

MEMORANDUM

To: Scott Athearn, Dollinger Properties

From: Darin Smith and Paige Peltzer

Subject: Lincoln Landing Urban Decay Analysis; EPS #171049

Date: April 12, 2017

The Economics of Land Use



The proposed Lincoln Landing mixed-use development (Project) is located at the site of the former Mervyn's Headquarters building in the City of Hayward (City). Economic & Planning Systems, Inc. (EPS) understands that the Environmental Impact Report for the Project concluded that the Project would not result in urban decay. EPS has been retained to review economic data and confirm whether this conclusion appears to be appropriate. Based on our analysis of the Project and its economic context in the City of Hayward, we concur that the Project is not likely to start an economic chain reaction that could lead to physical deterioration of the built environment and urban decay.

Background

The City's FY2014 – FY2018 Economic Development Strategic Plan has identified the Project's site as a key catalyst site for retail development.¹ Catalyst sites were identified based on criteria that include the potential impact on associated retail, high visibility, vacant or underutilized buildings, few owners, and acreage.

The proposed development will include 476 apartments and 80,500 square feet of retail. While retail tenants have yet to be identified, the Project is intended to include a varied mix of retail types and sizes, with pad sizes ranging from 6,000 square feet to 50,000 square feet for larger anchor stores. Though the Lincoln Landing Project is not as large as a typical regional retail center, its proximity to highways 238 and 580 offers the potential to draw customers from outside the Trade Area should the tenant mix include a highly popular retailer or an unique experiential retail atmosphere.

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¹ City of Hayward Economic Development Strategic Plan, p. 24

Summary of Key Findings

- 1. The retail sector in the City of Hayward is very strong and is expected to remain so in the near future. The current vacancy rate for retail space in the City is 2.1 percent, indicating that current demand for space is high.**

The retail market in the Hayward Trade Area has steadily improved since 2012, as lease rates have increased and vacancy rates have decreased. Population and employment in Hayward is expected to continue to grow and further increase demand for retail over the next five years. The expected demand from this growth is anticipated to exceed the supply of retail from the Project and all other retail space currently in the City's development pipeline.

- 2. Leakage analysis for the City of Hayward identified several types of retail that are not fully capturing their sales potential within the City. The proposed development has not yet specified retail tenants, leaving open the possibility that the tenants could be oriented toward goods not fully provided by existing retailers in the vicinity of the Project.**

A retail leakage analysis of the City of Hayward identifies six retail categories for which opportunities for new stores or expansion exist in Hayward. These include stores for home furnishing; food and beverage; clothing; sporting goods, hobby, book, and music; and food and drinking places. These retail types could be attracted to the Project site without affecting existing retailers.

- 3. Even if some of the existing retailers close due to an inability to compete effectively with the Project's retail, it is likely that the vacated properties can be re-tenanted and/or redeveloped for productive uses rather than falling into "urban decay" conditions.**

While not specifically defined under CEQA, "urban decay" is assumed herein to mean that properties suffer long-term vacancies, disinvestment, and problem behaviors (graffiti, litter, etc.) due to a lack of economic incentive for property owners to maintain their property, possibly in response to competition from new development. Even if some existing retail stores do close due to underperformance exacerbated by the introduction of competition from the Project's retail, the retail sector in the City is expected to be strong enough to re-absorb the vacated space within a few years, thus substantially diminishing the likelihood of the significant and long-term effects that constitute "urban decay."

Retail Context

A trade area is a geographic region that contains the elements of demand and supply that will determine the performance of a particular retail store or project. Trade areas are influenced by a variety of factors, including the location and density of the targeted residential population, the location of key competitors, and their relative distance, geographic and psychological barriers. Retail establishments outside a given trade area are not considered to be at risk of urban decay from development within the trade area.

There is no single or definitive methodology for establishing a trade area. The approach typically varies with the type of retail or specific tenants involved (e.g., a coffee shop has a smaller trade area relative to a "big box" store) as well as the overall size of a project. This analysis considers the entire City of Hayward the Trade Area for the Project due to its central and prominent location.

