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

Final Report

February 15, 2018

prepared for:

San Francisco Office of Economic and Workforce Development

STRATEGICECONOMICS

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INTRODUCTION

The San Francisco Office of Economic and Workforce Development (OEWD) contracted Strategic Economics to provide a series of issue briefs about the trends affecting the City's Neighborhood Commercial Districts (NCDs). NCDs include most of the City's neighborhood retail, outside of Downtown, mid-Market, the northeastern waterfront, and Stonestown Galleria.[1] This report is intended to provide background information and analysis on changing industry trends and other conditions affecting the NCDs that City agencies may use in exploring policy changes, programs, and other strategies to help the NCDs adapt to changing conditions.

This report includes issue briefs on the following three topics:

1. The national restructuring of the retail, restaurant, and personal services industries.
2. Factors required to support successful San Francisco retail districts.
3. Opportunities, costs, and challenges for retail, restaurant, and personal services businesses in San Francisco, and the adaptations that businesses are making in response to changing conditions.

An executive summary for this report is available for download on OEWD's website. The executive summary provides an overview of key findings from the report, as well as cross-cutting conclusions and implications for the NCDs drawn from the three issue briefs.

The three issue briefs are based on interviews conducted in August 2017 with over a dozen San Francisco retail brokers, business owners, staff from merchants' associations, community benefit districts, and business assistance providers, and other stakeholders; literature review; analysis of available data on sales trends, employment, visitation, and other relevant indicators; and previous work conducted by Strategic Economics. A complete list of interviewees and a bibliography are provided in the appendix.

Focus of the Study: Retail, Restaurant, Nightlife, and Personal Services Industries

This study focuses on retail, restaurant, nightlife and entertainment, and personal service uses. For the purposes of this study, these uses are defined as follows:

- **Retail Sales Establishments** (referred to as "retail," "retail stores," or "retailers" throughout the report) include brick-and-mortar and online stores selling physical products (such as groceries, clothing, sports equipment, toys, etc.).
- **Restaurants** include 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. Some data sources categorize these uses as "food services."
- **Nightlife and Entertainment:** Restaurants, bars, clubs, theaters, and other venues open during evening hours.
- **Personal Services and Fitness** include establishments providing personal services to the general public, such as hair salons, nail salons, barber shops, gyms or other fitness centers, etc.

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[1] For the purposes of this study, the term "neighborhood commercial district" is used broadly to include areas zoned Neighborhood Commercial Transit Districts.

Note that these definitions are based on common usage in the literature and by real estate professionals, and not intended to conform to the land use definitions in San Francisco's zoning codes. Moreover, these uses are not inclusive of all the uses found in ground floor storefronts in San Francisco's NCDs. Other common ground floor uses include (for example) financial services (e.g., banks and credit unions), medical services, civic organizations, and professional services that provide services in an office-like setting directly to the general public. While these other uses are not the focus of the study, the role of the overall mix of uses in supporting a successful NCD is discussed throughout the study.

ISSUE BRIEF #1: RESTRUCTURING OF THE RETAIL, RESTAURANT, AND PERSONAL SERVICES INDUSTRIES

ISSUE BRIEF SUMMARY

Purpose and Approach

The retail, restaurant, and personal services industries are in the midst of a major transformation. Based on discussions with local stakeholders and review of literature and data, this issue brief describes national trends that are currently affecting these industries, and how these trends are impacting San Francisco's NCDs.

Key Findings

National Trends

Based on literature review and interviews, Strategic Economics identified nine trends that are driving change in the national retail, restaurant, and personal services industries:

1. **Nationally, growth in retail and restaurant sales is concentrated in a few categories.** These include non-store (online) sales, food and beverage stores, restaurants and bars, building materials and home furnishings, and health and personal care stores.
2. **Major retailers are closing stores in record numbers**. This reflects a national oversupply of retail space, increased competition with online sales, and (for some retail chains) debt obligations associated with leveraged buyouts.
3. **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, with growth in categories including apparel, office supplies, sporting goods, toys, and groceries.
4. **Technology is allowing retailers, restaurant owners, and service providers to integrate brick-and-mortar and online sales strategies.** For example, brick-and-mortar businesses are taking advantage of online sales platforms, app-based delivery services, and online reservation services.
5. **Americans are increasingly spending their money on experiences – such as dining, nightlife and entertainment, and personal services – rather than objects.** Spending on dining out, health and wellness, and travel is increasing.
6. **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.
7. **In a challenging retail environment, discount stores are seeing continued growth.** Discount retailers that are adding stores include clothing stores (TJ Maxx, Marshalls), grocery stores (Grocery Outlet, Trader Joes), warehouse and general merchandise stores (Costco, Target), and dollar stores.
8. **After many years of growth, luxury spending appears to be slowing and luxury brands are struggling nationally.**
9. **E-commerce and retail industry consolidation are shifting employment patterns and driving demand for warehousing and distribution space.** Nationally, e-commerce employment is growing even as overall retail employment remains flat. And, while there is a national oversupply of traditional retail space, demand for "last mile" distribution space is growing.

Impacts of National Trends on San Francisco's NCDs

San Francisco's many competitive advantages for retail and restaurants have somewhat insulated the City's businesses from these national trends. These include a strong local economy; a culture that values shopping local and eating out; significant regional and international tourism; the attractive, walkable, urban environment offered by many NCDs; and a limited number of malls and formula retailers. Some reporting suggests that the national oversupply of retail is concentrated in suburban malls, particularly in slow-growing regions, and that retailers are increasingly focusing on faster-growing, urban areas.

However, after many years of growth, San Francisco's retail sector appears to be slowing. Sales tax revenues slowed between 2015 and 2016. According to brokers, NCD rents have plateaued, while vacancies in some NCDs are increasing. Retail employment in the city is growing, but relatively slowly compared to incomes or the rest of the economy. Business owners in the NCDs report increased competition with e-commerce and in more categories (e.g., groceries, clothing, personal care goods).

