

DMC Market Analysis Update Final

Forward

AECOM Technical Services, Inc. (AECOM) was retained by the Destination Medical Center Economic Development Agency (DMC EDA) to conduct a market demand study for the Destination Medical Center (DMC) project. In particular, the study is intended to inform the EDA's baseline market projections which were originally prepared in 2014 and provide market analysis information that may help guide development and investment on the DMC project over the next five years. Data sources includes public and private information available to AECOM from generally accepted sources for such analyses, plus from interviews with public and private individuals engaged in the market sectors analyzed, public officials, property and business owners. Data were collected and analyzed during August – December, 2018.

AECOM devoted the level of effort consistent with (i) the level of diligence ordinarily exercised by competent professionals practicing in the area under the same or similar circumstances, and (ii) consistent with the time and budget available to develop the Report. The Report and Analyses are based on estimates, assumptions, information developed by AECOM from its independent research effort, general knowledge of the industry, and information provided by and consultations with DMC EDA and DMC EDA's representatives. A full statement of the general and limiting conditions of the report and analyses is included at the conclusion of the document.

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Glossary

ADR - Average Daily Rate, statistic used in the hotel industry that represents the average income per occupied room in a given time period

CAGR - Compound Annual Growth Rate, a common measure of growth used to understand the constant rate over multiple time periods

Capture Rate – the percentage of a market or population that buy/rent/move to a district or project

F.I.R.E. - Finance, Insurance and Real Estate

Gross Rent – Tenant pays a set amount, while the landlord covers other expenses

Gross Demand – Total unit demand at a set point in time

Incremental Demand – Change in unit demand for a defined period of time

MFR – Multi-family Residential, housing classification in which multiple separate housing units are found within one building or several buildings within one complex

Net Absorption – Overall change in units/square feet occupied by tenants in a set period of time. Newly vacated units/square feet contribute negative values, while newly leased units/square feet contribute positive values

Negative /Positive Absorption – Negative absorption indicates a newly vacant units/square feet, and positive absorption indicates newly leased units/square feet

RevPAR – Revenue per Available Room, standard metric used to assess hotel performance, calculated by multiplying the ADR by the occupancy rate

RDE – Retail, Dining and Entertainment

ROCOG – Rochester-Olmsted Council of Governments

Room Night Supply Capacity – The annual total of available rooms in a given geography, calculated by total rooms multiplied by 365 days in the year

Triple Net Rent (NNN) - A net lease under which the tenant assumes all expenses of operating a property, including both fixed and variable expenses and any common area maintenance that might apply. However, the landlord is responsible for structural repairs.

Key Assumptions

Region - Unless otherwise specified, Region (regional growth, regional demand, etc.) will refer to the Rochester Metropolitan Statistical Area, which comprises Olmsted, Wabasha, Dodge and Fillmore Counties.

DMC-Vicinity – This geography is understood to contain the area within the official Destination Medical Center boundary and properties immediately across the street.

Mayo Growth – A major driver of demand for the four land uses covered in this report will be the continued expansion of Mayo Clinic, whose growth projections are a critical assumption in the estimates for ongoing development in the Region. Any significant deviation from their growth projections could necessitate adjustments to demand forecasts for all four land uses.

Population/Household Growth – Projections of baseline population and household growth are based on “Employment & Population Projections, Looking Ahead through 2040,” published by the Rochester-Olmsted Council of Governments Planning & Analysis Division in 2014. While AECOM updated projections based on the most recent data, it is assumed that long-term growth remains on track with official government forecasts.

DMC Market Update

Summary Market Estimates ⁽¹⁾

Office & Med-tech — AECOM estimates incremental demand between approximately 100,000 and 130,000 additional square feet of Non-Mayo Downtown Office Space for the 5-year period from 2019-2024 (37,000-55,000 square feet of professional office space and 65,000-75,000 square feet of med-tech space). From 2019-2034, AECOM estimates incremental demand between approximately 230,000 and 340,000 square feet of Non-Mayo Office Space (115,000-190,000 square feet of professional office and 115,000-150,000 for med-tech space).

Hotel — AECOM estimates total supportable rooms at target occupancy rate (70%) for Downtown hotels to increase from around 3,000 to 3,400 from 2019 to 2024. By 2034, AECOM estimates total supportable rooms to reach approximately 4,100. If the Downtown hotel market adheres to the average historical occupancy rate of approximately 64%, demand for hotel rooms would be greater.

Residential — AECOM estimates incremental demand of between approximately 900 and 1,400 additional Multi-family Residence (MFR) housing units in the DMC-Vicinity/Downtown region for the 5-year period from 2019-2024. From 2019-2034, AECOM estimates incremental demand between approximately 3,400 and 5,000 additional housing units before deducting projects from the current pipeline.

Retail, Dining, Entertainment — AECOM estimates incremental demand of between approximately 68,000 and 128,000 additional square feet of Retail, Dining and Entertainment for the 5-year period between 2019- 2024 for the downtown market. From 2019-2034, AECOM estimates between approximately 195,000 and 360,000 square feet of supportable space.

(1) Estimates are independent of known current pipeline of projects

What's Happened

Office Market

Residential Market

Retail, Dining, Entertainment Market

Hotel Market

Since 2014?



Office* Market

How has the office/ med-tech market performed in recent years?

*This office market analysis segregates conventional professional office (finance, insurance, legal, etc.) and med-tech office (scientific, technical and medical services)



DMC/Downtown Office Market

Analysis of data from CoStar show no or negative growth in the DMC/Downtown Rochester office market from 2014 to 2017.



Office Space Inventory

There were no new office buildings from 2014 to 2017. However, the H3 building was built in 2013 on the site of the former C.O. Brown Building and opened to tenants in 2015.



Office Rent

Annual Gross Rents per SF for marketed space increased from just below \$15 to \$27 between 2014 and 2017.



Vacancy Rate

Vacancy rates jumped from an average of 3% per year to 15% in 2017, largely due to renovations of the Associated Bank building.



Future Development

Discovery Square's first med-tech building with 90,000 square feet is set to open in 2019 and Berkman Apartments are set to add an additional 20,000 square feet of professional office space.

Hotel Market

How has the hotel market performed in recent years?



DMC/Downtown Rochester Hotel Market

Analysis of data from Smith Travel Research (STR) show positive growth in the DMC/Downtown Rochester hotel market from 2014 to 2017.



Hotel Room Inventory

The total number of hotel rooms increased from 2,830 to 2,974 from 2014 to 2017 with the additions of Aspen Select and Fairfield Inn and Suites.



Hotel Property Development

There are near-future plans to continue developing hotels in the DMC/Downtown area. After the introduction of new product, development rate may slow as inventory is absorbed.



Occupancy Rate

A slight dip in occupancy from 2014 to 2017 of negative 0.9 percent, likely due to the increased supply. New product coming online may soften occupancy initially.



Average Daily Rate

Even with slightly lower levels of occupancy, ADR saw an up-tick from \$131.45 to \$135.60 in real terms adjusted for inflation.

Residential Market

How has the residential market performed in recent years?



DMC-Vicinity/Downtown Residential Market

Analysis of Multi-family Residence (MFR) data from CoStar show positive growth in the DMC-Vicinity/Downtown Rochester housing market from 2014 to 2017.



Housing Unit Inventory

The total number of MFR Housing Units increased from 696 , growing to 999 from 2014 to 2017, approximately 100 units per year on average.



Apartment Building Development

There are numerous MFR properties that are under construction or have been proposed in the DMC-Vicinity/Downtown Housing Market (1,282 units as of 2018, for the next three to four years, approximately 320 to 425 per year.



Vacancy Rate

The Vacancy Rate remained stable between 2014 and 2017, with an uptick beginning in 2015 and 2016 when new buildings came onto market that peaked above 11% in 2016 , but dropped to ~4% in 2017.



Effective Rent per Unit⁽¹⁾

Rent ranges from \$950 for a studio to over \$3,000 for a penthouse. Average rent increased by 6% from 2014 to 2017, reaching \$1.69 per square foot.

Retail, Dining, Entertainment (RDE) Market

DMC/Downtown retail market performance



DMC/Downtown Rochester Retail Market

Analysis of data from CoStar shows both stability and flux in the DMC/Downtown retail market.



Retail Inventory

Total Downtown/DMC retail inventory (~444,000 SF) has not changed significantly since 2007 (pre-recession). While some new space added, some new vacancies off-set the increase.



Rents

Were consistently lower than in the City as a whole until 2017, when they approached parity with citywide rates.



Vacancy Rates

Vacancies peaked in 2015 (12%), but currently at 3% which is slightly above City and County rates and reflects a market with opportunity for growth.



Net Absorption

Positive recent net absorption of 39,320 SF from 2016 to present but relatively flat (5,000 SF) from 2014-2017 due to negative absorption in 2014 and 2015 (~34,000 SF)

Demographics, Population & Jobs

Households, Income, & Jobs

The foundation of most of the market analyses, household and job growth continues to be positive for Rochester and Olmsted County, with both jurisdictions ahead of statewide averages.

Falling unemployment rates and rising incomes offers continuing strong support for DMC's development.



Population and Households

According to the US Census Bureau's American Community Survey, Olmsted County's population was 154,930 and the City of Rochester was 115,733 in 2017. This same source estimates there are 61,873 households in Olmsted County, of which 46,645 are in the City of Rochester.

In 2014, the Rochester Olmsted Council of Governments (ROCOG) produced population and employment projections through 2040 based on demographic trends and accelerated growth from Mayo Clinic investments. These estimates predicted the population of Rochester would grow at a Compound Annual Growth Rate (CAGR) of 1.6% for the period between 2010 and 2020. The reported numbers from the US Census show that the population of Rochester grew at a CAGR of 1.5% between 2010 and 2020, slightly less than originally projected, but within a reasonable margin.

In 2014, Maxfield Research prepared a Housing Needs Assessment for Olmsted County and Rochester that predicted households would grow at a CAGR of 2% for the period 2010-2020 (1). The reported numbers from the Census have been lower, showing a CAGR of 1.2% from 2010 to 2017, though growth has accelerated in the past two years. **Annual household growth since 2015 has been above 4%, indicating the original projections could be on track by 2020.**

Rochester has constituted roughly 75% of the total population and households of Olmsted County since 2010. This percentage could grow as DMC initiatives attract more residents into and near downtown Rochester.

(1) "Comprehensive Housing Needs Assessment for Olmsted County Minnesota," Maxfield Research Inc. (2014).

Figure 1.1: Historic and Current Population of Olmsted County and Rochester

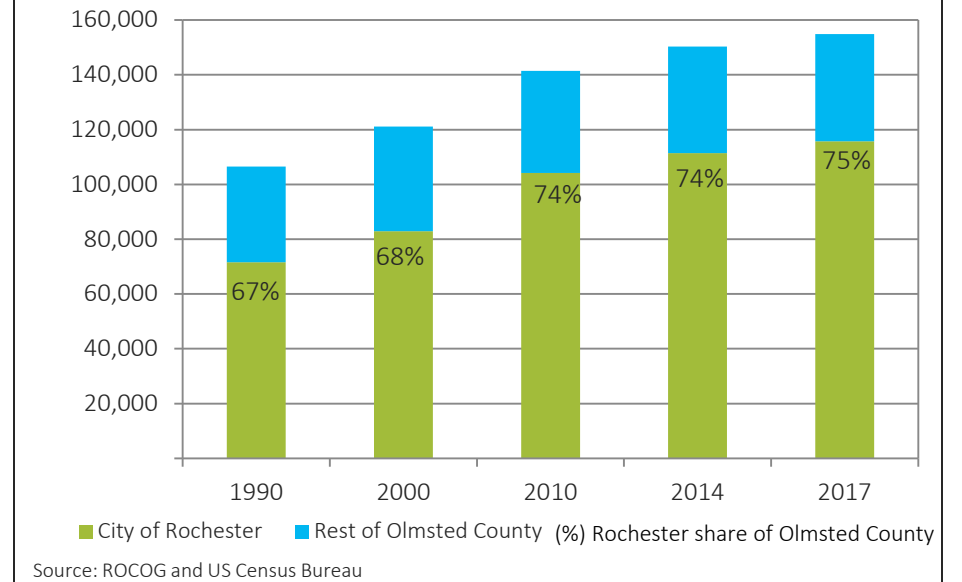


Figure 1.2: City of Rochester Projected and Reported Household Growth

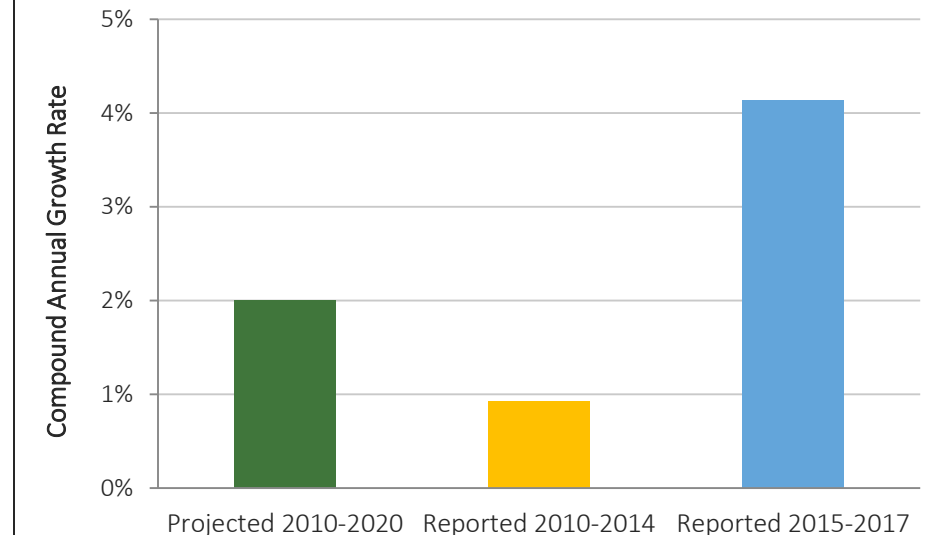
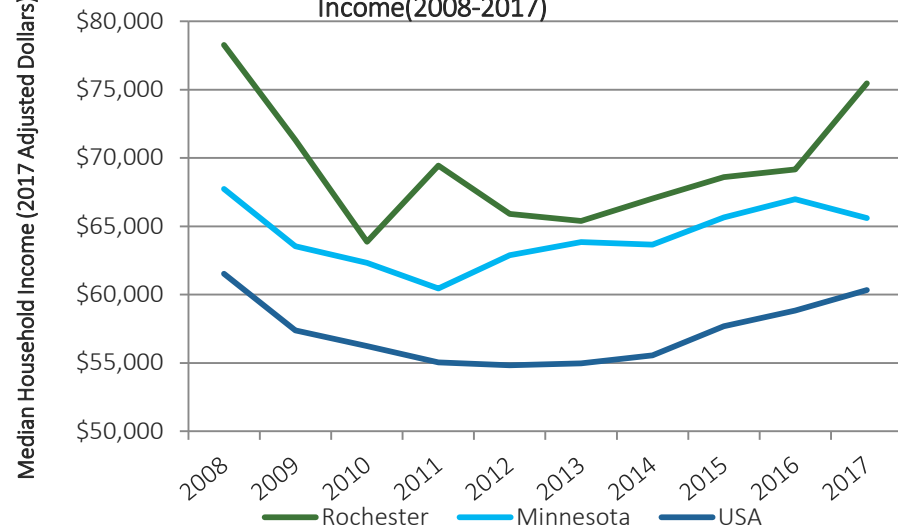


Figure 1.3: Historical Inflation Adjusted Median Household Income(2008-2017)



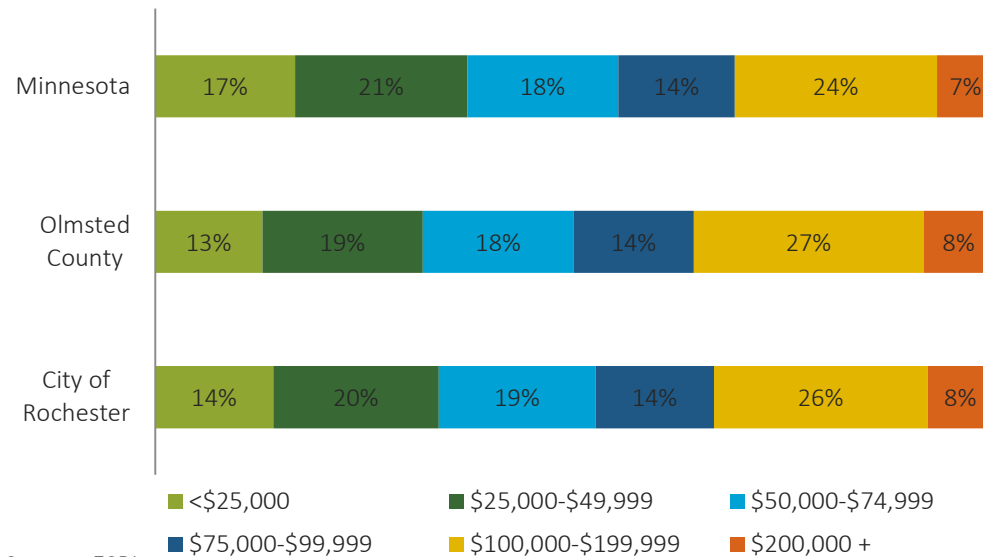
Source: US Census Bureau, Bureau of Labor Statistics

Median Household Income

Median household income in the City of Rochester has been consistently higher than that of both the state of Minnesota and the United States as a whole. Households in Olmsted County fall into slightly higher income bands than those of the City of Rochester, but the general distribution in 2018 is very similar for the two geographies.

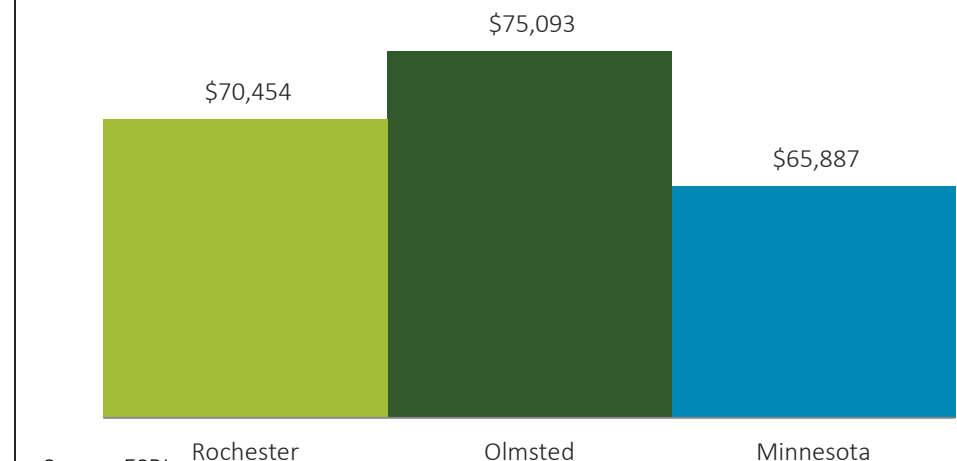
Both Olmsted County and the City of Rochester have slightly higher percentages of households earning more than \$100,000 a year and slightly lower percentages earning less than \$50,000 a year compared to the state of Minnesota. All three geographies have slightly increased concentrations of high income households (less than 1% for Minnesota and 4% for Olmsted County and Rochester) and slightly decreased concentrations of low income households (4% for all 3 geographies) since 2014.

Figure 1.4: Household Distribution by Income, 2018



Source: ESRI

Figure 1.5: Median Household Income Comparison, 2018

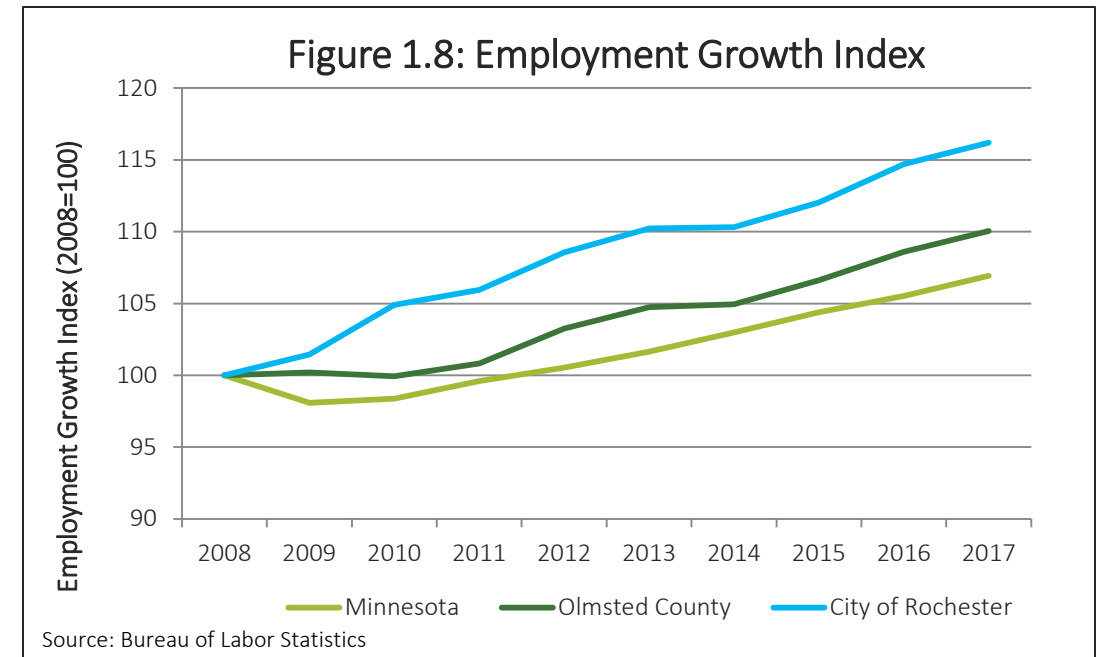
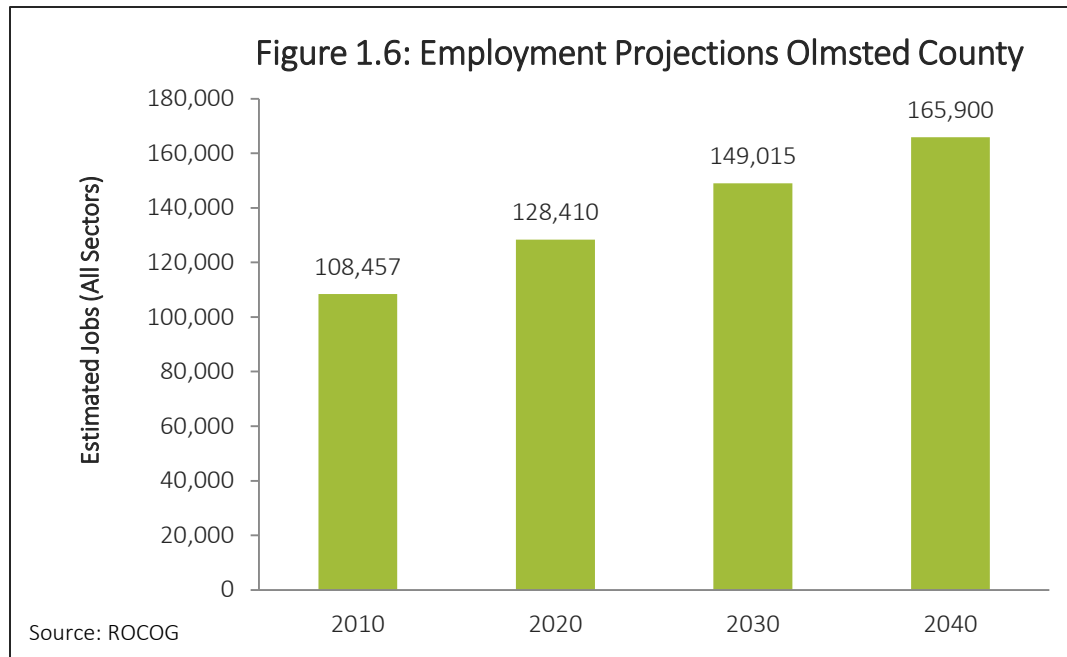
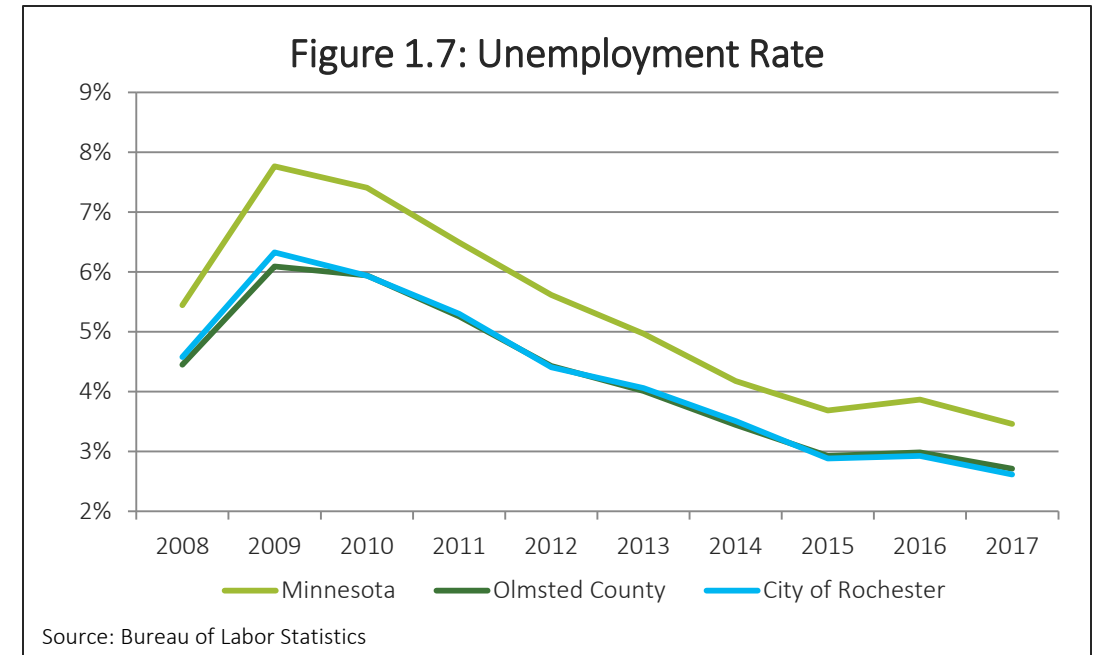


