



# FINANCE, REAL ESTATE, & CREATIVE INDUSTRIES

INDUSTRY INSIDER

2021





# ECONOMIC DEVELOPMENT BOARD

BOARD OF DIRECTORS

KATHRYN HECHT, CHAIR JORGE ALCAZAR SKIP BRAND PAM CHANTER  
TERRI DENTE LINDA KACHIU WAYNE LEACH MICHAEL NICHOLLS  
RICHARD MARZO JORDAN KIVELSTADT  
SHEBA PERSON-WHITLEY, Executive Director

## EDB FOUNDATION SPONSORS

### FOUNDATION LEVEL



Luther Burbank®  
*Savings*

### PRESENTING LEVEL



### PREMIER LEVEL



### EXECUTIVE LEVEL

- AMERICAN RIVER BANK
- COMCAST
- MIDSTATE CONSTRUCTION
- SONOMA CLEAN POWER
- NORTH BAY ASSOCIATION OF REALTORS
- SUMMIT STATE BANK
- PISENTI & BRINKER LLP

SONOMA COUNTY BOARD OF SUPERVISORS



# CONTENTS

---

- 4. EXECUTIVE SUMMARY
- 6-8. MOODY'S INDUSTRY ANALYSIS



# EXECUTIVE SUMMARY

March 2021

The Sonoma County Economic Development Board (EDB), in partnership with the Workforce Investment Board (WIB), is pleased to present this 2021 Local Industry Insider Report. For additional information, questions, comments, or suggestions, please contact us at (707) 565-7170 or visit [www.sonomaedb.org](http://www.sonomaedb.org).

**Disclaimer to the Reader:** *The forthcoming details in this report reflect trends sourced from data gathered during the novel COVID-19 pandemic. Figures, such as employment rates, have been susceptible to great variability and are ever-changing.*

## HIGHLIGHTS



**Real Estate:** Both the Sonoma County and national housing markets are proving to be resilient despite the pandemic's effects on the labor market. Home prices in Sonoma County are increasing at a roaring pace and demand remains sturdy. Even with the robust price appreciation, the number of homes sold in the last six months is greater than that of a year ago; January home sales are up 30% from the same month in 2020. Furthermore, the number of days a home stays on the market has dropped to its lowest level since early 2018. However, the commercial real estate market had a much more difficult year. Commercial vacancy rates increased through 2020, and despite the vaccine roll-out, they may linger on if firms shift towards remote work or expansion to lower cost areas.

