



**COMPREHENSIVE
ECONOMIC
DEVELOPMENT
STRATEGY UPDATE
AND STUDY SESSION**

CITY COUNCIL ITEM #2

FEBRUARY 13, 2023

www.cityofpaloalto.org



COMPREHENSIVE ECON. DEV STRATEGY

- Economic Development remaining a City Council Priority
 - Development of Comprehensive Economic Development Strategy is foundational to this continued priority
 - Focus the ongoing efforts and provide a roadmap for future investments
 - Various other elements of the priority can be better pursued as part of overall strategy
 - Streetsense here to discuss their findings through their research – presented as ‘diagnostic’



CITY OF
PALO
ALTO

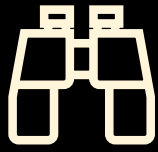
PHASE 2 DELIVERABLE

PALO ALTO ECONOMIC DEVELOPMENT STRATEGY DIAGNOSTIC

PREPARED FOR PALO ALTO, CA
FEBRUARY 13, 2023

STREETSENSE





01 PROJECT OVERVIEW

PROJECT TIMELINE

Before advancing to a discussion of strategic interventions, the Diagnostic phase of this exercise ensures that we share a collective understanding of the challenges at hand. This milestone is important to establish consensus for action and precedes a discussion of recommendations that will be led or supported by public sector investments, policies and programs.

We are here



IMMERSION & DISCOVERY

- Kick off session
- Field work
- Stakeholder engagement
 - Focus groups and interviews with business owners, hotel operators, residents, City Staff
- Council presentation

DIAGNOSTIC

- Retail market analysis
- Administrative capacity assessment
- Business environment assessment
- Physical assessment
- Coordination with California Ave/Ramona St Consultant
- Council presentation

ECONOMIC DEVELOPMENT STRATEGY

- Draft work plan development
- Final work plan development

IMMERSION & DISCOVERY/DIAGNOSTIC

STUDY PURPOSE

- To develop a market-informed economic development strategy that will ensure Palo Alto's post-COVID competitiveness by identifying impactful public sector interventions, policies and investments for which there is both need and consensus for action.

TODAY'S PURPOSE

- Present and Discuss Diagnostic Findings
- Confirm alignment on key take aways and guiding principles before advancing to recommendations



MARKET ASSESSMENT

- Competition Assessment
- Retail Demand Assessment



ADMINISTRATIVE CAPACITY

- Regulatory Framework
- Organizational Capacity & Stewardship



BUSINESS ENVIRONMENT

- Sales Tax Analysis
- Hospitality/ Tourism Assessment



PHYSICAL ENVIRONMENT

- City-Wide Connectivity & Accessibility
- District SWOT Analysis



STUDY AREAS

The diagnostic focuses on areas within Palo Alto where this is an existing concentration of retail activity.

REGIONAL/SUPER-REGIONAL CENTERS

DOWNTOWN & STANFORD SHOPPING CENTER

- most significant tax base contributors
- face the greatest competition for visitors within the region
- must maintain "best-in-class" status to remain competitive

COMMUNITY-SERVING CENTERS

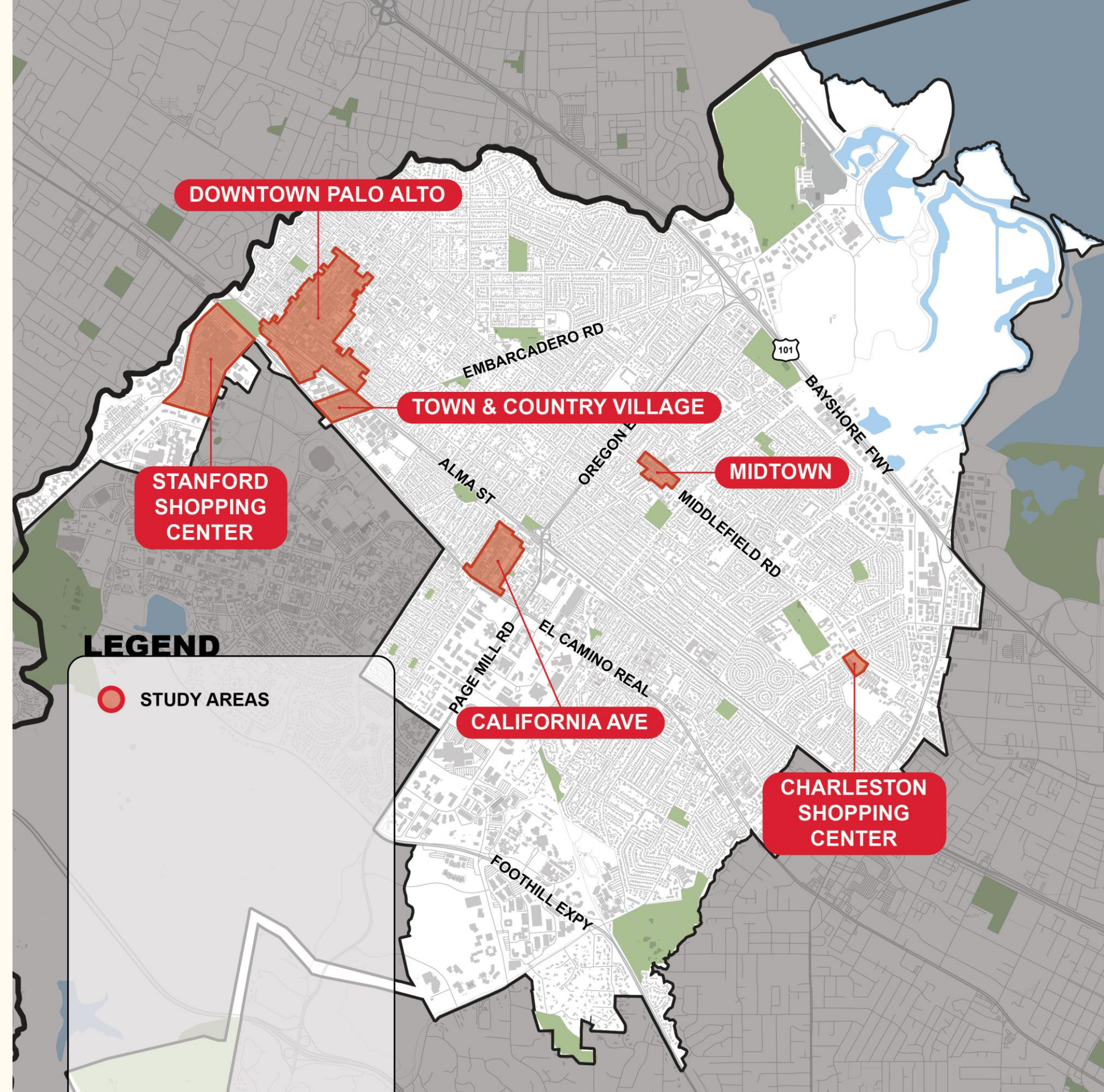
CALIFORNIA AVE & TOWN & COUNTRY VILLAGE

- moderate tax base impacts
- local promotion and marketing strategies, if any
- tend to benefit from activations that meet community interests and needs

NEIGHBORHOOD-SERVING

MIDTOWN & CHARLESTON SHOPPING CENTER

- minimal tax base impacts
- least affected by COVID pandemic, typically the most stable asset class
- local customer base with little need for promotion



IMMERSION & DISCOVERY/DIAGNOSTIC

THE RETAIL ECOSYSTEM



IMMERSION & DISCOVERY/DIAGNOSTIC

THE RETAIL ECOSYSTEM

Where does the public sector play a role in influencing or directing the actions of key stakeholders?