Although the precise tenanting of the retail anticipated for the Project is not determined, the Project is likely to draw demand primarily from within the City and to a lesser extent from beyond the City's boundary. Ultimately, the significance of this draw will depend on the tenant mix and existence of competitive supply elsewhere relative to retail categories of the Project. Should the Project successfully serve as a "catalyst site" as envisaged by the City's plans and policies, then gradually the City could increase its sales capture because of new regional growth and maturation in the City's retail sector with the provision of a deeper and wider range of product categories.

Projected Demand

Located in Alameda County in the East Bay region, the City of Hayward has a population of approximately 154,557 with nearly 74,000 jobs.² The City of Hayward is the third largest city in the County of Alameda. It has experienced steady population growth over the last 10 years, having increased from a population of 140,305 in 2007. Hayward's median household income was approximately \$61,000 in 2016.³ Income plays an important role in consumer demand for retail goods. For example, lower-income households typically demand less and different types of retail goods and services than higher-income households.

Population and Employment Growth

The City's population and employment growth are expected to contribute to future retail demand. Hayward's population is expected to grow to 164,610 by 2021. The city's number of jobs is expected to increase by roughly 17 percent to 87,800 jobs by 2040 based on Association of Bay Area Governments (ABAG) projections. This analysis assumes median household income in Hayward will remain constant (adjusted for inflation) during the forecast period. This is a conservative estimate since the Trade Area may experience a gradual increase in real income. To the extent that household incomes increase, Trade Area residents' disposable expenditures also increase which would improve retail performance.

Trade Area Sales Flow

EPS has projected retail demand in Hayward based on historic retail sales, which have steadily increased the past five years. According to ESRI Market Place data, in 2016 Hayward had roughly \$2.3 billion in retail sales.

Total sales typically include four major expenditure sources:

1. Resident households.
2. Workers who live elsewhere (non-residents).
3. Visitors, such as tourists, through commuters, and other non-residents.
4. Business-to-business, internet, and other non-site based purchases.

This analysis assumes that visitor expenditure and business-to-business purchases will not be significantly affected by development of the Lincoln Landing Project. As a result, it concentrates on resident households and employee spending as key demand drivers for retail sales associated

² ESRI Business Analysis Community Profile Report.

³ ESRI Business Analysis Community Profile Report.

with the Project. Employee expenditure is based on an average taxable spending of \$15 per day reflective of typical lunch and gasoline purchases, while average household expenditure is based on the remainder of the retail taxable sales (net of employee expenditure) divided by the number of the Trade Area residents. These per employee and per household estimates are shown in **Figure 1** and are assumed to be fixed going forward (i.e., the total will increase in proportion to the Trade Area population and employment growth, respectively).

Figure 1 Hayward Sales from Population and Employment Growth

Item	Total
2016 Annual Retail Sales¹	
Hayward	\$2,254,162,801
2016 Hayward Demographics	
Population ²	154,557
Employment ³	73,750
Non-Resident Employment ⁴	14,750
Trade Area Expenditure	
Per Capita ⁵	\$12,795
Per Employee ⁶	\$3,750
5-Year Projections	
Population Growth ³	10,053
Employment Growth ⁷	5,590
Non-Resident Employment Growth	1,118
New Sales from Growth	
New Sales from Population Growth	\$128,630,964
New Sales from Non-Resident Employee Growth	<u>\$4,192,500</u>
Total New Sales	\$132,823,464

[1] ESRI Market Place Profile for Hayward 2016.

[2] CA Department of Finance, 2016.

[3] ESRI Community Profile.

[4] Assumed to be 20 percent of employment.

[5] Calculated by subtracting employee spending from total sales and dividing by population.

[6] Assumes employees spend \$15 a day on retail, 250 days of the year.

[7] Association of Bay Area Governments.

Sources: ESRI; DOF; ABAG; Economic & Planning Systems, Inc.