Source: ESRI

Labor Force

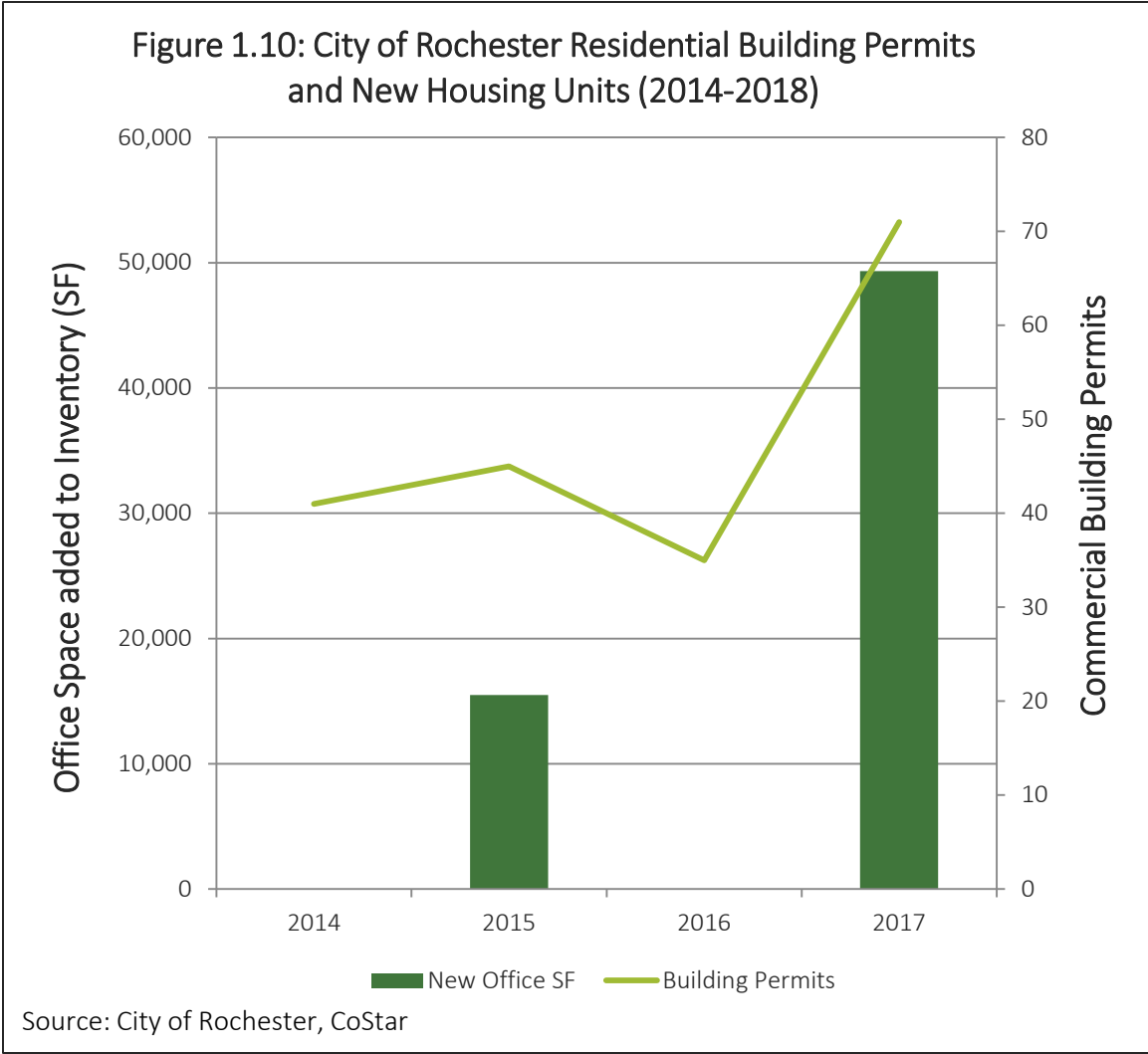
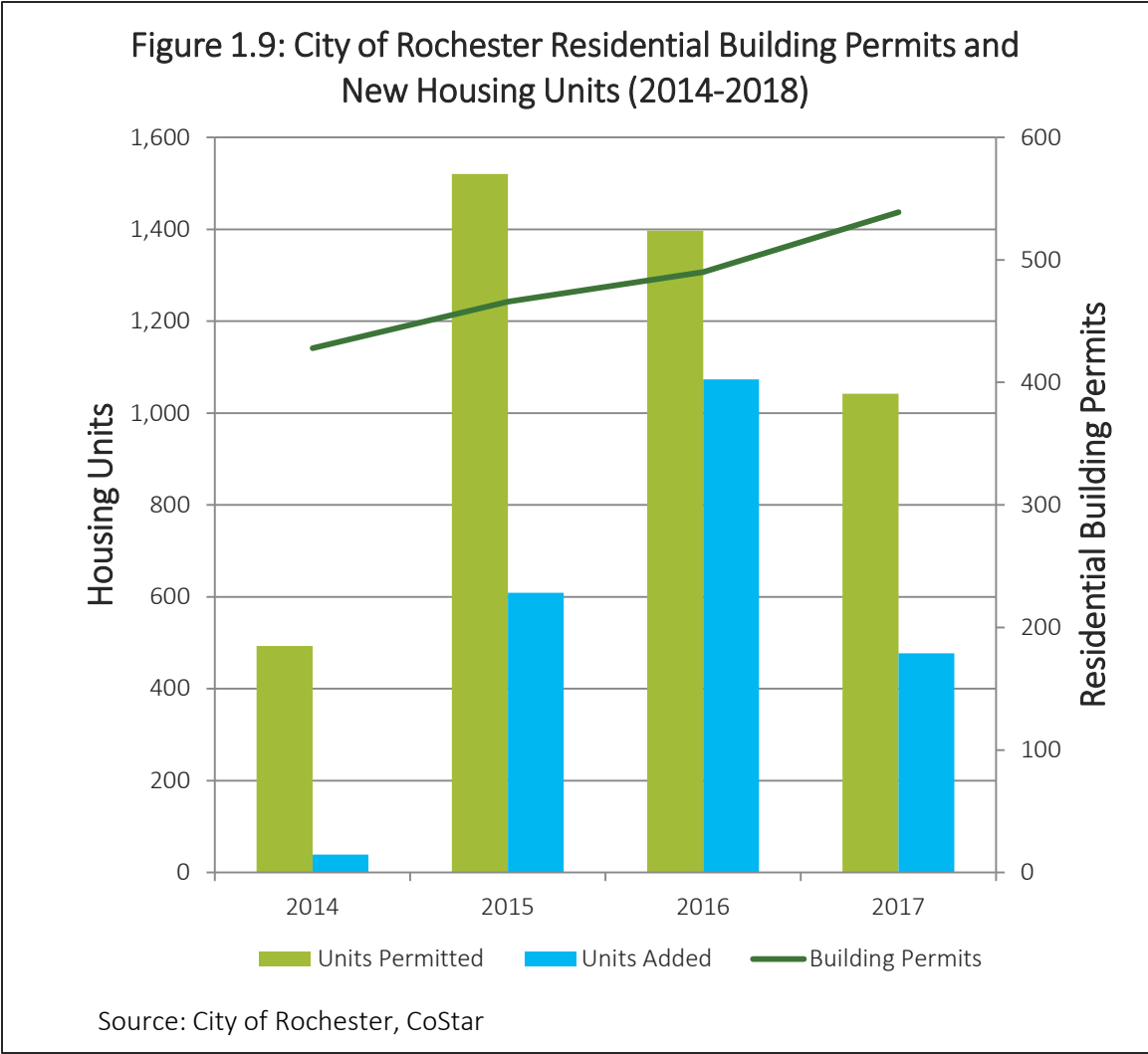
The unemployment rate for Olmsted County and the City of Rochester have been consistently lower than the unemployment rate of Minnesota, all of which have trended downward since their spike during the Great Recession. In 2017, the unemployment rate for the City of Rochester was 2.6%, compared to 3.5% for the state. All three geographies were below the national average in 2017. Convention considers a 4% unemployment rate as “Full Employment,” allowing capacity for a fluid labor market.

The Employment Growth Index illustrates the higher rate of job growth in the City of Rochester compared to Olmsted County and Minnesota. In 2014, ROCOG produced employment projections from 2010 through 2040. These forecasts estimated a CAGR of 1.7% for total employment in Olmsted County from 2010-2020. According to the most recent data from the US Bureau of Economic Research, total employment grew at 1.5% between 2010 and 2016. Employment growth by sector is examined in the Office Demand section.



City of Rochester Permit Trends (2014-2018)

The City of Rochester has permitted an average of 1,113 housing units per year and added an average of 550 housing units per year between 2014 and 2017. Residential building permits have averaged 480 per year between 2014 and 2017. Commercial building permits averaged 40 permits per year from 2014 to 2016 and saw an uptick to 71 permits in 2017. Commercial office added to the city’s inventory did not increase in 2014 and 2016 but saw gains of 15,500 and 49,000 in 2015 and 2017 respectively.



Looking Forward

Office Market

Residential Market

Retail, Dining, Entertainment Market

Hotel Market

2019-2024 & 2034



Office & Med-Tech

Commercial Office and
Medical-Technology Sector



Office Market Drivers



Professional Office

Professional Office space demand is a function of regional economic growth and will be accelerated by DMC implementation related to emerging med-tech industry clusters associated with Discovery Square. It accommodates business services such as financial, legal, marketing, administrative, sales, and some information and software services, and personal services such as finance, insurance, legal, counseling, etc. There should be opportunity to create Co-Working space for start-ups, small firms, and company representatives.



Med-Tech Flex Office

Demand for Med-Tech Flex Office space is specific to implementation of Discovery Square. The initial years are expected to be driven by Mayo Clinic's relationships and partnerships, with the intent of diversifying over time to include companies that have their own business relationships or choose to locate on a speculative basis because of local talent and the potential to expand the customer base to include Mayo and other Discovery Square companies. There should be some cross-over with the Professional Office sub-market for technology services and professional services, including Co-Working space. Enhancement of the associated ecosystem to support new and young companies may accelerate the rate of growth.



Divergence of Office Needs

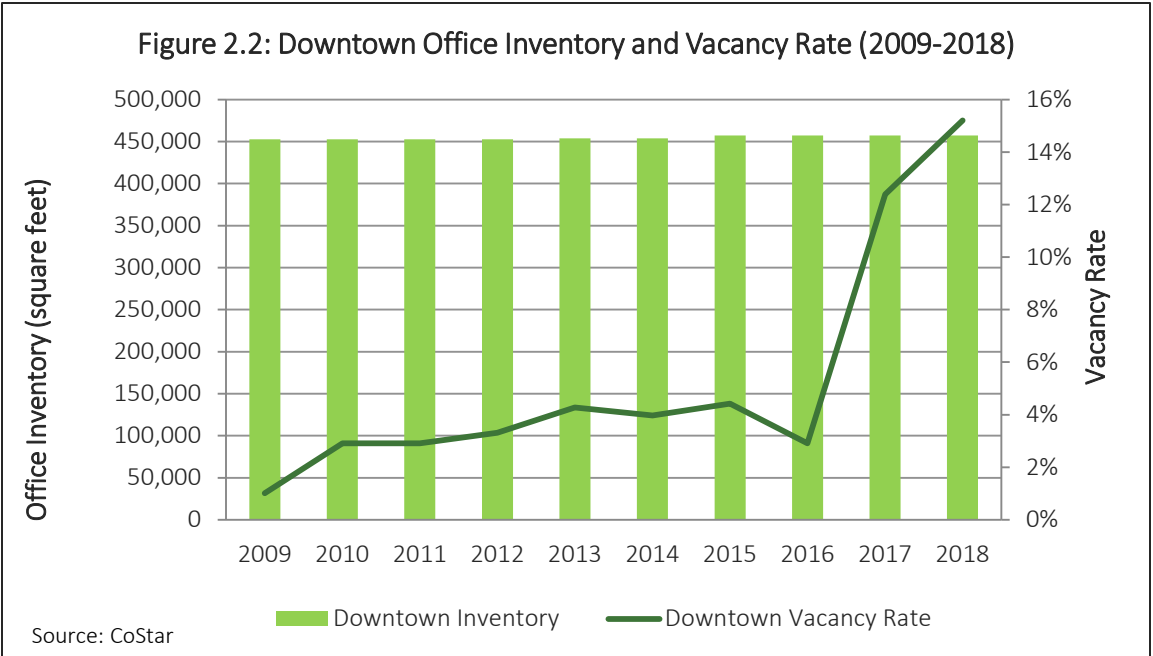
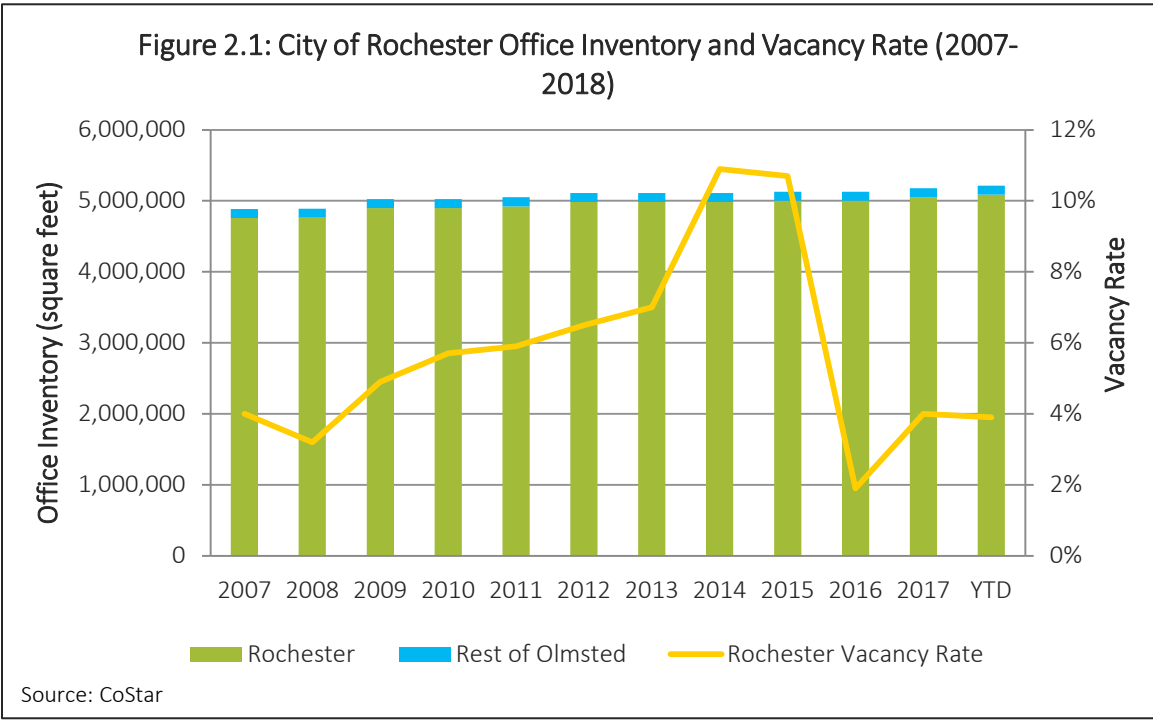
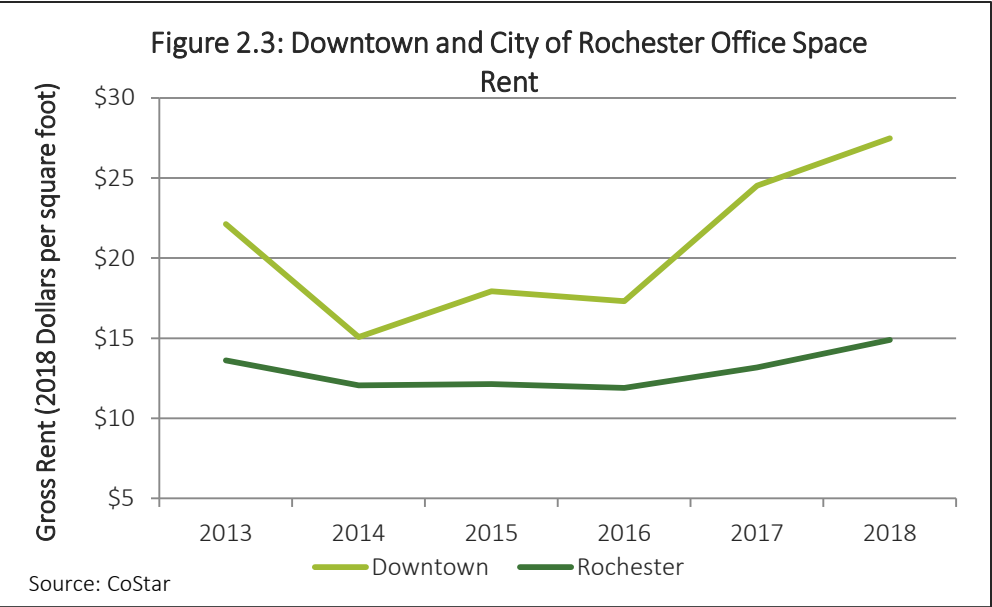
While many the needs of may professions are met with conventional office space, many scientific and technical professions are moving towards a flex office model that includes space for laboratories, equipment and specialized collaborative areas.

Office Market: Current and Historic

Data from CoStar indicates that there are approximately 5.2 million square feet of office space throughout Olmsted County, including the operations of Mayo Clinic. Vacancy Rates for office space in the City of Rochester reached 11% in 2014, largely due to the restructuring of IBM’s operations in Rochester.

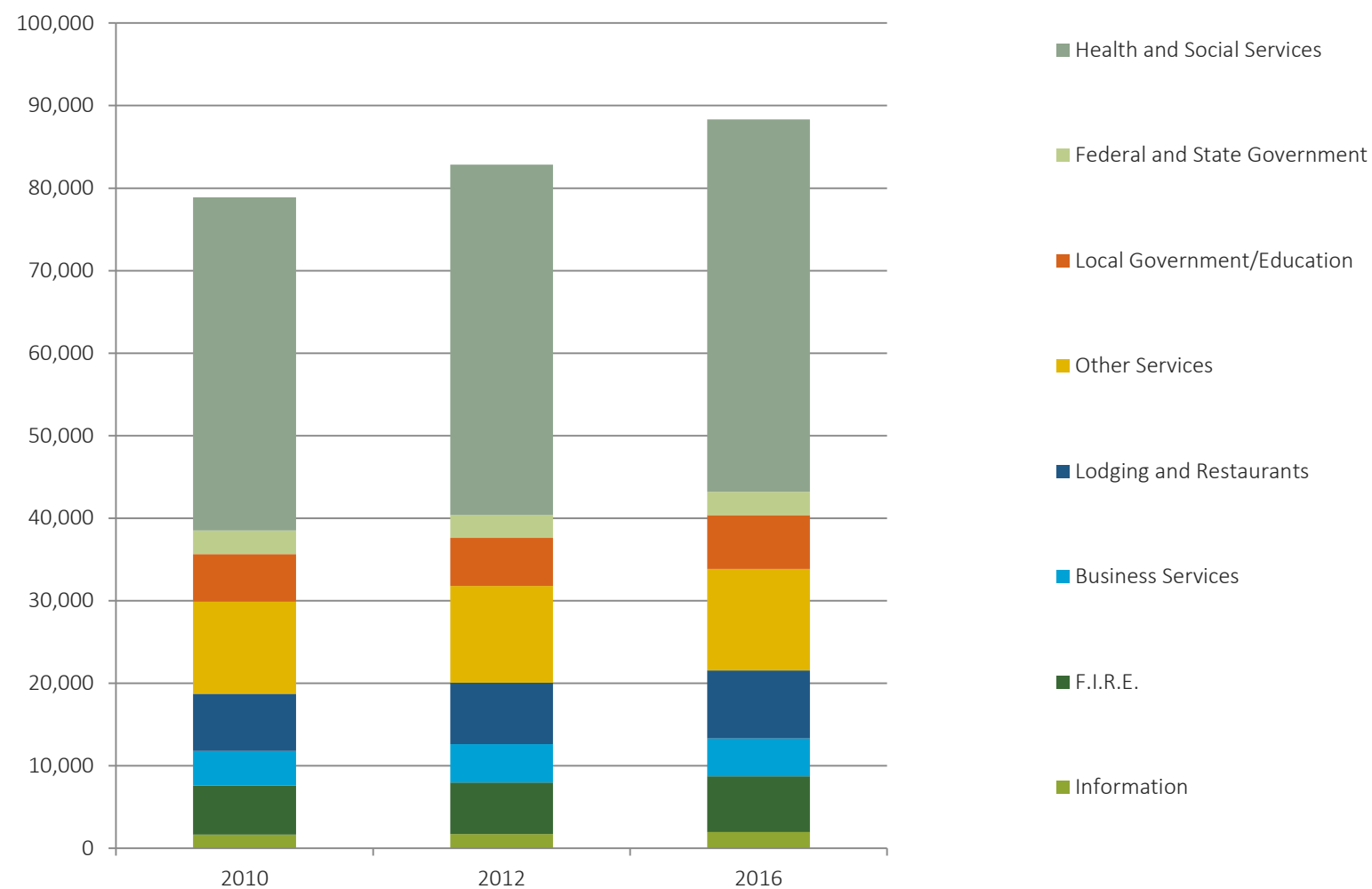
Downtown Rochester, defined as a single Census tract, has 20 buildings with approximately 460,000 square feet of non-Mayo office space. While the vacancy rate for this space was low historically, it jumped to 12% in 2016 and rose to 15% according to the most recent data from 2018. This increase is due largely to the Associated Bank building, which added 52,000 square feet of vacant space to the inventory between 2016 and 2017.

Gross Rent for office space Downtown is higher than that of Rochester as a whole. Despite the high vacancy rate, annual rent (Gross Rent Direct) for office space Downtown has increased by 25% since 2014 after adjusting for inflation, reaching \$27 per square foot in 2018. Triple Net Leases(NNN) are increasingly common, with 40% of properties reportedly offering a NNN arrangement. Estimates of Gross Rent account for these expenses.