PUBLIC SECTOR TOOLS

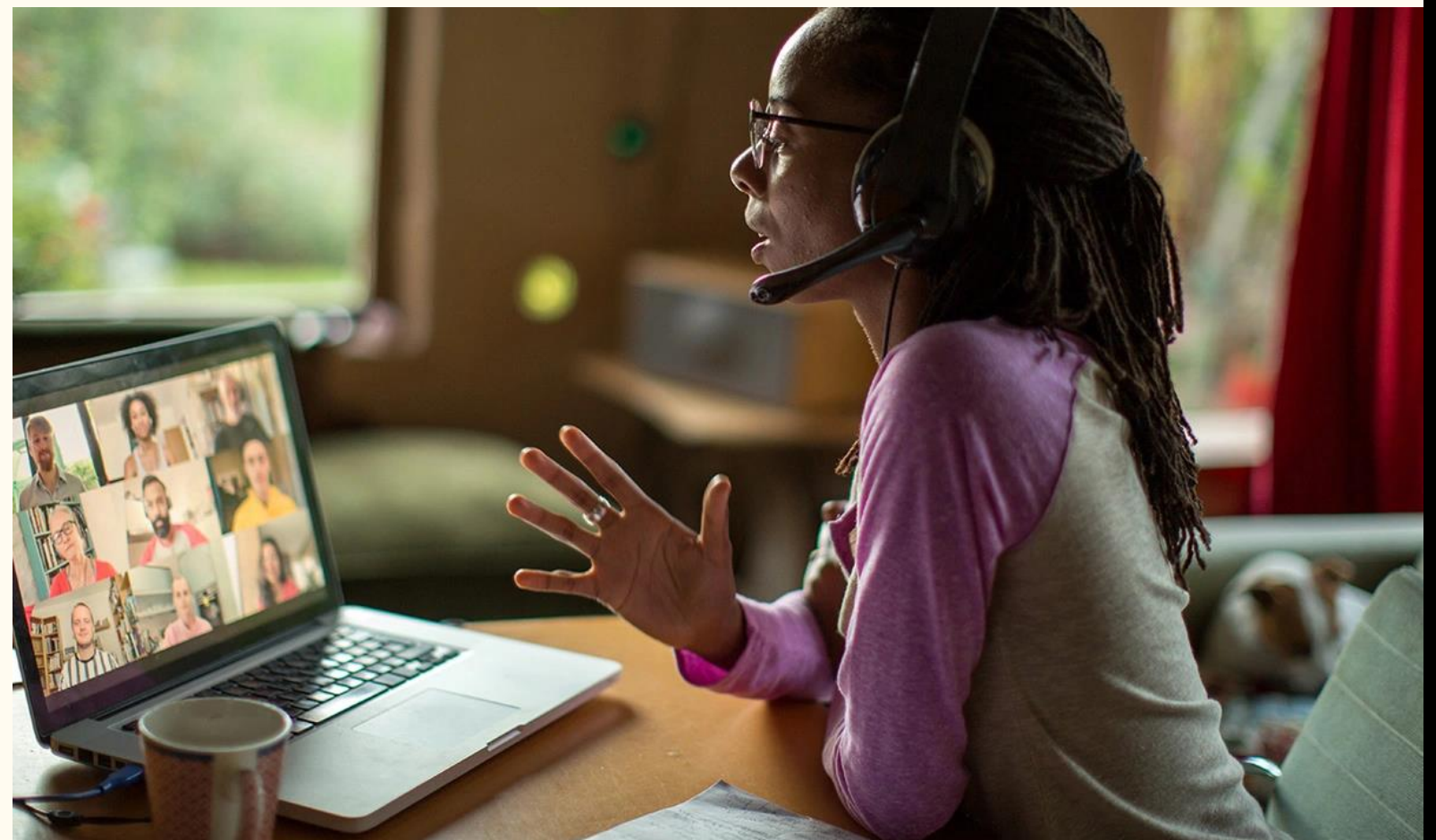
- Regulatory framework influences co-tenancy
- Financial incentives can help mitigate risk
- Funding and coordination of events to build community
- Investments in enhanced safety/cleanliness
- Improvements to access/convenience
- District marketing & branding campaigns
- Investments in public realm to improve sense of place





GLOBAL AND NATIONAL TRENDS

- Changing retail footprints
- Changing spending patterns
- Tenants are in the driver's seat
- Implications of hybrid work





03

RETAIL MARKET ASSESSMENT

- METHODOLOGY & APPROACH
- COMPETITION ASSESSMENT
- RETAIL DEMAND ASSESSMENT



COMPETITION ASSESSMENT

Given the urban-suburban typology of the Palo Alto market, retail competition for the site is measured on two levels – locally-serving neighborhood centers for convenience-based trips and regionally-serving destination hubs for experience-based trips. Retail customer behaviors are rooted in convenience, access, and visibility as well as tenant quality and variety of offerings. These factors are considered when assessing the market influence of each retail competitor.

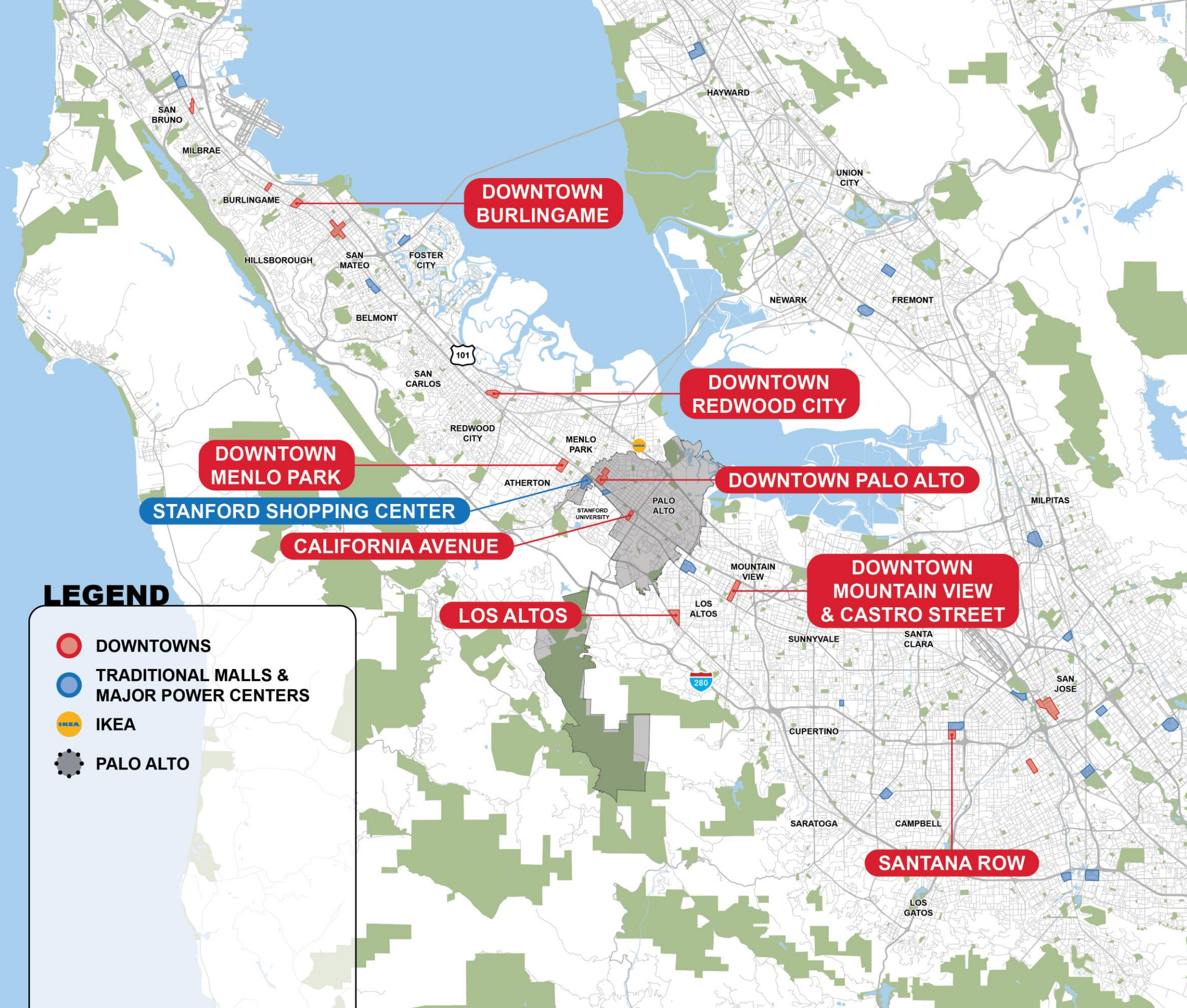


Retail market assessment:
REGIONAL RETAIL COMPETITION

Regionally-serving, experience-based retail centers are characterized by a dominant mix of good-based retail, including malls, power centers, and walkable downtowns and lifestyle centers.

TAKEAWAYS

- Two competing downtown environments within Palo Alto, Downtown/University Ave and California Ave, **spreading retail thin.**
- Stanford Shopping Center is the top performing shopping destination in the region, however, it cannibalizes retail in other districts.
- High vacancies on California Ave and Downtown Palo Alto are exacerbated by high rents and less desirable retail spaces.
- Retail rents in the region are high. The **average asking rent in Palo Alto is \$63.52 per SF** – 80% higher than the national average of \$27.55 per SF.*





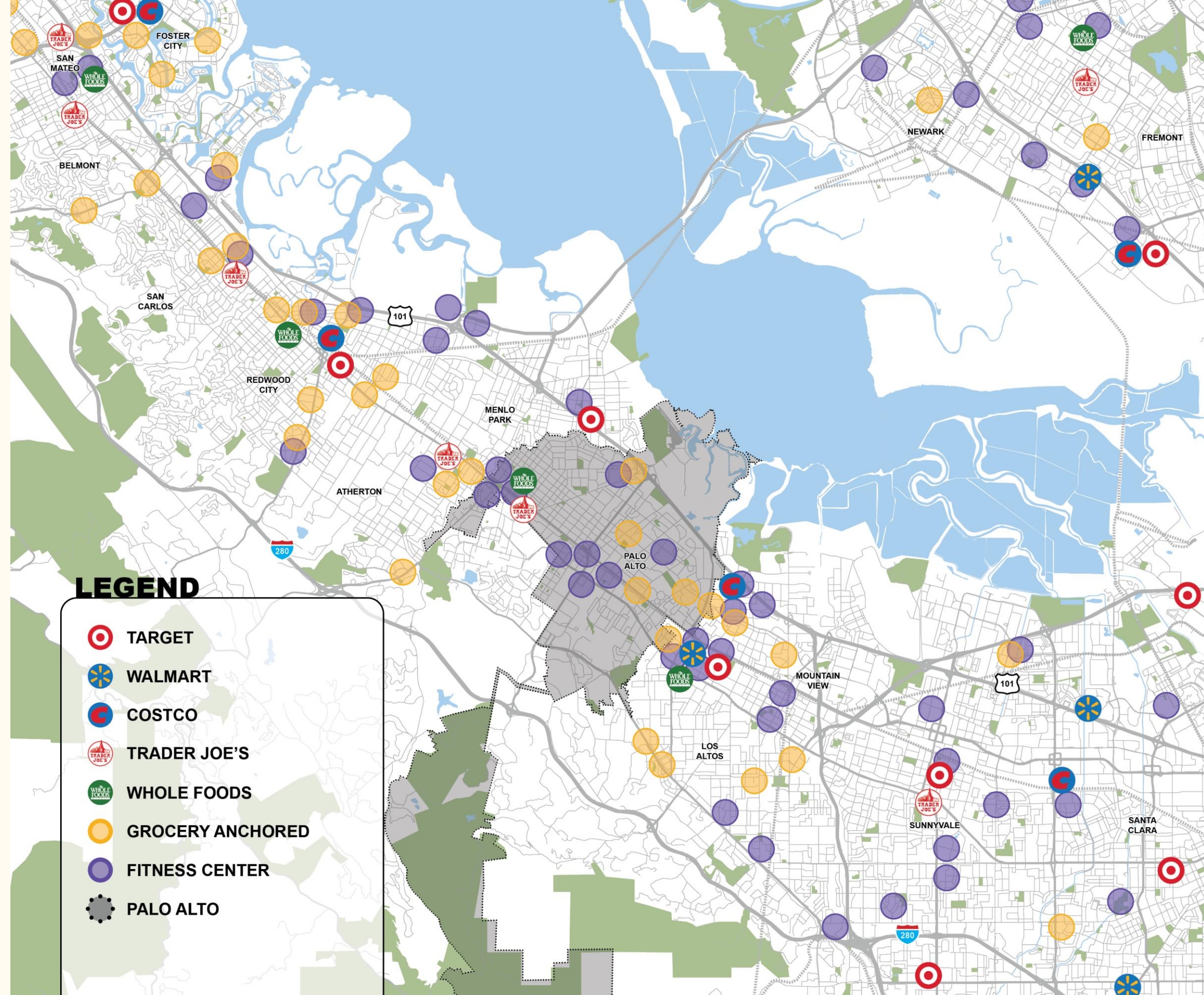
Retail market assessment:
LOCALLY-SERVING RETAIL COMPETITION