Consistent with national trends, restaurant, entertainment, and personal services uses are increasingly driving demand for ground floor space in San Francisco neighborhoods. While demand appears to be slowing generally, brokers report that most of the interest in ground floor space in the NCDs is coming from restaurants and service providers (such as fitness centers and medical services). This reflects the national trend towards increased spending on dining, services, and other experiences, and could mitigate some of the effects on vacancy rates of any local retraction in the retail industry. As discussed in more detail in Issue Brief #2, restaurants and personal services are also a key component of the experience provided by neighborhood shopping districts, serving to draw foot traffic to other businesses and providing spaces to linger and gather as a community.

Organization

The remainder of this issue brief is organized around the nine major trends listed above. For each trend, an overview of the national context is provided, followed by discussion of how the trend is playing out in San Francisco's NCDs. The issue brief also includes call-out text boxes on special topics including trends in the grocery and restaurant industries, and emerging delivery technologies.

NATIONAL TRENDS AND IMPACTS ON THE NCDS

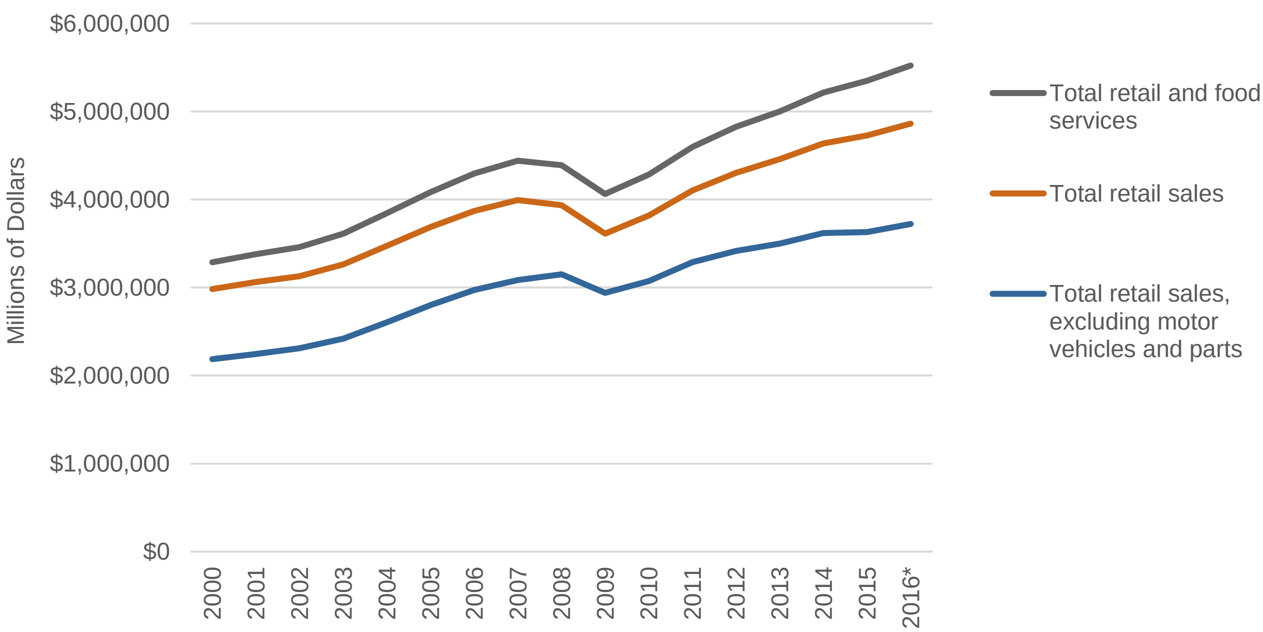
1. Nationally, Growth in Retail and Restaurant Sales is Concentrated in a Few Categories

Figure 1, below, shows total national retail and food services sales and total retail (including and excluding motor vehicles and parts) sales between 2000 and 2016, based on a national survey by the U.S. Census Bureau. Figure 2 shows retail store and food services sales by category, excluding motor vehicles and parts and gasoline stations. (Comparable data for personal services are not available.)

Since the end of the recession in 2009, total retail sales have grown moderately. Excluding motor vehicles and parts, retail sales grew by an average of about four percent a year between 2009 and 2014, slowing to two percent a year in 2015 and 2016 (Figure 1). Growth in retail sales was concentrated in just a few categories including food and beverage stores, non-store sales (a category that primarily includes online stores with no brick-and-mortar presence), building materials and home furnishings, and health and personal care stores. Sales in other categories have grown more slowly or declined (Figure 2).