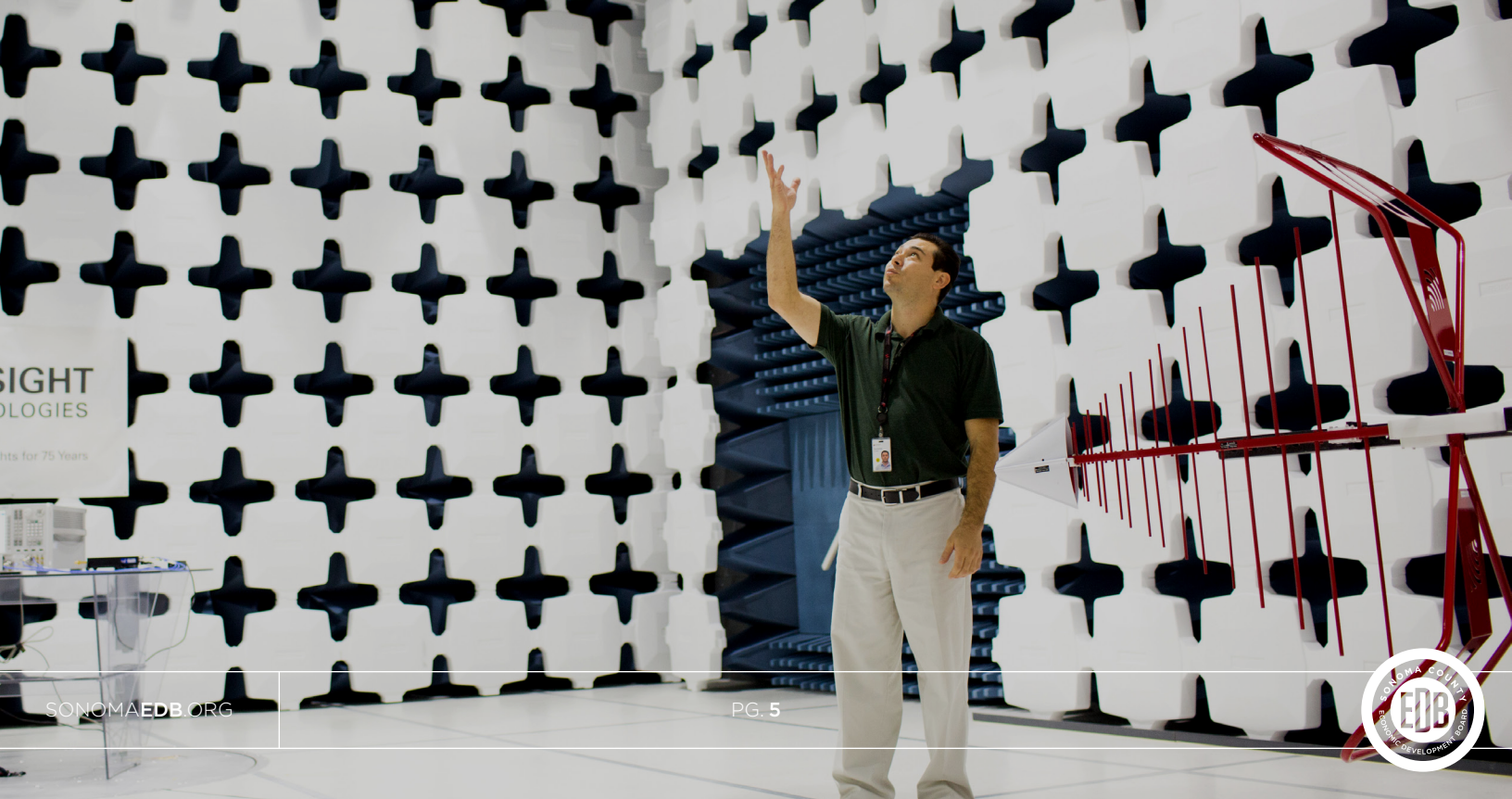


**Finance:** Despite the challenges that came in 2020, U.S. equity markets recovered at a quicker than expected pace. Sonoma County financial institutions saw a relative benefit from growth in new establishments. This growth was greater than that of US and California averages, for mid-size metro areas. The growth in new establishments stimulated local demand for financial services, such as obtaining credit and capital. The additional federal stimulus and increased vaccine roll out is likely to drive down consumer credit markets. However, there is an opportunity for unsecured lending activity to ramp up and satisfy demand for the industry sectors most negatively affected by COVID-19.



**Creative:** The Sonoma County Creative Cluster's job growth has stabilized for the time being. Growth in the high paying Tech and Bio-Medical jobs are staying relatively steady when compared to other Bay Area counties, where growth appears to be surging. Job growth in these sectors may continue to be stunted as firms seek expansion in lower cost regions of the United States. Coinciding with plateaued job growth, it is likely that wage growth will slow as well. These outsourced positions are some of the highest paying in the sector and make up half of the total wages in the county's creative cluster.







**Recent Performance.** Santa Rosa's recovery from the COVID-19 pandemic has taken a step back. After a precipitous drop in April, nonfarm payrolls recovered more quickly than the state average through the summer. However, employment has subsequently reversed course and fallen in the last two months, in contrast with the continuation of modest growth statewide. All told, payroll employment is down 10% relative to the pre-virus level, compared with 8% for California. Leisure/hospitality is the largest drag as restrictions and contagion fears have sapped demand. The jobless rate has halved since its peak in April but remains nearly triple its pre-pandemic level. The housing market nonetheless is in good shape. Home sales are surging even though house price appreciation is accelerating.

