



SAN FRANCISCO PLANNING DEPARTMENT

February 15, 2018

1650 Mission St.
Suite 400
San Francisco,
CA 94103-2479

Reception:
415.558.6378

Fax:
415.558.6409

Planning
Information:
415.558.6377

Memo: Informational Presentation on Retail Study and Neighborhood Commercial Districts

Dear Planning Commissioners,

On February 22, 2018 the Office of Economic and Workforce Development in conjunction with the Planning Department will present an informational item on the state of retail in the Neighborhood Commercial Districts. This presentation is the product of research conducted by Strategic Economics and OEWD, and sponsored by Supervisor Stefani's Office.

The materials attached to this memo are being provided in advance of the presentation in order to provide you with helpful background information. The attachment is OEWD's Executive Summary of the Strategic Economics study conducted on the state of retail in the Neighborhood Commercial Districts. The full report will be finalized no later than February 22, 2018 and will be sent to you electronically as soon as it is available.

If you have any questions or require further information please do not hesitate to contact me.

Sincerely,

A handwritten signature in cursive script that reads "Audrey Butkus".

Audrey Butkus
audrey.butkus@sfgov.org (415) 575-9129
San Francisco Planning Department

Attachment:

OEWD's Executive Summary of the Strategic Economics Study

State of the Retail Sector: Challenges and Opportunities for San Francisco's Neighborhood Commercial Districts

EXECUTIVE SUMMARY

January 2018

Overview

- **Introduction**
- **Overview of national trends**
- **Impact of national trends on San Francisco's neighborhood retail**
- **Other local challenges**
- **Business adaptations**
- **Best practices for successful commercial districts**
- **Conclusions and implications**



Introduction

Concerns motivating the study

- **How are national trends in the retail, restaurant, and personal services industries affecting businesses in San Francisco's Neighborhood Commercial Districts (NCDs)?**
- **What local challenges do San Francisco businesses face?** E.g., changing customer base, employee recruitment and retention, real estate conditions.
- **What characteristics do successful NCDs share?**
- **How might businesses and NCDs need to adapt to remain successful given national trends?**

Retail Apocalypse? The Sky Isn't Falling -- The Sector Is Just Evolving



Greg Maloney, CONTRIBUTOR

I write on the confluence of shopping centers, economic

[FULL BIO](#)

Opinions expressed by Forbes Contributors are their own.

America's 'Retail Apocalypse' Is Really Just Beginning

By Matt Townsend, Jenny Surane, Emma Orr and Christopher Cannon
November 8, 2017



WIKIPEDIA
The Free Encyclopedia

Article

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Retail apocalypse

From Wikipedia, the free encyclopedia

The **retail apocalypse** refers to the closing of a large number of **American retail** stores beginning in 2016.^[5] Over 4,000 physical stores are affected as American consumers shift their purchasing habits due to various factors, including the rise of **e-commerce**.^[6]

Study overview

- **Strategic Economics prepared a series of related issue briefs for the San Francisco Office of Economic and Workforce Development (OEWD):**
 - Issue Brief 1: National Retail Industry Trends and Implications for San Francisco
 - Issue Brief 2: What Makes a Successful San Francisco NCD?
 - Issue Brief 3: Costs and Challenges of Doing Business in San Francisco
- **This presentation serves as the executive summary for the issue briefs.**
 - Synthesizes key findings
 - Summarizes major implications for individual businesses and districts
- **Study does not provide specific policy and program recommendations, but is intended to inform future recommendations by departments and policy makers.**

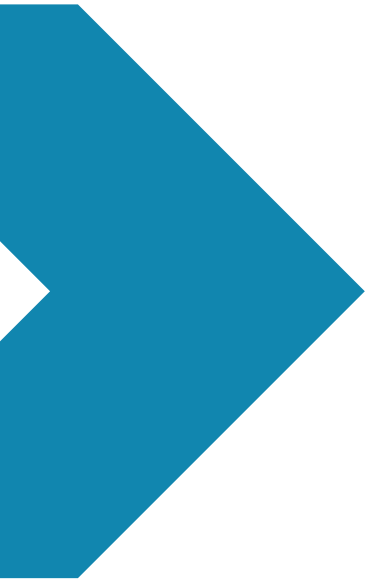
Approach

- **Literature review** on national retail trends.
- **Interviews with San Francisco stakeholders** including business owners, brokers, merchant associations, developers, neighborhood advocates
- **Case studies** of selected NCDs: Ocean Avenue, Upper Fillmore, Outer Geary, Mission Street, Calle 24
- **Analysis of available data** on sales and vacancies
 - Citywide
 - For selected districts (comprehensive data on NCD sales and vacancies are not available)
- **Research and analysis focused on neighborhood retail** (excluding Downtown, Union Square, mid-Market, the northeastern waterfront, and Stonestown Galleria)