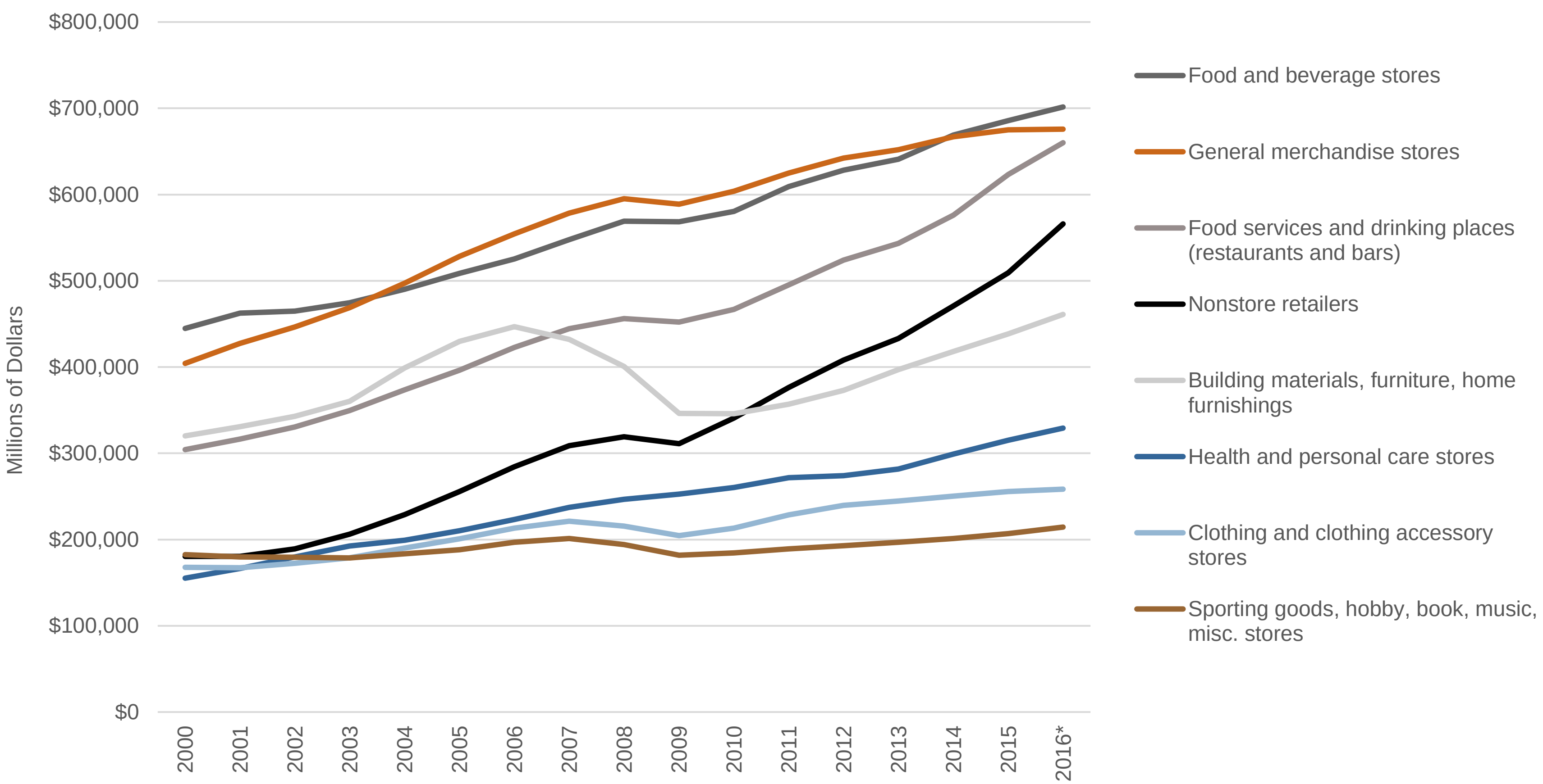
Meanwhile, food services (restaurants and bars) sales have grown much more quickly and steadily than retail sales, with growth accelerating in recent years. Between 2009 and 2016, total food services sales grew by an average of seven percent a year (Figure 2).

Figure 1. Estimated Annual Sales of U.S. Retail and Food Services Firms: 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

Figure 2. Estimated Annual Sales of U.S. Retail Firms by Type of Business: 2000-2016
Excluding Motor Vehicles and Parts & Gas Stations
(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.

Impacts of National Trends on San Francisco's NCDs

- **Retail and restaurant sales in San Francisco have increased more quickly than the national average, but began to plateau in 2016.** Figure 3 shows San Francisco's total sales tax revenues from retail and food services[2] from 2007 through 2016, the most recent year for which data are available. After dipping during the recession, sales tax revenues recovered rapidly starting in 2010, growing at an average rate of six percent a year between 2010 and 2015. However, between 2015 and 2016, sales tax revenues only increased by one percent. This may in part reflect consumers shifting to online purchases, as the data do not include e-commerce sales.

  Note that sales of nontaxable items, including food for home consumption, prescription medicines, and services, are not included in the sales tax data. In contrast, the national data discussed above and shown in Figures 1 and 2 are estimated gross sales based on business surveys.

- **Sales at restaurants and bars are increasing especially quickly in San Francisco, reflecting the City's status as a regional dining and nightlife destination, and a local culture that values dining out.** Figure 4 shows San Francisco sales tax revenues from retail and food services broken out in four categories: restaurants and hotels, food and drugs,[3] building and construction, and general consumer goods (all other goods). Restaurant and hotel sales tax revenues grew the fastest, by an average of nine percent a year between 2010 and 2015, and continued to grow more modestly (four percent) between 2015 and 2016. Food and drug and building and construction sales tax revenues also continued to increase through 2016.

- **After five years of growth, sales tax revenues from general consumer goods began to decline in 2015 and 2016** (Figure 4). Other data from the State Board of Equalization (not shown) suggests that the decline was led by a fall in sales from clothing and accessories stores and general merchandise stores, similar to the national trends shown in Figure 2 above.

- **Anecdotally, it appears that the businesses in the NCDs are experiencing a slowdown in sales.** The citywide data presented in Figure 3 include all the sales tax revenues generated in the city, including from the NCDs as well as Union Square, Stonestown Galleria, and other commercial areas. Issue Brief #2 provides sales tax data from selected case study NCDs and shows that sales tax revenues declined or plateaued between 2015 and 2016 in most of the case study districts. However, comprehensive data on sales in the NCDs are not available. Anecdotally, many businesses and business/merchant association representatives interviewed in mid-2017 observed that sales in the NCDs have slowed in the last 12-18 months. Potential factors cited included reduced consumer confidence about future economic growth, uncertainty about the national political climate, and increased competition with online sales. Restaurant and grocery store representatives also cited increased competition with other local, brick-and-mortar food stores and food services establishments as a challenge for individual businesses (restaurant and grocery store trends are discussed in more detail in text boxes later in this issue brief).