Office Employment Olmsted County

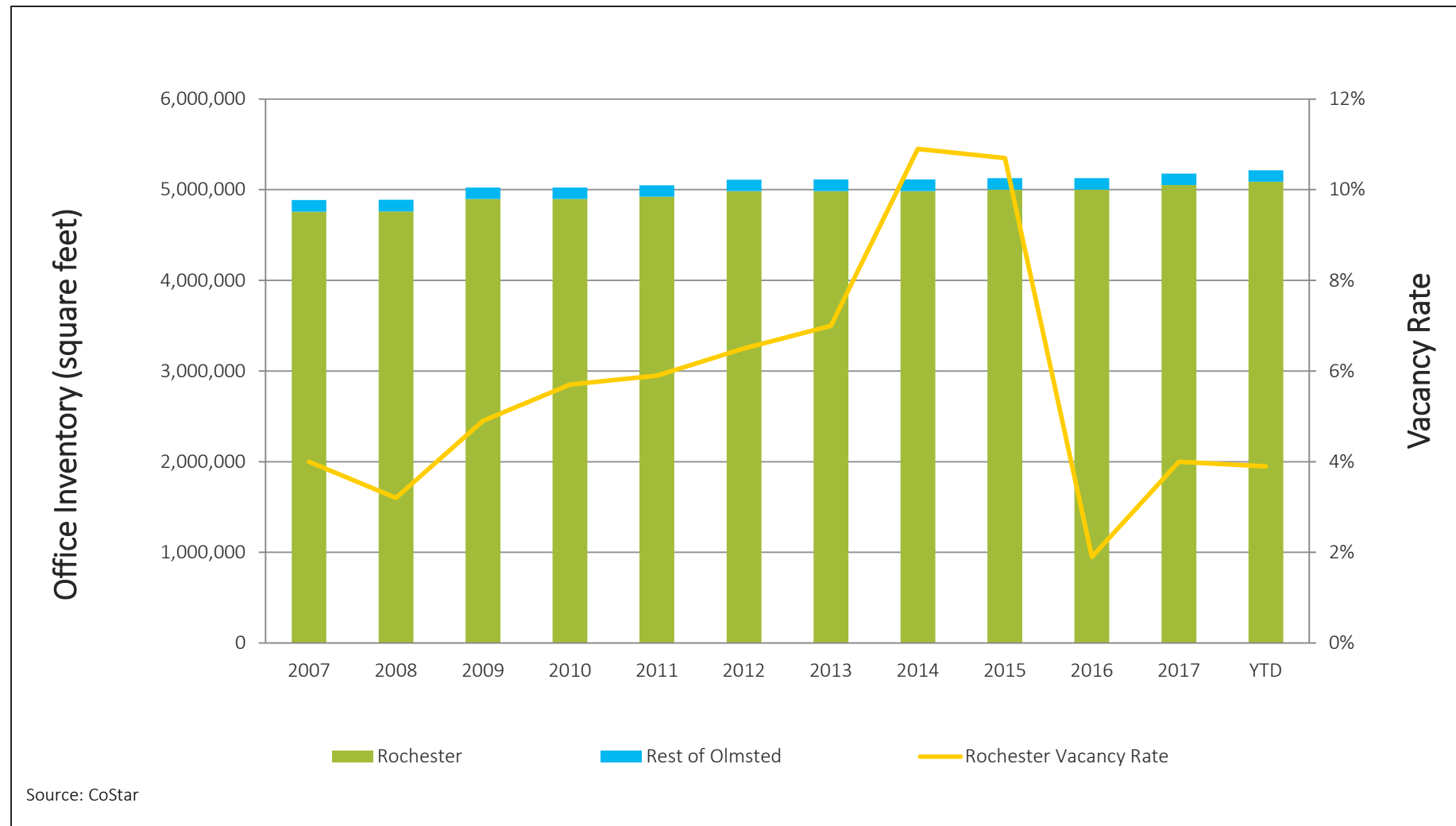
Figure 2.4: Olmsted County jobs that occupy office space increased by 12% from 2010-2016*



* Percentages have been applied to each to estimate office jobs per sector. Includes med-tech flex space

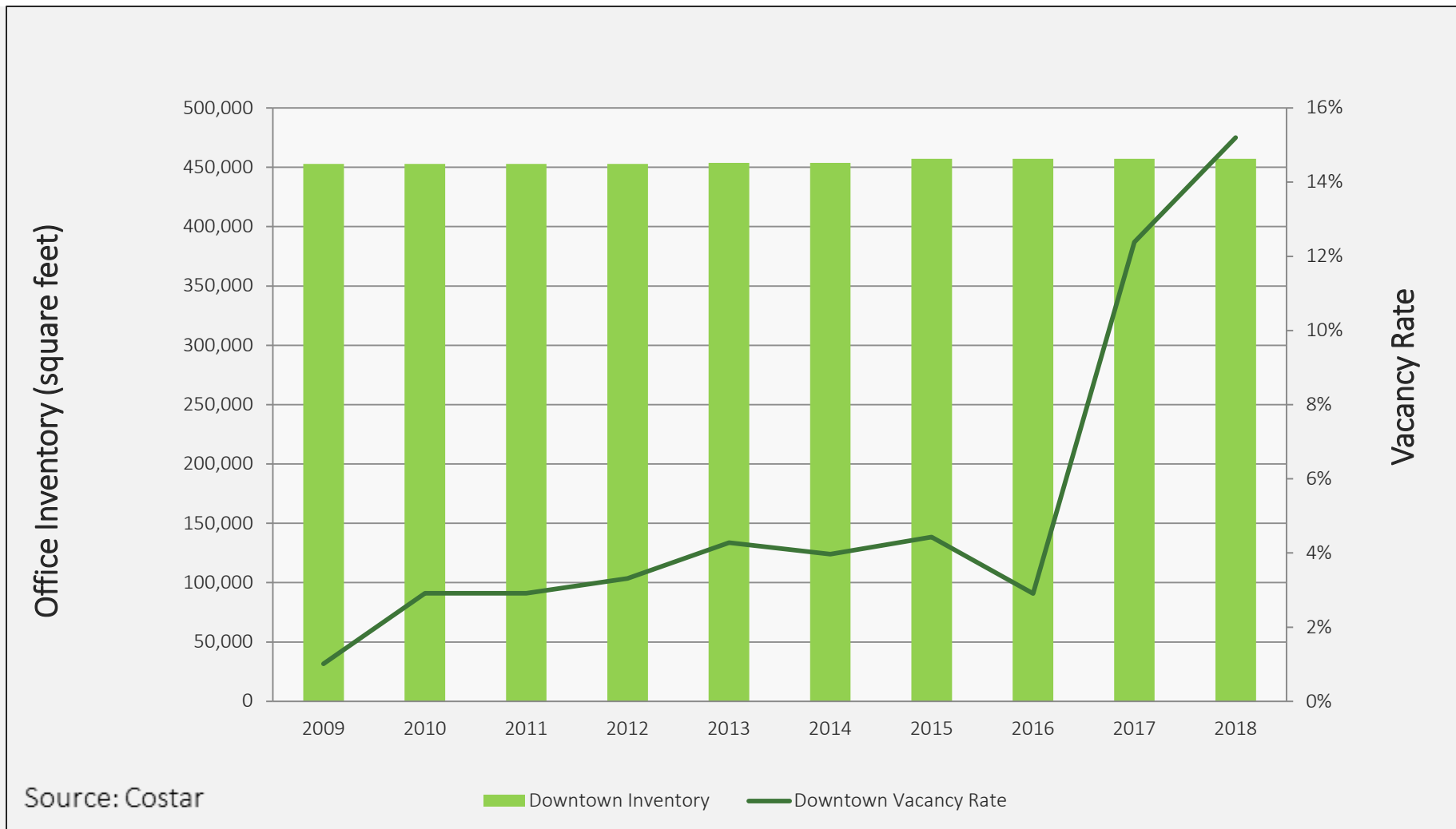
Office Inventory and Vacancy

Figure 2.6: Rochester and Olmsted County Inventory and Vacancy Rate 2007-2018 (YTD)



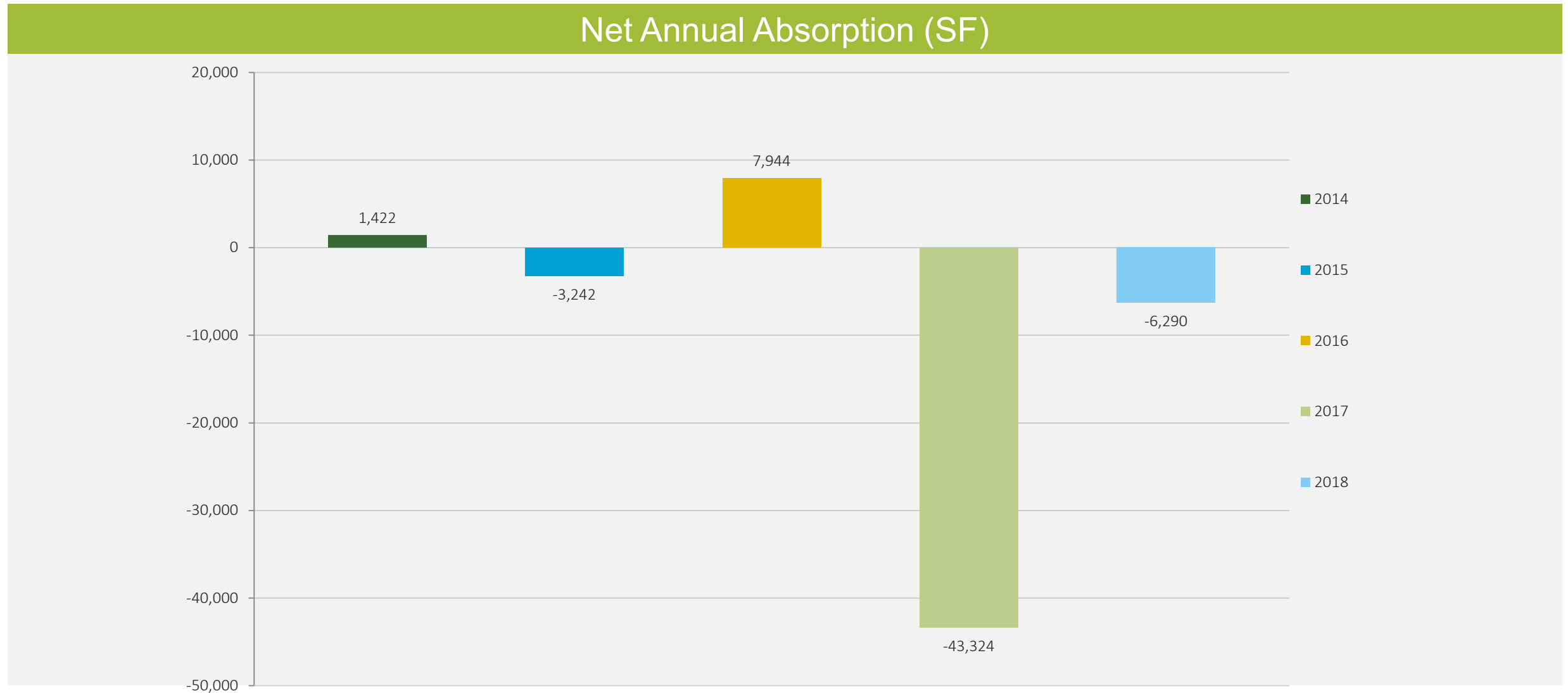
DMC/Downtown Office Inventory and Vacancy

Figure 2.7: Office Space Inventory and Vacancy Rate for DMC/Downtown Rochester Offices



Office Absorption – DMC/Downtown

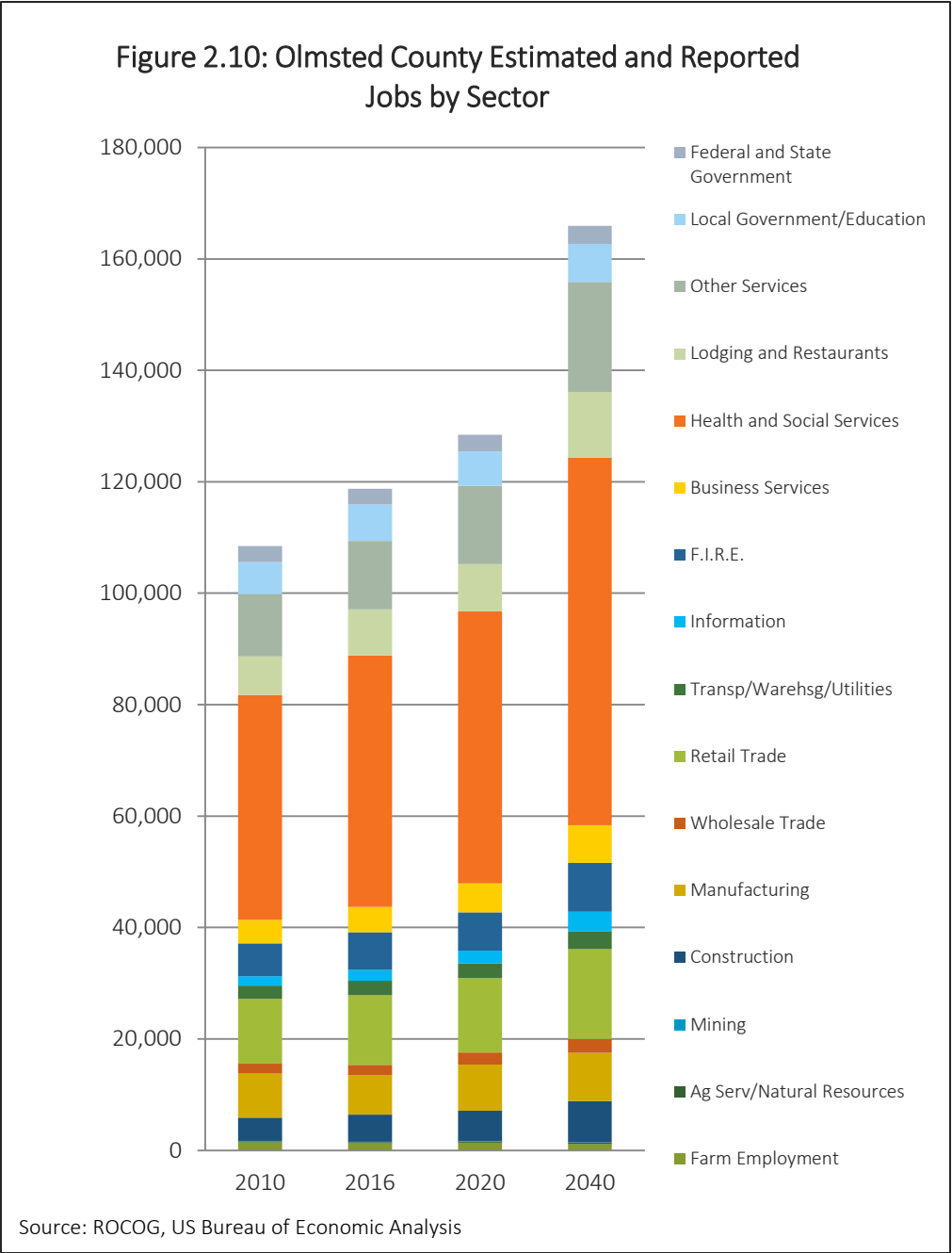
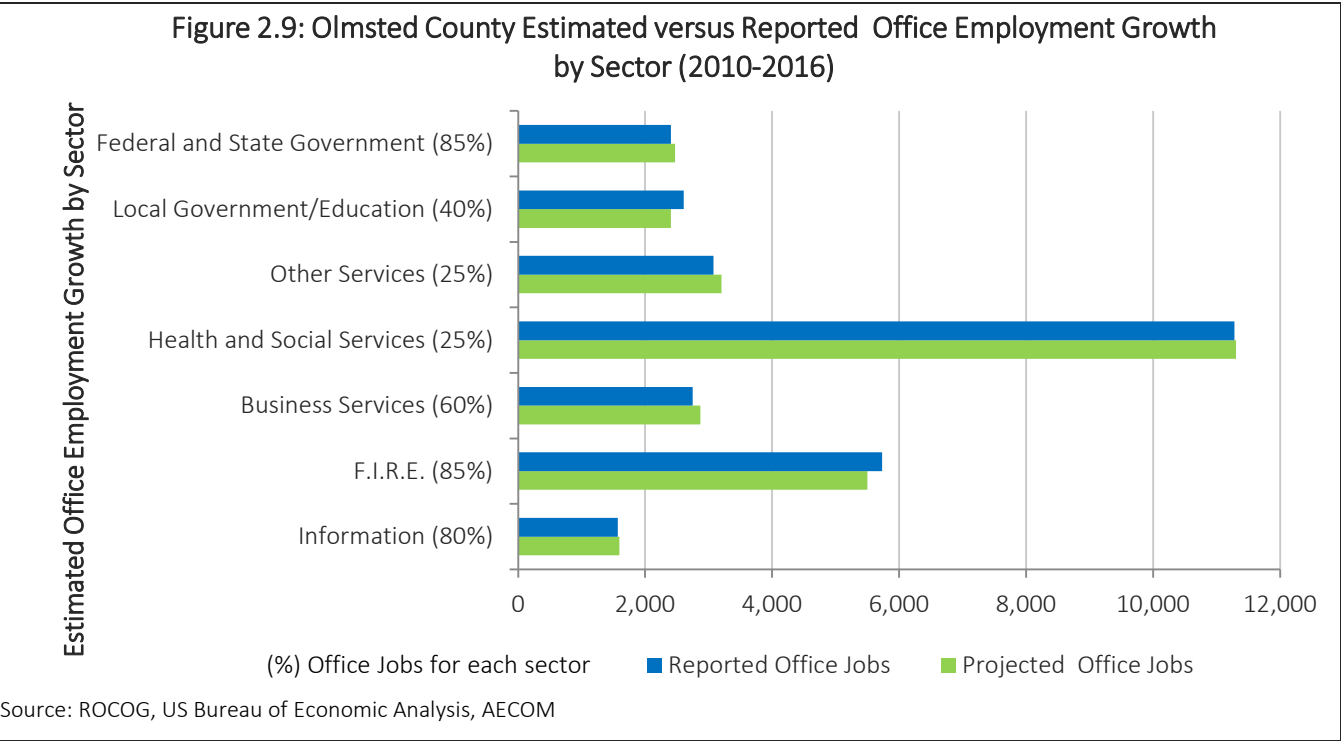
Figure 2.8: DMC/Downtown Rochester net office absorption since 2014



Updates to Previous Office Demand Model

The updated projections for Office Demand in Downtown Rochester differ from AECOM’s previous projections (2014) in two ways. First, due to technology, space per worker is decreasing. National trends indicate that that the average office space demanded per worker has declined (the model reduces the assumed ratio from 200 to 160 square feet per worker). Second, this report separates professional office from med-tech office due to different demands by sector, with med-tech requiring more space per worker for labs, storage, etc.

In 2014, AECOM utilized ROCOG employment growth projections by sector to estimate total future office demand for Olmsted County/Rochester and the portion of that demand that could be captured in Downtown. The original ROCOG projections estimated total employment would grow at a CAGR of 1.7% between 2010 and 2020, while the US Bureau of Economic Analysis reported that total employment grew at a CAGR of 1.5% from 2010-2016. Growth in several sectors requiring office space was stronger than expected (FIRE, Local Government/Education), while growth in others was weaker (Health/Social Services, Business Services). These adjusted growth rates were incorporated into sector employment projections for the near term.



Office Demand in the DMC

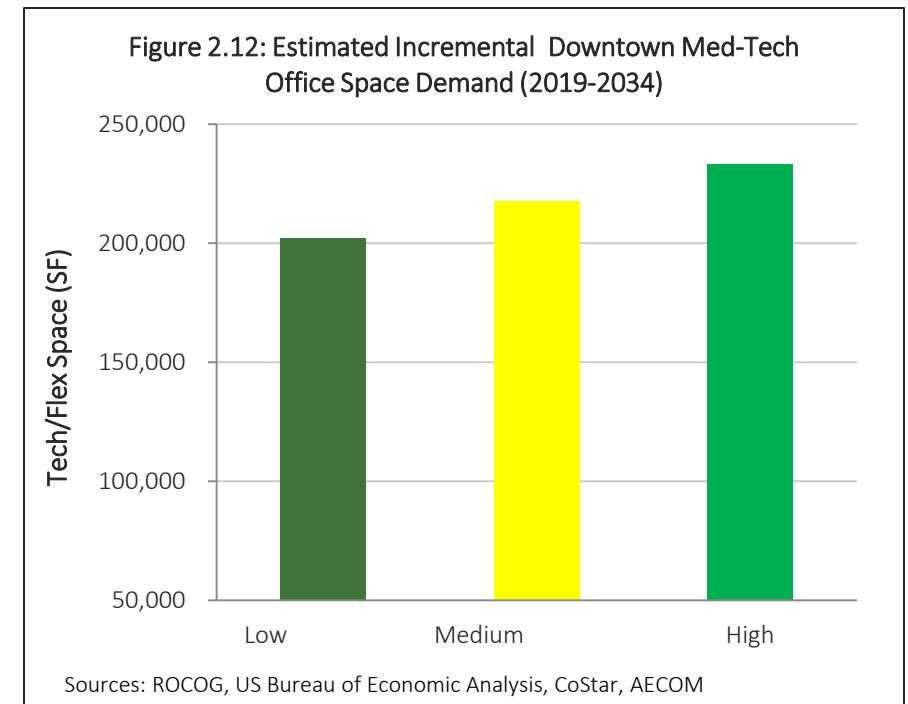
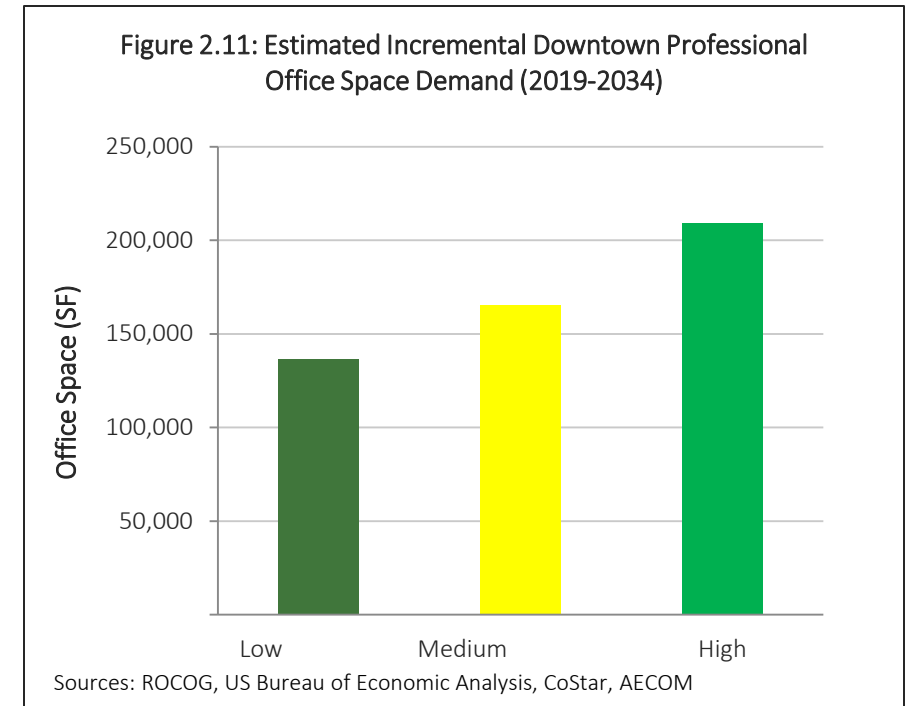
Based on employment projections for office workers from 2019 to 2034, excluding Mayo Clinic's normal operations not associated with DMC's Discovery Square, cumulative demand is estimated to reach 975,000 square feet of additional office space in the City of Rochester, of which approximately 664,000 is estimated for professional office space and 311,000 for flexible med-tech space.

Based on data from the US Census On the Map, the share of workers in the City of Rochester working Downtown was 30% for all workers, 40% for service sector workers, and 60% for medical/technical service workers.

Data from CoStar shows that of the 2,682,000 square feet of non-Mayo office space in the City of Rochester, 457,200 square feet (17%) are located Downtown.

Based on current capture rates and continued planned development in the DMC/Downtown, AECOM estimates demand for 136,000 to 209,000 square feet of additional professional office space, and 202,000 to 233,000 square feet of med-tech space in Downtown between 2019 and 2034. Estimates exclude direct employment from Mayo Clinic's regular operations not associated with Discovery Square.

Actual office demand in Downtown will be determined both by an increasing capture rate of regional job growth associated with office space, and DMC's initiatives, particularly related to Discovery Square. Since Discovery Square's opportunities are primarily associated with specific partnerships and engagements, as opposed to speculative demand, the DMC's planned capacity for Discovery Square exceed projected demand to allow capacity to exploit opportunities unforeseen at this time.

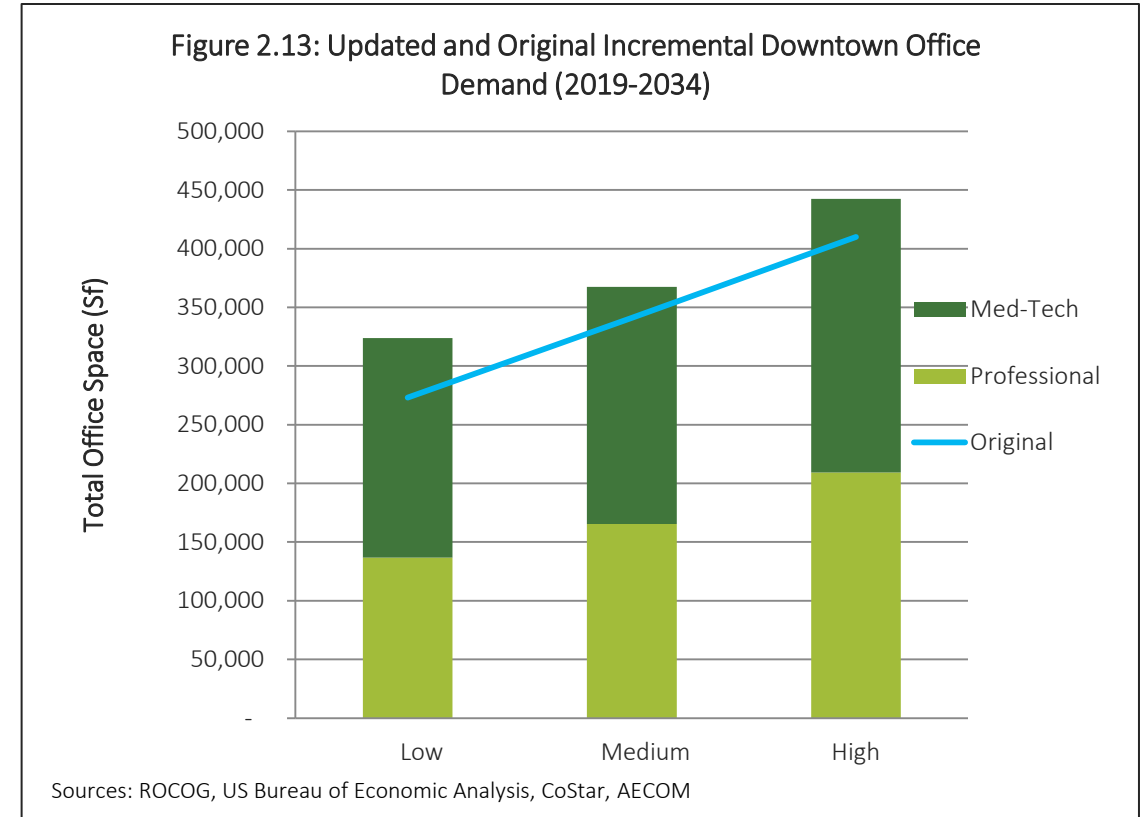


Comparison to Original Projections and Pipeline Development

The Office Market Analysis from the previous AECOM report (2014) estimated that demand for incremental office space in Downtown Rochester may reach between 273,000 to 410,000 square feet of additional office space between 2019 and 2034, excluding Mayo Clinic's normal operation growth not related to Discovery Square. This projection combined professional and med-tech office space and assumed 200 feet per worker.

The new demand analysis assumes 160 feet per worker for professional office workers and 220 feet per med-tech office worker. National trends indicate office space demands are changing for these sectors that require the integration of laboratory and technical equipment with conventional office space (1). Despite these changes, the new estimates are largely in line with previous projections.

While no new office buildings have been constructed since the previous report, two additional buildings with professional and med-tech office space are scheduled to open in 2019 or early 2020, adding 105,000 square feet of office space to Downtown Rochester. Successful execution of the DMC strategy, particularly related to Discovery Square, should achieve estimated growth of the office market. Absent successful execution of the DMC strategy, the current growth rate of the Professional office sub-sector alone may not fill the 105,000 square feet by 2024.