Introduction

Focus of the study: retail, restaurant, nightlife and entertainment, personal services industries

- **Retail Sales Establishments:** Brick-and-mortar and online stores selling physical products (such as groceries, clothing, sports equipment, toys, etc.).
- **Restaurants:** Establishments serving food and/or beverages for consumption on the premises (or in some cases for take-out), generally including cafés and bars as well as fine dining, casual, and other restaurants.
- **Nightlife and Entertainment:** Restaurants, bars, clubs, theaters, and other venues open during evening hours.
- **Personal Services & Fitness:** Establishments providing personal services to the general public, such as hair salons, nail salons, barber shops, gyms or other fitness centers, etc.

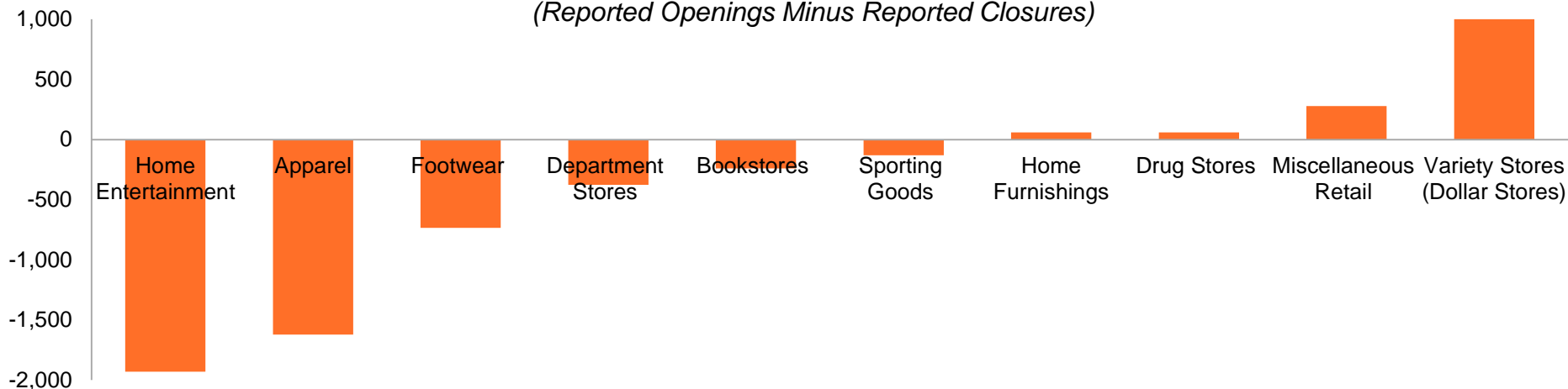


Overview of National Trends

Expanding and contracting retailers

- **Major retailers are closing stores in record numbers**, reflecting a national oversupply of retail space, increased competition with online sales, and (for some retail chains) debt obligations associated with leveraged buyouts.

National Announced Net Store Openings for Selected Retail Categories, Q1 to Q3 2017
(Reported Openings Minus Reported Closures)



Note: Only categories for which data are available are shown. Different sources vary in reported numbers.

Source: ICSC and PNC Real Estate, 2017, from Bloomberg's 2017 article, "America's Retail Apocalypse is Really Just Beginning"