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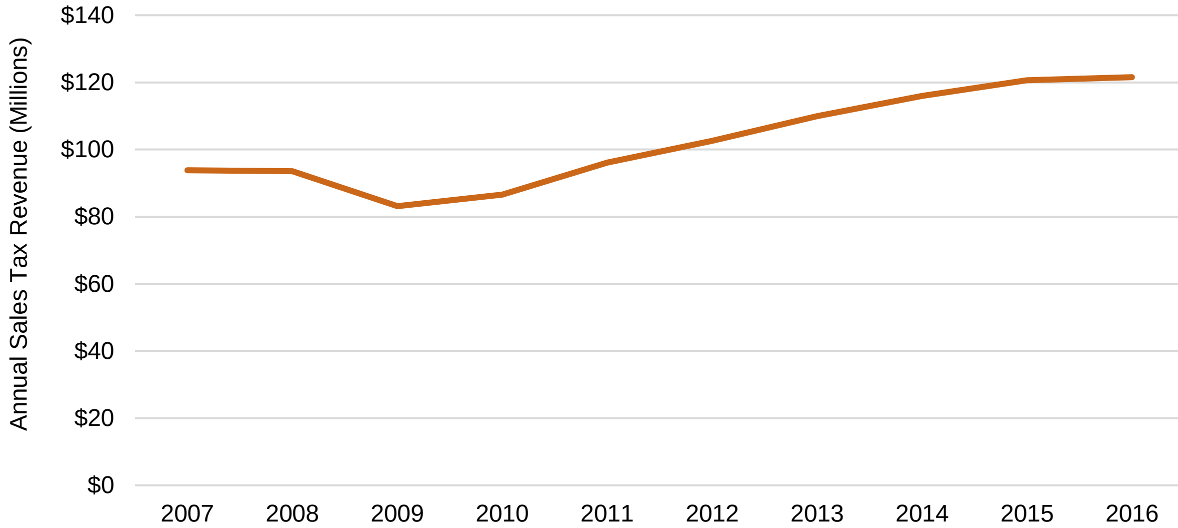
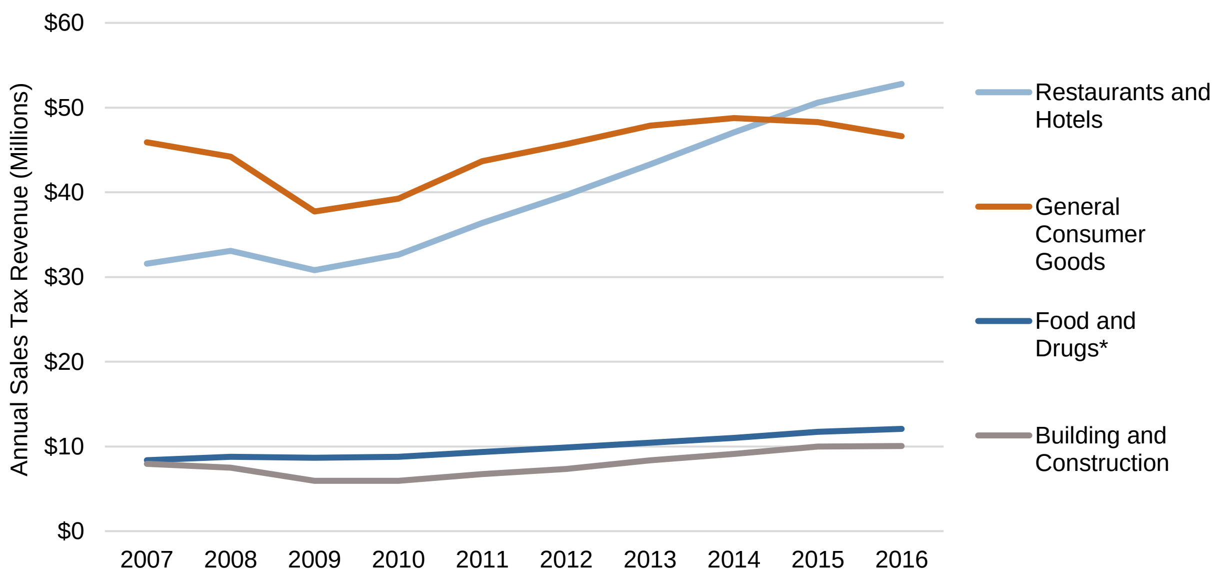
[2] Excluding sales tax revenues from the following categories: autos and transportation, fuel and service stations, and business and industry (business-to-business) sales. The data do not include online sales.
[3] Note that this category significantly underrepresents total food and drug sales, since food for home consumption and prescription medicines are not taxable in California.

Figure 3. Annual Sales Tax Revenues from San Francisco Retail and Food Services Firms, 2007-2016
Excluding Motor Vehicles and Parts, Gas Stations, Business-to-Business, and Online Sales (in Millions of Dollars; Not Adjusted for Inflation)



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

Figure 4. Annual Sales Tax Revenues from San Francisco Retail and Food Services Firms by Category, 2007-2016
Excluding Motor Vehicles and Parts, Gas Stations, Business-to-Business, and Online Sales (in Millions of Dollars; Not Adjusted for Inflation)



