



CITY COUNCIL STAFF REPORT

From: City Manager

Report Type: Study Session

Lead Department: City Manager

Meeting Date: February 13, 2023

TITLE

Comprehensive Economic Development Strategy Update and Study Session

RECOMMENDATION

Staff recommends that the Council receive this report and provide feedback on critical focus areas for inclusion in the drafting of a Comprehensive Economic Development Strategy.

EXECUTIVE SUMMARY

This report and accompanying study session represent the next step in the City's creation of a Comprehensive Economic Development Strategy. The City's consultant, Streetsense, 'diagnostic' is attached to this report and will be the focus of the study session. The purpose of the study session is Council discussion and feedback on the diagnostic findings and draft Guiding Principles. Both of these and the general consensus of the City Council through its discussion will be used to inform the next and final step of drafting the comprehensive economic development strategy.

Streetsense is working 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."

Streetsense was selected as the consultant to create the Comprehensive Economic Development Strategy and presented their first impressions to Council on November 7, 2022. The first phase of their work was focused on learning and gathering data and speaking with stakeholders. This second phase of their work, the diagnostic, is focused on analyzing and synthesizing the information they gathered to accurately assess and discuss the issues we are facing as a City.

BACKGROUND

This study session is the second of three planned discussions between Streetsense and the City Council regarding the creation of a comprehensive economic development strategy. On November 7, 2022, Streetsense presented their in-progress work to City Council. At that meeting, they discussed the purpose and goals of the comprehensive economic development

strategy, the phases and timeline of their project, and preliminary considerations and findings from their work to date.

The report for the November 7, 2022 study session is available online¹, as is the presentation², and the video of City Council's discussion³, and the summary minutes from the meeting⁴. Following their discussion with the City Council in November, Streetsense continued their information collection and research phase. Streetsense has since completed the diagnostic, the second phase of the project, which is the focus of this report and accompanying study session. The third and final phase will be the creation of a comprehensive economic development strategy with recommendations. This third phase will also be brought to the City Council for consideration and adoption.

ANALYSIS

Before reaching the third and final phase of Streetsense's work, it is important that stakeholders – including the City Council – share a collective understanding of the challenges at hand within the city limits of Palo Alto. The attached diagnostic is important to establish consensus on the areas that Streetsense will target in its a comprehensive economic development strategy. Recommendations in this strategy will be guided by this diagnostic and the stakeholder feedback surrounding it, ultimately leading to support through City investments, interventions, policies, and programs.

Streetsense's work focuses on six study areas that have been classified into three categories.

- *'Regional/super-regional centers':*
 1. Downtown/University Avenue
 2. Stanford Shopping Center,
- *'Community-serving centers':*
 3. California Avenue
 4. Town & Country Village, and
- *'Neighborhood-serving' areas:*
 5. Midtown
 6. Charleston shopping Center.

This 'Diagnostic,' phase two of the contracted project, comprehensively analyzes the City's current condition through four areas. The full diagnostic is included as Attachment A to this report and will be discussed in greater detail by Streetsense on February 13, 2023. A summary

¹ City Council Staff Report November 2, 2022 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2022/20221107/20221107pccsm-amended-linked-q.a-2.pdf#page=8>

² Presentation From November 2, 2022 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/item-presentations/2022/20221107/20221107pptccsm-item-2.pdf>

³ Video From November 2, 2022 https://www.youtube.com/live/VdBcadUd_Fc?feature=share&t=945

⁴ Summary minutes From November 2, 2022 <https://www.cityofpaloalto.org/files/assets/public/agendas-minutes-reports/agendas-minutes/city-council-agendas-minutes/2022/20221114/20221114smccsm.pdf>

of highlights is below; the full Diagnostic concludes with findings and guiding principles on slide 62.