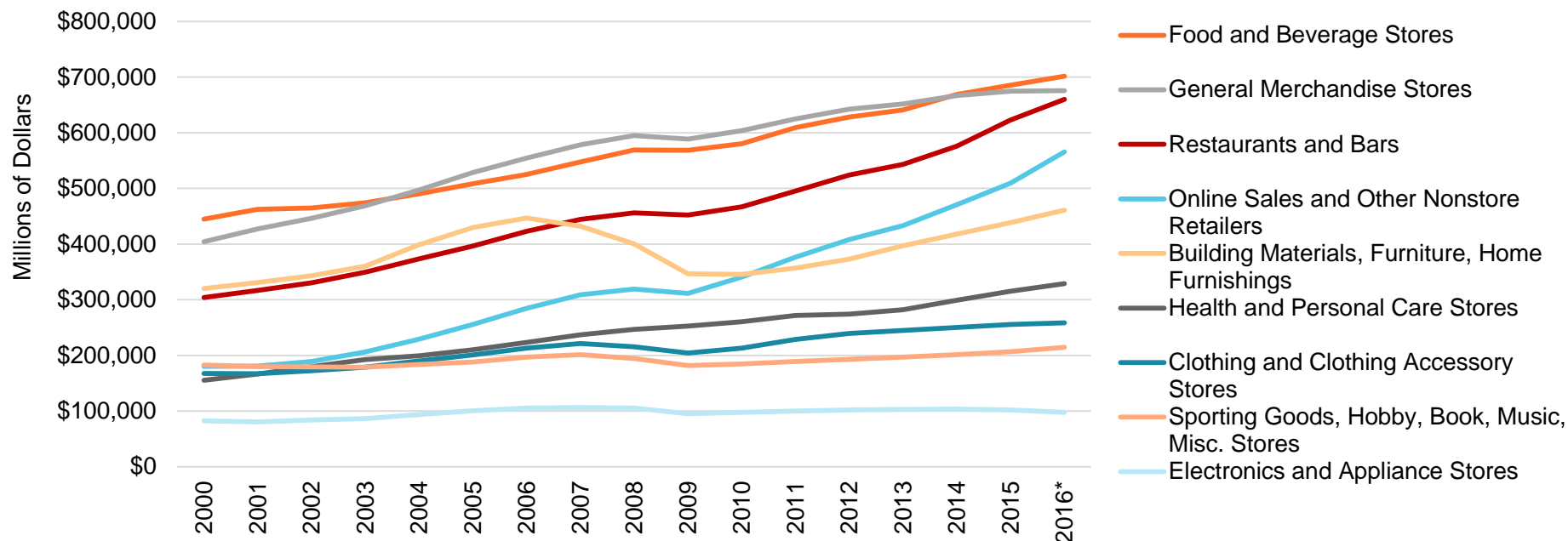
- **Discount stores are seeing continued growth, while luxury brands are struggling.** Discount retailers are adding stores, including discount clothing stores (TJ Maxx, Marshalls), discount grocery stores (Grocery Outlet, Trader Joes), warehouse and general merchandise stores (Costco, Target), and dollar stores.

National Trends

Restructuring of the national retail, restaurant, and personal services industries

- **Nationally, growth in retail and restaurant sales is concentrated in a few categories** including online sales, food and beverage stores, restaurants and bars, building materials and home furnishings, and health and personal care stores.

Estimated Annual Sales of U.S. Retail Firms by Type of Business: 2000-2016
(in Millions of Dollars, not Adjusted for Inflation)



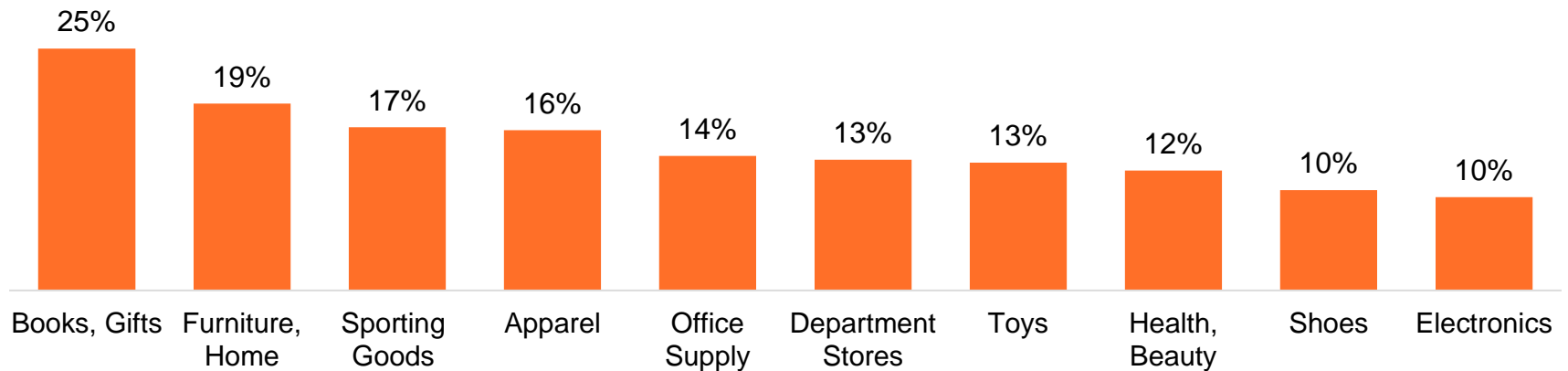
Based on monthly sales for 2016; annual 2016 estimates have not yet been released.

Sources: U.S. Census Bureau, 2015 Annual Retail Trade Survey (released March 6, 2017) and Annual Revision of Monthly Retail and Food Services: Sales and Inventories—January 1992 Through March 2017; Strategic Economics, 2017.

Increasing influence of e-commerce

- **Online sales are driving retail growth, and expanding into new categories.** Nationally, non-store retailers accounted for 40 percent of retail sales growth between 2014 and 2016.
- **At the same time, technology is allowing retailers, restaurant owners, and service providers to integrate brick-and-mortar and online sales strategies.** Including online sales, app-based delivery services, and online reservation services.