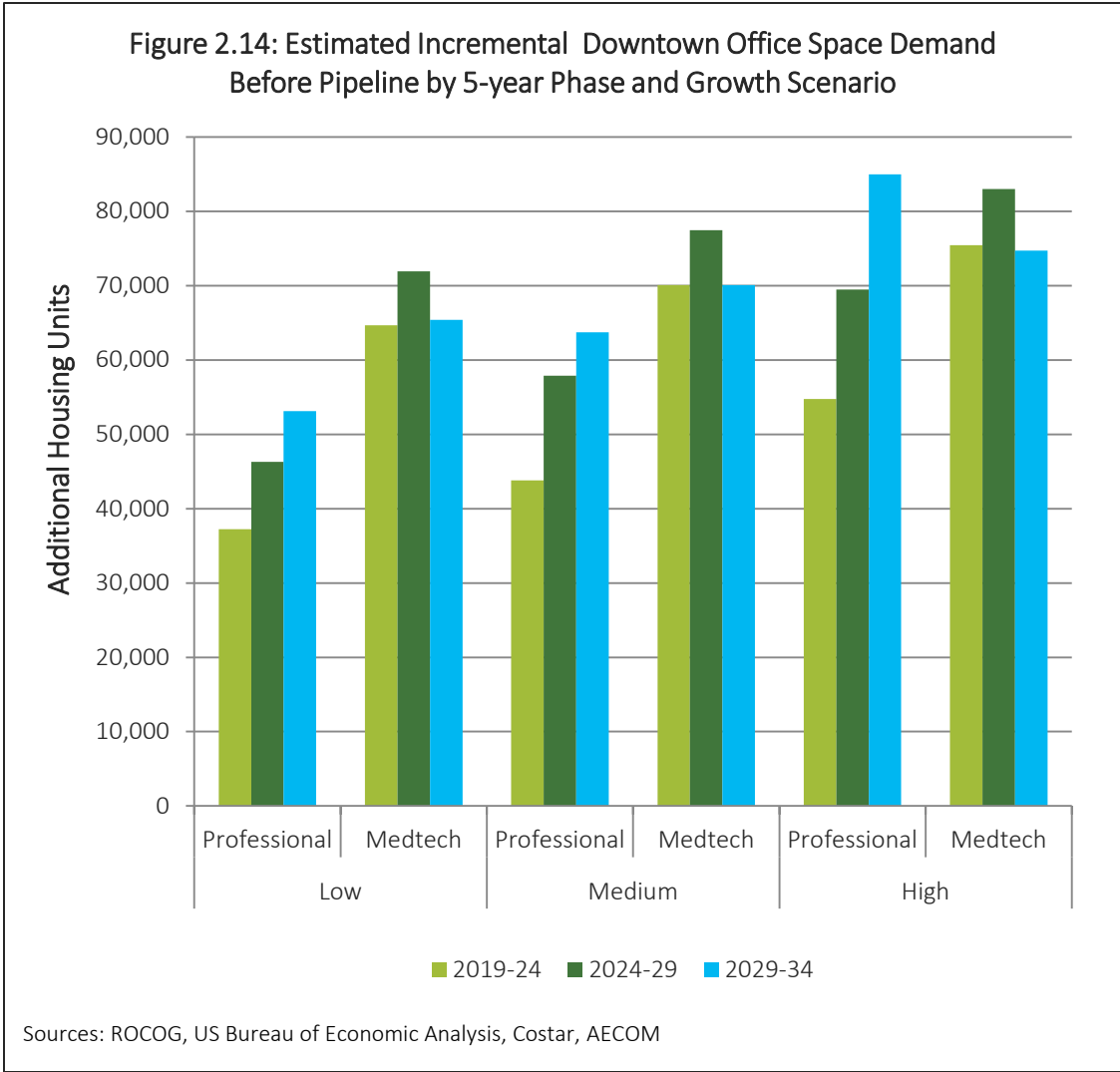


(1) "Tech Office Trends 2017," JLL Research Report (2017)

Estimated Incremental Office Demand by 5-Year Phases

The current pipeline of about 20,000 square feet of professional office space should satisfy about half of the demand for additional professional office space during the 2019-24 period. The remaining demand will most likely be satisfied with upgrades and renovations of existing inventory and/or additional office space in new mixed-use developments, rather than new development of stand alone conventional professional office buildings. Med-Tech, however, is being addressed with the first phase of Discovery Square, which is expected to open during this period. Phase 2 is already in planning stages and may also come on line during this period, positioning to accommodate mid-term demand into later in the 2020s as well. The Med-Tech rate of growth is driven by Mayo partnerships and discrete users, as opposed to speculative demand and development.

| Table 2.1: Estimated Incremental Downtown Combined Office Space Demand (2019-2034) | | | | | | | |
|--|--------------|---------------|----------|-------------------------------|---------|---------|-----------------------|
| | | Total 2019-24 | Pipeline | Total Net of Pipeline 2019-24 | 2024-29 | 2029-34 | Total Net of Pipeline |
| Low | Professional | 37,242 | 20,000 | 17,242 | 46,312 | 53,105 | 116,659 |
| | Med-Tech | 64,671 | 85,000 | (20,329) | 71,922 | 65,385 | 116,978 |
| | Total | 101,913 | 105,000 | (3,087) | 118,234 | 118,490 | 233,637 |
| | | | | | | | |
| Medium | Professional | 43,814 | 20,000 | 23,814 | 57,890 | 63,726 | 145,431 |
| | Med-Tech | 70,060 | 85,000 | (14,940) | 77,454 | 70,055 | 132,570 |
| | Total | 113,874 | 105,000 | 8,874 | 135,345 | 133,782 | 278,000 |
| | | | | | | | |
| High | Professional | 54,768 | 20,000 | 34,768 | 69,468 | 84,968 | 189,204 |
| | Med-Tech | 75,450 | 85,000 | (9,551) | 82,987 | 74,726 | 148,162 |
| | Total | 130,217 | 105,000 | 25,217 | 152,455 | 159,694 | 337,366 |
| Sources: ROCOG, US Bureau of Economic Analysis, CoStar, AECOM | | | | | | | |



Hotel

DMC/Downtown Rochester Hotel Market



Hotel Market Drivers



Growth in Mayo-Related Stays

The unique circumstance of the Rochester hotel market is that much of the Sunday through Thursday hotel market is driven by patients and family in town for Mayo Clinic. It is important to the hotel market that Mayo patients and related visitors continue to come to Rochester for services. While the growth of Mayo's inpatient population has slowed due to new treatment options, the out-patient services can continue to drive room nights.



Growth in non-Mayo-Related Stays

Visitors to the DMC area, including Mayo patients and families, business visitors, and attendees at events, are the drivers of hotel room nights. The greatest opportunity for growth in additional room nights is in the latter part of the week. Increased events at the Mayo Civic Center, the rehabilitated Chateau Theater, sporting tournaments, conferences and University-sponsored activities can increase occupancy and, hotel development.



Inventory and Rates

Hotel development is directly influenced by occupied room nights in the market compared to the total inventory of available rooms at different price points. As inventory increases, downward pressure is placed on occupancy and new hotel development slows until room demand increases. The introduction of short-term accommodations, such as Airbnb, disrupt the balance of room inventory and occupancy. Downtown Rochester is attracting a wider range of lodging types – full service, limited service, and extended stay. Due to development and land costs Downtown, most budget options will likely remain outside of the DMC.

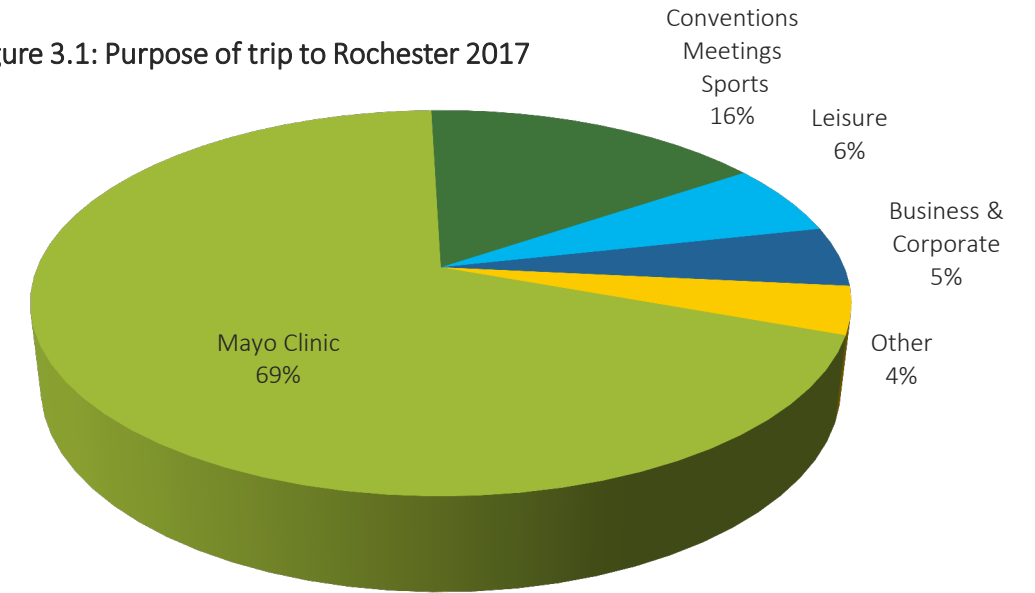
City of Rochester Hotel and Hospitality

According to Experience Rochester (formerly known as Rochester Convention and Visitors Bureau), the hospitality industry is the second largest industry in Rochester, with 14,800 full time employees. Experience Rochester estimates that in 2017, 3.34 million annual overnight visitors spent \$493 million and generated an overall economic impact of \$1.2 billion.

69% of visitors to Rochester reported Mayo Clinic as the purpose of their visit and 16% came to Rochester for conventions, meetings and sporting events. There were 292 events at Mayo Civic Center (MCC) in 2017, with 297,575 attendees who were responsible for 35,722 room nights associated with MCC.

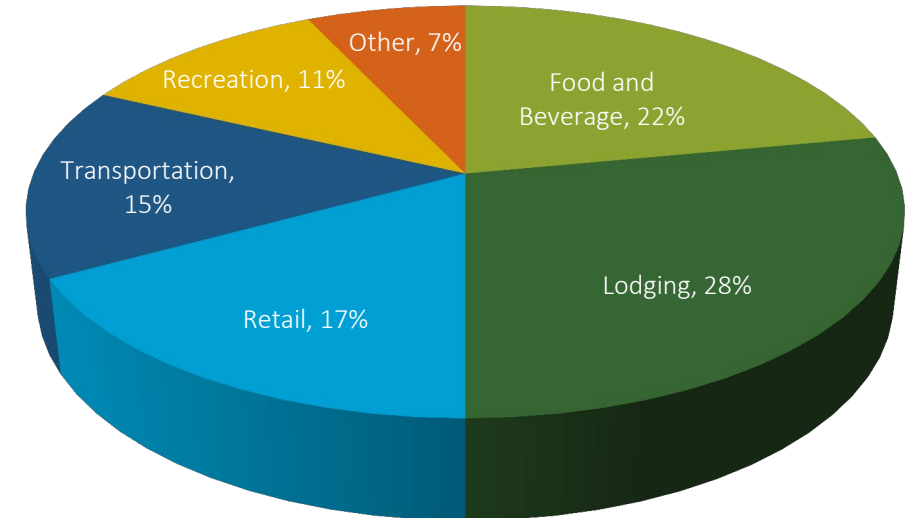
According to Experience Rochester, the largest percentage of tourism dollars in 2017 were spent on lodging (28%), while other sectors also generated significant revenue (22% for Food and Beverage, 17% for Retail).

Figure 3.1: Purpose of trip to Rochester 2017



Source: Experience Rochester

Figure 3.2: Where Tourism Dollars Go 2017



Source: Experience Rochester

Hotel Analysis: Historical Performance

DMC/Downtown Rochester Hotel Market 1995 - 2017

According to Smith Travel Research (STR), the total hotel room nights supply capacity increased from 766,500 in 1995 to 1,017,255 room nights in 2017, which represents an additional 250,755 room night supply in the market and a compound annual growth rate (CAGR) of 1.3 percent.

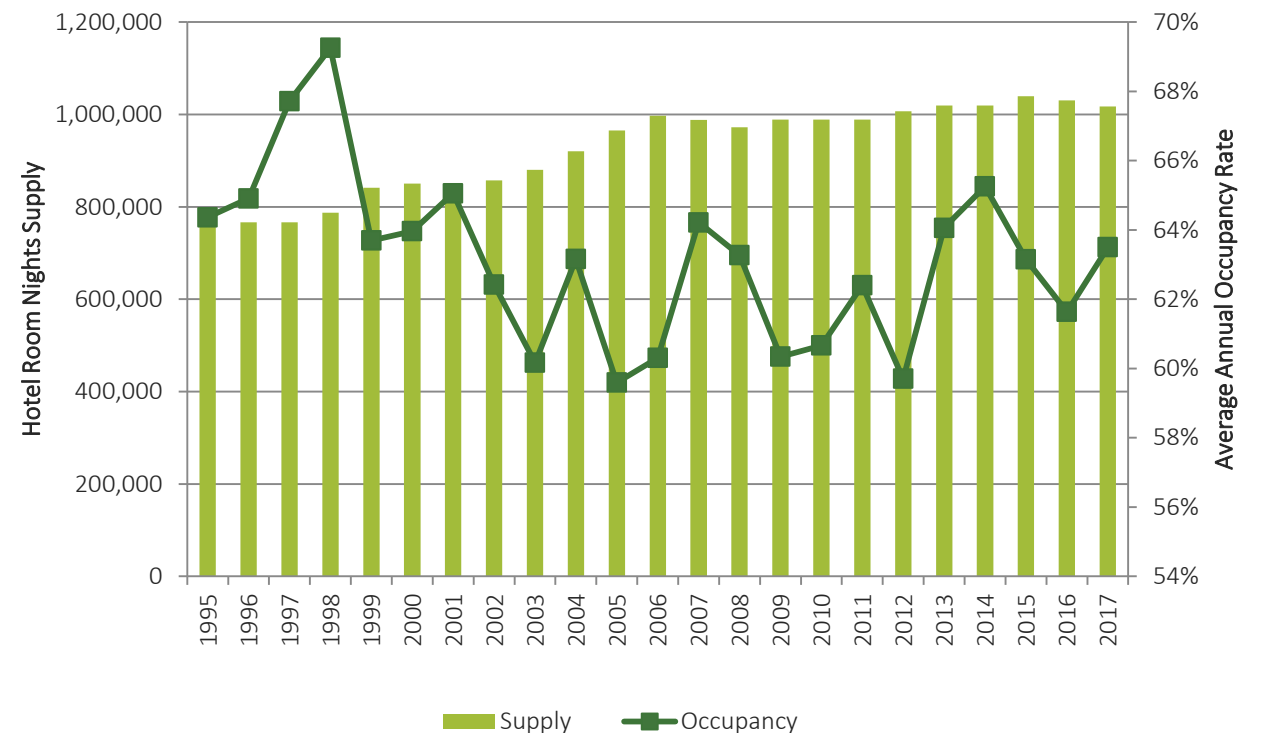
This compares to an estimated demand of 683,000 annual occupied room nights in 2017, for a 2.1% CAGR since 2014, which is estimated to increase to over 732,600 room nights in 2018 given year-to-date trends, which is an accelerated annual growth rate of 7.3%.

Average annual occupancy peaked in 1997 and 1998, yet has otherwise maintained a somewhat constant level, averaging 63.2 percent from 1995 to 2017. Due a number of hotel properties opening during this time period, differences in occupancy are natural as supply changes; new product coming online may soften occupancy for a short period.

In more recent years, from 2014 to 2017, occupancy experienced a CAGR of negative 0.9 percent. This is mainly in response to an increase in hotel room supply outside the downtown district seen in both 2015 and 2016.

Average daily rate (ADR) has shown significant growth in DMC/Downtown Rochester. In 1995, the ADR was \$67.43. By 2017 it was more than double at \$135.60 in nominal terms. This represents a CAGR of 3.2 percent, which is a strong indicator that the market has been healthy enough to support increased rates.

Figure 3.3: Hotel Room Night Supply & Average Annual Occupancy Rate, DMC/Downtown Rochester Hotel Market, 1995 - 2017



Source: Smith Travel Research, AECOM; September 2018.

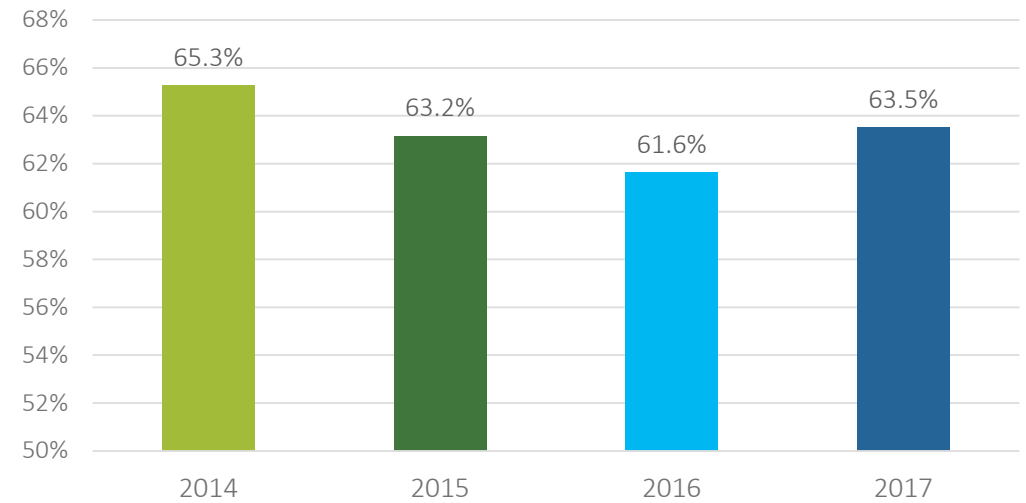
Hotel Supply and Occupancy

According to data from Smith Travel and Research, the average annual occupancy rate for hotels in Downtown Rochester has ranged between a high of 65.3% in 2014 to a low of 61.6% in 2016. The most recent data for 2017 showed an average annual occupancy rate of 63.5% for 2017, roughly the average value from 2014-2017.

Despite having below target average annual occupancy rates between 2014 and 2017 (target of 70%), the Average Annual Daily Rate (ADR) dropped only slightly in 2016 to \$131.39 and rose the following year to \$135.60. Accounting for inflation as calculated by the Consumer Price Index, ADR for Downtown Rochester hotels reached a high of \$137 in 2015, and dropped to \$134.18 in 2016. This indicates that hotels were able to maintain relatively stable prices from 2014-2017 despite occupancy rates under the target of 70%.

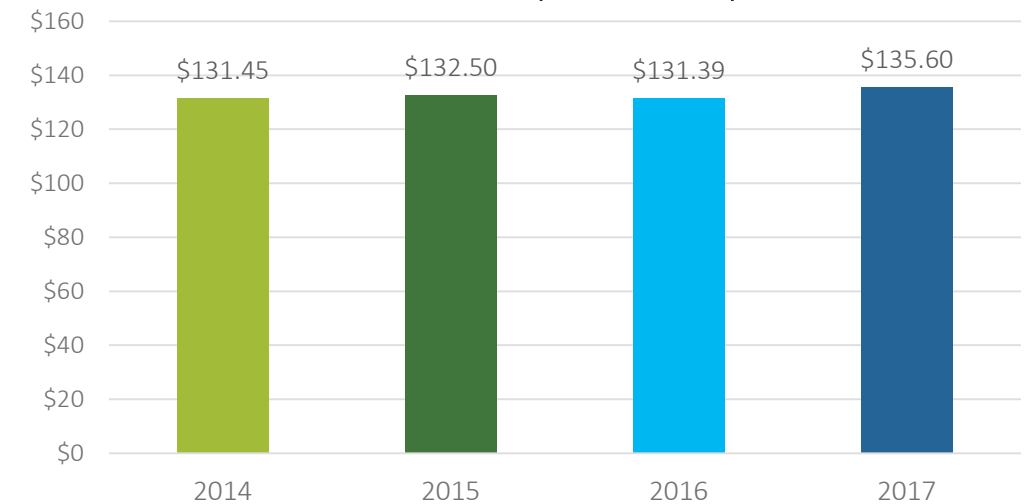
Recent changes have reduced the total number of rooms in Downtown Rochester from 2,830 in 2014 to 2,703 in 2018. The Fairfield Inn opened in 2015, bringing 91 rooms to the market. On the other hand, the Days Inn Rochester Downtown (71 hotel rooms) is scheduled to close for demolition and the Holiday Inn Rochester Downtown (173 hotel rooms) will close for renovations, both before the end of 2018. The latter is scheduled to reopen as Hotel Indigo in 2019.

Figure 3.4: Average Annual Occupancy Rate Downtown Rochester Hotels



Source: STR, Bureau of Labor Statistics

Figure 3.5: Real Average Annual Daily Rate Downtown Rochester Hotels (2017 Dollars)



Source: STR, Bureau of Labor Statistics

Hotel Analysis: Inventory

Inventory

From 2014 to 2017, the total number of hotel properties increased from 17 to 19, while room inventory increased from 2,830 to 2,947 hotel rooms in hotels serving the DMC-Vicinity/Downtown district.

Based on interviews with industry professionals and operators regarding the known developments in the DMC/Downtown Rochester area, an additional 699 rooms may be added to the market by 2021. This takes into account the closure and removal of 71 rooms at the Days Inn Rochester Downtown property and 173 rooms at the Holiday Inn Rochester Downtown.

Five new or rebranded and renovated hotels are slated to come online in the near future, which will grow the total number of rooms available by 23.7 percent.

| Table 3.1: Hotel Property | # of Rooms | | | | | | | | | |
|--|------------|-------|-------|-------|-------|-------|-------|-------|-------|--|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | |
| Aspen Suites | 82 | 82 | 82 | 82 | | | | | | |
| Aspen Select | | 52 | 52 | 52 | | | | | | |
| Broadway Plaza | 121 | 24 | 24 | 24 | | | | | | |
| Centerstone Plaza Hotel Soldiers Field Mayo Clinic Area | 214 | 214 | 214 | 214 | | | | | | |
| Courtyard Rochester Mayo Clinic Area St Marys | 117 | 117 | 117 | 117 | | | | | | |
| Days Inn Rochester Downtown | 71 | 71 | 71 | 71 | -71 | | | | | |
| Doubletree Rochester Mayo Clinic Area | 212 | 212 | 212 | 212 | | | | | | |
| Fairfield Inn & Suites Rochester Mayo Clinic Area St Marys | | 91 | 91 | 91 | | | | | | |
| GuestHouse Inn Rochester West | 119 | 119 | 119 | 118 | | | | | | |
| Hilton Garden Inn Rochester Downtown | 143 | 143 | 143 | 143 | | | | | | |
| Holiday Inn Express & Suites Rochester West Medical Center | 85 | 85 | 85 | 85 | | | | | | |
| Holiday Inn Rochester Downtown | 173 | 173 | 173 | 173 | -173 | | | | | |
| Homewood Suites | 36 | 108 | 108 | 108 | | | | | | |
| Kahler Apache | 149 | 149 | 149 | 149 | | | | | | |
| Kahler Inn & Suites | 271 | 271 | 271 | 271 | | | | | | |
| Marriott Rochester Mayo Clinic Area | 202 | 202 | 202 | 202 | | | | | | |
| Residence Inn Rochester Mayo Clinic Area | 89 | 89 | 89 | 89 | | | | | | |
| Springhill Suites Rochester Mayo Clinic Area St Marys | 86 | 86 | 86 | 86 | | | | | | |
| The Kahler Grand Hotel | 660 | 660 | 660 | 660 | | | | | | |
| Hilton Rochester Mayo Clinic Area (UC) | | | | | | 264 | | | | |
| Bloom Riverfront Towers (P) | | | | | | | | 181 | | |
| Gonda Hotel (P) | | | | | | | | | 200 | |
| Hotel Indigo (P) | | | | | | 173 | | | | |
| Hyatt House Hotel & Suites (UC) | | | | | | | 175 | | | |
| Total (Actual) | 2,830 | 2,948 | 2,948 | 2,947 | 2,703 | 3,140 | 3,315 | 3,496 | 3,696 | |

1/ UC = Under Construction.
2/ P = Proposed or planned.
3/ Kahler Apache was formerly Ramada.
4/ Days Inn Rochester Downtown is proposed to be demolished in the near-future.
5/ Hotel Indigo is proposed to replace the existing 173-room Holiday Inn Rochester Downtown. For the purpose of this analysis, Hotel Indigo is forecast to have 173 rooms, or less, depending on the new room layouts.
6/ The Kahler Grand Hotel is going under a major modernization and renovation.
Source: Smith Travel Research, AECOM; September 2018.

Estimated Hotel Demand By 5-Year Phases

Three new hotels are scheduled to open in 2019 and 2020: The Hilton, Hyatt Hotel and Suites and Hotel Indigo. According to data from Smith Travel Research, these 3 hotels will add a combined 612hotel rooms to Downtown Rochester. By the end of 2020, the downtown market will have 19 hotels with 3,315 total hotel rooms.