1. Market Assessment (begins on Streetsense slide 13)
 - a. Competition Assessment
 - b. Retail Demand Assessment
2. Business Environment (begins on Streetsense slide 26)
 - a. Sales Tax Analysis
 - b. Hospitality/Tourism Assessment
3. Administrative Assessment (begins on Streetsense slide 37)
 - a. Regulatory Framework
 - b. Organizational Capacity and Stewardship
4. Physical Assessment (begins on Streetsense slide 48)
 - a. City-Wide Connectivity and Accessibility
 - b. District SWOT Analysis

1. Market Assessment

Market Assessment reviews retail uses and groups them into Neighborhood Goods and Services (includes grocery stores, neighborhood markets, dry cleaners, barber shops, and others), Food and Beverage (includes restaurants, bars, cafes, and others), and General merchandise, apparel, furniture and other (includes apparel stores, clothing stores, hardware stores, sports stores, and others). Non-retail uses, such as financial, educational, religious, or governmental institutions are not factored into the retail demand model.

Competition Assessment: Streetsense has measured retail competition for Palo Alto on two levels; Convenience, access, visibility, tenant quality, and a variety of offerings are all factors that inform the assessment of market influence by each retail competitor.

- Locally-Serving neighborhood centers for convenience-based trips: Palo Alto faces strong competition for groceries and has a number of big-box retailers clustered along the periphery of City limits in neighboring jurisdictions.
- Regionally-serving destination hubs for experience-based trips: the City faces competitive downtown environments in nearby cities as well as traditional malls. Additionally, there is competition even within Palo Alto with University Avenue, Stanford Shopping Center, and, to some extent, California Ave. all operating as regional hubs.

Annual retail rents and vacancies in Palo Alto based on Streetsense's analysis:

- Retail rents are high, with rental rates 80% higher than the national average of \$27.55 per Square Foot. Stanford Shopping Center is the most expensive (\$77.48/sf), followed closely by University Ave (\$76.68/sf) and Town and Country (\$72.00/sf).
- Overall retail vacancy rate in Palo Alto was about 8% at the end of 2022; University Avenue is estimated to be running a 10% vacancy rate in retail space and California Ave.

was higher at 15% vacancy. The National Average is 6.5% retail vacancy for the same period.

Retail Demand Assessment: Streetsense’s market assessment looked at the demand for retail in Palo Alto. As the City continues to navigate the transition from COVID-19 pandemic, the level of retail demand is an important factor in developing a comprehensive economic development strategy. Through Streetsense’s analysis, they concluded that:

- Hybrid work has reduced the demand for retail in Palo Alto by more than 100,000 square feet (roughly equivalent to the amount of combined retail space at Midtown and Charleston Shopping Centers).
- Retail demand will steadily increase, especially as new developments continue in the region, but according to their calculations the demand will not catch up to the existing retail supply for more than 10 years.

2. Business Environment

As a subcontractor to Streetsense, HdL conducted a sales tax analysis as part of examining the local business environment. Streetsense also examined the current state of the City’s hotels and visitors through its Hospitality/Tourism Assessment.

Sales Tax Analysis: HdL found that small and locally owned business were the hardest hit during COVID-19, with restaurants, retailers, and personal service providers being particularly impacted. Highlights of HdL findings include:

- Local businesses are still not back to pre-pandemic cash flow nor revenue margins, however sales tax has increased from pandemic lows. This suggests that inflation, labor shortages, and other disruptions continue to adversely impact these vulnerable businesses.
- Declines in sales tax revenues were occurring before the pandemic, which may be an indicator of broader trends that were at work and then worsened by the COVID-19 pandemic.
- Palo Alto’s downtown areas of University and California Avenue have had the slowest sales tax recoveries from the COVID-19 pandemic, while Stanford Shopping Center and Town and Country Village have better recovered.
- Neighborhood Goods and Services were the least affected by the pandemic from a sales tax perspective. This category makes up only 4% of total sales tax for the six focus districts of the study (2% of Citywide Sales Tax), and therefore its resilience was not impactful to overall revenues. Additionally, Palo Alto has the lowest sales dollar per capita for Neighborhood Goods and Services businesses compared to neighboring cities.

Hospitality/Tourism Assessment: found that Palo Alto’s lodging sector was recovering consistent with the national pace. However, since the largest contributors to occupancy are

medical, education, and business travelers, this sector remains vulnerable in the face of recession concerns.