E-commerce as a Share of Total Revenue, by Retail Category



Employment & real estate impacts of e-commerce

- **E-commerce employment is growing, as overall retail employment remains flat.** In the last five years, national employment attributed directly to e-commerce has doubled – even without accounting for associated increases in warehousing and logistics jobs.
- **While there is a national oversupply of traditional retail space, demand for “last mile” distribution space is growing.** This includes warehouses located within close proximity to major population centers (e.g., five to seven miles), as well as lockers and other types of small-scale distribution and fulfillment facilities.



Growing importance of offering an “experience”

- **Americans are increasingly spending their money on experiences – such as dining, personal services, and fitness – rather than objects.** Increased spending on food away from home, health and wellness, and travel.
- **Retail stores are experimenting with new strategies to capitalize on increasing demand for experiences.** For example, by serving food and drinks, offering classes or events, and expanding opportunities for customers to interact with products before purchasing.



Source: Bird & Beckett, 2015 (left); San Franpsycho 9th Avenue, Yelp; 2017 (right)

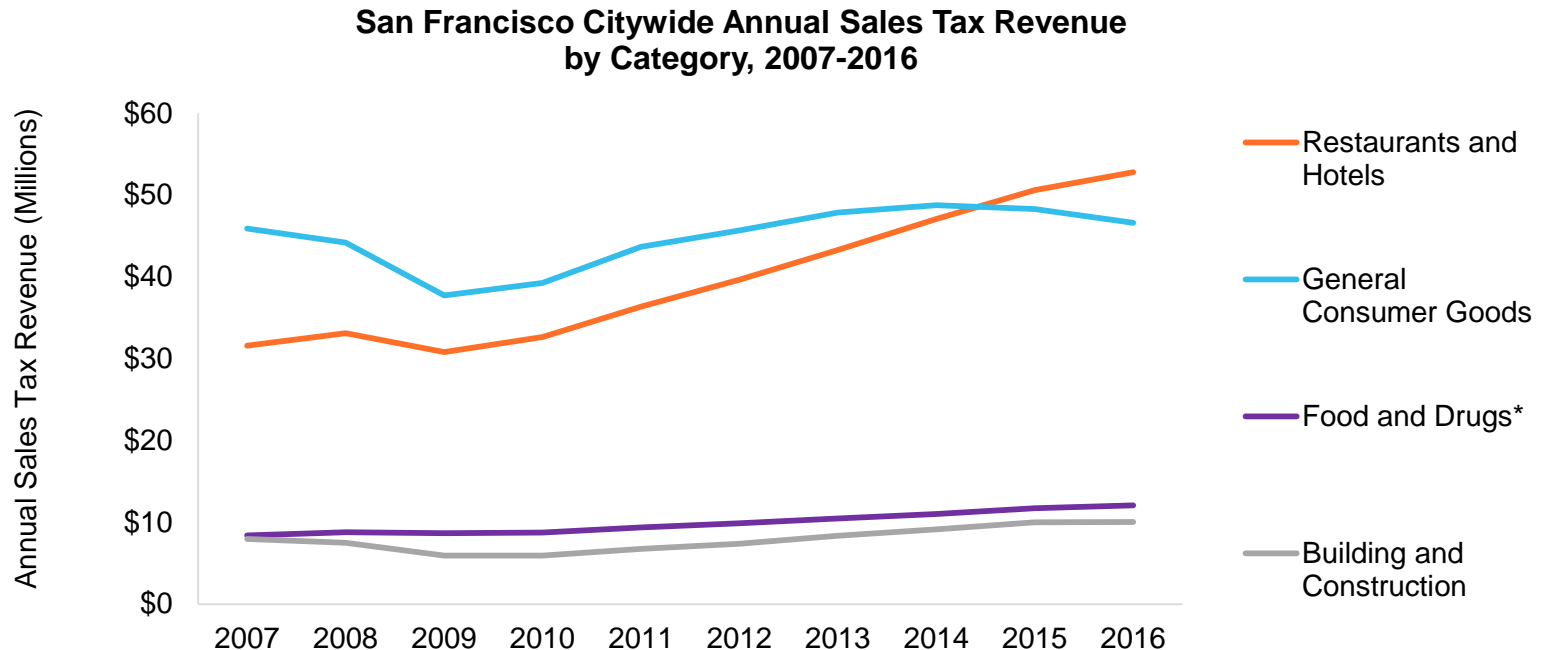


Impact of National Trends on San Francisco's Neighborhood Retail

Impact of National Trends on San Francisco Retail

San Francisco's retail has been somewhat insulated from national challenges

- **Between 2007 and 2016, retail and restaurant sales in San Francisco increased more quickly than the national average.** However, retail sales started to slow in 2016.