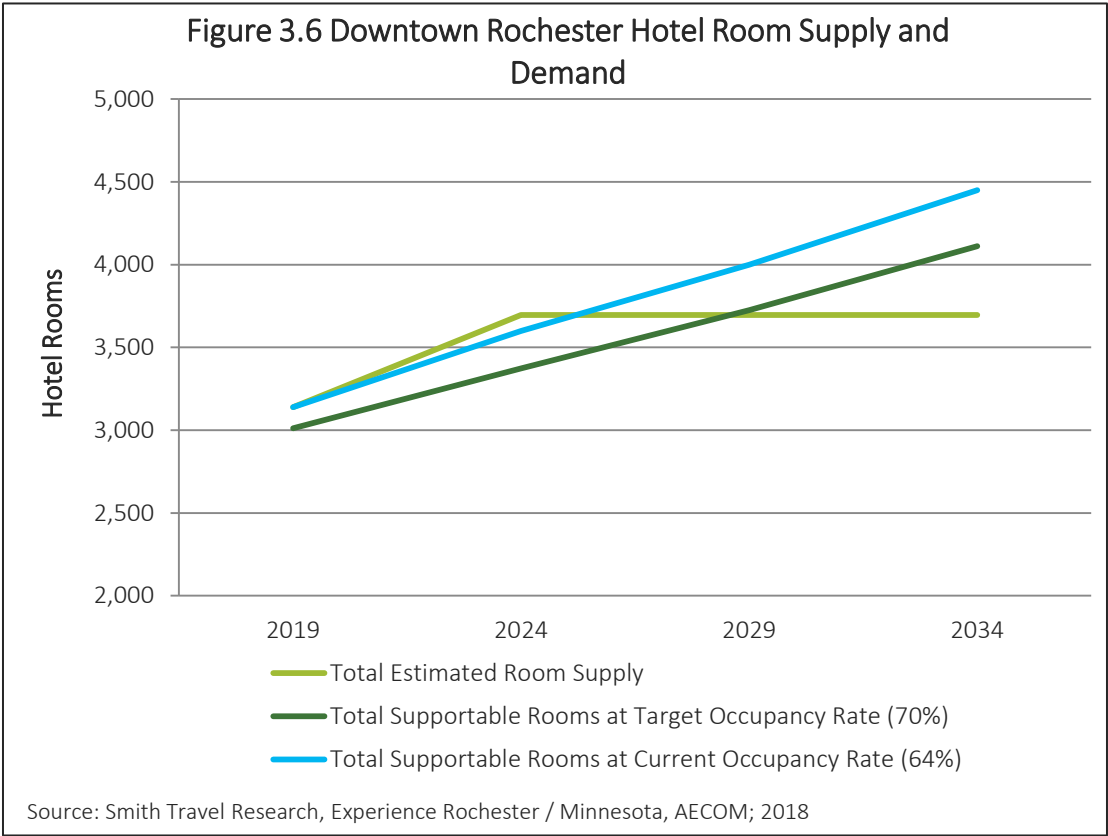
Two more hotels may open by 2024. Gonda Hotel and Bloom Riverfront Towers will bring an estimated 200 and 181 hotel rooms respectively to Downtown Rochester. Thus, there are 993 hotel rooms currently proposed or under construction estimated to open between 2019 and 2024, after which the total inventory may reach 3,696 hotel rooms.

AECOM estimates that the annual average daily occupied room demand for Downtown Rochester will grow at approximately 5% next year with new hotels coming on line, then ramp down to a stabilized annual growth rate of 2%, for a CAGR of 2.3% between 2019 and 2034. With a 70% target annual occupancy rate, Downtown Rochester may support approximately 4,112 total rooms by 2034. Accounting for the current pipeline hotel rooms scheduled to open in the period between 2019 and 2034, demand may overtake supply by the late 2020s. At the current occupancy rate (64%), demand may overtake current and pipeline supply 3-4 years earlier.

The increase in supply during the next five years, even given anticipated growth in demand, may result in a temporary period of lower occupancy rates in the historical mid-60%s, rather than the industry standard 70% occupancy target. Therefore, there may be a near term period when the market must first demonstrate it can absorb the new inventory. Support for more hotel rooms than already planned and proposed can accelerate if new activity facilities are successfully introduced into the market that generate more visitations and room nights, if the current inventory is reduced through room conversion, consolidation or closure, or through more market price-point differentiation. The ability of the Civic Center and new meeting hotels to grow the conference, meeting, and entertainment market could also accelerate demand.

| Table 3.2: Estimated Downtown Rochester Hotel Demand 2019-2034 | | | | |
|--|---------|---------|---------|-----------|
| | 2019 | -- 2024 | -- 2029 | -- 2034 |
| Occupied Room Demand | | | | |
| Estimated Rochester DMC Occupied Room Nights | 769,259 | 861,855 | 951,557 | 1,050,596 |
| Estimated 2014-2017/Assumed 2019-2034 Annual Growth Rates | 5% | 2% | 2% | 2% |
| Days in year | 365 | 365 | 365 | 365 |
| Estimated Annual Average Daily Occupied Room Demand | 2,108 | 2,361 | 2,607 | 2,878 |
| Room Supply | | | | |
| Existing at Beginning of Period | 2,703 | 3,696 | 3,696 | 3,696 |
| Planned (Subtractions) Additions | 437 | 556 | 0 | 0 |
| Total Estimated Room Supply | 3,140 | 3,696 | 3,696 | 3,696 |
| Estimated Supportable Rooms | | | | |
| Occupancy Rate - Target | 70% | 70% | 70% | 70% |
| Total Supportable Rooms at Target Occupancy Rate | 3,011 | 3,373 | 3,724 | 4,112 |
| Surplus (Deficit) Room Supply at Target Occupancy Rate | | | | |
| Estimated Occupancy Rates | 67% | 64% | 71% | 78% |

Source: Smith Travel Research, Experience Rochester / Minnesota, AECOM; 2018

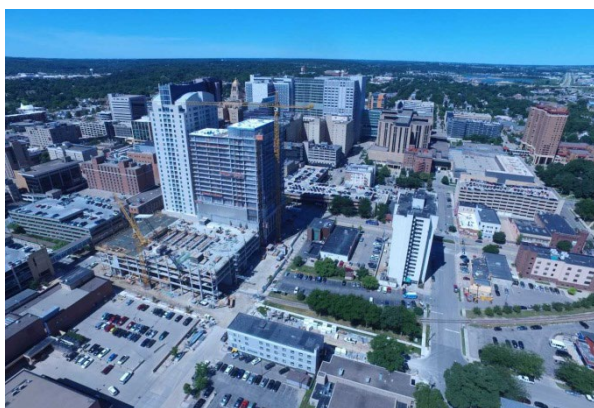


Residential

Multi-family residential units



Residential Market Drivers



Capture of Regional Growth & Select Downtown Workers

Housing demand is driven by regional population growth and household formation. A growing share of multi-family housing will accrue downtown through community building, place-making, public investments, and amenities associated with DMC's implementation, creating a unique living environment in the region closer to jobs and services. Targeted groups for these developments include the young adult Downtown workers, households without children, empty-nesters, and housing for seniors, from independent to assisted living.



University Students & Faculty

There is an opportunity to capture anticipated growth in the University of Minnesota, Rochester student population, plus other higher education institutions, and a share of faculty and administrative staff given proximity to the new campus as they expand over time.

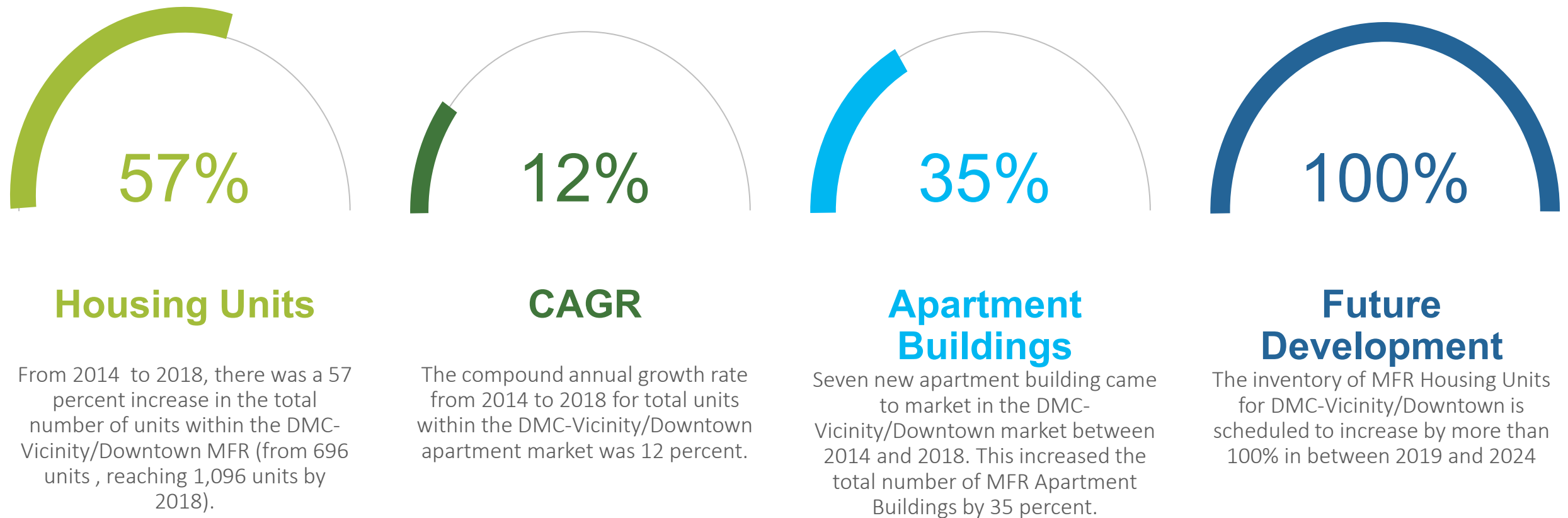


DMC Generated Household Growth

As DMC is implemented and jobs are created, household growth should accelerate and create incremental demand for housing, some of which will be desired within proximity of the DMC. Housing for a segment of the Hospitality industry and support services of Mayo and DMC needs to be affordable and consistent with wages. Demand for higher-end second homes for frequent medical visitors and families, professional staff with primary homes in other cities, and/or shared units (Airbnb) may grow.

Housing Units Inventory

Figure 4.1: DMC-Vicinity/Downtown ⁽¹⁾ change in MFR housing units inventory over recent years

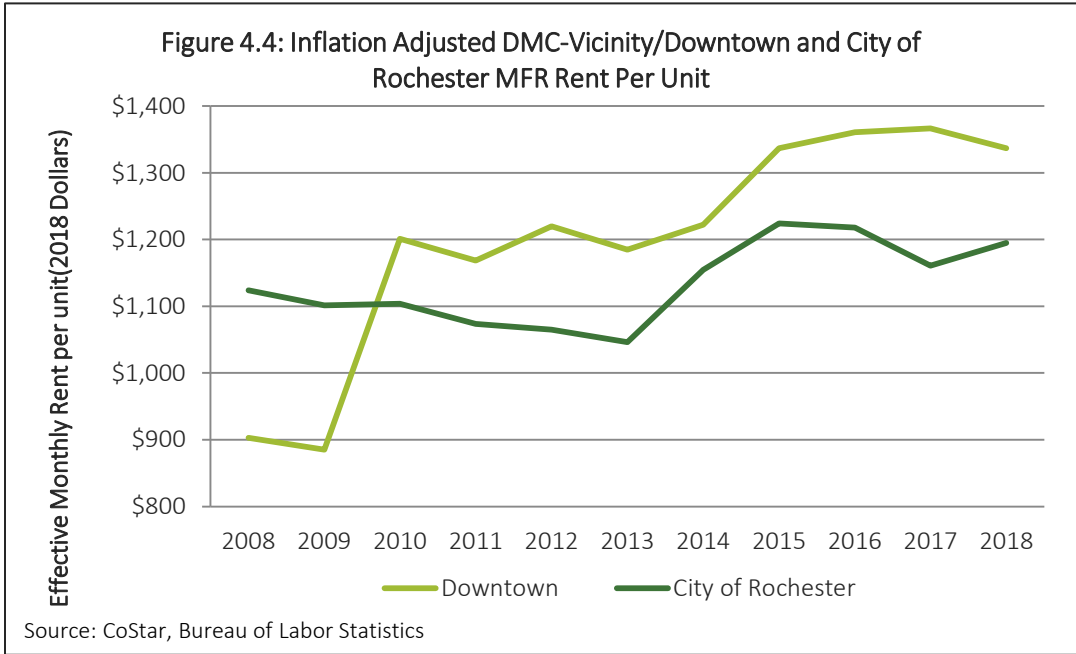
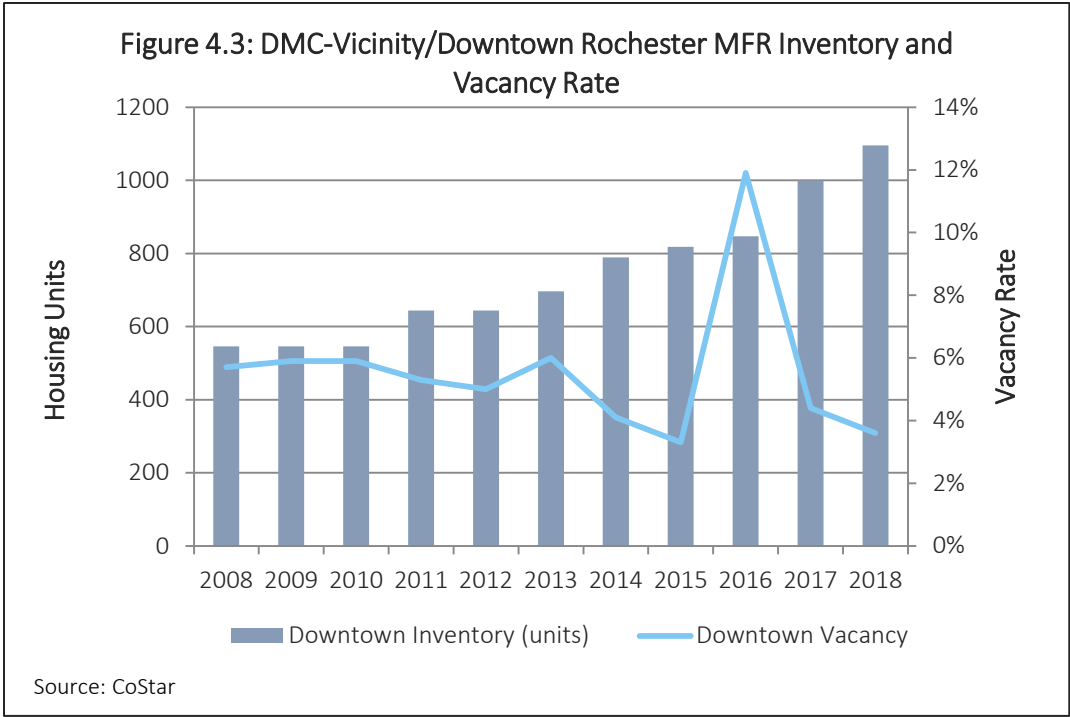
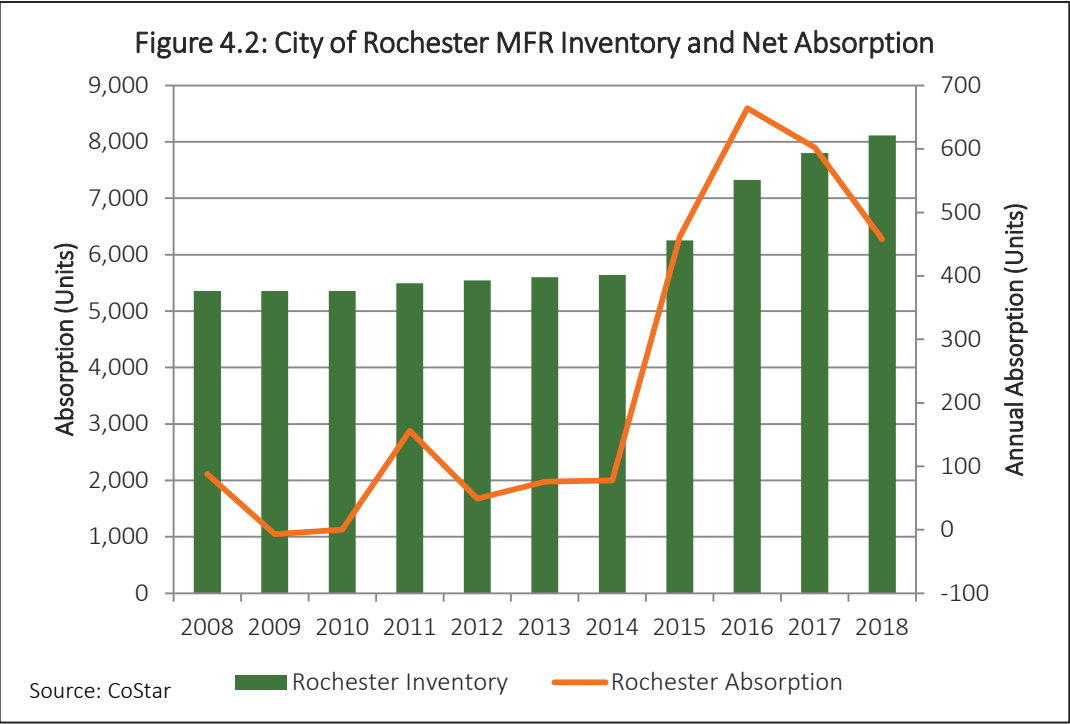


Residential Market: Current and Historic

Data from CoStar indicates there are 8,112 multi-family units in the City of Rochester, 1,096 of which, or 13.5%, are located in the DMC-Vicinity/Downtown. Citywide net absorption has tracked closely to added inventory, averaging 238 units a year for the past 10 years, reaching above 600 units in 2016 and 2017 in response to large additions of housing units in those years.

The vacancy rate for DMC-Vicinity/Downtown MFR units jumped from its historical range between 3% and 7% to above 12% in 2016 , as many units were brought to market (400 housing units between 2014-2018). These units were quickly absorbed, which indicates healthy demand for multi-family units in Downtown Rochester. The most recent reported vacancy rate was 3.6%, considered equilibrium.

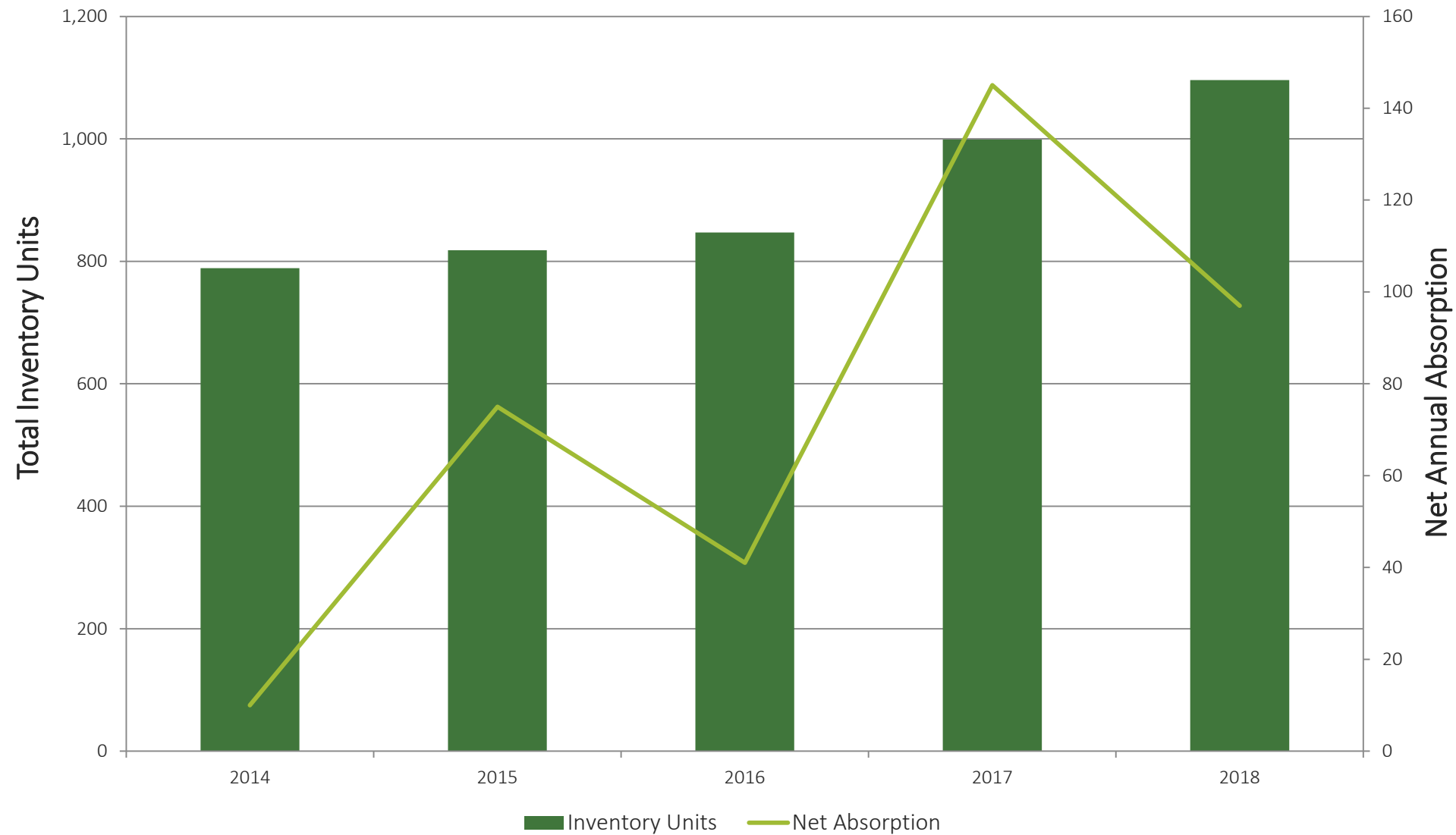
Average effective monthly rent ⁽¹⁾ for DMC-Vicinity/Downtown MFR housing units overtook the citywide average in 2010 and is currently \$200 more per unit despite averaging 200 square feet less than the city of Rochester at large. Rent for DMC-Vicinity/Downtown MFR housing units has grown at a CAGR of 1.35% since 2010 after adjusting for inflation, compared to 1% for the City of Rochester. As of 2018, the effective rate per square foot in the DMC was \$1.62 compared to \$1.25 for the City of Rochester.



(1) Effective Rent is asking rent minus concessions, which may include utilities or other amenities, depending on the agreement

Inventory and Absorption

Figure 4.5: DMC-Vicinity/Downtown MFR Housing Total Inventory and Net Annual Absorption



Updates to Previous Residential Demand

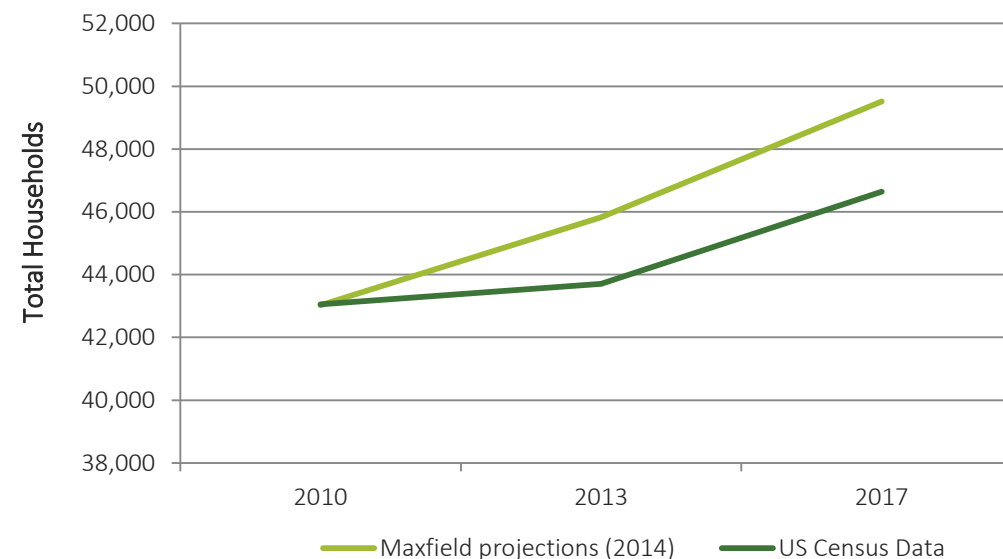
Population and employment are the key drivers for housing unit demand, and household formation related to demographics and social trends. Housing type is estimated by various household characteristics including size, age, income and regional characteristics of the market. AECOM updated the estimates for housing demand based on existing ratios, changing residential patterns and planned development.

In 2014, Maxfield Research estimated 2% household growth CAGR for the period 2010-2020 (1). The reported numbers from the Census have been lower, showing a CAGR of 1.2% from 2010 to 2017, though growth has accelerated in the past two years. Annual household growth since 2015 has been above 4%, indicating the original projections could be on track by 2020 if this stronger growth continues.

Householders under 65 are a key demographic determinant for housing demand, as their characteristics and behavior impact the direction of the housing market. According to the US Census, from 2010 to 2017, householders under 65 that owned homes in the City of Rochester declined marginally, while householders under 65 that rented their homes increased at a CAGR of 3% over the same period. This indicates a shift in housing tenure, with a drop in propensity to own from 70% to 65% among City of Rochester households under 65. Given the large Millennial generation of young adults early in their careers, the increase in the renter market is common in many residential markets. As this generation ages into the family formation stage of life and their incomes grow, the propensity to own may rebound.