**Macro drivers.** After languishing for several months, there are early indications that economic activity is picking up. Prospects for a stronger economy are improving, as there are increasingly compelling reasons to be optimistic. COVID-19 vaccinations are ramping up while infections and hospitalizations are declining, and herd immunity looks more likely by summer. The economy is benefiting from the \$900 billion relief package passed into law at the end of last year, and Moody's Analytics expects around \$1.6 trillion in added support proposed by President Biden's American Rescue Plan will be headed for passage before mid-March. There is also a lot of pent-up demand for various activities curtailed by households during the pandemic, and middle- and especially high-income households have plenty of financial firepower to unleash that demand. As of December, we estimate there was over \$1.6 trillion in excess personal saving over the course of the year, equal to 7% of GDP. There is, of course, the desire to travel again, eat out, go to a ball game or movie, or simply get a haircut.

To be sure, inflation will accelerate, and if the economy sticks roughly to our script, inflation will rise meaningfully above the Federal Reserve's 2% target. However, this is by design. It is precisely what the Fed is aiming for in its new monetary policy framework after more than a decade of unsuccessfully battling undesirably low inflation. There is even a meaningful possibility that at some point in the next two or three years inflation will accelerate beyond what the Fed is comfortable with, say closer to 3%. But the Fed has a clear guidebook for fixing this problem, namely higher interest rates. Interest rates are expected to normalize in late 2022 or early 2023.

**Financial services.** Following the carnage wreaked by the COVID-19 pandemic, U.S. equity markets recovered at a much quicker pace than they did following the Great Recession. The Standard & Poor's 500, for example, recouped all of its losses by August of last year, and its torrid pace continued through the end of the year and into 2021. Buoyed by fiscal stimulus and low yields, stocks will continue to surge in early 2021. Year-ago prices in the second quarter are expected to grow by 25%. However, with valuations stretched and price-earnings multiples as high as they have been since the Y2K bubble, stock price growth will gradually lose some of its breakneck pace as the year progresses. As the U.S. economy may grow near a whopping 6% in 2021, Treasury yields will follow suit with the 10-year yield approaching 1.5% by year's end. In a similar vein, broad credit spreads will remain low despite specific-sector woes.

Despite the challenges of 2020, Sonoma County's financial institutions enjoyed a solid year. Growth in new establishments has kept ahead of that of the U.S. and California's mid-size metro areas, generating demand for credit and capital and supporting local financial institutions. Summit State Bank, the second largest bank in the county by assets, reported a 62% annual increase in net income in 2020 compared with a year prior. Meanwhile, Santa Rosa-based Exchange Bank fared worse, with a slight decrease in net income in 2020. However, the bank's total assets were \$3.1 billion, a 17.4% increase.

Additional stimulus, vaccine momentum in the U.S., and a final resolution to the odyssey of the recent election cycle will calm consumer credit markets and set the stage for strong growth in the second half of the year. While the early part of 2021 will be slow going as the ripple effects of virus restrictions fade away, unsecured lending will expand once sectors of the economy shuttered since the first quarter of last year slowly reopen to satisfy pent-up demand.

Housing will continue to drive headline growth even if mortgage rates creep higher as the economy fully reopens. On the performance side, lenders will gain clarity on the state of existing loans as forbearance programs wind down, while simultaneously maintaining a prudent approach to lending despite a more optimistic forecast for losses than could have been imagined last March. A peak in the total delinquency rate to less than 3.5% is not expected until late 2021 or early 2022. However, while sturdy demand for credit will aid bank profits, increased

earnings will not translate into a large increase in industry employment. Financial services employment will advance modestly and retrace its 2017 peak only by 2030, because of high business costs, outsourcing, and automation in depository credit intermediation.

**Real estate.** The nationwide housing market fared much better than expected in 2020 despite the enormous labor market dislocation, and Sonoma County is no exception. House price appreciation is surging. After outright price declines in 2019, house price appreciation is advancing at its most robust pace since early 2018. Furthermore, affordability concerns have eased somewhat thanks to the muted gains prior to the pandemic. The Moody's Analytics affordability index for Sonoma has risen to its best reading since 2013. Most measures of housing demand are strong and augur a favorable outlook. Home sales have outrun last year's pace in each of the last six months, and January's figures place them up approximately 30% compared with the same month in 2020. Likewise, the average days on market for Sonoma homes has fallen to its lowest level since the second quarter of 2018. Sonoma is likely benefiting from a rush of Bay Area residents fleeing dense higher-cost neighborhoods in San Francisco.