Project Household Income and Spending

In addition to projected citywide population and employment growth, EPS is able to estimate the contributions to retail sales made by the Project's residents. The amount and types of expenditures made by residents is largely dependent on their household income. EPS's previous fiscal impact analysis of the Project estimated household income of future residents at Lincoln Landing based on housing rent estimates for the Project. According to the Project developer, rent for apartments at the Project is expected to be on average \$2,500 per month, or \$30,000

per year. Based on this rent price, EPS estimated average future household income to be \$100,000. This is significantly higher than the median household income of the City. As shown in **Figure 2**, on average, Project households are expected to spend \$34,846 per year on retail goods and services. In all, Project households are projected to spend a total of \$15.8 million annually. This analysis assumes that the City's retail businesses will capture about 74 percent of the Project's household retail demand.⁴ Given projected retail demand of \$15 million annually, a 74 percent capture rate would generate approximately \$11.7 million of new annual retail sales in the City.

Figure 2 Project Household Spending

Retail Category	Average Retail Expenditures per HH	% of Income	Annual Retail Expenditures	Percent of Total
Assumptions				
Weighted Average Household Income	\$100,000			
No. of Households by Income Category	452			
Taxable Retail Category (1)				
Motor Vehicle and Parts Dealers	\$7,022	7.0%	\$3,175,332	20.2%
Furniture and Home Furnishings Stores	\$764	0.8%	\$345,283	2.2%
Electronics and Appliance Stores	\$2,664	2.7%	\$1,204,650	7.6%
Food and Beverage Stores (2)	\$2,750	2.8%	\$1,243,550	7.9%
Health and Personal Care Stores	\$3,585	3.6%	\$1,621,090	10.3%
Gasoline Stations	\$3,316	3.3%	\$1,499,532	9.5%
Clothing and Clothing Accessories Stores	\$2,406	2.4%	\$1,088,140	6.9%
Sporting Goods, Hobby, Book, & Music Stores	\$1,431	1.4%	\$647,310	4.1%
General Merchandise Stores	\$4,026	4.0%	\$1,820,578	11.6%
Miscellaneous Store Retailers (3)	\$63	0.1%	\$28,270	0.2%
Food Services and Drinking Places	\$4,069	4.1%	\$1,840,221	11.7%
Subtotal, Taxable Retail Goods	\$32,096	32.1%	\$14,513,956	92.1%
Selected Non-Taxable				
Food and Beverage Stores (2)	\$2,750	2.8%	\$1,243,550	7.9%
Total Annual Retail Expenditures	\$34,846	34.8%	\$15,757,506	100.0%
Annual Retail Expenditures Captured in Hayward (4)		74%	\$11,679,125	
Annual Taxable Retail Sales Captured in Hayward		74%	\$10,757,433	

[1] Spending on building materials, garden equipment, and supplies assumed to be spending by homeowners, and has been left out of this analysis.

[2] Category includes non-taxable food and taxable grocery-store purchases. Fifty percent assumed to be taxable and 50 percent assumed to be non-taxable.

[3] Includes florists, gifts, novelties, souvenir stores, stationery, and office supplies.

[4] IMPLAN data for Hayward ZIP codes 94545, 94541, 94542 suggests a citywide capture rate of 74% based on distribution of spending by retail category as shown.