Neighborhood serving retail centers are characterized by a dominant mix of Neighborhood Goods & Services tenants, often grocery-anchored.

TAKEAWAYS

- Grocery competition is strong throughout the region.
- Big box retailers are not allowed in Palo Alto by regulation. However, they are concentrated along the periphery of Palo Alto, **cannibalizing the retail offering within the city.**
- Target and Costco are particularly prevalent in the region, with nine and seven stores, respectively within the examined area.

Source: Streetsense analysis Q4 2022.





RETAIL DEMAND ASSESSMENT



Retail market assessment: **TRADE AREAS**

Based on the competitive landscape, natural and psychological boundaries, travel patterns, and population trends, Streetsense defined the following trade areas:

PRIMARY TRADE AREA

Users: Palo Alto residents, employees, students, overnight guests, and daytime visitors

Frequency: High - at least once or twice per week

Purpose: Convenience-based shopping and dining

SECONDARY TRADE AREAS

Users: Nearby residents (Mountain View, Los Altos, Menlo Park, Redwood City)

Frequency: Modest - once or twice every two weeks

Purpose: Change up from options closer to home, work, or school

TERTIARY TRADE AREAS

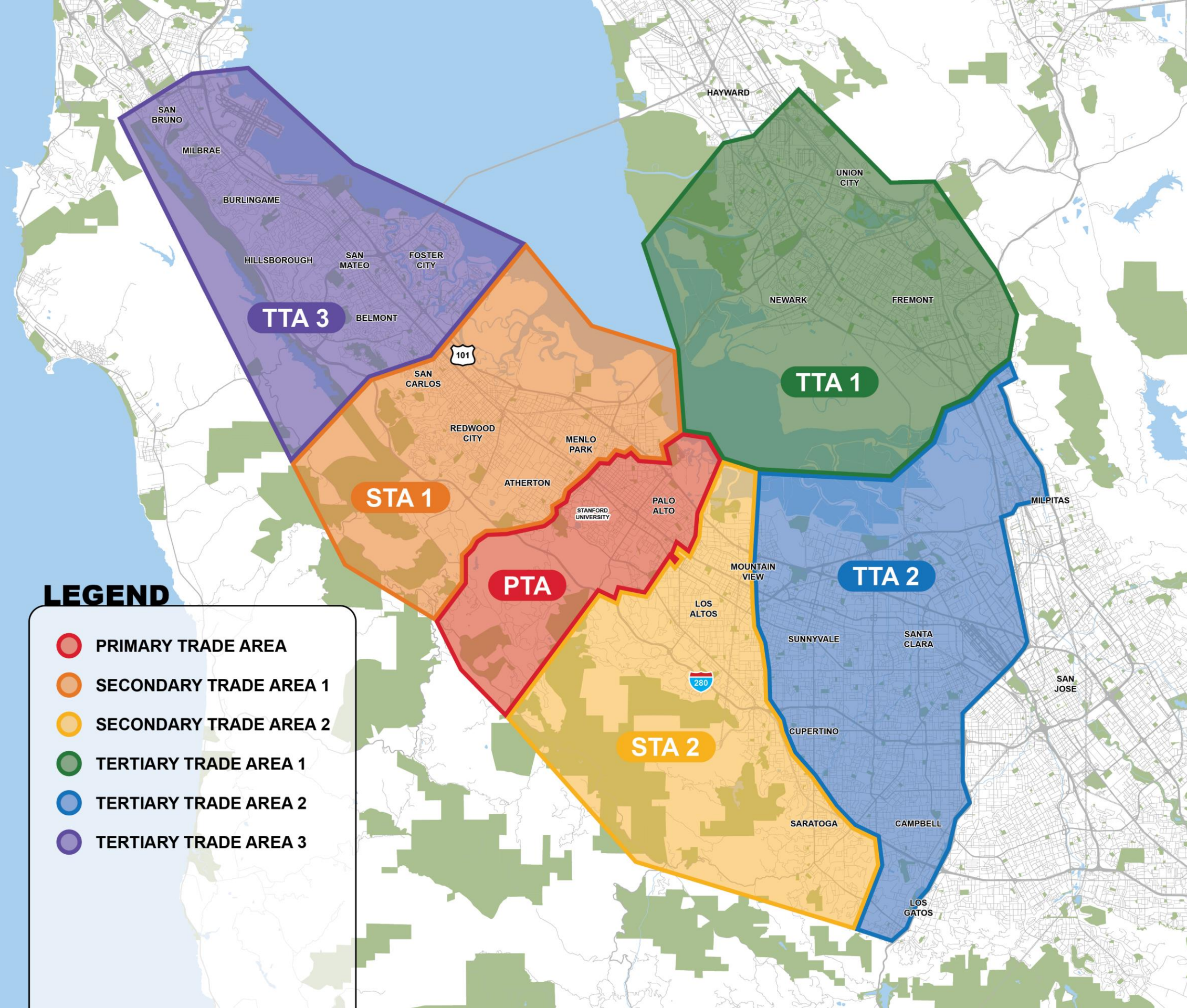
Users: Regional residents (San Mateo, San Bruno, Burlingame, Sunnyvale, Santa Clara/Western San Jose, Fremont, Newark)

Frequency: Low - once or twice every month

Purpose: Experience-based shopping and dining

LEGEND

-  **PRIMARY TRADE AREA**
-  **SECONDARY TRADE AREA 1**
-  **SECONDARY TRADE AREA 2**
-  **TERTIARY TRADE AREA 1**
-  **TERTIARY TRADE AREA 2**
-  **TERTIARY TRADE AREA 3**





Retail market assessment:

SHIFTS IN DEMAND POST-COVID

114,826

Total employees working within Palo Alto

69,889

Non-office-based employees working within Palo Alto

44,937

Office-based employees working within Palo Alto

37% of office-based employees are going into an office (San Jose metro area)

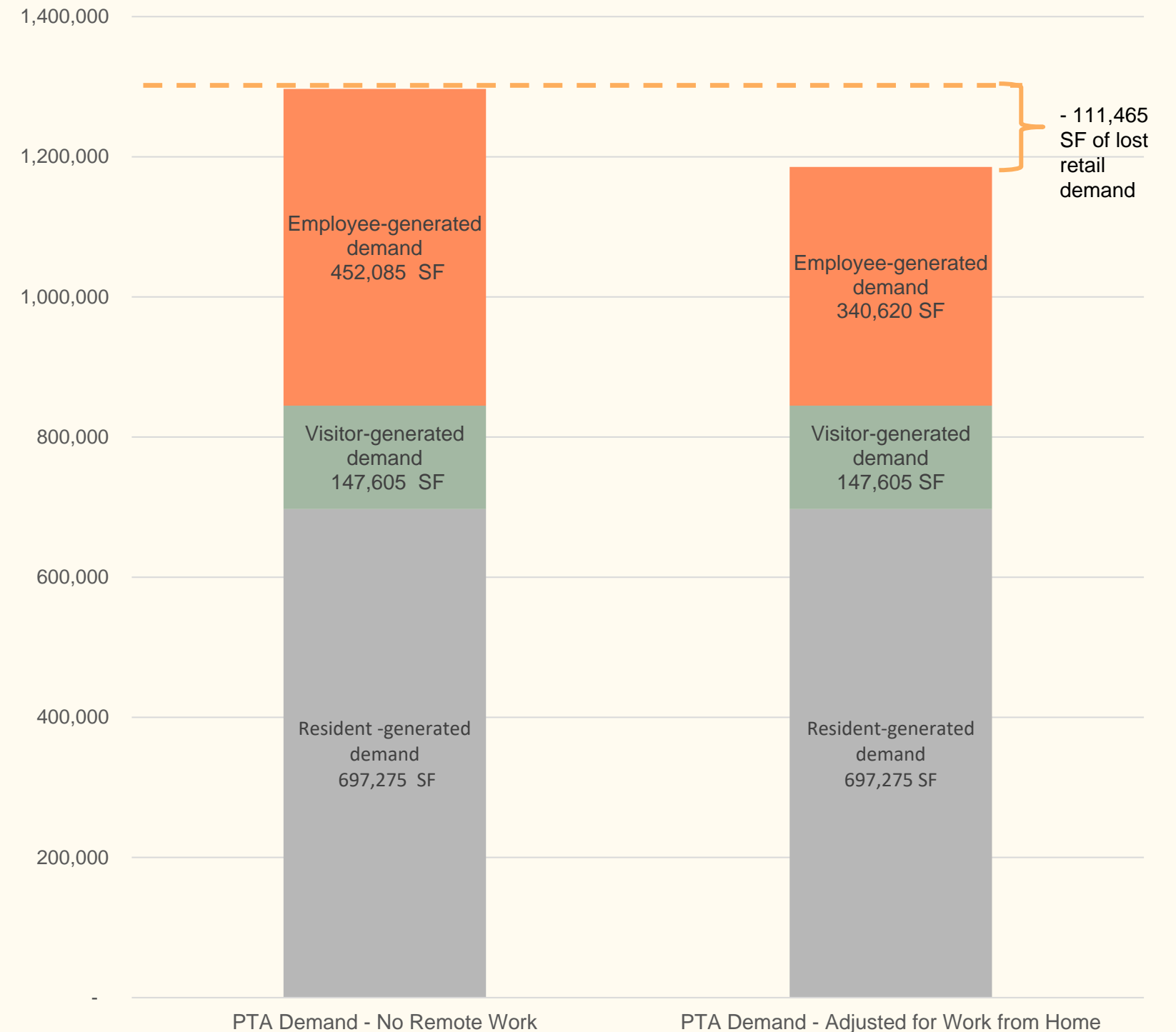
In Palo Alto, **hybrid work has reduced the demand for retail by over 100,000 SF**, roughly equivalent to the amount of retail space at Midtown and Charleston Shopping Center combined.