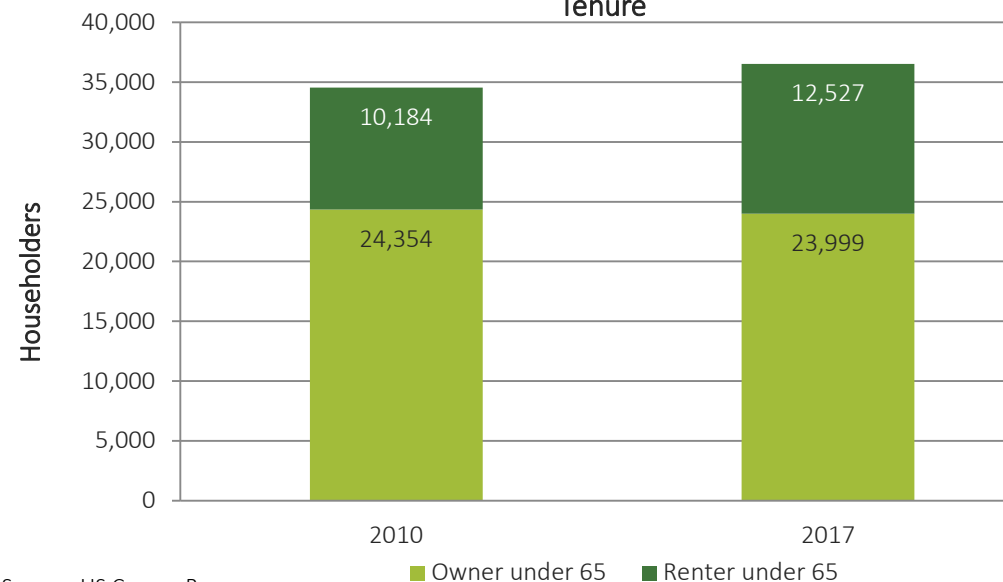
(1) "Comprehensive Housing Needs Assessment for Olmsted County Minnesota," Maxfield Research Inc. (2014).

Figure 4.6: City of Rochester Projected versus Reported Household Growth



Source: US Census Bureau, Maxfield Research

Figure 4.7: City of Rochester Householders under 65 by Housing Tenure



Source: US Census Bureau

| Table 4.1: Estimated City of Rochester Incremental MFR Housing Unit Demand (2019-2034) | | | | |
|---|---------|---------|---------|-------|
| Housing Category | 2019-24 | 2024-29 | 2029-34 | Total |
| For Sale Multi-family | 637 | 643 | 643 | 1,923 |
| Rental Multi-family | 1,903 | 1,891 | 1,891 | 5,685 |
| Senior Housing | 622 | 400 | 400 | 1,422 |
| Total | 3,162 | 2,934 | 2,934 | 9,030 |
| 1/ Senior Housing refers to any housing development classified as Active Adult, Affordable/Subsidized Senior Housing, Congregate Housing, Assisted Living and Memory Care | | | | |
| Source: US Census Bureau, Maxfield Research, AECOM | | | | |

Residential Demand in the DMC

After determining the incremental demand for housing in the City of Rochester, a share of this demand was assigned based on existing residential ratios and planned growth in the DMC vicinity. Single family homes were excluded from the analysis due to this housing category’s relative scarcity Downtown.

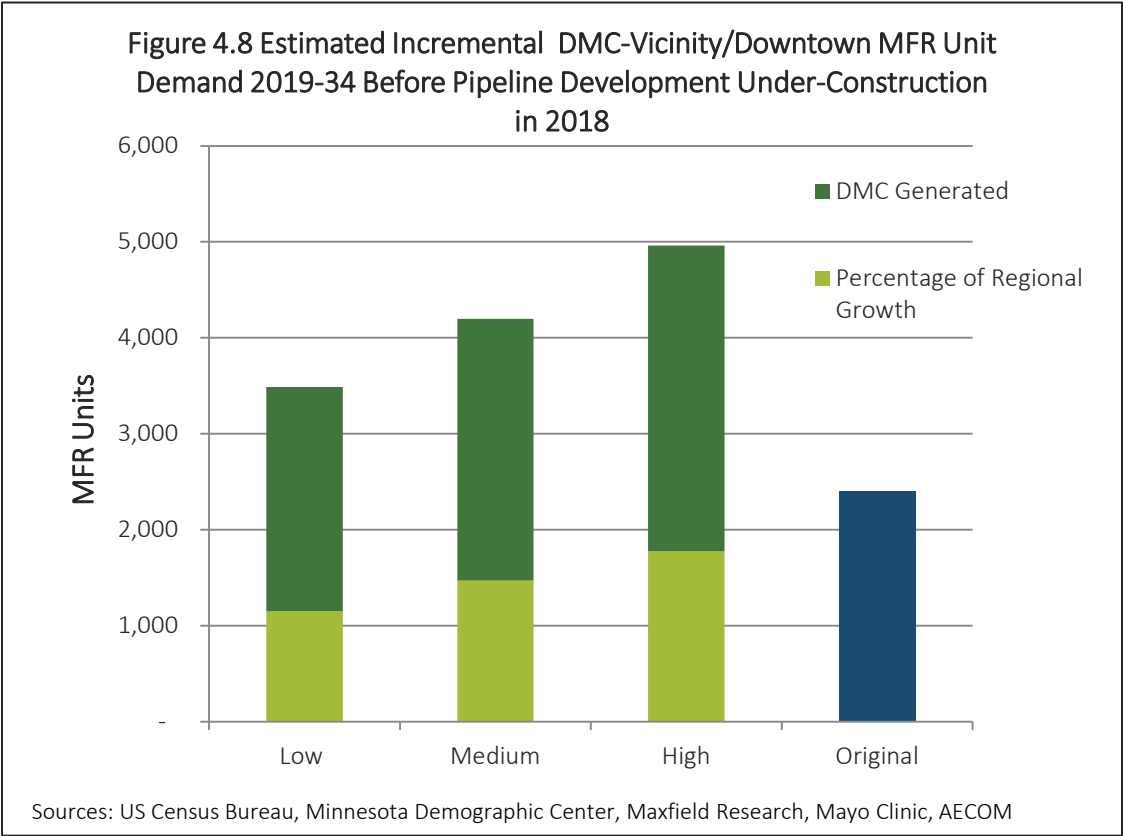
AECOM estimates demand for 9,030 housing units for the City of Rochester as the result of regional growth from 2019 to 2034, of which an estimated 1,923 may be for-sale multi-family units, 5,685 may be rental multi-family units, and 1,422 some category of Senior Housing (Active Adult, Affordable/Subsidized, Congregate, Assisted Living, Memory Care). Estimates are based on projections of household formation, current distribution of income, and historical housing patterns.

Downtown Residential Demand from Capturing a % of Regional Growth

Based on the current share of these housing types and units in the pipeline, Downtown’s capture of citywide growth for these three categories is estimated at range from a low of 1,100 to a high of over 1,750 additional housing units by 2034 before deducting pipeline projects planned and under-construction.

Downtown Residential Demand from DMC Generated Growth

In addition to housing demand from regional population growth, there will be additional housing demand from DMC employment growth (direct, indirect, and induced employment growth). AECOM estimates that a further 2,300 to 3,200 housing units could result from DMC job growth and its multiplier effects by 2034. If DMC initiatives successfully catalyze more robust employment growth or fall below expectations, the MFR demand range would be expected to adjust accordingly.



Comparison to Original Demand Projections and Pipeline Development

The Residential Market Analysis estimates that Downtown Rochester may demand between 3,400 and 4,950 additional housing units between 2019 and 2034. New baseline estimates for housing demand are very similar to the previous projections, with fewer for-sale housing units and more rental units due to changing patterns of regional housing tenure. The estimate for regional growth assumes housing demand based on current growth rates and anticipated shifts in Downtown’s capture rate. DMC generated demand was estimated as a range resulting from future job growth brought about by DMC initiatives.

Numerous housing developments have been constructed since 2014 in Downtown and the DMC vicinity, and more are in the pipeline (proposed or under-construction) to be added to housing inventory between 2019 and 2024. Several developments adjacent to Downtown, across the river and within a few blocks of Mayo’s St. Mary’s Campus are also considered to service the DMC market (defined here as DMC Vicinity). There have been 400 housing units added to DMC-Vicinity/Downtown, with a further 1,282 units in the pipeline.

The current pipeline of 1,282 units exceeds estimated demand for additional housing units for 2019-2024 for Low and Medium Growth Scenarios, but matches demand for a High Growth Scenario. While these data indicate healthy demand for new MFR housing units, developers will track closely how the market absorbs the added inventory.

| Table 4.2: Estimated Incremental Downtown MFR Unit Demand (2019-34) | | | |
|---|----------------------------|---------------|-------------|
| | Capture of Regional Growth | DMC Generated | Total |
| Low | 1,100 | 2,300 | 3,400 |
| Medium | 1,470 | 2,700 | 4,100 |
| High | 1,750 | 3,200 | 4,950 |
| Original | -- | -- | 2,200-3,100 |
| Notes: 1/ Original Projection includes Regional Growth and DMC Generated | | | |
| Sources: US Census Bureau, Minnesota Demographic Center, Maxfield Research, AECOM | | | |

| Table 4.3: Downtown and DMC Vicinity Recently Completed and Current Pipeline | | | |
|--|----------|--------------|-------|
| | Downtown | DMC Vicinity | Total |
| Completed (2014-2018) | 259 | 141 | 400 |
| Pipeline (2019-2024) | 1,023 | 259 | 1,282 |
| Total | 1,282 | 400 | 1,682 |
| Notes: 1/ DMC Vicinity includes properties directly across the river and near St Mary's Campus | | | |
| 2/ Pipeline includes properties proposed or under construction | | | |
| Source: City of Rochester, AECOM | | | |

Rochester DMC Multifamily Residences

October 2018

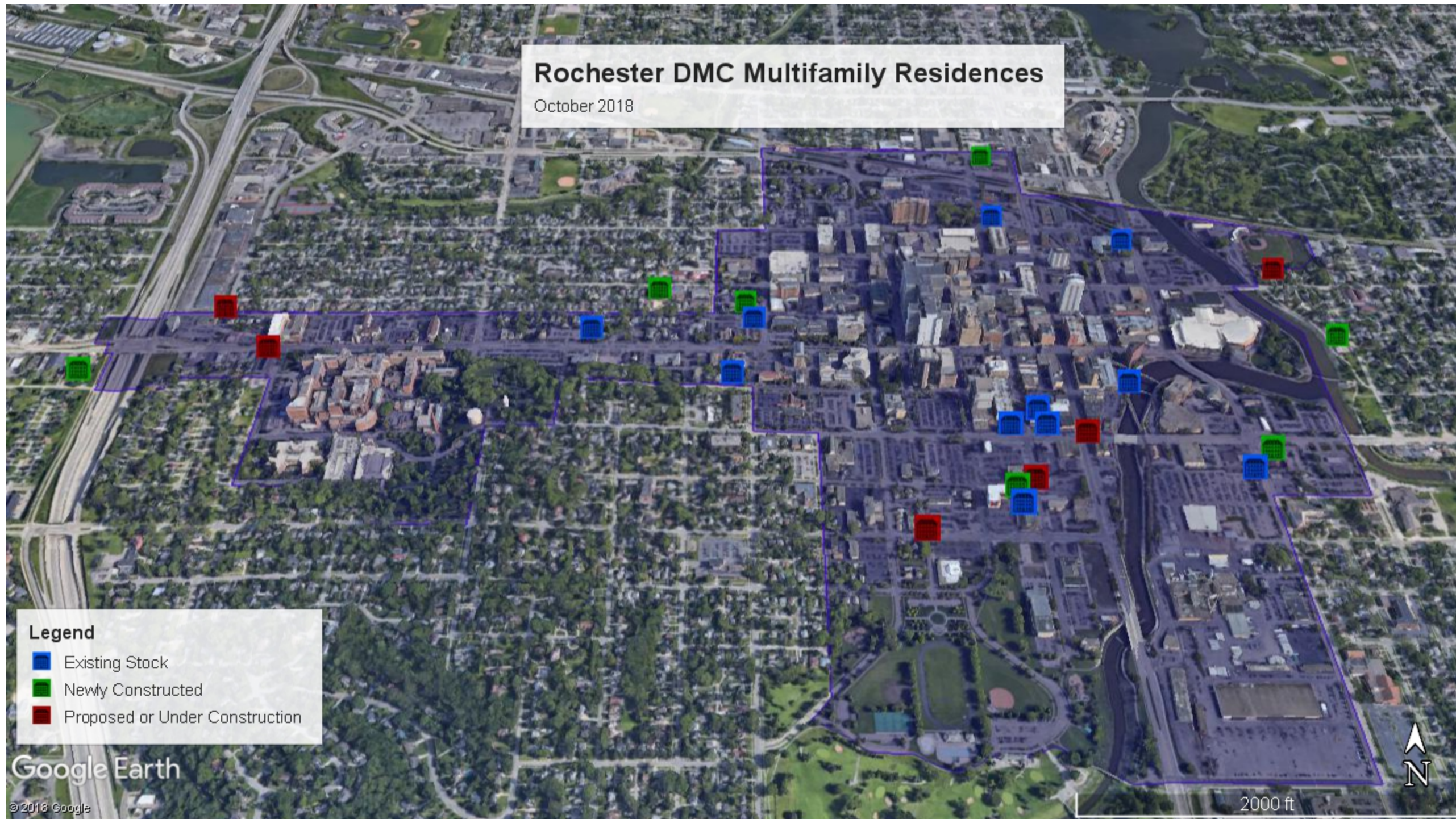
Legend

- Existing Stock
- Newly Constructed
- Proposed or Under Construction

Google Earth

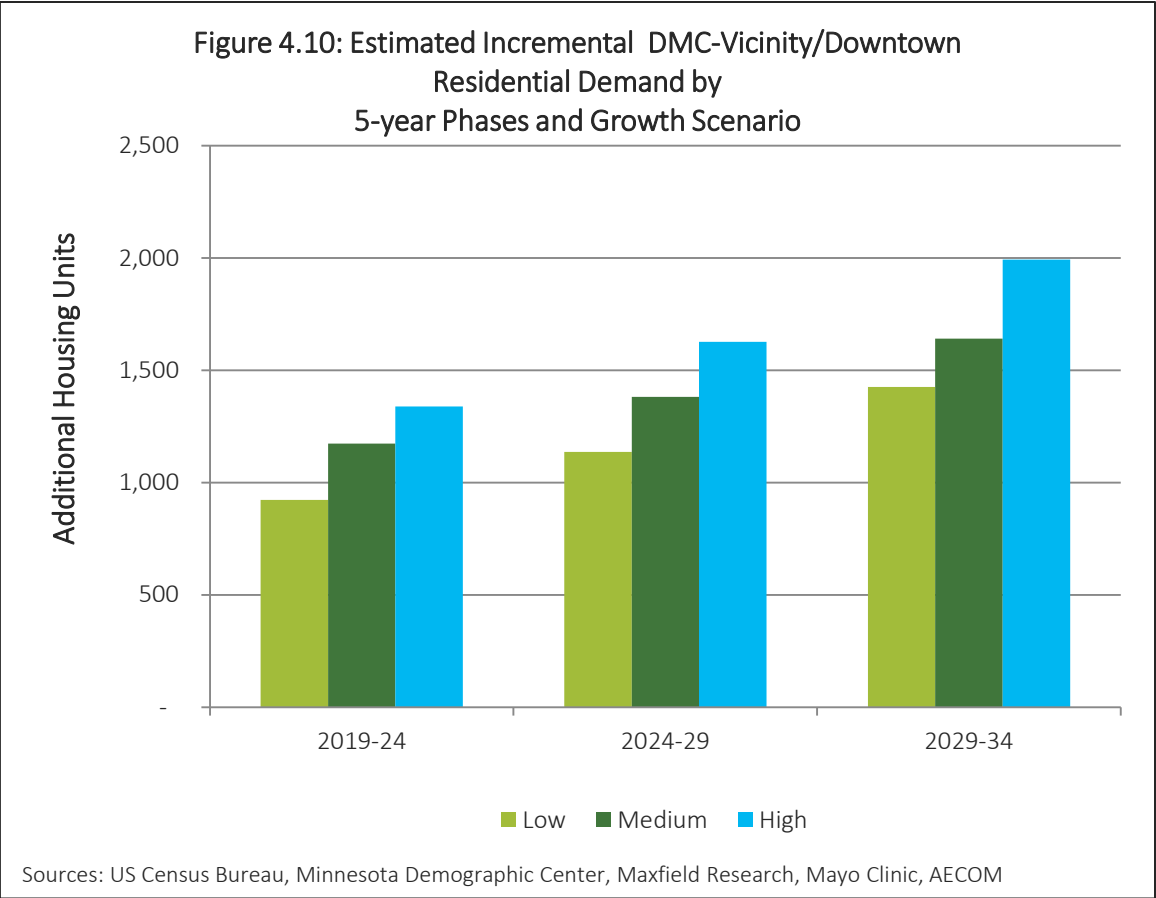
© 2018 Google

2000 ft



Estimated Incremental Residential Demand by 5-Year Phases

The current pipeline of 1,282 units planned and under-construction in DMC-Vicinity/Downtown exceeds the Low and Medium scenarios for the 2019-2024 time period, but is slightly below the High scenario. These projects, if built, and the recent housing development activity that was absorbed prior to 2019, reflect accelerated near term demand and strong market acceptance, closer to or exceeding the long-range High Scenario estimates. The current pipeline projects and their timing over the next three years represents an annual absorption of about 400 units per year. While additional new development activity in the near term may slow somewhat to absorb this new inventory introduced by the current pipeline projects, continued activity at approximately 250-300 units per year during the balance of the 2019-2024 period, for a total of 1,350-1,550 units would not be unreasonable unless the economy enters into a downturn or recession during this timeframe. While this accelerates absorption to include demand not modeled until the 2024-29 time period, the economic recovery has been unusually long and a recession during this period would not be unexpected. If this were to occur, residential development activity through the 2020s would still remain on track.



| Table 4.4 Total Estimated Incremental Demand for DMC-Vicinity/Downtown Housing Units (2019-2034) | | | | | |
|--|------------------------|---------|-----------|-----------|-------|
| 923 | | 2019-24 | 2024-2029 | 2029-2034 | Total |
| Low | Total Estimated Demand | 924 | 1,137 | 1,426 | 3,486 |
| | Current Pipeline | 1,282 | 0 | 0 | 1,282 |
| | Net Estimated Demand | (358) | 1,137 | 1,426 | 2,204 |
| Medium | Total Estimated Demand | 1,174 | 1,382 | 1,641 | 4,197 |
| | Current Pipeline | 1,282 | 0 | 0 | 1,282 |
| | Net Estimated Demand | (108) | 1,382 | 1,641 | 2,915 |
| High | Total Estimated Demand | 1,339 | 1,627 | 1,994 | 4,960 |
| | Current Pipeline | 1,282 | 0 | 0 | 1,282 |
| | Net Estimated Demand | 57 | 1,627 | 1,994 | 3,678 |

Sources: US Census Bureau, Minnesota Demographic Center, City of Rochester, Maxfield Research, AECOM

Retail, Dining & Entertainment



Retail, Dining & Entertainment Market Drivers



Capture of Regional Household Income Growth & Spending

Demand for Retail, Dining and Entertainment (RDE) space is driven by population growth and household spending, with a growing capture rate of Rochester spending, particularly in food and beverage and entertainment spending.



DMC Employees and Visitors

With the growth in new jobs at Mayo and at new businesses attracted to the DMC, there is an opportunity to capture additional spending. Employees spending tends to be focused on limited service food and beverage and convenience shopping. By also offering entertainment and full service restaurants, the DMC can transition to after-work spending as well.

Visitors to downtown, including patients and family in town for Mayo, business travelers, and attendees at events are key markets for downtown RDE.



DMC Generated Household Growth

Targeting shopping, dining and entertainment needs of new DMC residents, as well as students. Growth in DMC-located households should open demand for more household shoppers goods and food and beverage stores for consumption at home.

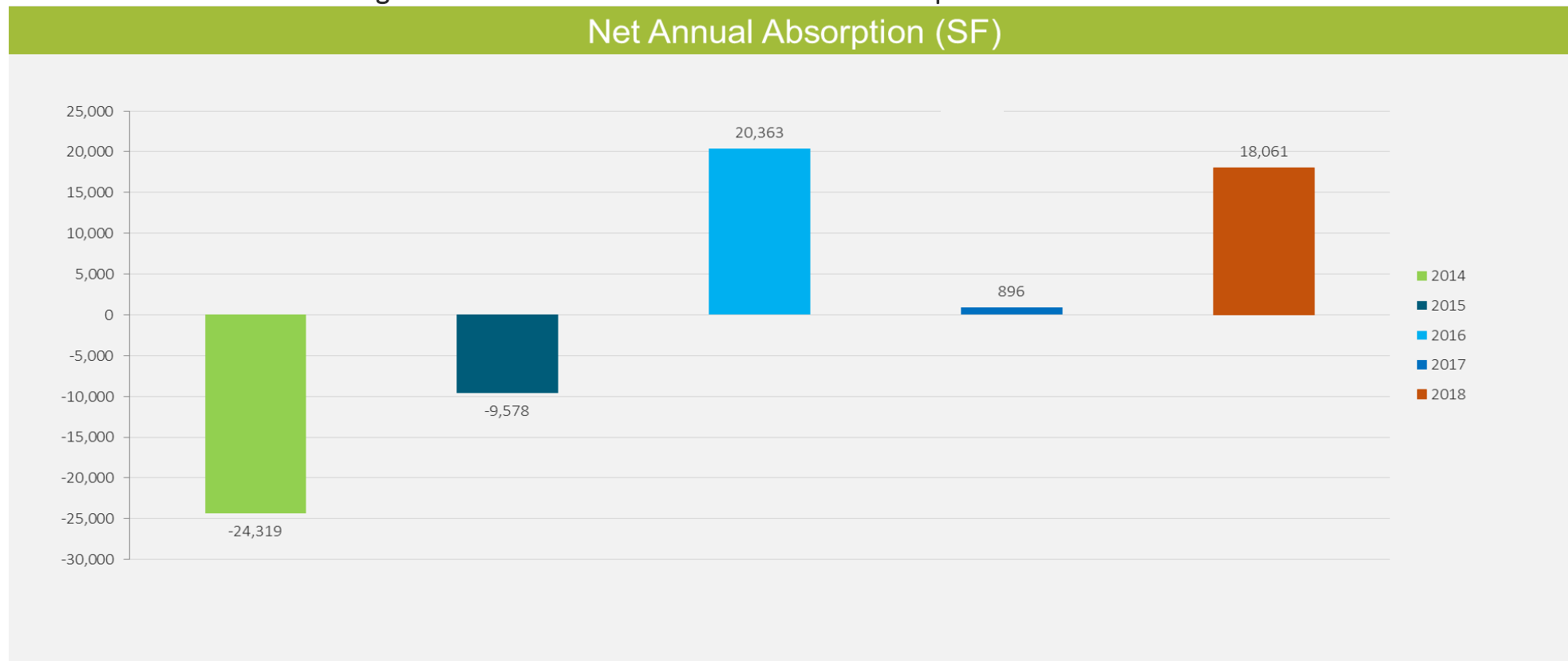
Retail/ Dining/ Entertainment Changing Environment

With national unemployment levels at their lowest in 50 years and consumer confidence growing, one would expect that the RDE sector would be growing. Increasing household incomes also bode well for RDE spending. Last year, U.S. retail sales rose 3.9 percent to \$3.53 trillion, exceeding the National Retail Federation's (NRF) forecast for a 3.2 percent to 3.8 percent rise. The NRF projects a 10 to 12% boost for online and other non-store sales. The greatest improvement has been enjoyed by large-format retailers such as Wal-Mart, Costco, and by online retailer Amazon. Translating those gains to downtown-scale retailers is still the challenge.

The national retail experience for small businesses – the types mostly found in downtown areas such as the DMC, is still recovering slowly due to changes in technologies, greater access to and use of online shopping with rapid delivery. An industry “shake-out” of some long-time general retailers continues.

In Downtown Rochester, the larger RDE category continues to underperform. The 2014 study estimated potential annualized 2015 – 2019 demand potential for ~6,600 – 8,800 SF. Total annual net absorption from 2014 to present is about 1,200 SF which is below demand projections.