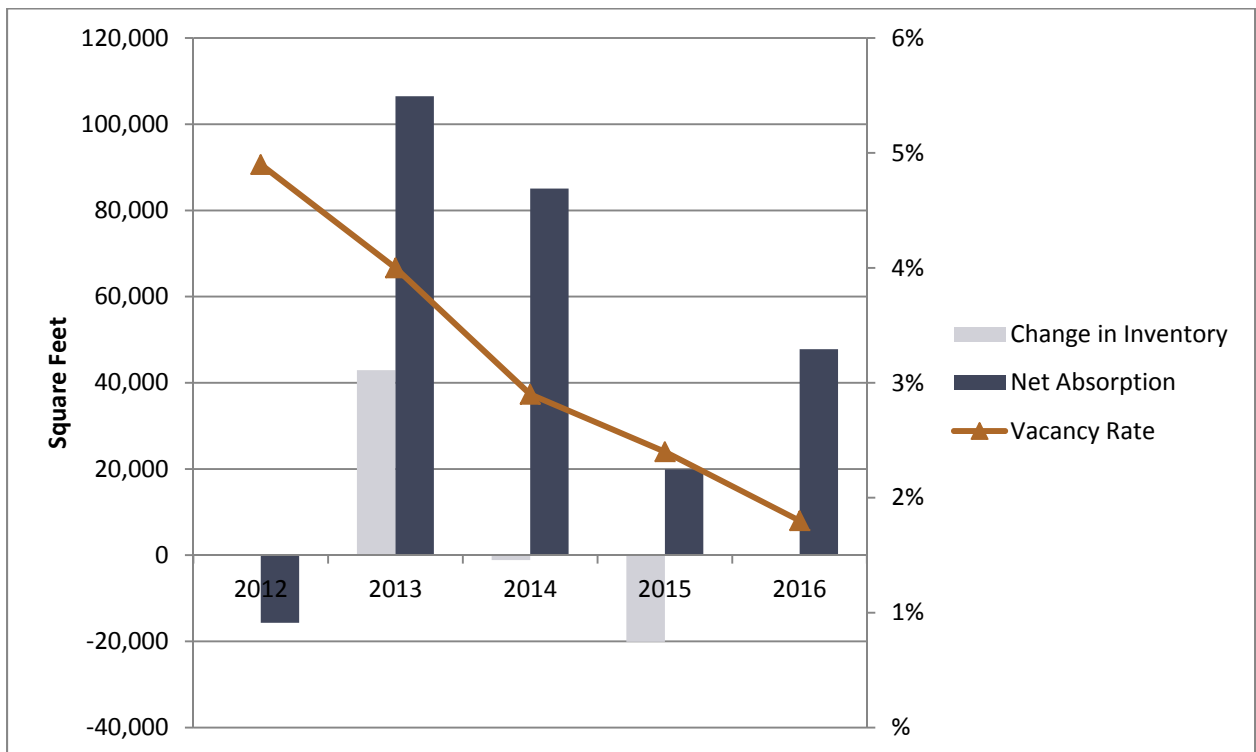
Sources: BLS, 2014 Consumer Expenditures Survey; IMPLAN 2014; and Economic and Planning Systems, Inc.

⁴ An IMPLAN analysis for Hayward indicates that City retail businesses captured roughly 74 percent of the household spending potential within the City in 2016.

Trade Area Trends

CoStar, an industry-standard data source for commercial real estate, estimates Hayward’s retail market to consist of approximately 7.7 million square feet of space. Since 2012, Hayward retail has experienced increases in rental rates and decreases in vacancy. Based on CoStar data, annual lease rates increased from \$16 per square foot in 2012 to \$21 in 2016. Vacancy rates in the City decreased from a healthy 4.9 percent in 2012 to an even stronger 1.8 percent in 2016 as shown below in **Figure 3**. The current retail vacancy rate is 2.1 percent in the first quarter of 2017. The City’s office supply has a much less competitive vacancy rate of 17 percent, but the Project will not add office space to the City’s inventory, so this type of space is not relevant to the Project’s urban decay analysis.

Figure 3 Hayward Market Trends



Future Supply

EPS gathered information on anticipated future retail supply within major retail development in the Trade Area based on data from the City’s Economic Development Department, as summarized below in **Figure 4**. EPS understands that the precise levels and retail tenants for the area have yet to be determined; therefore, this report does not differentiate between types of retail. Future retail projects are distinguished by their status as one of the following categories in the development approval process:

1. *Under Construction.* Projects that have broken ground, are currently being constructed, and will likely be available for occupancy within the next several years. There is currently one project in this category with about 5,900 square feet of retail space.
2. *Approved.* Projects approved by the City but have not broken ground. These projects are expected to be developed and enter the market during a longer time horizon. There are currently a number of approved projects within the Trade Area, although their timing for development is uncertain. These projects combine for 13,300 square feet of retail space.

3. *Proposed.* Proposed projects include applications that have been submitted to the City and are currently being reviewed by staff. These projects are usually more speculative given the uncertainty associated with approvals and longer implementation horizons. If the proposed projects come to fruition, the total retail square footage added to the Trade Area would be 59,523 square feet or 140,023 square feet, including the 80,500 square feet in the Lincoln Landing Project.