*Note that because food for home consumption and prescription medications are not taxable, the taxable sales data shown here significantly underrepresent total (gross) sales at food and drug stores.

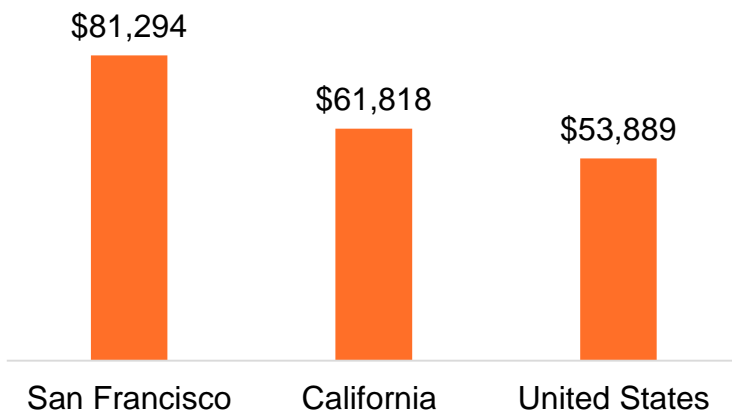
Sources: San Francisco Office of the Controller, 2017; Strategic Economics, 2017.

Impact of National Trends on San Francisco Retail

San Francisco has many competitive advantages for retail and restaurants

- **Strong economy**, including job growth, high household incomes, and low unemployment rates
- **Local culture** that values shopping local and eating out
- **Significant regional and international tourism**
- **Limited number of regional shopping malls & a large number of independent businesses**
- **Many NCDs offer an attractive, interesting shopping experience**

Median Household Income (in 2015 dollars)



San Francisco Top Tourist Activities in 2016

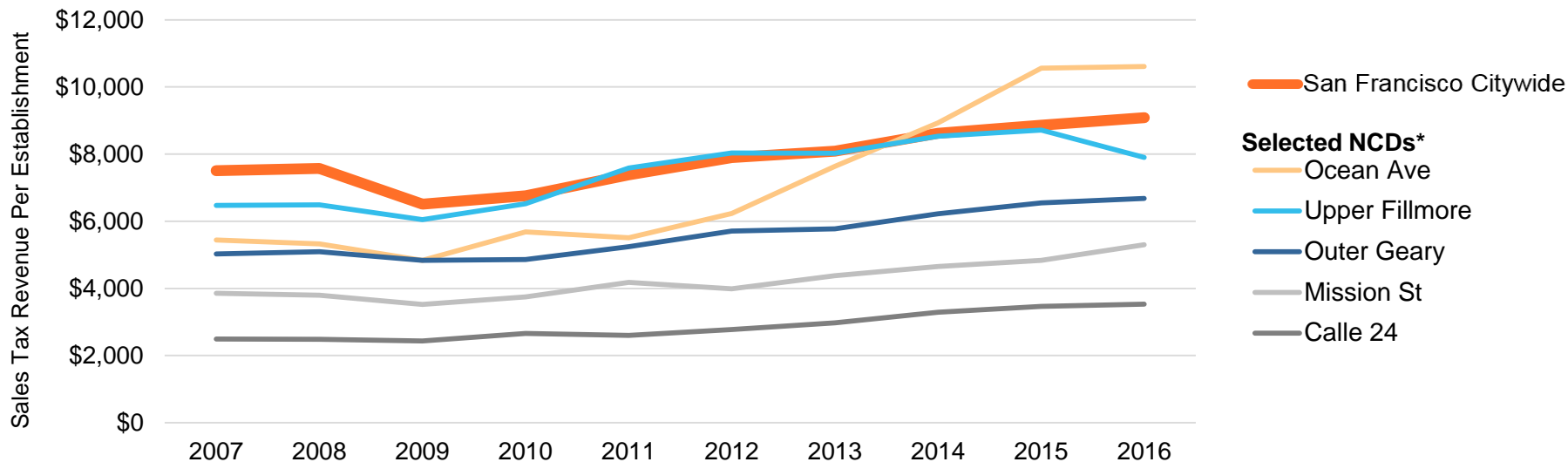
1. **Dine in Restaurants**
2. **Shop**
3. **Visit Parks**
4. **Visit Friends & Family**

Impact of National Trends on San Francisco Retail

While SF offers many advantages, the local retail sector is not immune to the changes

- **Sales appear to have flattened** between 2015 and 2016.
- Business owners report **increased competition with e-commerce** and in more categories (e.g., groceries, clothing, personal care goods).

Sales Tax Revenue Per Establishment in San Francisco and Selected NCDs, 2007-2016



*NCD sales tax revenues include estimates of revenues generated by stores with multiple locations. Stores with multiple locations in San Francisco report their total sales in the city, but do not report sales for individual locations. Per-store sales for individual locations are estimated by dividing the citywide total by the number of locations citywide. Sources: San Francisco Office of the Controller, 2017; Strategic Economics, 2017.