As expected, permit issuance has slowed as the rebuilding efforts from the devastating 2017 Tubbs Fire has unwound. Permit Sonoma tracks the rebuilding process from both the Tubbs Fire and more recent 2019 Kincade Fire. The Resiliency Permit Center provided expedited permitting and inspection services and has been instrumental in streamlining the process to ensure a faster recovery. According to the center's data, nearly 1,400 of the 2,000 structures within its jurisdiction are either in the rebuilding process or completed, with nearly half fully completed. As a result, single-family permit issuance is slower than it was in each of the two previous years but remains above its level seen in the previous recovery years.

The commercial real estate market, on the other hand, had a much more difficult year in 2020. Nonessential business closures and contagion fears led to business closures and thus a significant rise in vacancy rates for all property segments, with retail and office segments suffering the worst. Vacancy rates for retail space ended 2020 at nearly 14%, compared with just above 12% prior to the pandemic. Retail vacancy rates increased by a similar amount, rising to 7.7%, compared with 4.8% in the first quarter of 2020. The vaccination rollout and opening of

offices that have been shuttered for nearly a year will ease some of the pain, but the proliferation of remote work may spell trouble for the office market as firms opt for lower-cost areas.

**Insurance.** Sonoma County suffered another year of headline-making wildfires, though structural damage was very limited, especially in comparison to the devastation of the Tubbs Fire. The LNU Lightning Complex fires and the Glass Fire destroyed a few hundred structures, a small number relative to the thousands destroyed in the Tubbs Fire. Nonetheless, 2020's fire season in California, coupled with the still-lingering effects of fires in years past, has left the insurance landscape in Sonoma very uncertain.

The devastation of 2020's fire season and ongoing complications from previous years' payouts led California to enact new measures designed to improve fire insurance coverage. Last year, the state insurance commissioner took a step to prevent property insurance companies from dropping a slew of homeowner customers, banning insurers for a year from canceling coverage for people residing in or near areas where the state's 16 wildfires burned last year. It protects 140,000 policyholders living close to where the Kincadee Fire sparked in north Sonoma County in late October from losing coverage on their properties. Earlier this month, Insurance Commissioner Ricardo Lara said his office will work with four state agencies charged with wildfire response and prevention to establish statewide standards for home hardening—from replacing single- with dual-paned windows to creating fire-resistant landscaping—that he hopes will reduce wildfire risks and make insurance more affordable and available in California. It has become harder for some Californians to obtain homeowner coverage because of wildfire risks, forcing more of them to get coverage from the state's insurer of last resort, the FAIR Plan.

Residents in Sonoma County are finding it increasingly difficult to obtain sufficient coverage. Insurers are either refusing to cover homes in fire-prone areas or proposing massive premium hikes. According to the insurance commissioner's office, the most recent data show that insurers dropped residential policies statewide by more than 30% while enrollments in the FAIR Plan jumped more than 200%.

**Creative cluster.** Sonoma County's creative industries have stabilized, although further contributions to employment and income growth will be minimal. High-paying software publishing, computer systems design, and

biomedical research payrolls have held steady in recent years, contrasting with the surging traditional Bay Area powerhouses. These industries, which make up more than half of total creative cluster employment and wages, will add few new workers over the coming years, as Sonoma's top tech and medical device firms favor expansions in low-cost locations in the U.S. and overseas over Sonoma.

For example, Medtronic, one of the county's largest technology employers, announced another round of layoffs in late 2020 in various departments, including research and development, global operations, and manufacturing. The restructuring will entail job cuts, but the firm has yet to specify how many and where the cuts will take place. While Medtronic and Keysight Technologies will anchor Sonoma's tech presence, they have gradually shifted manufacturing jobs to lower-cost centers in the U.S. and overseas while adding research staff elsewhere in the U.S.