The urban decay analysis presented in the final section evaluates the impact of new retail assuming the Lincoln Landing and other pipeline projects represent the only new retail supply added to the Trade Area. Based on EPS research and information, there is approximately 78,754 new square feet of retail projected to enter the market, excluding 80,500 square feet within the Lincoln Landing Project. Assuming this retail pipeline achieves average sales of \$450 per square foot – a figure used in EPS’s previous economic impact study representing typical sales for smaller retail tenants – the total retail pipeline in Hayward including Lincoln Landing is projected to achieve sales of roughly \$72 million annually.

Figure 4 City of Hayward Retail Pipeline

Project Status and Name	Retail Square Footage	Annual Sales¹
Under Construction		
808 A Street	5,936	\$2,671,200
Approved		
Maple & Main	5,295	\$2,382,750
Mission Village	<u>8,000</u>	<u>\$3,600,000</u>
Subtotal	13,295	\$5,982,750
Proposed		
Eden Shores	50,000	\$22,500,000
Mission Crossings	7,225	\$3,251,250
Matyas Village	<u>2,298</u>	<u>\$1,034,100</u>
Subtotal	59,523	\$26,785,350
Total Excluding Lincoln Landing	78,754	\$35,439,300
Lincoln Landing	80,500	\$36,225,000
Total Including Lincoln Landing	159,254	\$71,664,300

[1] Assuming an average sales rate of \$450 per square foot.

Source: Hayward Development Activity Website; Economic & Planning Systems, Inc.

Retail Leakage Analysis

This report provides a retail leakage analysis by major retail category that characterizes the types of retail offered in the City of Hayward relative to the purchases of local residents. The analysis is based on 2016 retail sales data from ESRI Community Analyst report. The data, as shown in **Figure 5**, illustrate the concept of “retail leakage” and “retail capture” by showing how much of a particular category is in demand versus actually sold in the Trade Area relative to the income and demographic characteristics of local residents.

Figure 5 presents retail leakage calculations for the City of Hayward based on the expenditure potential of local residents. These calculations exclude non-retail expenditures, such as business-to-business sales. The report identifies several retail store categories for which opportunities for new stores or expansion exist in Hayward. These include stores for home furnishing; food and beverage; clothing; sporting goods, hobby, book, and music; and food and drinking places. Because there is unmet local demand for these categories, these retail types could be attracted to the Project site without affecting existing retailers. For example, the City of Hayward is currently undersupplied with food and beverage stores by roughly \$75 million in sales. This means that consumers often leave the City to make food and beverage purchases, and a new in-town store may help to diminish that sales “leakage.” The amount of “leakage” the City experiences in these underserved retail categories collectively amounts to more than \$150 million in sales.

Figure 5 Hayward Retail Leakage Analysis

Retail Category	Supply Retail Sales	Demand Retail Potential	Excess Supply/ (Deficit)
City of Hayward			
Motor Vehicle and Parts Dealers	\$427,030,692	\$383,008,757	\$44,021,935
Furniture and Home Furnishings Stores	\$56,787,910	\$59,216,569	(\$2,428,659)
Electronics and Appliance Stores	\$101,017,618	\$98,052,317	\$2,965,301
Bldg. Materials & Garden Equip. & Supplies	\$140,860,553	\$85,669,688	\$55,190,865
Food and Beverage Stores	\$276,418,598	\$351,966,400	(\$75,547,802)
Health and Personal Care Stores	\$128,636,646	\$115,827,907	\$12,808,739
Gasoline Stations	\$101,849,372	\$106,238,153	(\$4,388,781)
Clothing and Clothing Accessories Stores	\$93,278,009	\$127,009,436	(\$33,731,427)
Sporting Goods, Hobby, Book, & Music Stores	\$42,800,848	\$53,614,538	(\$10,813,690)
General Merchandise Stores	\$596,563,231	\$281,017,181	\$315,546,050
Miscellaneous Store Retailers	\$117,810,573	\$89,856,310	\$27,954,263
Food Services and Drinking Places	\$171,108,751	\$197,292,868	(\$26,184,117)

Source: ESRI Community Analyst, 2015 retail market place data in 2016 geography.