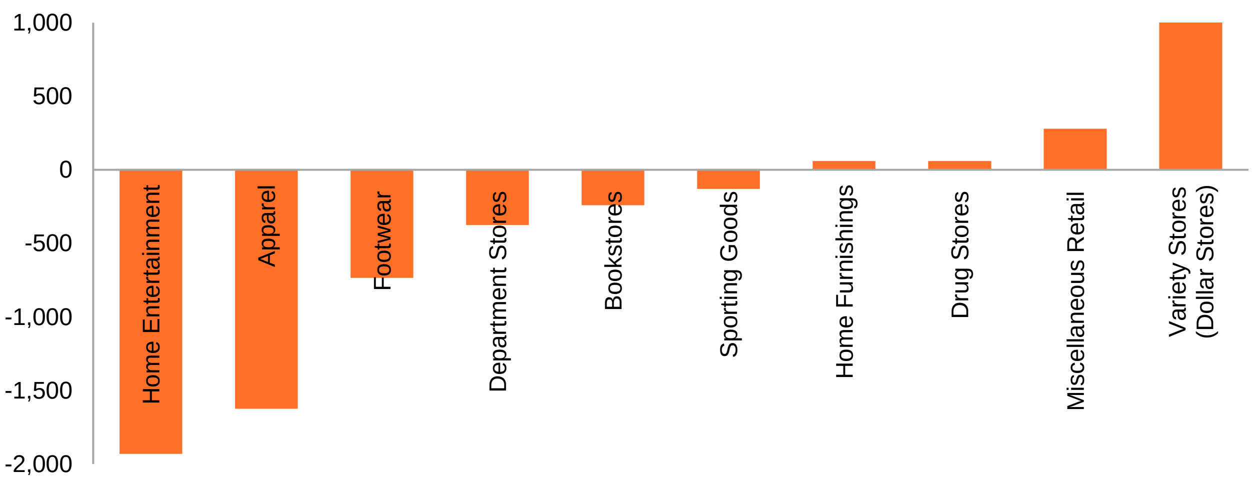
*Note that because food for home consumption and prescription medications are not taxable, the taxable sales data shown here significantly underrepresent gross sales at food and drug stores.
Sources: San Francisco Office of the Controller, 2017; Strategic Economics, 2017.

2. Major Retailers are Closing Stores in Record Numbers

The past year has been notable for a flurry of retail bankruptcies and store closure announcements. In the first three quarters of 2017, U.S. chain retailers announced that they would close 6,800 locations – compared to 3,000 announced openings.[4] As Figure 5 shows, most of the announced closures are in the home entertainment, apparel, electronics, footwear, and department store categories. Examples of stores that have recently declared bankruptcy – and plans to close some or all of their locations – include J.C. Penney, RadioShack, Macy's, Kmart, Sears, Sports Authority, Payless ShoeSource, Gymboree (children's clothes and shoes), rue 21, Wet Seal, The Limited, Gordmans (a department store), Gander Mountain (hunting and outdoor goods), and hhgregg (appliance, electronics, and furniture).[5] Even retailers that are doing relatively well (such as Best Buy) are closing some locations to reduce costs, or paring back showroom space and dedicating part of their retail footprint to warehousing and distribution for goods purchased online.

Some of the challenges underlying these closures include the continued shift from brick-and-mortar to online sales, as well as a shift from spending on goods to spending on experiences. Both these trends are discussed in more detail below. Another contributing factor to store closures is that some retail chains are saddled with billions of dollars in loans (often from leveraged buyouts by private equity firms). As these loans are coming due, some retailers have been unable to refinance their debt due to rising concerns about the strength of the retail sector.[6] Fundamentally, however, the United States appears to be grappling with an oversupply of retail space. The U.S. has 23.5 square feet of retail per person, compared to 16.4 in Canada and 11.1 in Australia, the next two countries with the most retail space per capita.[7] According to CoStar Group, a real estate data company, the U.S. has about a billion square feet of oversupply in retail space; to reach equilibrium, retailers will need to shed about 10 percent of their footprint.[8]

Figure 5. National Announced Net Store Openings for Selected Retail Categories, Q1 to Q3 2017 (Announced Openings Minus Announced 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"

[4] Townsend et al., "America's 'Retail Apocalypse' Is Really Just Beginning."
[5] Thompson, "What in the World Is Causing the Retail Meltdown of 2017?"; Isidore, "Retail Bloodbath."
[6] Townsend et al., "America's 'Retail Apocalypse' Is Really Just Beginning."
[7] Peterson, "There's One Major Thing Everyone Gets Wrong about Amazon and the US Retail Apocalypse."
[8] Hepler, "Union Square Struggles with Retail Challenges."

Impacts of National Trends on San Francisco's NCDs

- **While San Francisco has experienced some chain store closures, commercial districts in the city – and specifically in the NCDs – may be somewhat protected from the full impact of the national retail industry consolidation.** So far, the national wave of bankruptcies and store closures appears to include relatively few stores in San Francisco (including, for example, several Radio Shacks throughout the city, and Macy's locations in Stonestown Galleria and Union Square). It is unclear how many stores in San Francisco's NCDs will be affected, but it seems likely that the immediate impact will be limited. Some reporting suggests that the national oversupply of retail is concentrated in suburban malls, particularly in slow-growing regions, and that retailers are increasingly focusing on faster-growing urban areas.[9] Moreover, chain (or "formula") retail is less prevalent in San Francisco compared to the national average, and is largely concentrated in outside of NCDs in Downtown, South of Market, the northeastern waterfront, and Stonestown Galleria.[10] However, chain retailers often occupy some of the larger storefronts in NCDs, and previous research has found that their closure can result in reduced foot traffic and long-term vacancies that are challenging to fill.[11] (The implications of chain or formula retail in the NCDs, as well as the City's formula retail controls, are discussed in more detail in Issue Brief #3.)
- **Available data indicate that vacancy rates in some San Francisco's NCDs are rising.** Retail broker reports indicate that San Francisco has one of the lowest vacancy rates for ground floor storefronts in the nation.[12] However, broker reports primarily track space in and around Union Square and Downtown San Francisco.[13] While comprehensive data on vacancies are more challenging to obtain for the NCDs, OEWD tracks ground floor vacancy rates for 24 NCDs that are part of San Francisco's Invest in Neighborhood economic development program. 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%.[14]
- **Brokers also report that demand for ground floor space in the NCDs appears to be slowing.** Anecdotally, local retail brokers indicate decreased demand for ground floor space in the NCDs over the past few months to a year. In addition, after many years of sustained growth, some brokers report that ground floor rents in the NCDs are starting to stabilize or decline. (OEWD does not track rents and other reliable data sources are not available.) As with the anecdotal decline in sales discussed under Trend 1 above, it is unclear why this slowdown is occurring. Possible factors could include cooling regional economic growth and the effects of restructuring in the retail industry.
- **To some extent, vacancies left by traditional retailers may be filled by other uses.** While demand appears to be slowing generally, brokers report that most of the interest in ground floor space in the NCDs is coming from restaurants, nightlife and entertainment, and service providers (such as fitness centers and medical services) and that this trend has intensified in the last 18 months

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[9] Rothstein, "Even Developers Agree The U.S. Has Way Too Much Retail Space"; Grabar, "The Retail Apocalypse Is Suburban."
[10] Strategic Economics, "San Francisco Formula Retail Analysis."
[11] Strategic Economics.
[12] Cushman & Wakefield, "San Francisco Retail Marketbeat, Q1 2017."
[13] Based on discussions with San Francisco retail brokers and review of broker reports.
[14] 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).

or so. As discussed in more detail below, this mirrors a national trend towards restaurants, nightlife and entertainment, and personal services filling space formerly occupied by retailers, and could mitigate some of the effects on vacancy rates of any local retraction in the retail industry.