Demand for ground floor retail space in the NCDs appears to be slowing

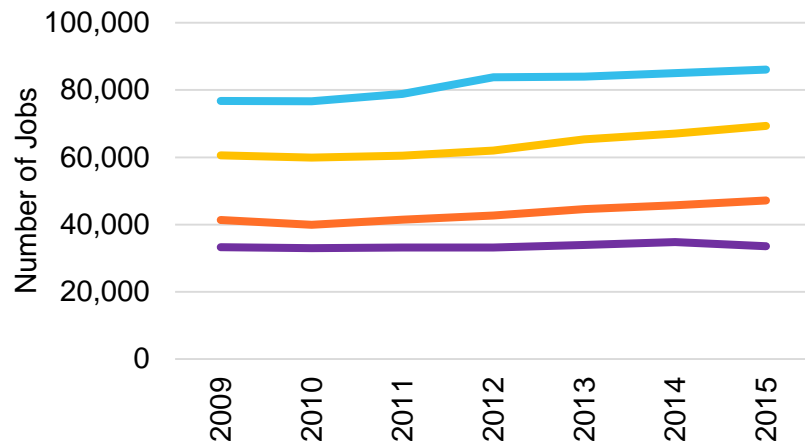
- Real estate brokers report **NCD rents are plateauing**, after many years of growth.
- **Fewer traditional retailers are seeking space**, while there is increased interest from other potential tenants of ground floor commercial space (e.g., personal service, restaurants, medical services).
- Between 2015 and 2017, **a significant number** of the 24 NCDs for which OEWD survey vacancy data is available **experienced an increase in vacancy**. About one-third of these NCDs saw vacancies increase by at least 2%.
 - Note: this includes properties that OEWD classifies as either “vacant” (i.e., unoccupied and currently being marketed for a new lease) or “inactive” (i.e., unoccupied but currently under renovation or otherwise being prepared for a new lease, and not being actively marketed).

Impact of National Trends on San Francisco Retail

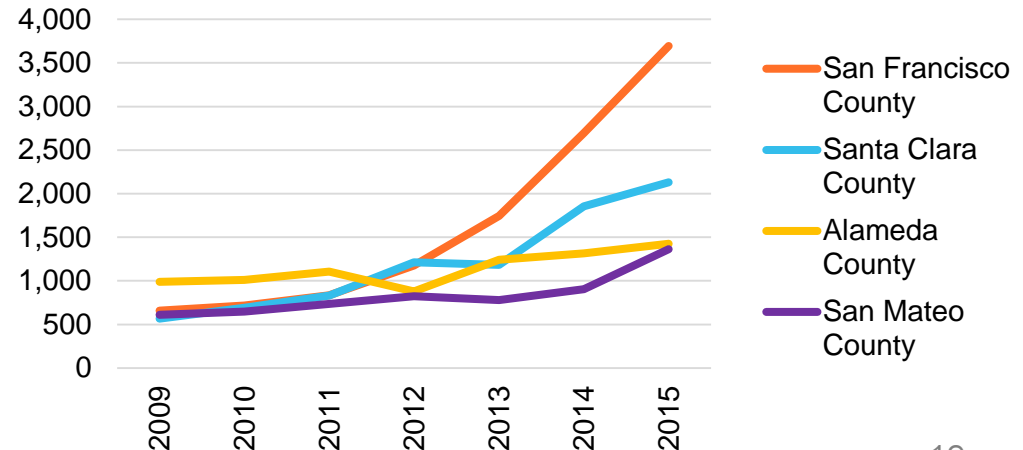
Retail employment is growing, but relatively slowly compared to incomes or the economy overall

- **Retail jobs in San Francisco increased by 14% between 2009 and 2015** (excludes jobs in restaurants and personal services) **compared to a 27% increase in the total number of jobs** in San Francisco over the same period.
- **Slightly more than half** of the City's net new jobs in retail (3,035 out of 5,800) were **in the “electronic shopping” category**. This category likely represents at least some office-based tech employment.

Retail Employment, 2009-2015



Electronic Shopping Employment*, 2009-2015



*NAICS Code 4541.

Sources: California Employment Development Department, Quarterly Census of Employment and Wages, 2009-2015; Strategic Economics, 2017.



Other Local Challenges

The cost of doing business is high

- **Employee recruitment and retention challenges**
 - Low unemployment rates
 - High housing costs
 - Competition with other industries offering better compensation or more flexible hours.
- **High labor costs** related to competition for labor, high cost of living, and the unintended consequences of San Francisco's progressive labor laws.
- **High rents**, including lease structures with automatic rent escalations.