Urban Decay Analysis

This section defines urban decay, describes the analysis methodology and assumptions, and evaluates the potential impact of the Lincoln Landing Project and other known major retail projects on the Trade Area retail market. The results of this analysis are used to evaluate the degree to which the potential impacts might result in the physical deterioration of the environment within the Trade Area and examine whether local retail has the potential to start an economic chain reaction that leads to physical deterioration and urban decay.

Urban Decay Description and Assumptions

Urban decay is a physical effect that can result from extended vacancy, deferred maintenance, and abandonment. In its study entitled *Supercenters and the Transformation of the Bay Area Grocery Industry: Issues, Trends, and Impacts*, the Bay Area Economic Forum describes the process as follows:

“Vacant buildings, along with their large parking lots, can attract litter, graffiti, and vandalism, as well as loiterers and homeless population. A decaying building both worsens its own prospects for refurbishment and weakens the vitality of the buildings around it.”

The primary impetus of urban decay often stems from financial conditions faced by the individual property owners; if a landlord is unable to collect rent on a vacant property with minimal likelihood that it can be re-leased, s/he may lose the incentive to maintain it. The effect can spread to adjacent properties and become a self-fulfilling prophecy as customers start to avoid an area and other property owners or tenants perceive an area as no longer vital or safe. Urban decay can be reinforced by a reduction in the fiscal resources of local governing entities because of declining sales and property revenue.

The urban decay process generally takes a number of years to fully materialize and is reinforced by declining economic conditions in a broader area. It is generally not the result of a single property standing vacant for one or two years in an otherwise vibrant market.

It is worth noting that a freestanding big box retail building that has been abandoned (known as a “ghost box”) or declining regional shopping center (known as a “grayfield”) can pose a particularly high risk for urban decay if not promptly re-leased. Not only are these facilities bigger and thus generally more difficult to quickly re-lease or reuse compared to smaller “infill” sites, they are also more visually significant and thus provide a more widespread signal of decay and negative business climate. In contrast, areas with a number of smaller parcels (e.g., downtowns) with varied building types often have a better chance of being adapted and re-leased.

Given the multi-faceted nature of urban decay, its prospects for likelihood can be difficult to predict or quantify with precision. This analysis focuses on three indicators to assess its probability:

- 1. Existing Condition of Retail Sector:** All other things being equal, a weak or faltering retail sector will be more susceptible to urban decay. Conversely, a new competitive retail project is less likely to precipitate urban decay if existing market conditions are strong. As described previously, the Hayward retail market is currently in a very strong position.
- 2. Incidence, Duration, and Size of Sales Shift and/or Vacancies:** Urban decay is more likely if a new competitive project results in a relatively large and prolonged shift in retail sales away from existing establishments or high and extended periods of vacancy. Although there is no absolute rule, generally speaking, a shift in retail sales away from existing establishments within a Trade Area of greater than 10 percent and lasting three to five years may be large enough to lead to the physical abandonment of buildings. Most establishments can usually withstand a temporary sales shift of 5 to 7 percent over a three- to five-year time frame, as this is equivalent to a typical business cycle downturn. Likewise, market-wide vacancy rates of greater than 10 percent and lasting longer than five years can be difficult to sustain without seeing some symptoms of urban decay.
- 3. Attributes and Reuse Options of Affected Properties:** The type, location, and parcel configuration of affected properties as well as the range of potential reuse options will also play a role in their susceptibility to urban decay. As noted above, an abandoned “ghost box” poses a particularly strong risk for urban decay because of the difficulty in finding an appropriate replacement tenant. Given the size and configuration of the big box center, finding viable replacement uses can be difficult and prolonged.

Potential for Urban Decay

Methodology

The proposed Lincoln Landing will potentially capture retail sales from three major sources:

1. New demand from households and employment growth in the Trade Area.
2. Demand that has been historically "leaked" to establishments outside the City.
3. Demand historically captured by existing establishments in the Trade Area.