TAKEAWAYS

- Palo Alto's daytime population can no longer support the same level of retail it did pre-covid, with fewer shoppers coming from Stanford Research Park and other office-centric areas to generate foot traffic during the work week
- Shifts in daytime population and the balance between residents and employees require a **right-sizing of retail**

Source: Sitewise, 2022; Bureau of Labor Statistics 2022; Kastle Systems 2022.

PTA Retail Demand Hybrid Work Scenario - 2022





Retail market assessment: **DEVELOPMENT PIPELINE**

Significant development pipeline in the surrounding markets.

At full build out, these projects will add:

17,700 residential units

15.8 million SF of office/life science space

2,300+ hotel keys

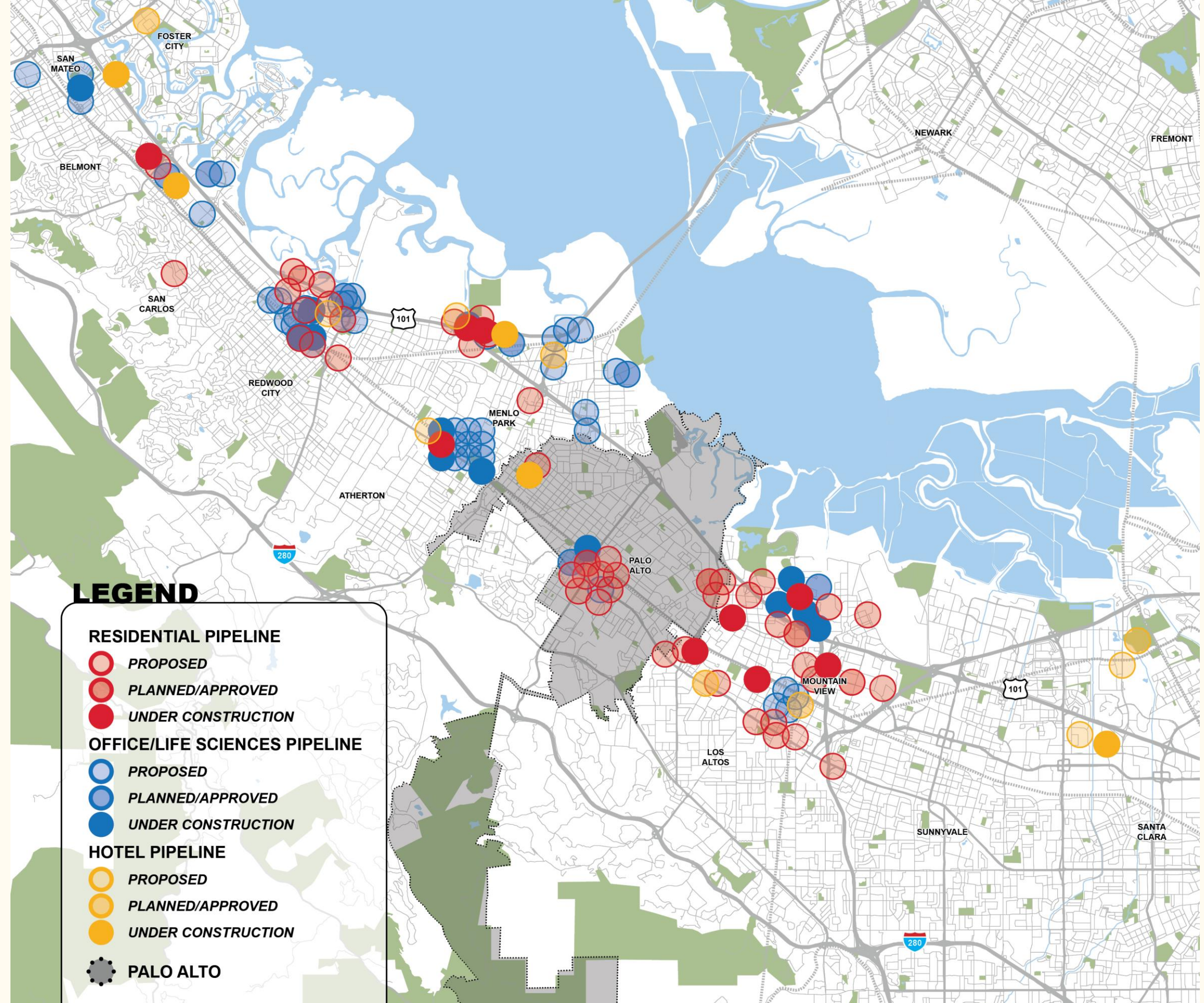
TAKEAWAYS

- Menlo Park, Redwood City, and Mountain View have robust office/life science pipelines, growing density and building future daytime populations.
- Fueling the retail ecosystem - density and daytime populations drive retail spending, thereby growing retail demand.
- Retail in districts like California Ave would benefit from increased density and daytime populations

* Map shows multi-family residential developments over 50 units and office/life sciences developments over 25,000 SF

Source: Moody's Analytics, 2022.

STREETSENSE





Retail market assessment:

RETAIL DEMAND PROJECTIONS

Based on resident, employee, overnight guest, and daytime visitor spending, local and regional competition, and projected population growth, the site can support the following:

2,571,970 SF

Total retail demand in 2022

2,627,980 SF

Total retail demand in 2027

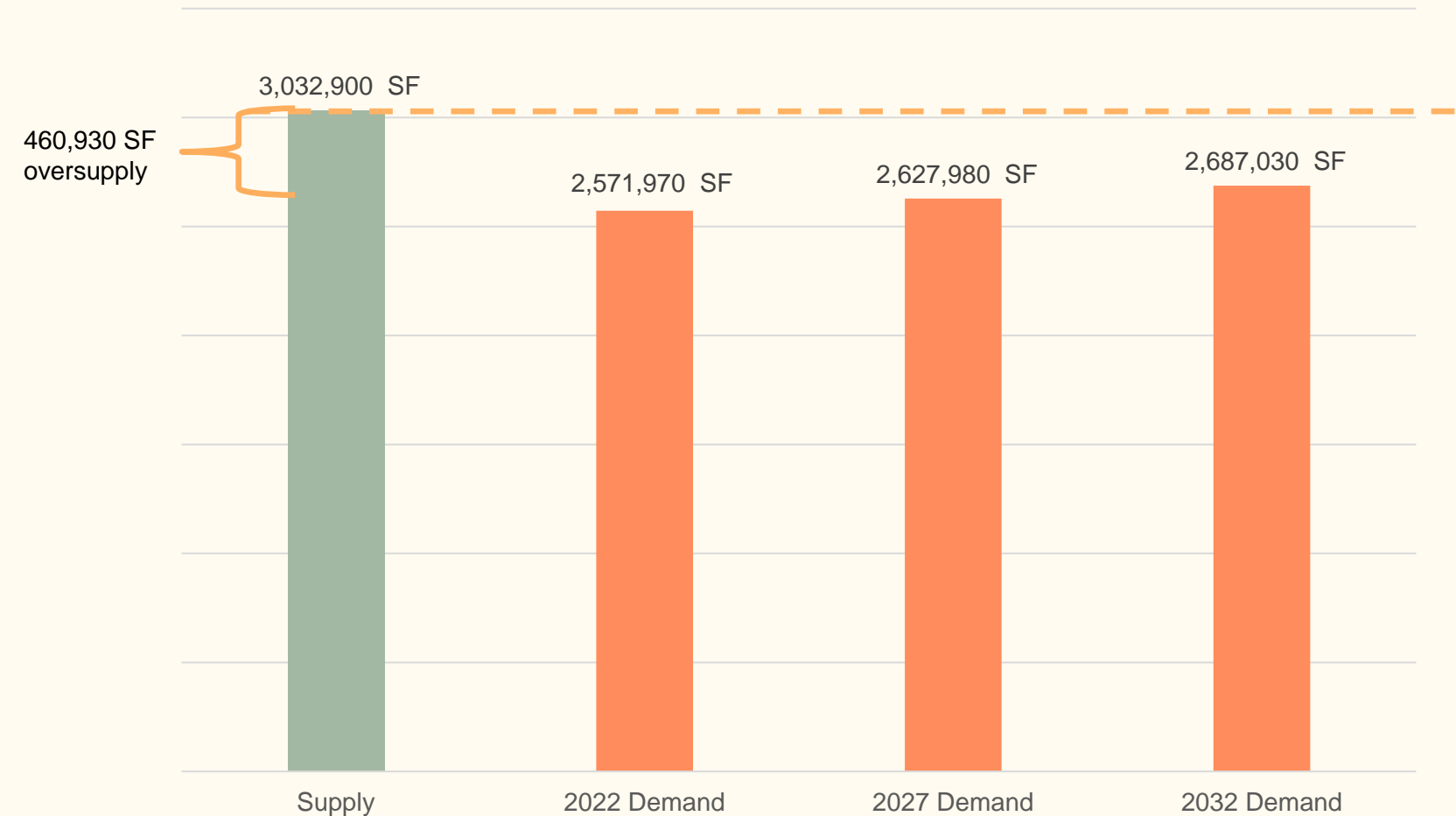
2,687,030 SF

Total retail demand in 2032

TAKEAWAYS

- **Retail needs to be right-sized** -- Retail demand will steadily increase however, without intervention, demand will not reach parity with the existing retail supply over the next 10 years
- **Oversupply > vacancy**, indicating that **vacancy will continue to rise** among lower quality or poorly positioned space
- Potential interventions to the retail ecosystem –
 - **Broadening the mix of uses to increase daytime customer base** with office and residential uses
 - **Supplementing with non-traditional retail** uses like entertainment, civic, and cultural uses to activate the ground plane

Retail Supply and Demand Projections



Source: Michael Baker; Streetsense analysis 2022.



04 BUSINESS ENVIRONMENT

- SALES TAX ANALYSIS
- HOSPITALITY/ TOURISM ASSESSMENT



SALES TAX ANALYSIS

- NATIONAL AND LOCAL SALES TAX REVENUE TRENDS
- FOCUS AREA SALES TAX REVENUES
- COMPETING CITIES
- KEY TAKEWAYS



Business environment:

LOCAL SALES TAX REVENUE TRENDS

Small, locally owned businesses were the hardest hit during the COVID-19 Pandemic, particularly restaurants, retailers and personal service providers.

Common economic influences/conditions include:

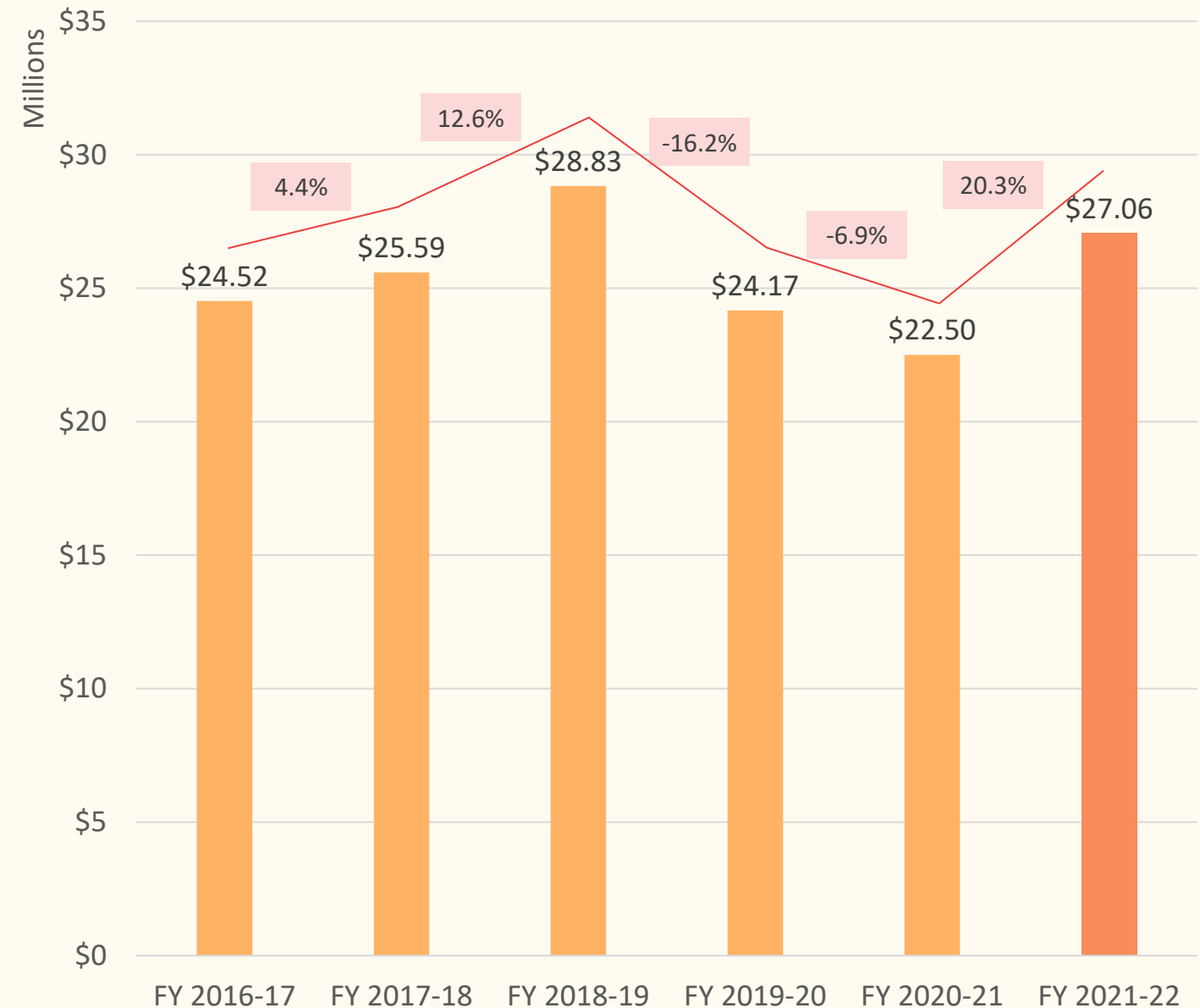
- Inflation and increasing costs of doing business
- Supply chain and manufacturing disruptions
- Employment/ labor shortages
- Shift to online shopping
- COVID-19 safety protocols and compliance
- Interest rates rising

Palo Alto’s total FY 2021-22 sales tax revenues increased by 20% from FY 2020-21. FY 2021-22 revenues were still 6% below pre-pandemic sales tax in FY 2018-19. CPI-U for the San Francisco Area increased by 4.9% from the 12 months prior to December 2022.

TAKEAWAYS

While sales tax recovery is important, it's not a true reflection of recovery and profitability of small businesses. Sales Tax revenues are mostly back to pre-pandemic (FY 2018-19) numbers by the end of FY 2021-22, but many small, locally owned businesses are not back to pre-pandemic cash flow and required revenue margins.

City of Palo Alto Sales Tax Revenue by Fiscal Year*



*The graphic above is representative of sales tax revenues by Fiscal Year for all sales tax producing businesses in Palo Alto. Sources: HdL Companies; bls.gov



Business environment:

FOCUS AREA SALES TAX REVENUES BY FISCAL YEAR

Neighborhood focused areas produce a low amount of sales tax relative to the other shopping areas and there is a higher volume of essential stores like grocery stores, markets, pharmacies, etc. Combined, Charleston and Midtowns made up about 1% of the City's total sales tax revenue in FY 2021-22.

Downtown Palo Alto, which makes up 12% of total sales tax revenue in the City, has been the slowest to recover from the Pandemic. Downtown FY 2021-22 sales tax revenues are 25% below pre-Pandemic FY 2016-17 sales.

California Avenue makes up 2.2% of total sales tax in the City. Sales tax on California Avenue is 12.8% below pre-Pandemic sales in FY 2018-19, and 9% below FY 2016-17.