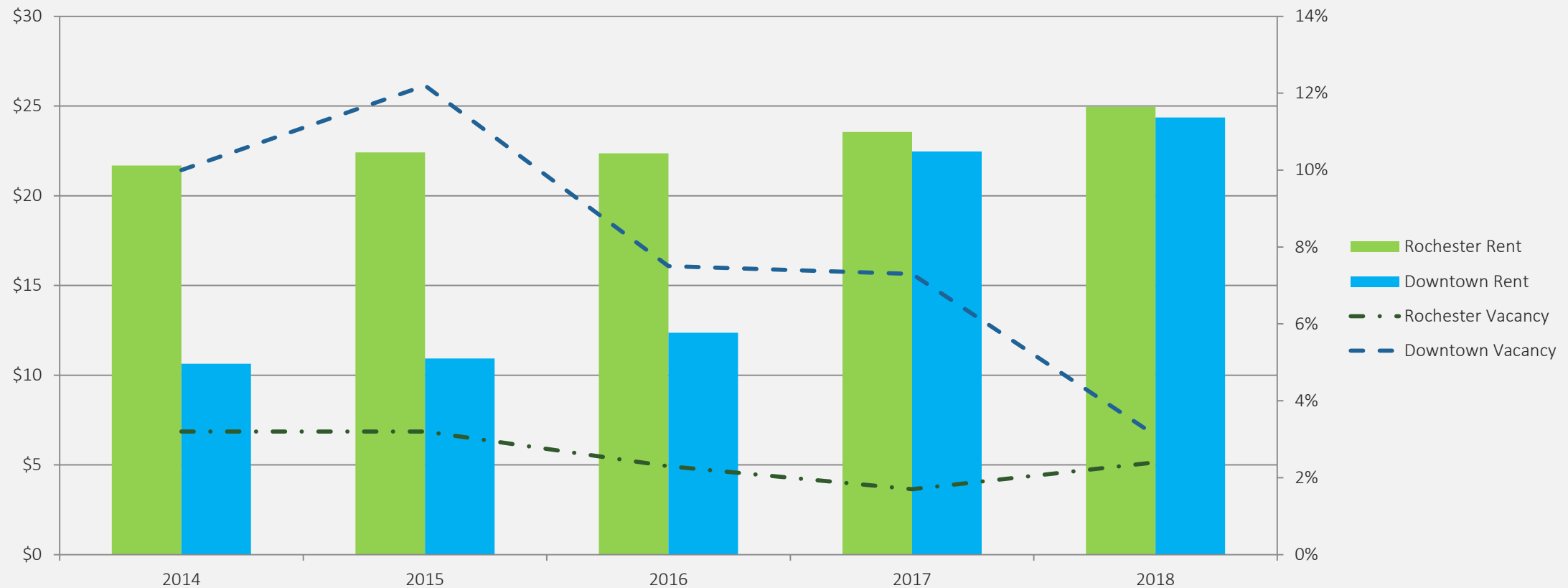
Figure 5.1: Downtown Rochester Net Retail Absorption Since 2014



Retail Rents

Figure 5.2: DMC/Downtown Rochester retail rents approaching parity with average citywide rents

Annual Triple Net Retail Rents (SF)



- DMC/Downtown retail rents have risen substantially as vacancies have dropped. Rising rents have occurred within existing retail inventory

Retail/ Dining/ Entertainment Demand – Supportable vs Performance

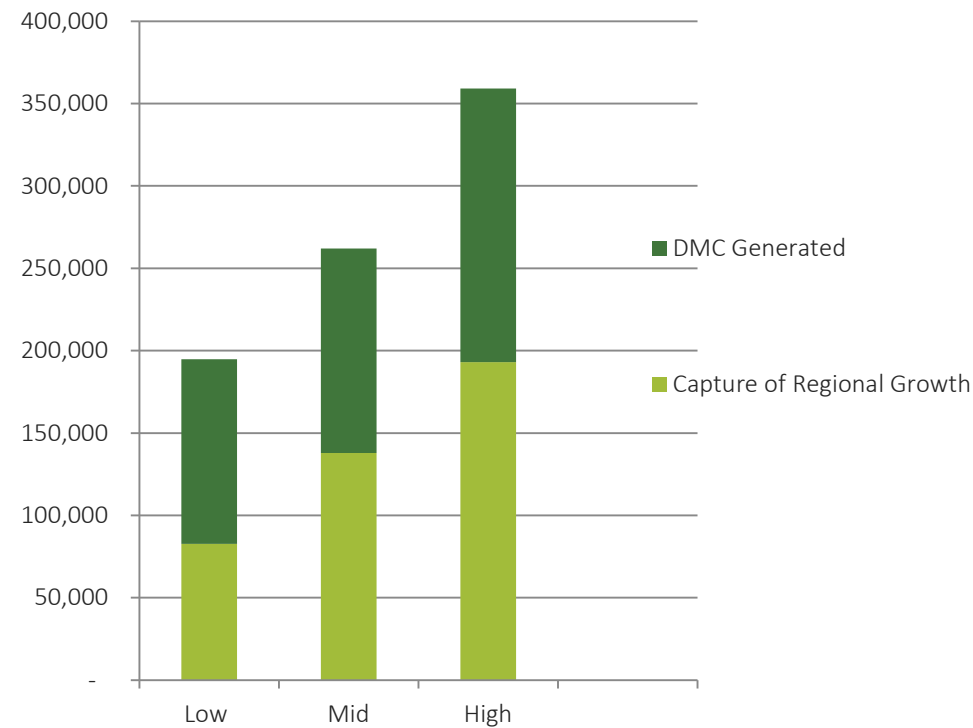
Demand for retail, dining and entertainment (RDE) space is driven by growth of population, household income, number of employees, visitors, students, and “inflow” (those not included in the previous categories). The supportable square footage by type of establishment is based on spending patterns typical of the different market groups and their respective incomes.

AECOM updated the estimates for total supportable retail demand in Olmsted County using data that is available through the US Economic Census, the Census of Retail Trade, the population and jobs estimates and other sources, then assigned high, medium, and low demand capture ranges on estimated growth. The DMC should be able to support more retail than originally estimated. However, this estimate reflects the *potential* supportable square footage in the DMC if the estimated demand generated by DMC development is realized. The table below shows the total estimate of supportable square footage to range from 195,000 to 359,000 square feet.

| Estimated Supportable Square Footage Demand 2019-2034 | | | |
|---|---------|---------|---------|
| | Low | Mid | High |
| Capture of Regional Growth | 82,771 | 137,951 | 193,132 |
| DMC Generated | 112,000 | 124,000 | 166,000 |
| | 195,000 | 262,000 | 359,132 |

In the original retail demand analysis, the period roughly covering 2019 to 2034 estimated total RDE supportable square footage of approximately 320,000 square feet. While the original estimate for Phase 1 was only 50,000 net square feet, losses of other businesses and low absorption of space was the reason for low net growth for the sector.

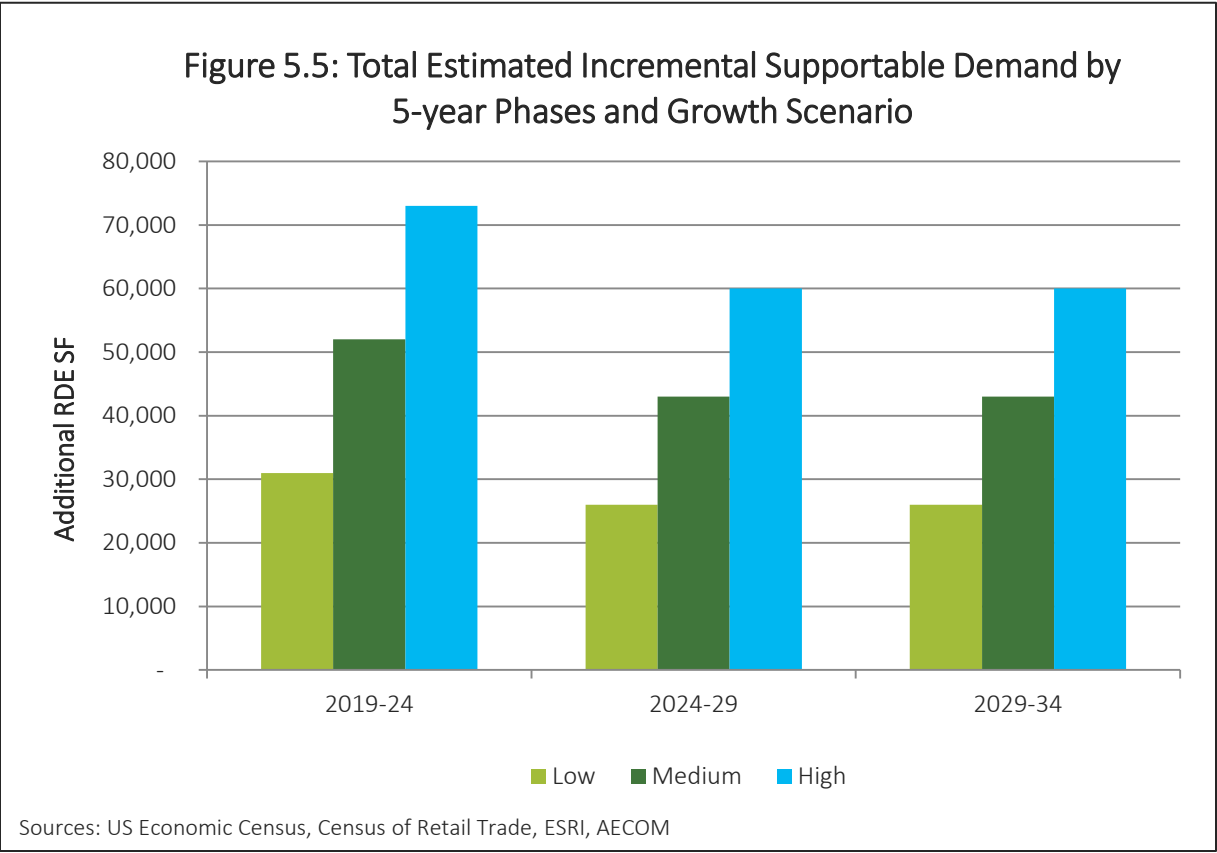
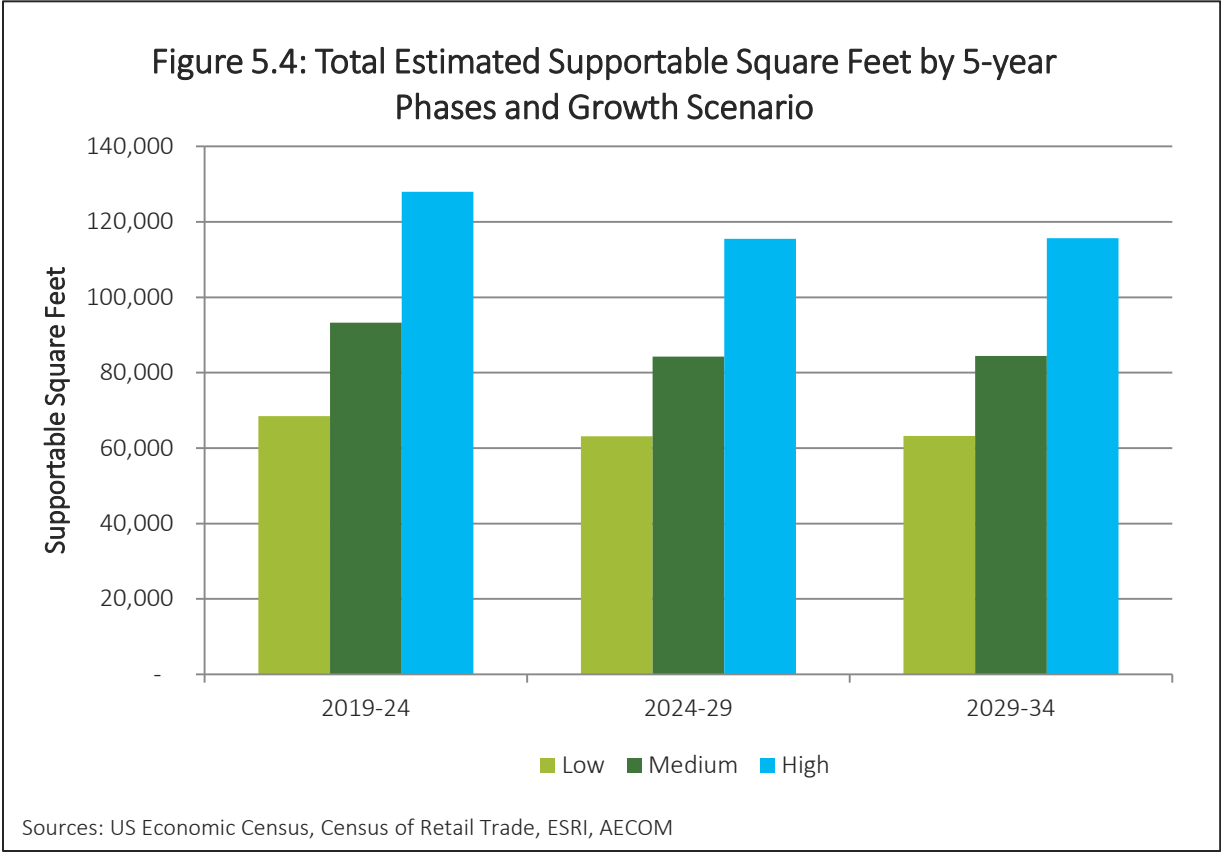
Figure 5.3: Estimated Total Supportable RDE Square Feet – DMC/Downtown



Sources: US Census of Retail Trade, US Economic Census, ESRI, AECOM

Estimated Incremental Retail/ Dining/ Entertainment Demand by 5-Year Phases

Over the next 5-year phase the downtown is estimated to be able to add from approximately 31,000 to 73,000 square feet of retail, dining and entertainment space; from an estimated total of 68,000 to 128,000 square feet. Because the inventory of net total square footage in downtown has remained relatively flat in a growing economy, there is pent-up supportable demand for RDE space not being realized.



Dining and Entertainment Sub-sectors

Dining, including full-service and limited service restaurants, continues to be a significant part of Downtown Rochester's RDE offering. A number of new full-service restaurants have opened, some as part of new mixed-use commercial developments. In some cases, the new restaurants occupy spaces previously held by previous restaurants so that the *net new* space allocated to full-service restaurants has shown only a small uptick. Limited service restaurants are typically small in space, so absorption of square footage by this category will be limited.

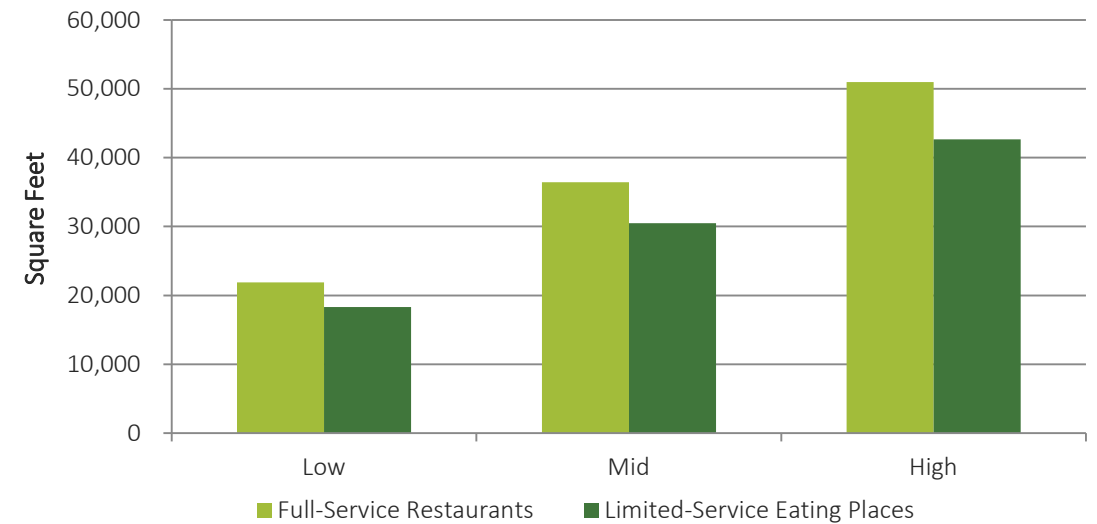
As hotel, office, and residential growth occurs, the opportunities for food and beverage service business will grow.

Entertainment businesses can include movie theaters, live performance theaters, venues presenting live music but categorized as a food service business (such as a pub that offers live entertainment), and family entertainment centers (FEC). FECs are indoor or small outdoor amusement operations that offer a wide variety of entertainment for all ages. Traditional FECs include bowling alleys, miniature golf courses, and skating rinks, but new FECs present integrated technology games, food and beverage services. Indoor centers range from 15,000 to 20,000 square feet in size. Bowling alleys integrated with arcades, restaurants and music have made a comeback in recent years by expanding entertainment choices. IAAPA statistics show that North American families go to FECs three to five times per year at an average cost of \$12 to \$22 per visit. One barrier to entry for an FEC in downtown may be the rising rent levels.

Five-Year Estimates

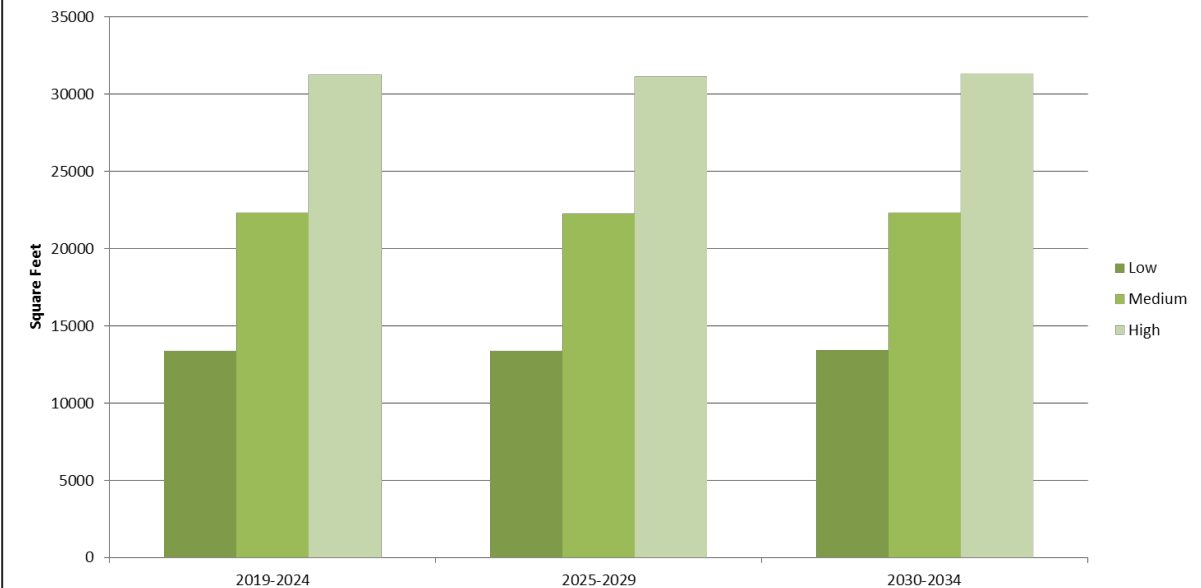
Over the next 5-year phase downtown restaurant demand is estimated to be able to add from approximately 13,000 to 31,000 net square feet of restaurant space.

Figure 5.6: Restaurant Demand Square Footage by Growth Scenario



Sources: US Economic Census, Census of Retail Trade, ESRI, AECOM

Figure 5.7: Estimated Incremental Supportable Restaurants by 5-year Phases and Growth Scenario



Sources: US Economic Census, Census of Retail Trade, ESRI, AECOM

Behind the Numbers



Behind the Numbers

Select Input and Observations



Interviews

AECOM conducted interviews with individuals from a variety of private and public organizations regarding market trends, prospects, and considerations. Here are some highlights:



Trends

Interviewees were positive about recent activity, particularly in housing and lodging, but cautious about the mid term given economic cycles and the amount under construction and proposed. They would like to see existing construction absorbed and price-points achieved. While high end market niche opportunities exist, the market is generally price sensitive. Affordable housing is needed. The med-tech sector is driven by Mayo collaborators. The market for general professional office is limited. Retail will be a function of growth in different market segments, particularly for restaurants and entertainment, some specialty goods and services, and some general retail as more households are added Downtown. Culture & entertainment are differentiators.



Prospects

Interviewees were optimistic about the long-term, but much development is still in early phases and unsubstantiated. The dependence on one major entity, Mayo, while secure and on track, is a risk factor for resiliency. It will be important to diversify in the long-run. For example, early biotech, biomed, and tech companies are mostly linked to Mayo; over time, some may establish independence, stimulating their own demand and diversifying the sources of market support. Room-night demand may diversify with segmentation and a growing meetings market at the Civic Center and larger hotels. A critical mass of retail is needed to attract more than Mayo visitors.

Behind the Numbers

Select Input and Observations



Considerations

The support network for innovation is critical to leverage Mayo and stimulate more aggressive growth rates. Rochester is a tertiary market nationally and needs to recruit and retain STEM research talent. The University of Minnesota, Rochester is a conduit to develop the health science and medical support workforce. Med-tech venture funds & eco-system support helps young companies.

The workforce to support other sectors – hospitality, retail, business services – will come from organic growth of the current population and from households drawn to the region to take advantage of emerging economic opportunities. Rochester and DMC are positioned to capture them, but housing needs to be affordable.

New business models have evolved since the DMC Plan was prepared five years ago, such as Airbnb affecting the lodging & housing markets, Lyft and Uber affecting the transport market, and virtual companies and co-working places affecting the office market and workplace configurations. The presence of more innovative cultural attractions (funky sub-districts) and public amenities would attract residents and employees. Strategies should be developed to leverage markets and programs to build a “Creative Economy in a Creative Town” reputation regionally and nationally.

Conclusions, Findings, and Strategic Opportunities



Office/Med-Tech Market

Demand Drivers

Professional Office – *DMC initiative*, particularly Discovery Square, creating demand for supportive professional services. Plus, *general market growth* over time as regional population and Mayo's visitation grows.

Med/Tech – *Mayo's relationships* and partnerships in early phases. Over time, Mayo's *partnering firms* will generate their own relationships and demand, independent of Mayo. Investment in support network and venture funding for *start-ups* to tap talent and entrepreneurs can also drive growth based on comparable innovation districts nationally.



TOTAL INVENTORY (SQ.FT.)

2014: 16 buildings with approximately 453,000 s.f. (excluding Mayo)

2018: 16 buildings with approximately 457,000 s.f.

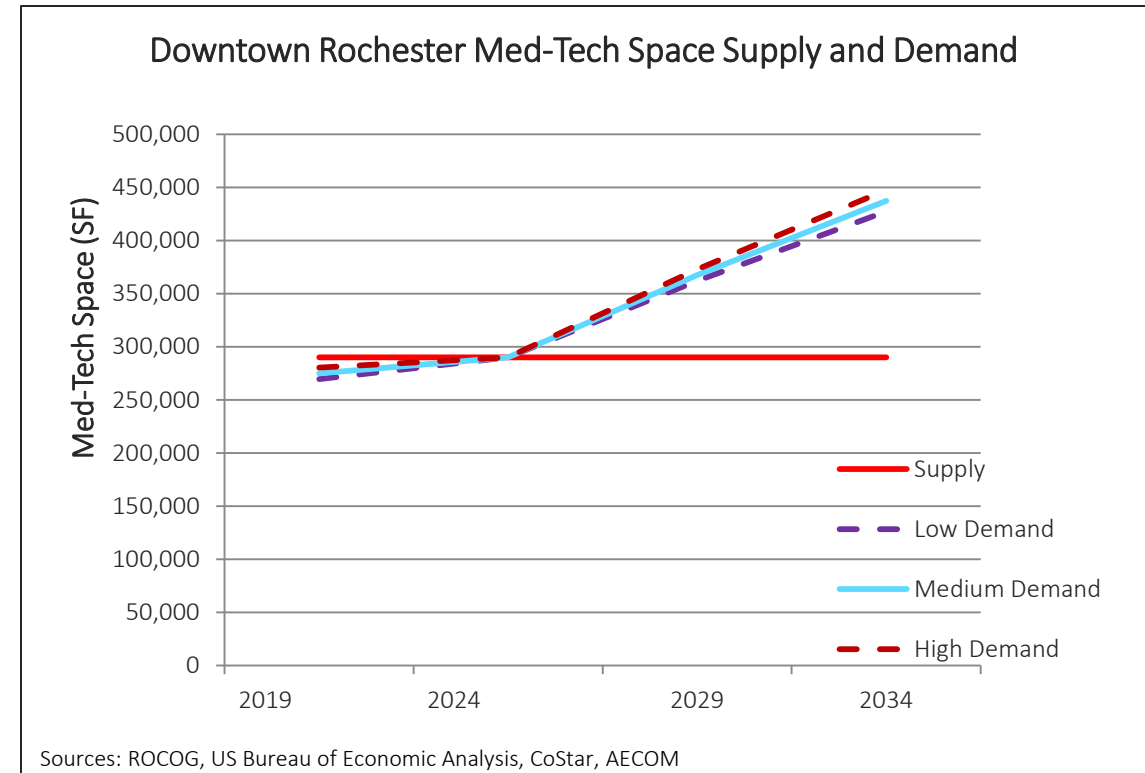
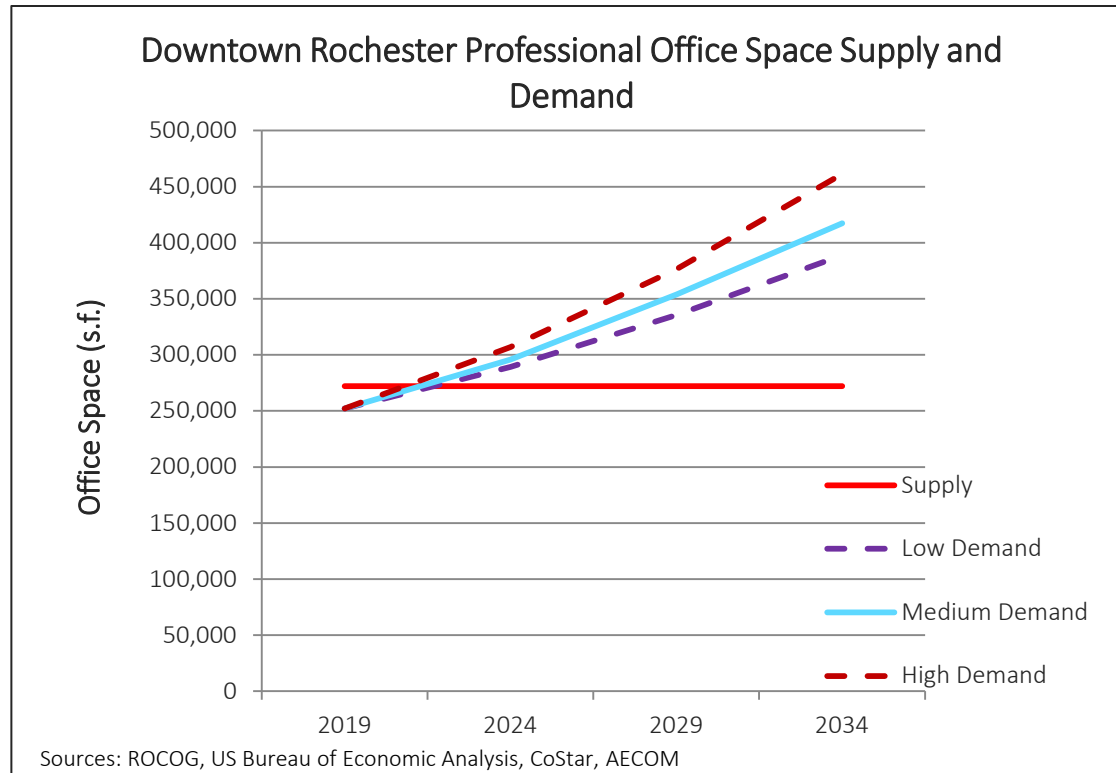
Pipeline: Approximately 105,000 s.f. (including Berkman & Discovery Square Phase 1)



ESTIMATED NEW DEMAND 2019-24

| Scenario | | Estimated Demand (s.f.) | Pipeline |
|----------|--------------|-------------------------|----------|
| Low | Professional | 37,000 | 20,000 |
| | Med/Tech | 65,000 | 85,000 |
| | | | |
| Medium | Professional | 44,000 | 20,000 |
| | Med/Tech | 70,000 | 85,000 |
| | | | |
| High | Professional | 55,000 | 20,000 |
| | Med/Tech | 76,000 | 85,000 |

Estimated Office Space Demand By 5-Year Phases



FINDINGS

The 2019-24 demand for professional office space will most likely be satisfied with **upgrades and renovations** of existing inventory and/or additional office space in **new mixed-use developments**, rather than new development of stand alone conventional professional office buildings.