The economic impact of the Project will depend upon the degree to which these three sources of demand are captured. To the extent that the Project captures newly created demand, or demand currently leaking outside the City of Hayward, the retail market impact on existing establishments will be minimized. However, negative retail market impacts may result if the Project captures sales from within the Trade Area that were formerly supported by existing retail establishments.

It is likely that a portion of the Trade Area residents will continue to shop elsewhere; however, this leakage is generally assumed to be offset by expenditures of non-Trade Area residents who would potentially be attracted to Hayward because of the addition of the Lincoln Landing Project.

Project-Specific Impacts

As an initial step, EPS has evaluated the retail market impact of the Lincoln Landing Project independently from other retail projects in the pipeline. The Project will contribute approximately 1 percent of additional retail space to the Trade Area. The retail in the Project is expected to add approximately 80,500 square feet of retail space and approximately \$36 million in annual retail sales to the Trade Area.

Based on the methodology and assumptions described above, the impact of the Project on the Trade Area retail sales in 2016 is estimated in **Figure 6**. As shown, while the Project would capture 27 percent of new demand associated with population and employment growth in the Trade Area, additional retail demand would exist during this time period. This suggests that to the extent that Lincoln Landing is the only new Project to enter the market in the next five years, it would not likely result in a significant shift from existing establishments in the Trade Area even without capturing any of the existing leakage. In other words, property owners and tenants are likely to continue experiencing an economic incentive to maintain their businesses (and properties) with the expectation that longer-term market trends are likely to be favorable.

Figure 6 Project's Trade Area Impact

Item	Total
Lincoln Landing Sales	\$36,225,000
New Sales from Trade Area Growth	\$132,823,464
Project as Percent of Trade Area Demand	27%

Sources: Economic & Planning Systems, Inc.

Project-Specific Impacts with Pipeline Projects

There is a number of under-construction, approved, and proposed retail projects in the Trade Area's pipeline. While the timing and development of approved and proposed projects is uncertain, total pipeline projects excluding Lincoln Landing are likely to add 78,754 square feet new retail supply to the Trade Area within the next several years. This retail space, in addition to the Lincoln Landing Project, is only estimated to capture 54 percent of the demand associated with new household and employment growth as shown in **Figure 7**. This means that there is likely to be no net shift in retail sales away from existing establishments.

Figure 7 Projects Impact with Total Pipeline

Item	Total
Retail Sales	
Lincoln Landing Sales	\$36,225,000
Sales from Other Pipeline Projects	<u>\$35,439,300</u>
Subtotal	\$71,664,300
New Sales from Trade Area Growth	\$132,823,464
Total Pipeline as Percent of Trade Area Demand	54%

Sources: Economic & Planning Systems, Inc.

Given that 46 percent of estimated retail demand growth is not expected to be captured by pipeline retail, it is likely that existing retailers will realize net gains in their sales. It is also possible that the Project can address some of the current leakage in certain sales categories from the City without relying on increased growth in retail demand from new residents and employees. Though the Lincoln Landing Project is not as large as a typical regional retail center, its proximity to highways 238 and 580 offers the potential to draw customers from outside the Trade Area should the tenant mix include a highly popular retailer or an unique experiential retail atmosphere.

Conclusion of Project Impacts

EPS has shown that the Lincoln Landing Project, along with pipeline projects will not capture all demand from leaked retail sales or Hayward's growing population or employment. This indicates that the Project's retail is unlikely to significantly reduce sales in existing retail spaces. Even if the Project's retail did replace some existing retail, it is unlikely that the retail space would remain vacant on a long-term basis given the current strong demand for retail in the Trade Area. Urban decay is a condition of buildings remain vacant long-term and eventually deteriorating. With a retail vacancy rate as low as 2 percent, Hayward is unlikely to experience urban decay. According to the Project's EIR, the existing vacant building has been subject to graffiti and squatting, so the development of the site should actually serve to ameliorate an existing "ghost box," and a large share of commercial office vacancies in the City, thus improving an existing condition of urban decay in Hayward.