9% prior to the end of the last great housing cycle in the late 1980s. Construction always plays a more important role in SON compared to the state and nation since the area has a large second-home market. Nevertheless, the local economy appears overconcentrated compared to historical trends and is at some risk should housing markets falter in late 2006 or 2007.

Section II:

Outlook for Sonoma County

By: Dr. Robert Eyster, Chair, Economics Department
Sonoma State University

Outlook for Sonoma County Economy, Fall 2005

The Sonoma County economy is showing signs of weakness, as are the national and state economies. This weakness is not just because of higher oil and gas prices. Higher gas prices have a psychological effect on both consumers and companies, and we are close to the time where the real effects are going to take hold. As we move toward winter, a general slowdown in gasoline demand should take place, outside any other natural disasters. All indicators point toward higher heating bills instead. Other issues include general inflation fears from continued consumption, higher interest rates, and general uncertainty in the financial markets. In short, Sonoma County is still a balanced economy, using its high-technology sectors and the wine industry for that balance, but is not immune to national economic slowdowns.

If we look to the Federal Reserve (FED) as an indicator of where the economy is headed, every signal the FED sends points toward an inflationary economy that is still productive. The eleven consecutive interest rate hikes show that the FED does not fear slowing down purchases of machines and equipment at companies in lieu of slowing down consumption behavior and inflation. Locally, there is some concern about real estate prices. As rates and general uncertainty rise, exacerbated by local unemployment slowly creeping up, Sonoma County's real estate markets should see some price contraction. For some of us, that is frightening; however, this should only be truly frightening for those who have consumed a great deal of their current home equity. It is unclear what the contraction's magnitude would be and how long it would last. External demand for housing in this County remains, as does internal demand. Unless an exodus of current homeowners took place, coupled with a stagnation of demand, it is unlikely any price reduction would be ruinous for most homeowner's net worth or long term.

However, Sonoma County citizens falsely watch home prices as an indicator that the economy is going to be ok. Our local high-tech industries, especially biotechnology, and wine industry are poised to continue growing. Watching their hiring and their trends will tell you more about this County's economy in specific than any other indicator. Their hiring reflects their forecasts of demand for their goods and services, and the more they hire, the more they intend to produce in the future. While our financial markets trends do not reflect much confidence in the economy, these hiring trends will show confidence or not.

Sonoma County citizens, firms and government alike must recognize that our local economy is in a tug-of-war with local forces moving forward and state and national forces pulling it toward stagnation. It important that all recognize the central role of petroleum prices in our economic lives, but not to make trends in gas prices the culpable party for all economic woes. The economy's consumption behavior has continued unabated without parallel income growth and during rising gas prices. If the national economy moves into recession, Sonoma County's economy will likely follow; if the national economy does not, Sonoma County will continue its moderate growth pattern upward, even if real estate prices contract and gas prices remain relatively high.

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