Med-Tech in **One Discovery Square pre-leased successfully**, anchored by Mayo Clinic and UMR, capturing accumulated unmet demand from prior period. Phase 2 requires more Mayo partnerships.



ECONOMIC DEVELOPMENT OPPORTUNITY

The Med/Tech rate of growth is driven by Mayo partnerships and discrete users, as opposed to general market demand to support speculative development. **More partnerships = more demand for more space**. Support **network and funding for start-ups** in Discovery Square may accelerate growth.

Hotel Market

Demand Drivers

Mayo visitation will still be the #1 demand drivers by a large margin. As the national senior population cohort grows, demand is expected to accelerate.

Programming and events at the Convention Center, Chateau Theatre and other venues can increase room-night demand. This will require events that encourage overnight stays later in the week and weekends when Mayo visitation demand is softer.



TOTAL INVENTORY (Rooms)

2014: 2,830 rooms

2018: 2,703 rooms (number reduced due to some consolidation for suites and recent/planned closings offsetting gains)

Pipeline: 943 rooms



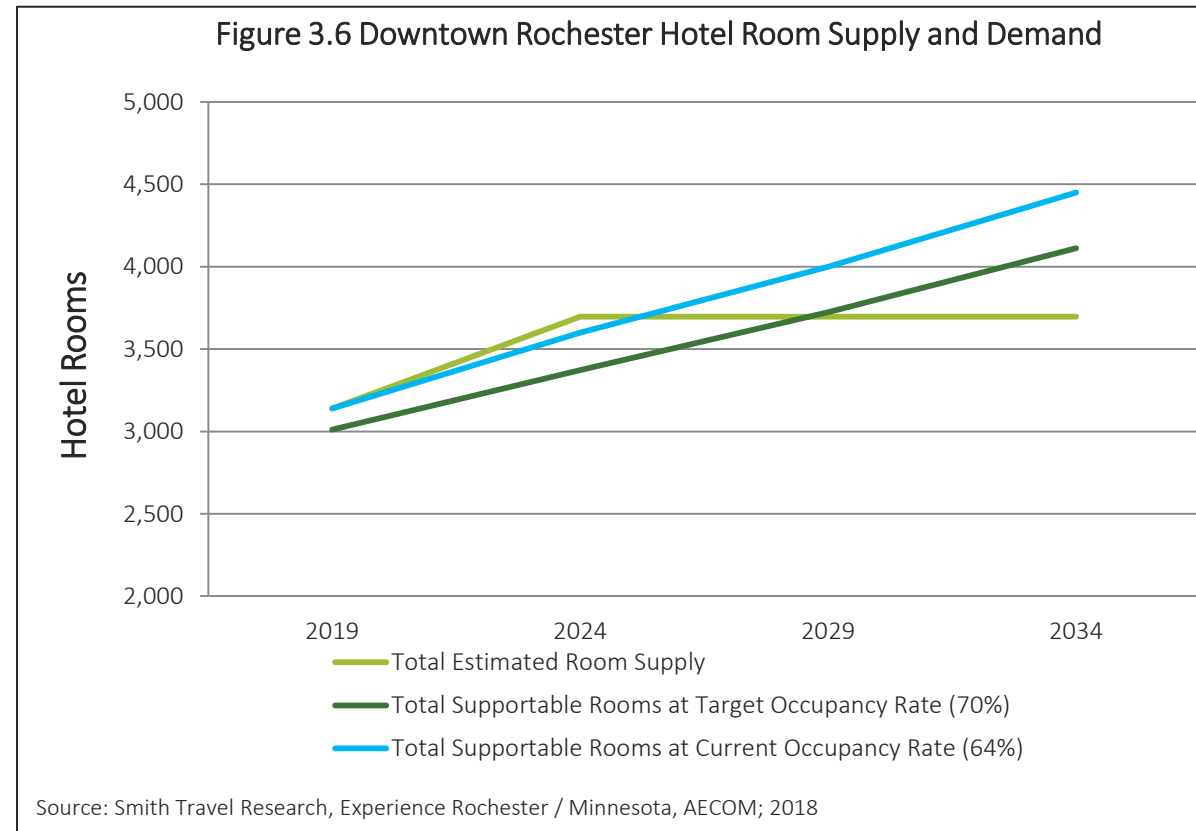
ESTIMATED NEW DEMAND 2019-24

Demand at 70% Occupancy Rate = 3,373 rooms

Supply = 3,646 rooms

Surplus = 273 rooms

Estimated Hotel Demand By 5-Year Phases



FINDINGS

Current hotel room inventory and pipeline is estimated to **satisfy demand until late-2020s** at a target occupancy rate of 70%; **mid-2020s if market operates at historical occupancy rate of mid-60%.**



ECONOMIC DEVELOPMENT OPPORTUNITY

With continued growth of the University of Minnesota-Rochester, Discovery Square, and Mayo Clinic’s global reputation, Rochester has the potential to position itself as a unique **national meeting destination** centered on innovations in health and well-being, as well as a **regional convention center**. Development of **event programming** with the Civic Center’s renovation, Chateau Theatre, and marketing by new meeting hotels will **grow room-night demand** for more hotels.

Accelerated growth in the near term is possible with **price-point differentiation** and the development of new facilities that generate additional room-night demand.

Residential Market

Demand Drivers

Increase **market share of regional growth** in multi-family demand resulting from community-building, place-making & public investments associated with DMC’s implementation, especially for **people working downtown, young adult, empty-nester, and senior populations**.

DMC associated job growth creates new households, thereby increasing demand for housing. **UMR’s growth plans** may create demand for specialized student and faculty housing. **Housing that is affordable** to low-and-moderate wage earners is needed to have a balanced market and provide close-in residences for service and support workers.



TOTAL INVENTORY (multi-family residential units)

2014: 789 units

2018: 1,096 units

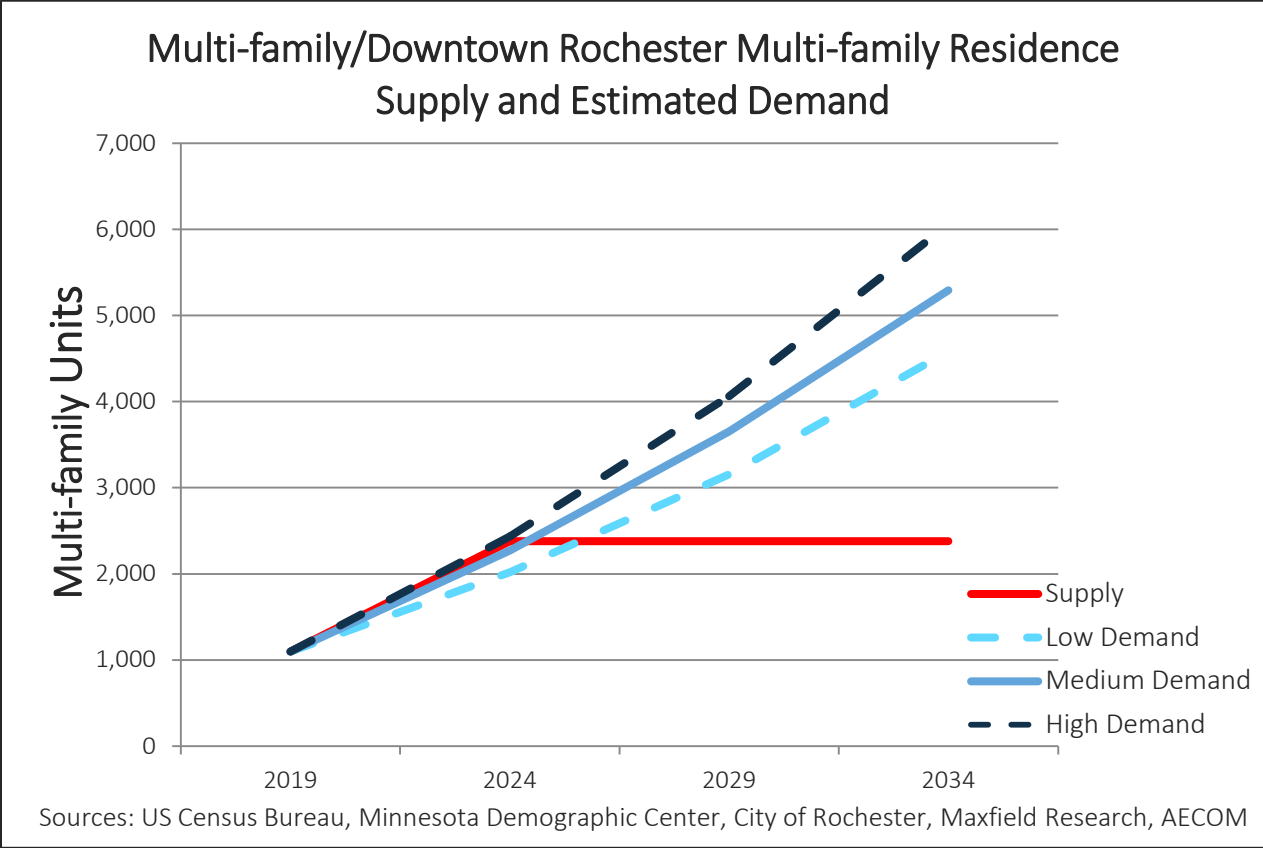
Pipeline: 1,282 units (estimated)



ESTIMATED NEW DEMAND 2019-24

| Scenario | Estimated Demand (units) | Pipeline |
|----------|--------------------------|----------|
| Low | 900 | 1,282 |
| | | |
| Medium | 1,150 | 1,282 |
| | | |
| High | 1,350 | 1,282 |

Estimated Multi-family Residence Demand By 5-Year Phases



FINDINGS

The DMC-Vicinity/Downtown Rochester MFR market will more than **double its inventory** of housing units between 2019-2024. These housing units are estimated to **meet or exceed demand in the near term**, depending on the capture rate and the rate of future job growth, which DMC’s implementation will influence. While demand may exist for condominiums, disincentives to build given potential legal risks, and the affordability of single-family housing in the region, softens interest in satisfying potential for-sale housing demand.



ECONOMIC DEVELOPMENT OPPORTUNITY

As the **DMC initiative** is successful in attracting firms that generate **jobs and increase household growth** and building **amenities to position** the downtown market, plus **demographic and price-point differentiation** of market segment niches, demand for multi-family housing should continue to increase. There is some **near term market caution** due to the length of the national economic growth cycle. Efforts to **improve affordability** through design, product differentiation, parking strategies, and subsidy for low-income households will help create a balanced community.

Retail/Dining/ Entertainment Market

Demand Drivers

More downtown workers and **DMC residents and students** will provide a foundation for limited service dining, convenience shopping, after-hours spending, and services. More Mayo, conference, event, and hotel **visitors** expands that base. Capturing a greater market share of **regional resident demand** for dining and entertainment is emerging and will accelerate with DMC's implementation and growing critical mass of activity and consumer options.



TOTAL INVENTORY

2014: 444,000 s.f.
2018: 456,000 s.f.
Pipeline: 103,000 s.f. (estimated)

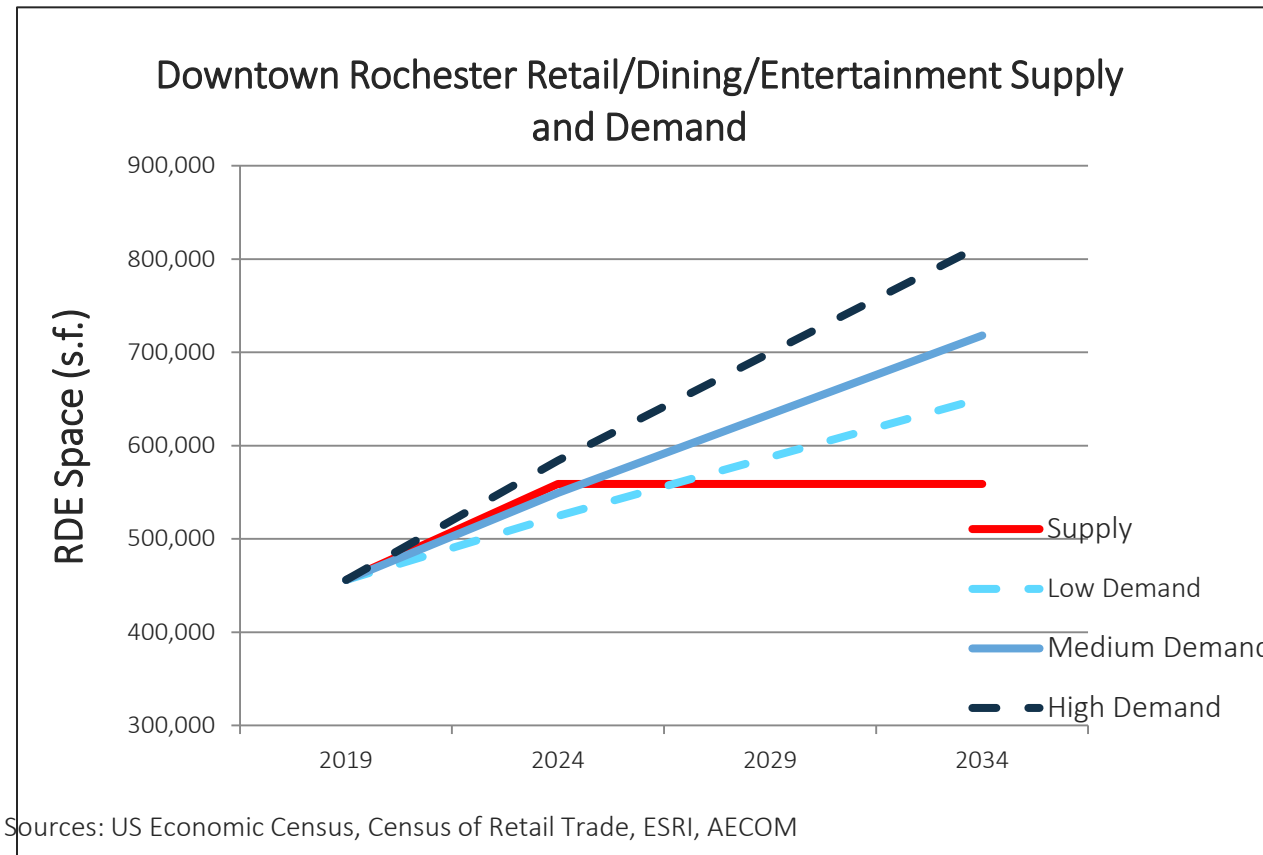


ESTIMATED NEW DEMAND 2019-24

| Scenario | Estimated Demand (s.f.) | Pipeline |
|----------|-------------------------|----------|
| Low | 70,000 | 103,000 |
| | | |
| Medium | 95,000 | 103,000 |
| | | |
| High | 130,000 | 103,000 |



Estimated Retail Demand By 5-Year Phases



FINDINGS

Retail inventory has been relatively stable for the past 5 years with **small additions** resulting from first floor retail in multi-family residences and **renovations** of older buildings. **Near term demand is satisfied**; DMC's implementation will bring more workers, residents, and tourists leading to **longer-term growth**. Clustering of dining & entertainment increases market share of **regional demand**.



ECONOMIC DEVELOPMENT OPPORTUNITY

Retail/dining and entertainment demand is a function of **growth in captured buying power**. Visitor growth, more downtown residents and workers, and a larger market share of regional demand for dining and entertainment will support more retail/dining and entertainment over time. As the residential community grows and matures, demand for **neighborhood services** will increase. A **critical mass of dining and entertainment in emerging districts** should induce greater demand from the regional market.

The next phase

While absorbing new inventory - build
“Place” with amenities & mobility to
position for the next growth cycle.



1. Med-Tech drives new demand for the other uses – double down on **more Mayo partnerships & Discovery Square’s supportive eco-system.**
2. Downtown housing is proven – focus on diversified workforce, affordable, and specialized housing to **create a balanced community.**
3. Near term lodging demand satisfied with new supply – **prioritize investments that create more room-night demand.**
4. Retail follows consumers - **develop a dining/entertainment strategy to capture demand.**

Ongoing Data Collection & Analysis



Demographics

Much of the analysis in this report is built off data from national and regional government sources. Because growth in population and employment drives demand for various land uses, tracking general demographic patterns is essential for ongoing analysis moving forward.

The US Census Bureau American Community Survey (ACS) tracks many key indicators for states, counties, cities and census tracts. The 5-year survey offers the most reliable data for smaller geographies, including subsectors of the City of Rochester. Data on population, households, age of householder, housing tenure and household income is uploaded every year (2017 data recently updated) and is free to download from the American Factfinder website (<https://factfinder.census.gov>)

The Bureau of Labor Statistics (BLS) tracks unemployment and labor force data for states, counties and cities in the Quarterly Census of Employment and Wages (QCEW). They also track inflation through the Consumer Price Index (CPI). Data sets are updated yearly and free to download from the Department of Labor (<https://www.bls.gov/data/>)

The Bureau of Economic Analysis (BEA) collects data on employment and income by geography and North American Industry Classification System (NAICS) sector. Data is updated yearly and available for counties and metropolitan statistical areas to track growth in job sectors. (<https://bea.gov/data/>)

The Rochester Olmsted Council of Governments (ROCOG) creates periodic projections for population, households and employment by sector. While the most recent report was published in 2014, ROCOG staff plans to produce a new report in 2019.

Professional Office and Med-Tech

Demand for both professional office and med-tech flex space is driven by growth in employment in sectors that require these land uses. Key indicators to track will be the employment numbers from the BEA and ROCOG listed above. NAICS sectors that require med-tech space are Health Care/Social Assistance and Professional, Technical, Scientific Services. NAICS sectors that require professional office space are Finance, Insurance, Information, Real Estate, Management of Companies, Government and Other Services.

CoStar Real Estate Information is a subscription service that tracks inventory, rent and absorption for Office, Retail and Multi-family Residence land uses. Data is available for counties, cities and city submarkets, or can be generated for custom geographies. CoStar is a paid subscription service (www.CoStar.com)

The US Census Bureau has an online mapping tool that draws from the Longitudinal Employer-Household Dynamics (LEHD) data to track the residence and place of employment for jobs for states, counties, cities, census tracts or custom geographies. Data is updated yearly, but after a significant lag owing to the nature of the data (most recent data available is 2015). (<https://onthemap.ces.census.gov>)

Hotel

Smith Travel Research (STR) tracks data on hotel rooms, occupancy rates, Average Daily Rates (ADR) and Revenue per Available Rooms (RevPAR) for a designated geography. STR offers a wide range of services and reports with prices reflecting the scale and complexity of their analyses. Requests for services are processed through their website (<https://www.strglobal.com>).

Experience Rochester tracks data on the number of visitors, purpose of visit and visitor expenditures by category. These data are useful to understand the drivers of hotel stays and their effects on the local economy. Information on hotels, restaurants, events and more is available on their website (<https://experiencerochestermn.com>).

Residential

The key indicators to track for residential land uses are those highlighted in the Demographics section, especially the population and household data from the US Census Bureau and ROCOG. The median income and age of householder data from the US Census are also important for tracking demand for various housing types.

The Rochester-Olmsted Planning Department tracks and updates data on multi-family residence developments throughout the county. They generate monthly reports on building permits and units permitted and publish periodic summaries on new construction and pipeline projects. The most recent report was published in April of 2018. (<https://www.rochestermn.gov/departments/planning-and-zoning>)

CoStar Real Estate Information is a subscription service that tracks inventory, rent and absorption for office, retail and multi-family residence land uses. Data is available for counties, cities and city submarkets, or can be generated for custom geographies. CoStar is a paid subscription service (www.costar.com)

Retail

ESRI Business Analyst is a paid subscription service available through ArcGIS Online that allows for the extraction of detailed data on consumer expenditures and other economic indicators. Data is updated regularly and offers yearly estimates (most recent data is for 2018). Information about pricing for subscriptions and detailed reports is available at their website (<https://www.esri.com/en-us/arcgis/products/arcgis-business-analyst/applications/desktop>).

Retail

Demand for additional retail space is largely an extension of a growing population and workforce. Numerous public and private sources track consumer behaviors and market patterns and produce reports depending on data needs. For this report, AECOM referenced Jones, Lang, La Salle IP 2018 for city-level retail sales per square foot, International Council of Shopping Centers 2017 for office worker retail spending patterns, Baker Tilly 2016 for food and beverage sales and the University of Minnesota-Rochester 2018 for student expenditures.

ESRI Business Analyst is a paid subscription service available through ArcGIS Online that allows for the extraction of detailed data on consumer expenditures and other economic indicators. Data is updated regularly and offers yearly estimates (most recent data is for 2018). Information about pricing for subscriptions and detailed reports is available at their website (<https://www.esri.com/en-us/arcgis/products/arcgis-business-analyst/applications/desktop>).

Costar Real Estate Information is a subscription service that tracks inventory, rent and absorption for Office, Retail and Multi-family Residence land uses. Data is available for counties, cities and city submarkets, or can be generated for custom geographies. Costar is a paid subscription service (www.costar.com).

The US Economic Census tracks data for employment and consumer spending by NAICS product codes for states, counties, metropolitan areas and zip codes. The Economic Census is released every 5 years (data from the 2017 census will be released in 2019). Data is free and can be extracted from their website (<https://www.census.gov/programs-surveys/economic-census/data.html>).

Appendices



2019 Inventory

| DMC Vicinity/Downtown MFR Inventory | |
|-------------------------------------|--------------|
| Name/Address | Units |
| Central Towers | 105 |
| 318 Commons | 98 |
| Newbridge Apts. | 41 |
| Metropolitan Market | 62 |
| Broadway Plaza | 12 |
| Fontaine Towers | 151 |
| 845 2nd St SW | 11 |
| Clinic Suites | 14 |
| Uptown Terrace | 9 |
| The Francis | 17 |
| Uptown Landing | 23 |
| Civic Square Apts. | 125 |
| Uptown Court Apts. | 28 |
| 501 on 1st | 84 |
| Flats on 4th | 92 |
| 1st Ave Flats | 68 |
| Lofts/Oliver Apartments | 15 |
| The Lofts at Mayo Park | 29 |
| Uptown Apts Homes | 29 |
| Nicholas Apts | 83 |
| The Riverwalk Apts | 347 |
| Urban on First | 107 |
| Residence at Discovery Square | 152 |
| Total | 1,702 |

| 2019 Downtown Office Space Inventory | |
|--------------------------------------|-----------------------------|
| Name/Address | Rentable Building Area (SF) |
| Wells Fargo Bank | 107,124 |
| 100 1st Ave SW | 37,053 |
| Mayo Medical Education | 59,841 |
| Minnesota Bio-business Center | 111,395 |
| Premier Banks Building | 37,246 |
| Mayo Gonda | 1,320,000 |
| Morgan Stanley Center | 10,000 |
| Brackenridge Skyway Plaza | 38,223 |
| 18 3rd St SW | 12,868 |
| 11 4th St SE | 18,548 |
| 223 Broadway Ave N | 8,975 |
| Sterling State Bank Building | 27,000 |
| Associated Bank Building | 97,000 |
| Kimley Horn | 5,500 |
| 401 S Broadway | 18,042 |
| Restovich-Braum & Associates | 2,360 |
| US Bank Building | 91,974 |
| Oddfellows Building | 913 |
| 21 2nd St SE | 1,416 |
| H3 Building | 27,500 |
| 300 1st Ave NW | 15,200 |
| Discovery Square | 85,000 |
| Total | 2,133,178 |

| 2019 Downtown Hotel Inventory | |
|--|--------------|
| Hotel | Rooms |
| Aspen Suites | 82 |
| Aspen Select | 52 |
| Broadway Plaza | 24 |
| Centerstone Plaza Hotel Soldiers Field Mayo Clinic Area | 214 |
| Courtyard Rochester Mayo Clinic Area St Marys | 117 |
| Doubletree Rochester Mayo Clinic Area | 212 |
| Fairfield Inn & Suites Rochester Mayo Clinic Area St Marys | 91 |
| Guesthouse Inn Rochester West | 118 |
| Hilton Garden Inn Rochester Downtown | 143 |
| Holiday Inn Express & Suites Rochester West Medical Center | 85 |
| Homewood Suites | 108 |
| Kahler Apache | 149 |
| Kahler Inn & Suites | 271 |
| Marriott Rochester Mayo Clinic Area | 202 |
| Residence Inn Rochester Mayo Clinic Area | 89 |
| Springhill Suites Rochester Mayo Clinic Area St Marys | 86 |
| The Kahler Grand Hotel | 660 |
| Hilton Rochester Mayo Clinic Area | 264 |
| Hotel Indigo | 173 |
| Total | 3,140 |

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