3. Online Sales are Driving Retail Growth and Expanding into New Categories

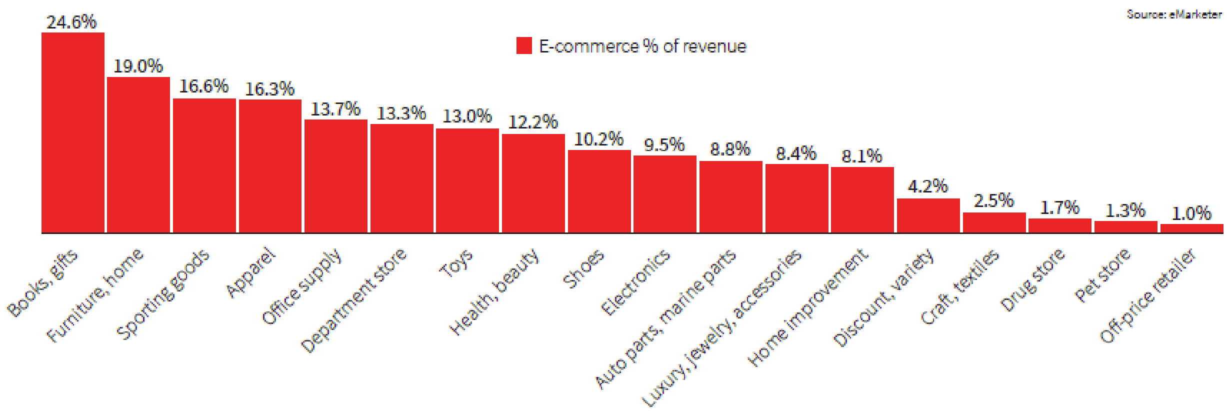
As discussed above and shown in Figure 2, non-store sales – a category that includes online stores without a brick-and-mortar presence – are growing significantly faster than any other retail category. In 2016, non-store sales accounted for 12 percent of total national retail sales. However, more than 40 percent of the growth in total retail sales occurred at non-store retailers between 2014 and 2016.[15] A single online retailer – Amazon – appears to be driving much of the growth. One study found that 43 percent of all online retail sales in 2016 went to Amazon, and that Amazon accounted for the majority (53 percent) of growth in e-commerce sales for the year.[16]

Surveys show that consumers prefer to shop online when it saves them money and time. Consumers prefer to shop in-person when experiencing a product in person is considered more important than price or convenience, when they need a product immediately that is more readily available in a store (for example, a loaf of bread or quart of milk), or when purchasing the product in-person is cheaper (for example, because of high shipping costs).[17]

As delivery becomes faster and cheaper, and consumers become increasingly familiar with purchasing products online, online shopping is moving beyond books, music, and video to a wider range of categories including sporting goods, apparel, office supplies, and toys. Figure 6 shows e-commerce as a percent of revenue by category. Even for categories where e-commerce accounts for a relatively high percentage of total revenues, in-person sales still drive the majority of sales revenues. Note that Figure 6 includes non-store sales, as well as sales that are made at stores that have an in-person as well as an online location. For example, furniture store sales are often made in-store, through a sales representative who places a custom order online; these sales are attributed to e-commerce.

[15] 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 (analysis by Strategic Economics).
[16] B. I. Intelligence, "Amazon Accounts for 43% of US Online Retail Sales."
[17] JLL, "Bagged or Boxed? The Future of 13 Retail Categories."

Figure 6: E-Commerce as a Percent of Revenue by Retail Category



Excerpted from JLL, "Bagged or Boxed? The Future of 13 Retail Categories."

Impacts of National Trends on San Francisco's NCDs

- **Retailers in San Francisco's neighborhoods report that they are seeing increased competition with online sales, and for an expanding range of products.** Anecdotally, small retail businesses (and the brokers, merchant association representatives, and business assistance providers who serve them) report that competition with online sales has intensified in the past year, as the speed of delivery and range of products that consumers are buying online has increased. For example, grocery stores – which not long ago were considered relatively protected from online sales – are now competing against meal delivery kits, restaurant delivery, and delivery from other grocery stores.
- **At the same time, small retailers, restaurants, and other businesses are also taking advantage of online platforms to increase their sales**. This is discussed in more detail under Trend 4.

4. Technology is Allowing Retailers, Restaurant Owners, and Service Providers to Integrate Brick-and-Mortar and Online Sales Strategies

To compete more efficiently with online retailers, brick-and-mortar businesses are increasingly adopting "omnichannel strategies," defined as the integration of brick-and-mortar and digital channels to improve customer experience and increase sales.[18] These strategies can take several forms, including:

- **Integration of product sales and returns through digital and brick-and-mortar channels.** This omnichannel strategy is most commonly adopted by larger chain retailers with multiple stores, like Target or Best Buy. Customers can browse, buy, and return products both online and in-store, at their convenience. Some retailers have developed "click-and-collect" systems where customers can opt to buy products online and pick them up at the store, sometimes involving smart lockers or other systems for reducing wait times for customers collecting their orders.[19] A few grocery stores, including Kroger, Walmart, and Whole Foods, have also implemented click-and-collect systems.[20]

[18] Sopadjieva, Dholakia, and Benjamin, "A Study of 46,000 Shoppers Shows That Omnichannel Retailing Works."
[19] Wetten, "Future of Retail."
[20] Anderson, "Click-and-Collect Continues to Evolve, but Where Is It Headed?"