- Weekday occupancy of hotels is showing signs of improvement.
- Even prior to the COVID-19 pandemic, hotels in Palo Alto historically had higher vacancy rates over the weekends. This suggests that growing weekend occupancy rates with non-business travelers may be an area for further work.

3. Administrative Assessment

Streetsense also looked at various elements of the City to inform the Administrative Assessment including a review of the regulatory environment and understanding the ecosystem of partner organizations to inform organizational capacity and stewardship.

Regulatory Assessment: Recent trends in retail and changing work patterns may warrant revisiting certain sections of Palo Alto's zoning code; Streetsense noted in particular the highly regulated environments of Downtown and California Avenue. In contrast, Stanford Shopping Center and Town & Country Village provide centralized ownership resulting in more flexibility and clarity around what is allowed and what is not allowed to aid tenants.

Organizational Capacity and Stewardship: When Streetsense examined the ecosystem of partner organizations, they found that the City has different arts, culture, and entertainment organizations that provide options at both a City level and at a district level. However, there is a lack of partner organizations to help serve as stewards and partners in economic development for California Ave and University Avenue.

4. Physical Assessment

Streetsense included some of their preliminary thoughts on the Physical Assessment of Palo Alto when they discussed the project with City Council on November 7, 2022. This work was expanded as the fourth component of the diagnostic.

Accessibility and Connectivity: Streetsense explored the accessibility and connectivity of the City's roadway and transit networks. Some important gaps identified by Streetsense are already in the process of being addressed, notably the areas of grade separation and on-demand shuttle service to help improve transit access.

Focus Area SWOT Analysis: Streetsense performed a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis of the physical infrastructure for Downtown, California Avenue, Stanford Shopping Center, Town and Country, Midtown, and Charleston Shopping Center. This analysis looked at access/connectivity, parking, wayfinding/signage, sidewalks and street furniture, gathering spaces and building. This analysis is presented in Attachment A; positive attributes in each area are highlighted in green and areas for improvement are highlighted in red.

Guiding Principles for Drafting of Comprehensive Economic Development Strategy

Through the Diagnostic, Streetsense has developed their ‘guiding principles’ that will be used to help address the third and final phase of the project, which is the creation of a comprehensive Economic Development Strategy through recommendations.

The guiding principles developed by Streetsense are:

- Reinforce hierarchy of place
- Improve accessibility
- Adopt policies that reflect changing market conditions

Discussion of the guiding principles and the City Council feedback and consensus of priority principles will be an important part of the study session on February 13, 2023. This discussion will directly impact the third and final stage of this project, the drafting of a comprehensive Economic Development Strategy with recommendations for future actions.

FISCAL/RESOURCE IMPACT

The discussion on February 13 is not expected to affect immediate resource needs, the resources allocated to Economic Development are an important consideration for ongoing work. The City has ongoing funding for the Economic Development coordinator role and some ongoing funding for limited consultant support (less than \$25,000 annually).

As the City refines the scope of its economic development function through Streetsense’s work, scaling resources to align with that scope will require further resources and budgetary actions. Staff will work with Streetsense to develop proposals that appropriately scale the City’s economic development function to align with Council’s feedback throughout the process and will return with proposals for consideration through the development of the FY 2024 budget.

STAKEHOLDER ENGAGEMENT

Community stakeholders, including residents and representatives from various business sectors, including restaurants, retailers, hoteliers, property owners, and others, have been engaged consistently through the City’s recent work on economic development. As the City transitions out of the pandemic, staff will continue to engage residents and businesses in meaningful dialogue to help inform and maintain the City’s economic vibrancy.

ENVIRONMENTAL REVIEW

Holding a study session on economic development will not directly or indirectly cause physical changes to the environment and therefore this study session is not a project under the California Environmental Quality Act (CEQA).

ATTACHMENTS

Attachment A: Streetsense Diagnostic

APPROVED BY:

Ed Shikada, City Manager

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