**Long-term outlook.** Sonoma County's financial services, real estate and insurance industries will fare well in the near term as the economy marches into an accelerated recovery. While most of the industries have weathered the COVID-19 recession, an improving labor market nationally and locally will be an added boon to the housing market this year and next. Longer term, however, demographics may impose a speed limit on the residential real estate market. Net in-migration has slowed substantially over the past three years, as deteriorating housing affordability created barriers. Affordability concerns have eased somewhat in the past two years, but once again surging price appreciation and dwindling inventory of homes ensure that affordability will erode in the coming years.

The outlook for the insurance industry is more uncertain. Seemingly worse fire seasons every year have placed insurance carriers in a predicament between untenable premium hikes and refusing coverage. New statewide measures to make homes more fire resilient and improve coverage will prove beneficial to the industry's long-term outlook but will raise costs to consumers and insurance providers alike.

Low business costs relative to those in San Francisco and plentiful access to venture capital will still support Sonoma County as a global design hub, but rising business costs relative to other tech centers will handicap efforts to retain and grow its high-paying tech industries. As a result, the creative cluster's share of total

employment will trail that of the Bay Area economies and the broader U.S.

**Upside risks.** The surprise victory for Democrats in both of Georgia's runoff Senate elections has resulted in a sharp change in our fiscal policy assumptions. The Moody's Analytics February baseline vintage assumes Congress and the Biden administration will pass about \$2 trillion in additional stimulus during Biden's first term in office. We expect the next pandemic relief bill to total \$1.6 trillion, with an additional \$400 billion going toward infrastructure and social benefits over the next decade.

The U.S. economy could surprise on the upside. The housing market is set to benefit from a wave of millennials moving into their prime household-forming years, providing a bigger boon to housing and the broader economy. Mortgage rates are still near historic lows, creating a favorable market for homebuyers.

Sonoma may become an attractive destination for remote workers fleeing San Francisco, given its high quality of life and more spacious homes. A reversal in migration trends would supercharge the housing market and provide a larger customer base for the county's collection of financial services firms.

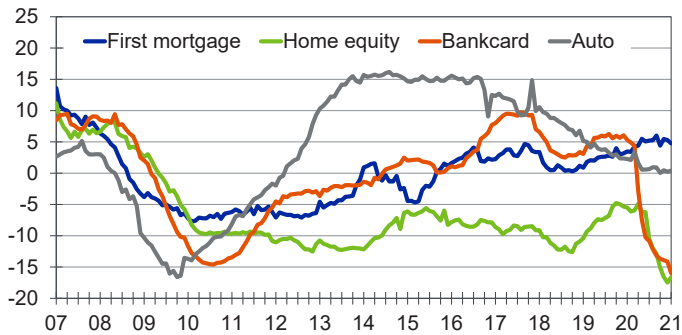
**Downside risks.** The Federal Reserve has played a critical role in supporting the economy during the pandemic, but its extraordinary policy response and a change in framework increase the risk of a policy error. Last year, the Federal Open Market Committee adopted average inflation targeting. The risk is that the shift in policy could cause the Fed to react too slowly in raising interest rates. If the Fed's policy response were to lag too far behind the economy, it could be forced to tighten more aggressively, resulting in a disruptive tightening of financial conditions. If fiscal stimulus were to run the economy hot in 2021, an inflation surprise might compel the Fed to tighten liquidity provisions or even policy rates earlier than anticipated, effectively putting an end to the current bull market.

Climate change is a growing risk, not only to the insurance industry but also to residents and real estate markets. Another devastating wildfire season throughout the state has demonstrated the havoc a natural disaster can wreak on Sonoma's insurers, and should they become increasingly risk-averse and deny coverage to parts of the county, this could create more problems for homeowners and further discourage in-migration to the area.