Land use regulations and permitting requirements

- **The permitting process can add significant cost and time to the process of opening a new business.**
 - The length and complexity of the permitting process for opening a new business or completing tenant improvements may make it more difficult for businesses to open or upgrade their space.
 - Depending on lease agreement, tenants may be required to pay rent during the permitting process.
- **Some laws intended to protect traditional retail by limiting other uses may:**
 - Limit retailer's flexibility to adapt to changing economic conditions (e.g., by serving food and beverage).
 - Restrict complementary uses that could drive foot traffic to traditional retail (e.g., restaurants, personal services, professional services, medical or office uses).

SF retailers face challenges adapting to a changing market

- **Loss of long-time customer base** due to demographic change.
- **Increasing competition** from other brick-and-mortar locations (e.g., proliferation of grocery stores and restaurants) as well as e-commerce.
- **Lack of technical expertise or financial resources** to adopt new technologies, or invest in capital improvements or new inventory to appeal to a changing clientele.

Businesses report public realm challenges

- **Real and perceived issues around cleanliness, order, and safety**, which may deter customers
- **Long-term vacancies**, which contribute to a sense of disinvestment





Business Adaptations

Rising costs and growing competition are prompting some businesses to adapt

- **In response to national trends and local challenges, some businesses are adopting creative and varied strategies to survive.** These strategies generally aim to:
 - Expand sales;
 - Reduce costs or pass costs on to customers; and/or
 - Diversify revenue streams.
- **While adopting these types of strategies will help some businesses continue to thrive, change is challenging and some businesses will not be able to adapt to a changing market.**
 - Policies and programs may support business owners by providing technical expertise or financial resources, but cannot force change on an unwilling business owner, or overcome fundamental challenges (e.g., lack of sufficient market demand for products or services).

Strategies to expand sales

- **Taking advantage of online apps and marketplaces:**
 - **For retailers, personal websites or third-party online platforms** facilitate online browsing and shopping.
 - **For restaurants, delivery through third-party delivery apps** is becoming a key way to compete and expand sales;
 - **For personal service providers, online booking platforms** are used to increase visibility and improve customers' experience/convenience;
- **Developing a stronger presence on social media:** In addition to maintaining a presence on Google Maps and Yelp, many business owners are taking advantage of social media (Facebook, Instagram, Twitter) to keep customers engaged and up-to-date on special sales and events.
- **Experimenting with ways to provide customers with a more interesting experience,** such as offering classes and workshops, hosting events, and serving food and beverage.

Business Adaptations

Strategies to reduce costs or pass costs on to customers

- **Adopting less labor-intensive business models.** For example:
 - **Fast casual dining.** This business model uses less labor than traditional table-service restaurants.
 - **Automation,** such as self-checkout kiosks at grocery stores or automats in restaurants (e.g. Eatsa).
- **Making do with fewer employees,** or employing family members who are not subject to the same labor laws as other workers;
- **Making do with less space,** by renting smaller spaces or co-locating with other uses;
- **Relocating to lower-cost locations,** either within San Francisco, or in some cases outside of the City.
- **Passing increased costs on to customers,** in the form of increased prices or restaurant surcharges.

Strategies to diversify revenue streams

- **Expanding or adjusting range of products to be more competitive and appeal to new customers.** For example, this could include a small grocery or corner store adding new local and organic produce.
- **Combining uses,** such as serving food or alcohol at stores and galleries, or combining PDR and retail space.
- **Subleasing part of their space to other retailers or other uses.**



Best Practices for Successful Commercial Districts

Successful Commercial Districts

Retail businesses function as part of neighborhood commercial districts

- Most businesses rely on the **spending power of households in the surrounding neighborhood (or trade area)** to generate demand.
 - Neighborhoods with more spending power (i.e., higher household densities and/or incomes) can support more local-serving retail.
- **Businesses also rely on each other, and on other uses in a district, to generate foot traffic.**
 - Customers may come to an NCD to buy groceries, eat lunch, or get a haircut, but stay to shop at a variety of other stores.
 - Other drivers of retail demand include local employers; cultural, educational, and medical institutions; professional services, medical, and other offices.
- The **quality of the pedestrian environment and of public spaces** can help attract (or potentially drive away) potential customers.
- **Cultural events, other special events, and public space programming** can also help draw foot traffic.

Successful Commercial Districts

From the national literature, factors that contribute to successful districts include:

- **Healthy business mix including:**
 - Anchors (or cluster of uses) that attract foot traffic
 - A diverse mix of retail and non-retail businesses, including restaurants, personal services, entertainment and nightlife
- **Appealing physical environment** including an attractive architectural character and street environment
- **Convenient, multi-modal access** including parking and curb space that is actively managed to balance the needs of different users.
- **Drivers of demand:** Local spending power, employment concentrations, medical/educational institutions, tourism.
- **High-capacity district management organizations** such as Community Benefit Districts, merchant associations, or Community Development Corporations.