- **Intermediary, application-based services to order and deliver food and other products.** Restaurants, including small businesses without an independent online presence, are increasingly processing to-go orders placed through third-party, application-based services. Examples include GrubHub, Caviar, Eat24, UberEats, Postmates and DoorDash. These services provide the customer with delivery service to their door. Some also allow customers to place an order online and pick it up at the restaurant, which business owners value as customer walk-ins can generate more tips and additional, incidental sales. Intermediary delivery services are also extending to other retail categories: for example, Postmates has couriers delivering from all types of businesses, while Instacart specializes in the delivery of groceries and other household staples.
- **Intermediary online services to make reservations at restaurants and personal services businesses.** Businesses that provide services on the premises, like restaurants and salons, are increasingly using third-party platforms to facilitate booking their services.[21] While these platforms are very convenient for customers and can reduce the cost of making reservations, they also charge fees that can represent a burdensome cost for some low-margin businesses.
- **Specialized online platforms that increase the visibility of niche businesses.** Some business owners are using online platforms dedicated to the specific type of product they sell, which increases their visibility and can boost their sales.

Underscoring the importance of integrating brick-and-mortar and online sales, many businesses that started online are now opening brick-and-mortar stores where customers can experience products in person. For example, Amazon has opened several book stores across the U.S. and is scheduled to open a new one in San José. Warby Parker, an online eyewear retailer, has opened a store in Hayes Valley. Reformation and Everlane, two online clothing brands, are opening stores on Valencia Street in San Francisco.

Impacts of National Trends on San Francisco's NCDs

- **Third-party apps are allowing some independent retailers, restaurant owners, and service providers to take advantage of the Internet to expand sales.** Already, many restaurant owners in San Francisco's NCDs are seeing delivery through third-party delivery apps as an essential way to expand sales, while some service providers are using online booking platforms. Some small retailers are experimenting with selling online as well, either through their own websites or third-party platforms. For example, furniture stores can list vintage furniture on the online platform Chairish to gain a broader audience. While third-party apps do charge fees, they can also help direct consumers to businesses (for example, through ratings and recommendations) and can provide data on sales trends that can help businesses better deploy their resources (for instance, by expanding staffing at certain times of day that tend to be busier). Many business owners are also taking advantage of social media (Facebook, Instagram, Twitter) to keep customers engaged.
- **Other small neighborhood businesses are struggling to maintain an online presence.** Maintaining an online presence can take staff time and may be more beneficial for businesses in some categories (such as those selling unique or highly curated clothing or furniture) than for others (e.g., a convenience or corner store). However, almost all businesses can benefit from maintaining a basic online presence, such as ensuring that the accurate address and hours are listed on Google Maps and Yelp. The challenges associated with maintaining an online presence are discussed in more detail in Issue Brief #3.

[21] "Fast-Growing Beauty and Wellness Platform Shedul.com Raises $6 Million"; Perry, "The 'Internet of Restaurants' Is Coming for Your Info."

- **Omnichannel strategies may be easier to roll out for chains than for small businesses.** Large chains already have an online presence and can benefit from economies of scale and an established network of stores where customers can browse, pickup, and/or return products.

- **It is too early to determine the full impact on NCDs of increased reliance on delivery services.** Restaurants and grocery stores often serve as anchors for NCDs, driving foot traffic to neighboring stores. To the extent that sales of food (or other goods) shift to a delivery model, this may reduce overall foot traffic in NCDs. However, San Francisco is on the cutting edge of delivery trends and it is too early to determine the effects. For example, while grocery delivery appears anecdotally to be growing in San Francisco, it seems likely that grocery stores will continue to attract significant in-person shopping (see text box, below).

Emerging Delivery Technologies

As the market for delivery continues to grow, several companies are developing new technologies to perform deliveries faster and at a cheaper cost, such as sidewalk delivery robots[1] and delivery drones.[2] These innovations are close to reaching the market, and in some cases, are already piloting deliveries in cities. For instance, Starship Technologies operates sidewalk robots that deliver food in a number of cities across the U.S., including Washington, D.C., and Redwood City, California. These robots are expected to function best in urban and suburban environments where sidewalks are not saturated by a flow of pedestrians (i.e., outside of central business districts like Manhattan or Downtown San Francisco), and aim to eventually provide on-demand delivery for as low as $1 per trip. This delivery technology could extend to other uses. For example, Starship Technologies is currently partnering with a hospital to develop medical deliveries.[3]

Because this technology is so new, there is little indication as to how neighborhood shopping districts might be affected. On the one hand, sidewalk drones or other delivery drones could help small, local businesses compete with Amazon and other large online retailers, by reducing the cost of delivery. Delivery robots could also help make delivery more efficient, reducing the traffic generated by large delivery trucks and vans. On the other hand, small, local businesses may not have the economies of scale required to compete with larger retailers in providing on-demand delivery, and drones could prove a nuisance on the sidewalk or in the air. The effects will only become clear as these technologies come into wider use over time.

[1] Glaser, "San Francisco Is Considering Legislation That Would Ban Sidewalk Delivery Robots"; Lonsdorf, "Hungry?"; Wong, "Delivery Robots."
[2] Meola, "Amazon, Domino's and the Future Drone Delivery Market."
[3] Interview with David Catania, Counsel for Starship Technologies, August 2017.