Colin Seitz  
February 2021

### Consumer Lending Pulls Back...

Sonoma County total outstanding balance, % change yr ago

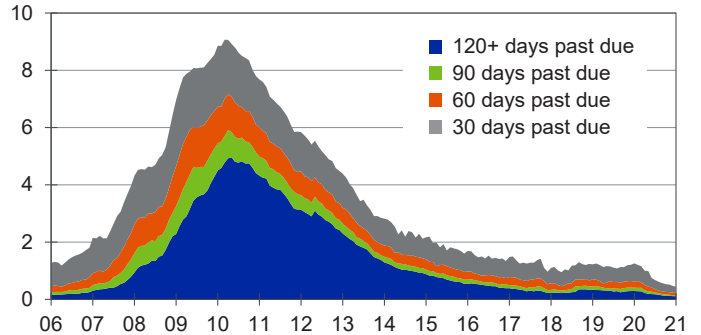


Sources: Equifax, Moody's Analytics

Home equity continues to fade from relevance as cash-out mortgage refinancing and the use of credit cards and personal loans to finance home improvement spending have supplanted new home-equity loan lending. Contributing to home equity's slowing in the second half of 2020 were announcements by several large lenders that they would no longer underwrite certain home equity facilities. The lack of travel, entertainment and leisure spending eroded outstanding bankcard balances.

### ...But Balance Sheets Remain Pristine

Sonoma County delinquency rates, % of outstanding \$

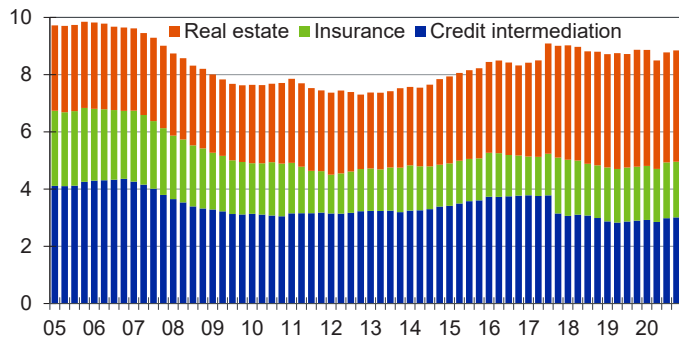


Sources: Equifax, Moody's Analytics

As a result of generous financial support from Congress in the form of unemployment benefits and direct stimulus, as well as elevated rates of saving among higher-income households, consumer credit performance unexpectedly improved during 2020. However, the state of household finances is not as rosy as the top-line numbers indicate. Forbearance remains in effect for many renters and homeowners, and consumer-facing industries will remain depressed until herd immunity is reached, by midyear at the earliest.

### Finance Payrolls Struggle to Break Higher

Financial services employment, ths

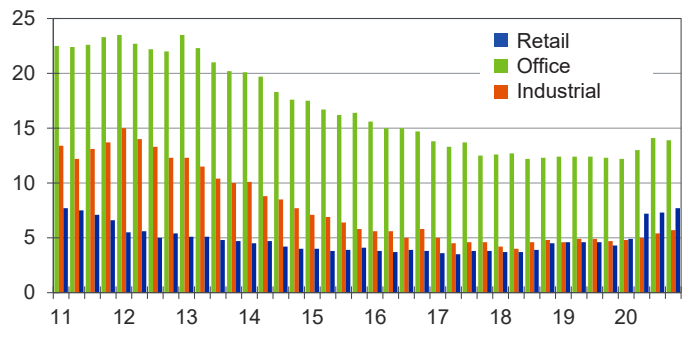


Sources: BLS, Moody's Analytics

Sonoma's financial services payrolls have held up well in the pandemic, but contributions to job growth will be slim moving forward. Despite record highs in the stock market and climbing asset values at Sonoma's largest financial institutions, employment in financial services sits slightly below its early-2018 peak. The tight purchase market has already lifted real estate and insurance payrolls, and further gains will rest on credit intermediation, which has traditionally expanded at a more modest rate.

### Vacancy Rates Climb Higher

Commercial vacancy rate, %



Sources: Keegan & Coppin Co., Moody's Analytics

Vacancy rates have climbed higher as nonessential businesses were forced to operate remotely or closed altogether in the wake of the pandemic and fear of contagion sapped demand at local retailers. White-collar services firms may shift permanently toward remote work to reduce operating expenses and provide flexibility for employees. Companies are also increasingly looking outside their immediate office locales to capitalize on talent in other locations by offering remote work opportunities, as well as to reduce labor expenses.





SONOMA**EDB**.ORG

707 - 565 - 7170

141 STONY CIRCLE, STE. 130, SANTA ROSA, CA 95401