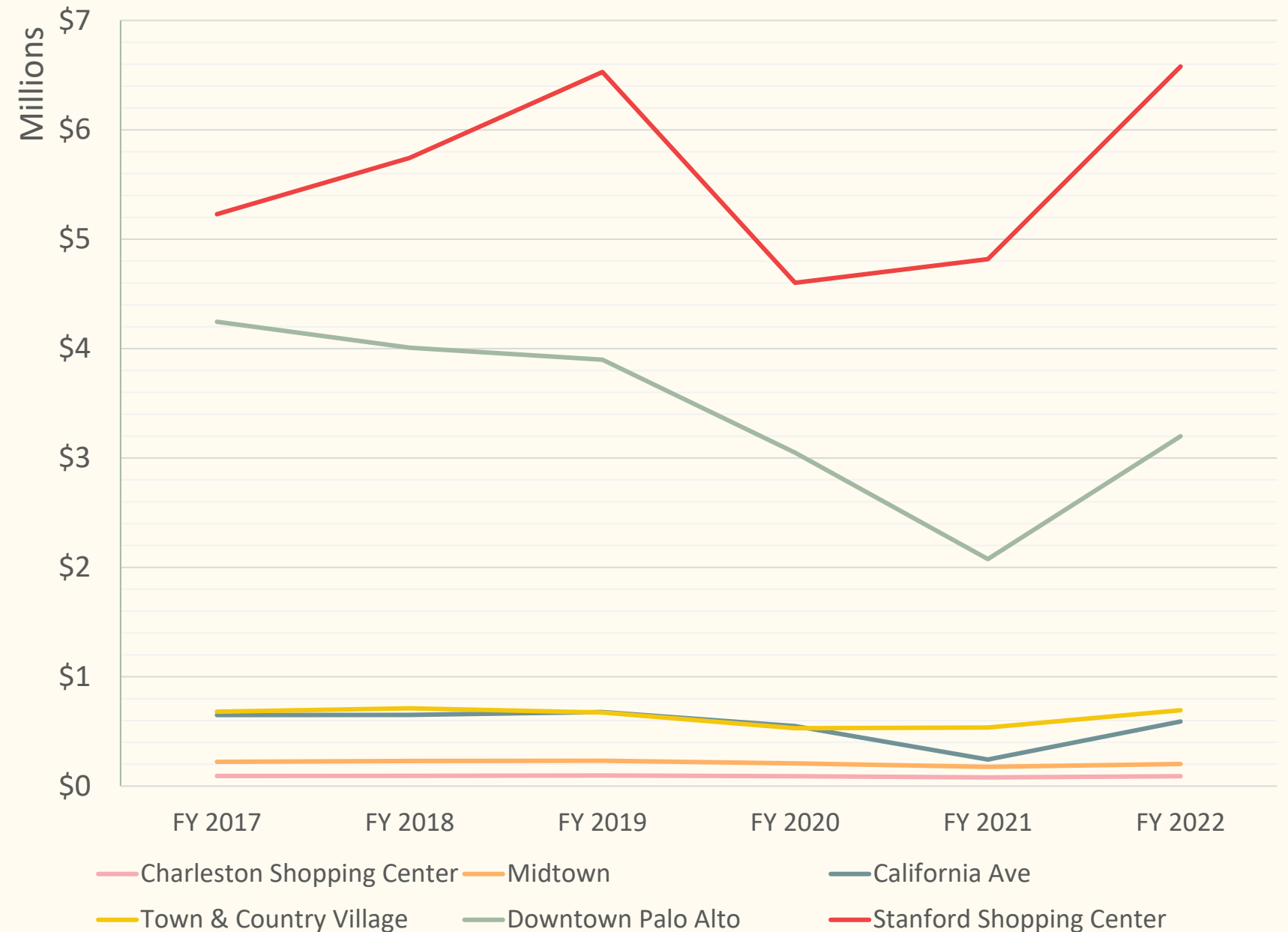
Town & Country Village experienced a 21% decrease in sales tax in FY 2019-20, though the shopping area is recovering from the Pandemic. Town & Country Village sales tax make up 3% of the total sales tax revenue in Palo Alto for FY 2021-22.

Stanford Shopping Center FY 2021-22 sales were 25% above pre-Pandemic FY 2016-17 sales tax revenues. Stanford Shopping Center makes up 25% of total sales tax revenue, mainly from retail sales.

TAKEAWAYS

- Total sales tax revenues are bouncing back from the Pandemic, but recovery from the COVID-19 Pandemic is uneven across key tax generating districts and the local economy is not fully recovered.
- Sales tax revenues in the neighborhood shopping areas, Charleston Shopping Center and Midtown, were the least impacted during the Pandemic.
- Downtown sales tax has been in a decline since before the Pandemic, but the Pandemic exacerbated the situation.

Sales Tax Revenues for Fiscal Years 2016-17 to 2021-22



Source: HdL Companies



Business environment:

FOCUS AREA SALES TAX REVENUES BY RETAIL CATEGORY FISCAL YEAR 2021-22

Neighborhood Goods & Services (NG&S)

NG&S makes up 4% of total sales tax revenue for the six focus districts (2% of total sales tax for the City of Palo Alto). Most NG&S businesses are not big sales tax producers (I.e., personal services, grocery stores, gyms). For example, Grocery Store taxable sales are roughly 25-30% of their total sales.

Food & Beverage (F&B)

F&B makes up 27% of total sales tax revenue for the six focus districts (11.4% of total sales tax for the City).

General Merchandise, Apparel, Furniture & Other (GAFO)

GAFO makes up 58% of the total sales tax revenue for the six focus districts (24% of total sales tax for the City).

Non-Retail

Non-retail sales tax revenue in the six focus areas include automotive sales, automotive rentals and repairs, business services, medical/biotech, and textile / furnishings. Non-retail makes up 11.4% of total sales tax revenue for the six focus districts (4.8% of total sales tax for the City).

TAKEAWAYS

- Charleston Shopping Center and Midtown show the highest percentage of NG&S relative to the total sales tax revenue in those shopping districts (40% and 54%, respectively).
- Downtown Palo Alto produces the highest value of F&B sales tax revenue
- Stanford Shopping Center and Downtown combined make up 95% up GAFO sales tax for the six focus areas (\$5.1M and \$1.1M, respectively).

District	Number of Businesses*	NG&S	F&B	GAFO	Non Retail	Totals
Charleston Shopping Center	10	\$36,161	\$23,525	\$30,590	-	\$90,276
Midtown	42	\$109,320	\$74,929	\$6,305	\$11,397	\$201,951
California Ave	99	\$56,322	\$437,306	\$38,449	\$58,149	\$590,226
Town & Country Village	59	\$87,101	\$328,968	\$274,874	\$3,237	\$694,180
Downtown Palo Alto	432	\$147,868	\$1,640,977	\$1,118,451	\$291,371	\$3,198,667
Stanford Shopping Center	151	\$5,980	\$574,954	\$5,063,008	\$934,975	\$6,578,917
District Total Sales by Category		\$442,752	\$3,092,536	\$6,531,677	\$1,299,129	\$11,354,217
Palo Alto Total Sales by Category		\$579,284	\$4,036,817	\$7,254,645	\$15,190,166	\$27,060,912

*Number of businesses is only representative of those that are sales tax producing. Non sales tax producing businesses not accounted for in this table may include offices, medical centers, certain business and personal services, and certain fitness centers or gyms.



Business environment:

COMPETING CITIES: RETAIL SALES DOLLAR PER CAPITA (SDPC) FISCAL YEAR 2021-22

Neighborhood Goods & Services (NG&S)

Palo Alto has the lowest NG&S SDPC, even lower than Burlingame and Los Altos who bring in less NG&S sales tax revenue compared to Palo Alto. Menlo Park has the highest SDPC in the NG&S category even though Redwood City and Mountain View receive a significantly higher amount of NG&S sales tax revenue.

Food & Beverage (F&B)

Palo Alto is doing better than most competing cities in bringing people to the City for F&B.

General Merchandise, Apparel, Furniture & Other (GAFO)

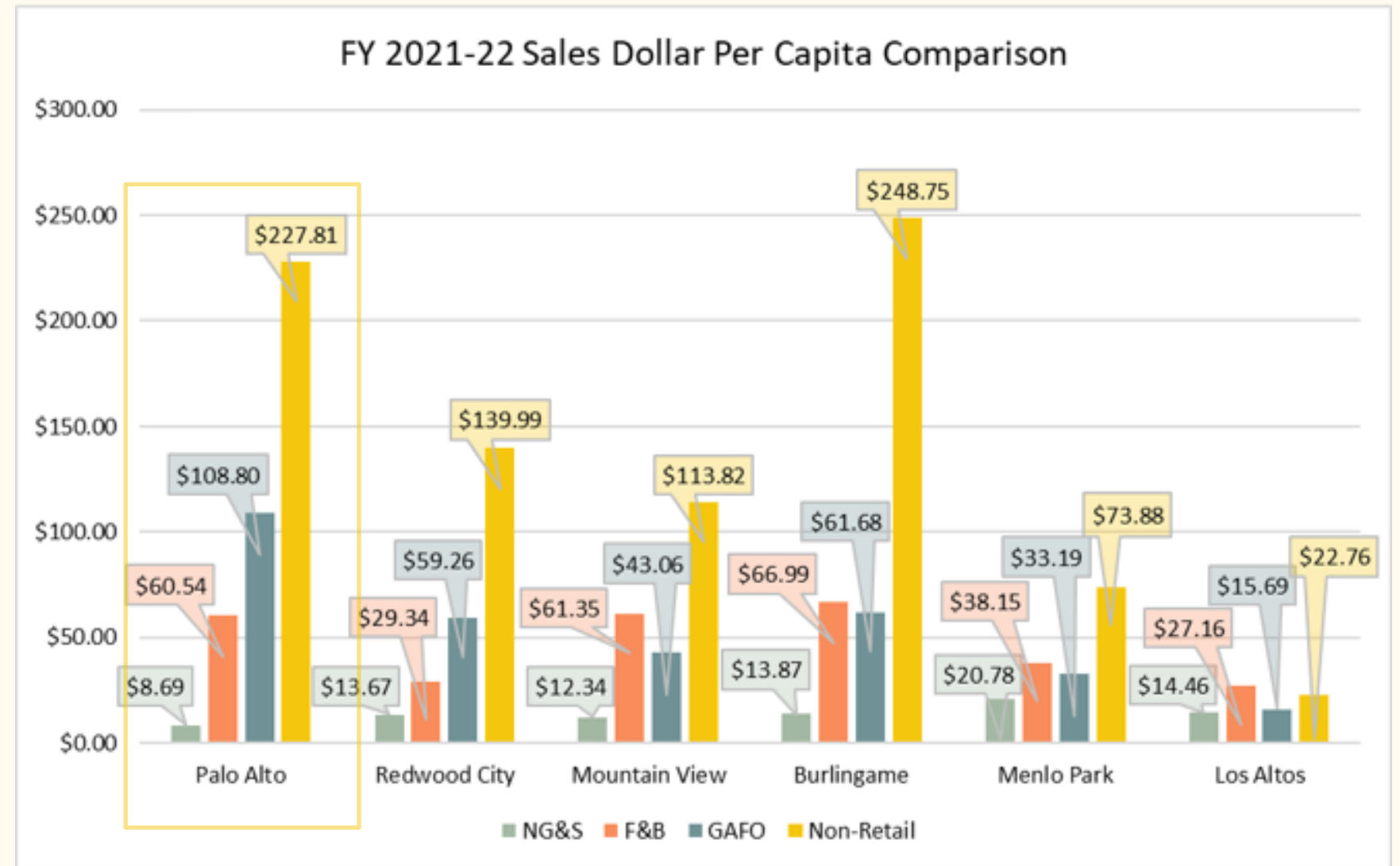
Palo Alto has the highest SDPC in the GAFO category, largely due to the Stanford Shopping Center.