What defines success?

- **Quantitative measures of success from the national literature include:**
 - Strong business sales performance
 - A healthy vacancy rate. While sources vary, 5-10% vacancy is generally seen as low enough to support a vibrant corridor, but not so low that there is no room for turnover.
- **However, different neighborhoods have different visions for what a successful NCD looks like, and how to achieve this vision.** Some of the more qualitative attributes that San Franciscans value in their NCDs include:
 - Cultural and historic preservation.
 - A business mix that provides goods and services to help meet the daily needs of residents, as well as the needs of workers and visitors.
 - A vibrant street life, both during the day and in the evening. At minimum, this involves safety and comfort in the public realm.
 - Opportunities for community gathering and social interaction.
 - Opportunities for small and independent businesses to thrive.



Conclusions & Implications

Conclusions

- 1. To thrive in a more challenging business environment, retailers need to embrace new technologies.**
- 2. Retailers need to be flexible and creative to provide customers with a more interesting experience.**
- 3. Diversifying the mix of uses in an NCD can help retailers expand their customer base.**
- 4. By offering an attractive, fun shopping and dining experience, NCDs can help retailers continue to draw foot traffic.**

Conclusions & Implications

Conclusion #1: To thrive in a more challenging business environment, **retailers need to embrace new technologies.** For example, this includes online sales, social media, and app-based delivery services.

Implications

- Businesses may benefit from **technical and financial support** in expanding their online presence, adjusting their inventories for a changing customer base, etc.
- **Curb management policies** may need to be revisited to effectively manage competing transportation needs (pedestrians, bicyclists, delivery vehicles, TNCs, and parking) to support a pedestrian-friendly environment and maintain customer access, while enabling new businesses to take advantage of emerging delivery technologies.

Conclusions & Implications

Conclusion #2: Retailers need to be flexible and creative to provide customers with a more interesting experience. For example, by offering classes and workshops, hosting events, and serving food and beverages, to draw shoppers into stores.

Implications

- **Land use policies may need to be modified to provide retailers more flexibility**, for example in experimenting with combining uses and expanding services (e.g., serving food and beverages or incorporating “maker” or PDR space).

Conclusions & Implications

Conclusion #3: Diversifying the mix of uses in an NCD can help retailers expand their customer base. The components of a healthy mix vary by district, but typically include some combination of the following:

- **Anchor businesses** that drive foot traffic to the district, including to other businesses in the same commercial district. Examples include full-service grocery stores, general merchandise stores, other larger stores (many of which are formula retail) or a cluster of related retail stores or restaurants.
- **Restaurants, nightlife, and entertainment** that complement retail sales and services by providing destinations and gathering spaces for potential customers.
- **Personal services & fitness centers** that provide needed services and also help draw foot traffic.
- **Professional services** that provide needed services in an office-like setting directly to the general public.
- **Office & housing uses** that may not directly serve the general public, but help generate foot traffic and demand for retail

Conclusions & Implications

Conclusion #3, Continued: Diversifying the mix of uses in an NCD can help retailers expand their customer base.

Implications

- New ground floor retail should **include a range of storefront sizes** and storefronts should be **designed to maximize marketability and be adaptable** to the needs of a diverse set of retailers, restaurants, etc. Design guidelines and use size regulations can help achieve this.
- **Office and housing** uses that may not be open to the general public could be located **above the ground floor, or on the ground floor in lower demand market locations** (e.g., at the periphery of an NCD)
 - In addition to supporting the long-term sustainability of ground floor retail by generating more demand, these uses can **help fill vacant space**.
- **Limiting ground floor retail requirements** for new development to the strongest locations for retail could help reduce potential vacancies. Concentrated nodes of retail are more appealing destinations, and allow shoppers to access multiple stores within easy walking distance.

Conclusions & Implications

Conclusion #4: By offering an **attractive, fun shopping and dining experience**, NCDs can help retailers continue to draw foot traffic.

Implications

- **Continuing to maintain and enhance the public realm** is critical to creating the kind of experience that will attract shoppers, while also supporting NCDs' role as community gathering places. This includes:
 - Streets that prioritize pedestrian comfort, safety, and security
 - Accessible and attractive public spaces
 - Cultural events, other special events, and public space programming
- **Celebrating local historic and cultural assets** can contribute to a unique and interesting environment.
- **High-capacity district management organizations can help districts create a great experience** for residents and visitors. These can include Community Benefit Districts (CBDs), Merchant Associations, Community Development Corporations (CDCs), or other types of management organizations