Non-Retail

Burlingame has the highest SDPC in non-retail sales, which likely comes from the auto and transportation industry (new and used car sales, rentals, repairs, etc.).

TAKEAWAYS

- Palo Alto residents are likely shopping for neighborhood goods and services in competing areas.
- Palo Alto is likely bringing consumers from outside the area to shop for non-retail sales tax producing goods and services, like auto and transportation, as well as from the Stanford Research Park.



SDPC is a macro approach to identify possible trends within a city or region regarding to spending habits. Average SDPC is derived by multiplying out the 1% total point of sales tax dollars and then dividing them by the population size of their community.

- **Below Average:** Suggests resident do some shopping outside of the area; lack of local supply by preferred retailer and restaurant concepts
- **Above Average:** Suggest consumers from outside the area are attracted to the local retail market; have preferred retailer and restaurant concepts.

Source: HdL Companies



05

ADMINISTRATIVE ASSESSMENT

- REGULATORY ASSESSMENT
- ORGANIZATIONAL CAPACITY & STEWARDSHIP



REGULATORY ASSESSMENT



Administrative Capacity:
ZONING CODE BASICS

Municipal codes are often an accumulation of general controls that were used to solve specific problems in specific places including:

- Concerns over rising retail rents from use groups (i.e. office, chain stores, storage facilities, etc.) perceived as contributing to rent inflation for "more desirable" uses
- Rules that restrict uses with a low-income or transient customer base, like laundromats
- Concerns over “bad actors”, like bars and dance clubs



GROWTH IN ON-LINE SHOPPING	Retailers are using stores for local distribution, which may be restricted as “warehousing & distribution”
TECHNOLOGICAL ADVANCES	Breweries, specialty food manufacturing and maker spaces are restricted as “Manufacturing & Processing”
DEMOGRAPHICS AND LIFESTYLE	Wellness and medical services are restricted as “Medical Office”





Administrative Capacity:

OVERVIEW OF APPLICABLE ZONING CONTROLS GOVERNING USES

Each overlay delineates separate permitting and use requirements and can make it difficult for an applicant to determine what rules apply.

		DISTRICT	BASE DISTRICT	OVERLAY 1	OVERLAY 2	OVERLAY 3	OVERLAY 4	OVERLAY 5
Highly Regulated Environments	CALIFORNIA AVE	CC – Community Commercial	Retail Preservation	R – Retail Shopping	P – Pedestrian Shopping	PTOD – Cal Ave Pedestrian and Transit Oriented	Cal Ave Parking Assessment District	
	MIDTOWN & CHARLESTON SHOPPING CENTER	CN – Neighborhood Commercial	Retail Preservation	GF – Ground Floor	P – Pedestrian Shopping	Special Regulations governing proximity to Residential		
	DOWNTOWN (University Ave)	CD – Downtown Commercial	Retail Preservation	GF – Ground Floor	P – Pedestrian Shopping			
	DOWNTOWN (Lytton)	CD – Downtown Commercial	Retail Preservation	P – Pedestrian Shopping				
	TOWN & COUNTRY VILLAGE	CC – Community Commercial	Retail Preservation					
	STANFORD SHOPPING CENTER	CC – Community Commercial	Retail Preservation					



Administrative Capacity:

ZONING OVERVIEW: CALIFORNIA AVENUE

CC(2)(R)(P)

Along California Avenue, many Retail and “Retail-Like” uses face regulatory barriers to entry, including businesses with 10 or more locations nationwide

CONDITIONAL USE PERMITS REQUIRED FOR:

- Beauty Salons exceeding 1,800 SF
- Nail Salons exceeding 1,800 SF
- Barber Shops exceeding 1,800 SF
- Fitness or Exercise exceeding 1,800 sf
- Learning Centers for Individual or Small Group Settings
- Laundry & Dry Cleaning
- Financial Services (Except Drive-In) on ground floor
- Medical Offices up to 5k *only when fronting Cal Ave.*
- Commercial Recreation Uses up to 5k *only when fronting Cal Ave*
- Formula retail (with more than 10 stores nationally)

UNMENTIONED AND THEREFOR NOT ALLOWED

- Light Industrial as accessory uses (i.e., maker spaces)

RESTRICTED GROUND FLOOR USE

- Residential



Fitness – Restricted by Square Footage



Drybar – Restricted under both Salon and Formula Ordinance



Pottery Making – Restricted under Learning Centers and/or Industrial



Pediatrician – Restricted under Medical Office



Administrative Capacity:

CITY-WIDE RETAIL PRESERVATION ORDINANCE

In 2015, zoning protections were passed to restrict ground floor retail conversions to non-retail uses in the face of significant competition for space from higher paying office tenants.

2015 MARKET CONDITIONS

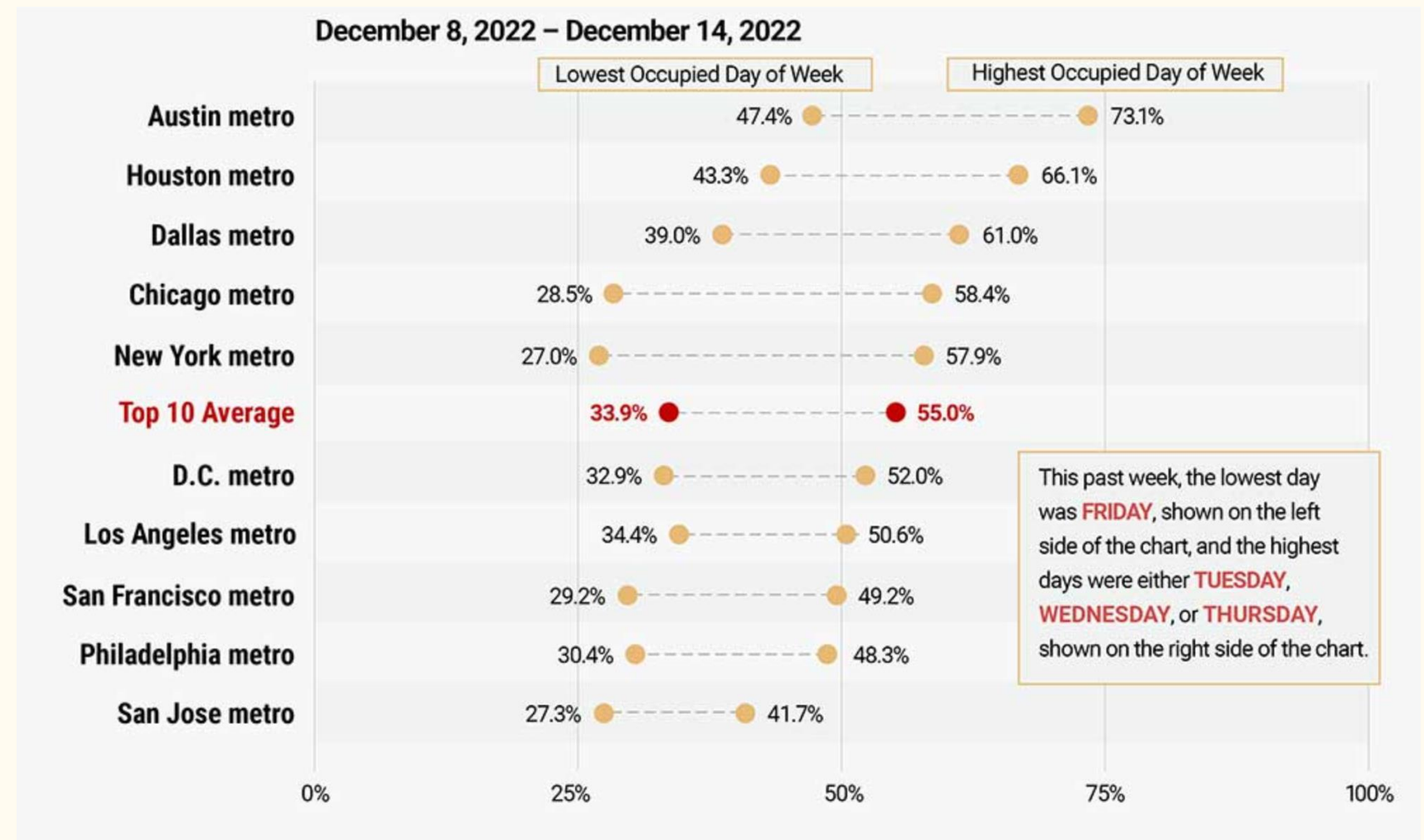
- At the time, Palo Alto was experiencing “record high commercial rental rates” (average \$61.44 psf) and “low office vacancy rates” (2.83%)

2021-2022 MARKET CONDITIONS

- 2022 Q3 Silicon Valley Office Vacancy: 17.7% (Source: [JLL](#)); 2021 Palo Alto Office vacancy rates 13.64% (Source: [CommercialCafe](#), 2021)
- 2021 office average asking rents: \$93.75 (Class A Space); \$37.04 (Class B Space)
- Office occupancy rates for San Jose metro are between 27.3% - 41.7%, the lowest of the top ten metro area measured by Kastle Systems nationwide.

OPPORTUNITY

Right-size the Retail Preservation Ordinance to focus on targeted areas of concentrated retail activity



Source: Kastle Systems Back to Work Barometer



ORGANIZATIONAL CAPACITY & STEWARDSHIP



Administrative Capacity:

ORGANIZATIONAL LANDSCAPE

Palo Alto is well served by Arts, Culture & Entertainment at both the City and District Level.

Palo Alto's Economic Development service delivery mechanisms are limited to the City and the Palo Alto Chamber, which is a city-wide membership organization.

At this time neither University Ave/Downtown nor California Avenue have active stewards to lead marketing, promotion, event coordination, enhanced sanitation and security (above and beyond what a city provides).

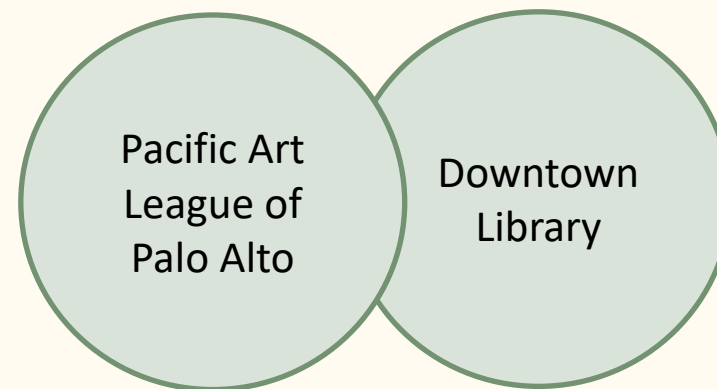
OPPORTUNITY

Reactivate and support improvements to stewardship along University and Cal Ave

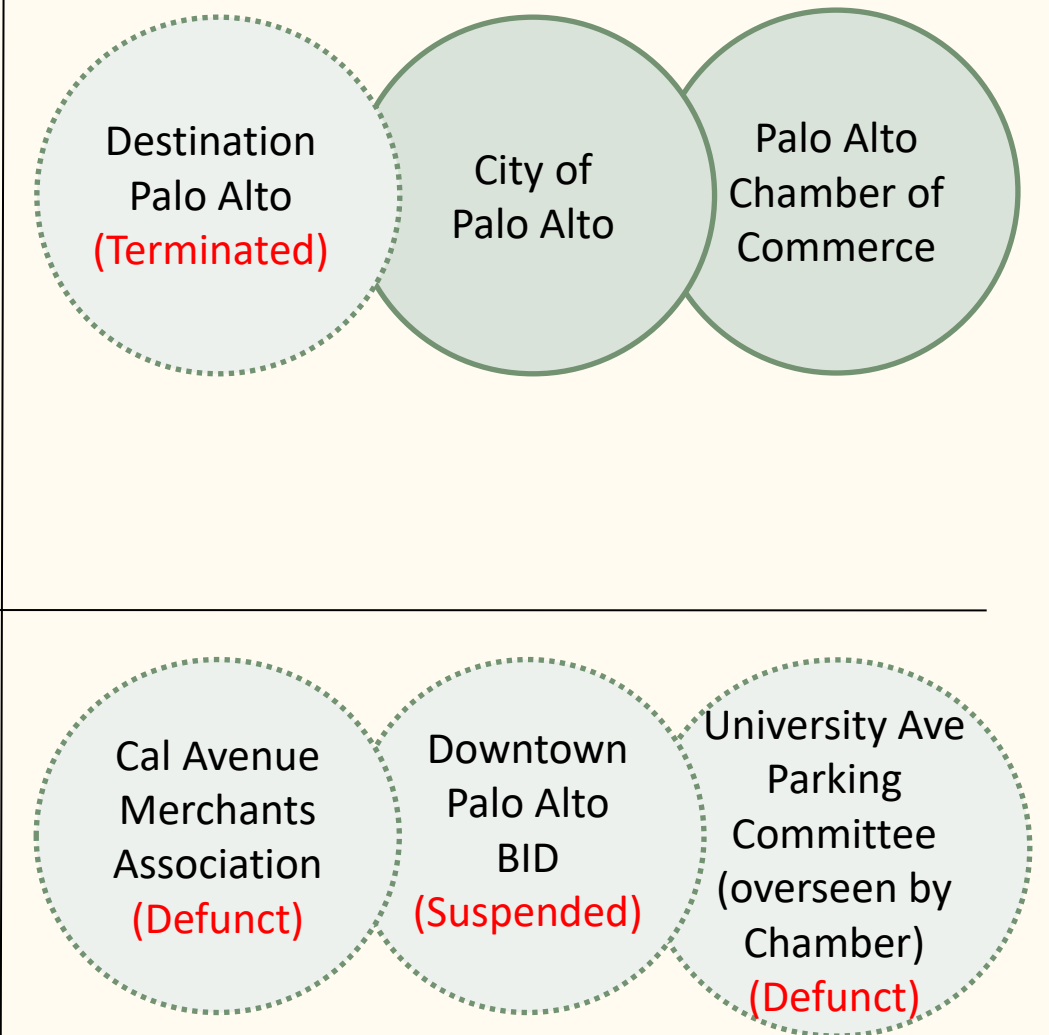
Arts, Culture & Entertainment



District



Economic Development

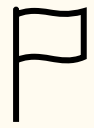




06

PHYSICAL ASSESSMENT

- PUBLIC AND PRIVATE REALM ELEMENTS
- ACCESSIBILITY & CONNECTIVITY
- FOCUS AREA SWOT ANALYSIS



Physical environment:
KEY TAKEAWAY

Districts with the most need for improvement and where city-led efforts have the most potential impact include:

01

DOWNTOWN



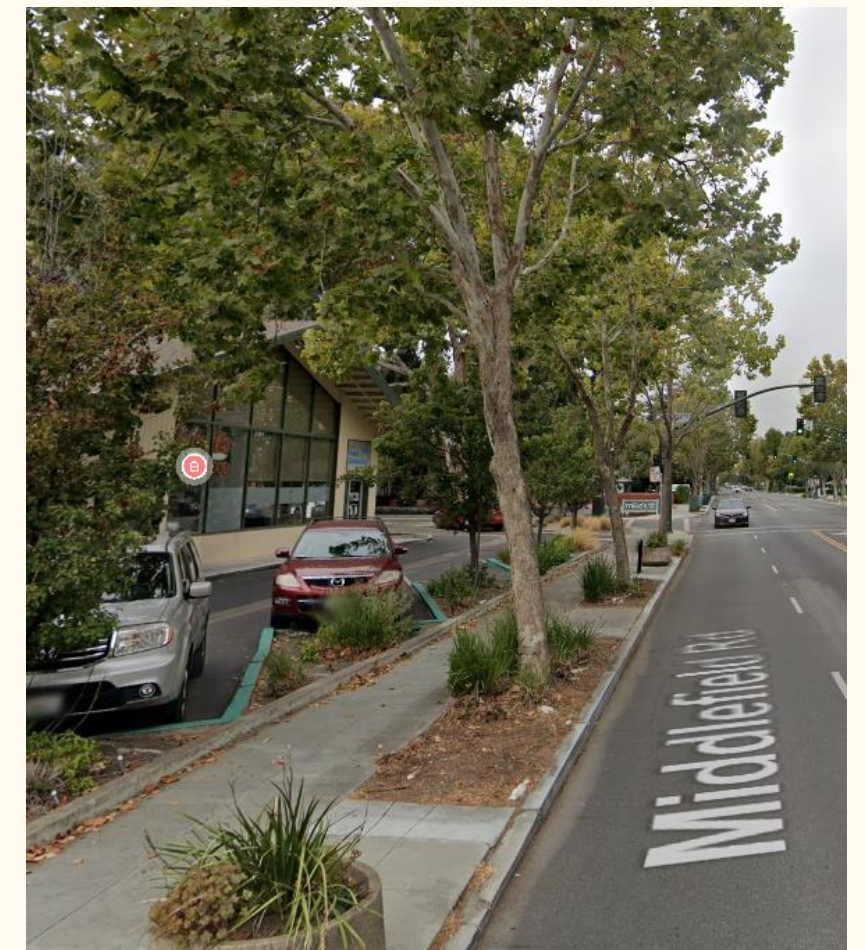
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CALIFORNIA AVENUE



03

MIDTOWN





07 GUIDING PRINCIPLES



GUIDING PRINCIPLES



REINFORCE HIERARCHY OF PLACE

- Stabilize and reinforce Downtown as a destination through improvements and stewardship
- Embrace California Avenue as a community and neighborhood serving place by increasing opportunities for new businesses and support for existing businesses

IMPROVE ACCESSIBILITY

- Embrace walking and biking solutions by fixing broken links and reinforcing walkability to/from all of the City's commercial districts
- Address parking policies and systems that add complexity and cost burden on low-wage, part-time workers

ADOPT POLICIES THAT REFLECT CHANGING MARKET CONDITIONS

- Ease the regulatory burden for businesses and revise outdated restrictions that create hurdles to tenancy
- Focus retail and retail-like uses in places where they are market-supported



THANK YOU