Grocery Industry Trends

The grocery industry is one of the bright spots in brick-and-mortar retail, with sales continuing to expand and many brands opening new stores across the country. Although there is some speculation that the grocery boom could result in an oversupply, other studies project continued growth over the next ten years.[1] Some of the trends affecting the industry include:

- **Rapid expansions (and increased competition):** Regional chains like Publix (in the southeast), Wegmans (in the northeast), and Trader Joe's, Grocery Outlet, and Sprouts (in the west) are adding new locations. Meanwhile, the German discount supermarket chains Aldi and Lidl are also entering the market. These chains are competing for sales with national, middle-market grocers (like Kroger, Albertsons, and Safeway) as well as general merchandisers like Walmart and Target. Even drug stores like CVS and Walgreens have increased their grocery offerings in recent years. Organic food and discount products (including store brands) have been some of the fastest growing product lines.
- **Omnichannel integration:** Like other retailers, grocery stores are experimenting with online sales strategies, including delivery and click-and-collect. However, the category appears to be somewhat resistant to e-commerce. Nationally, 93 percent of consumers say they prefer to buy groceries in person, in order to select fresh produce and access goods more immediately.[2] Amazon's recent purchase of Whole Foods suggests that online retailers see great value in brick-and-mortar grocery locations; Whole Foods' 430 existing stores (located predominantly in affluent urban areas) are expected to serve as hubs for delivery and for customers picking up pre-orders, while allowing those who prefer to pick out their produce in person to do so.
- **Increased importance of fresh and prepared foods, and decreased importance of processed food and commodities:** As shoppers have become more health conscious, the higher-margin products that line the edge of most stores (produce, meats, cheeses, baked goods, and prepared foods) are becoming more important, while sales of commodities and processed food in the center of the store are reportedly declining.
- **Differentiation with niche products, experience, and/or value:** In a crowded marketplace, stores are working to differentiate themselves by featuring niche goods (e.g., locally sourced goods), offering an enticing experience (e.g., natural light, airy layouts, more prepared foods and spaces for dining), and/or by offering deep discounts.

These trends are playing out in San Francisco's grocery stores. Grocers in many neighborhoods are seeing increased competition; for example, Bi-Rite is now competing with Whole Foods and Gus's Community Market for higher-end groceries in the Mission District. Traditional grocery stores are also competing with meal delivery services and restaurant delivery – a national trend, but one that may be particularly acute in San Francisco and other urban markets on the cutting edge of the app-based delivery trends. To compete with these services, stores are increasingly investing in prepared foods and spotlighting niche products and tastings.

Increased competition is affecting not just the top and middle of the market, but also convenience and corner stores. These stores are also struggling to adapt to City regulations on the sale of tobacco and alcohol, which are core products for many corner stores. While many stores are experimenting with shifting towards prepared foods, produce, and other fresh foods, competing with full-service grocery stores in these categories can be challenging. Finally, grocers of all types – like other retailers in San Francisco – are struggling to attract and maintain qualified workers. These and other costs challenges of doing business in the City will be discussed in more detail in a forthcoming issue brief.

[1] Abrams, "As Amazon Enters the Market, U.S. Grocers Focus on Becoming the One-Stop Shop."
[2] JLL, "Bagged or Boxed? The Future of 13 Retail Categories."
Other sources: Widness, "Four Trends Driving the Evolution of Grocery Stores"; Abrams and Creswell, "Amazon Deal for Whole Foods Starts a Supermarket War."

5. Americans are Increasingly Spending their Money on Experiences – such as Dining, Nightlife and Entertainment, and Personal Services – Rather than Objects

Examples of this trend include:

- **A steady increase in the amount of money households spend on food away from home**: The amount that consumers spend on food away from home[22] is reaching record levels among all age groups.[23] In 2015, food away from home accounted for 43 percent of the average Americans' spending on food – and 52 percent of the average Bay Area residents' food spending. [24]
- **Increased spending on health and wellness (i.e., gyms and fitness centers) and beauty**: CoStar reports that the number of fitness studios entering lease agreements is growing: in the first half of 2017, more than 19 fitness studio companies have absorbed more than 2.04 million square feet of space in 232 lease signings.[25]
- **Increased spending on travel**. Hotel occupancy rates are increasing, and airlines are flying more passengers than ever before. [26]

Consistent with these national trends, San Francisco has attracted a significant increase in visitation, with seven consecutive years of record-breaking growth in tourist numbers. In 2016, San Francisco welcomed 25.1 million visitors, a 2.3 percent increase from the previous year. These visitors brought an estimated $9.69 billion in spending to the city.[27]

Impacts of National Trends on San Francisco's NCDs

- **Many of San Francisco's NCDs may have an advantage over other (more suburban) retail districts in continuing to attract shoppers looking for a unique experience.** Indeed, mall developers in other parts of the country are looking to replicate the type of attractive, walkable, mixed-use environment found in San Francisco NCDs and other urban shopping districts.[28]
- **Restaurants, nightlife and entertainment, and personal services are a key component of the experience provided by neighborhood shopping districts, and are increasingly driving demand for ground floor space in San Francisco neighborhoods.** Brokers, business owners, and other stakeholders interviewed for this report described restaurants and cafés as playing two key roles in NCDs: serving as destinations or anchors that draw foot traffic to other businesses in the NCDs, and providing spaces to linger and gather as a community. Some personal service providers, such as hair salons, can also play this role.

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[22] Food away from home is defined as: "all meals (breakfast and brunch, lunch, dinner and snacks and nonalcoholic beverages) including tips at fast food, take-out, delivery, concession stands, buffet and cafeteria, at full-service restaurants, and at vending machines and mobile vendors. Also included are board (including at school), meals as pay, special catered affairs, such as weddings, bar mitzvahs, and confirmations, school lunches, and meals away from home on trips." Source: Consumer Expenditure Survey, https://www.bls.gov/cex/csxgloss.htm.
[23] Thompson, "Why Do Millennials Hate Groceries?"
[24] Strategic Economics, analysis of 2015 Consumer Expenditure Survey.
[25] Heschmeyer, "Wireless Stores and Discounters Among Most Active Retailers Leasing Space."
[26] Thompson, "What in the World Is Causing the Retail Meltdown of 2017?"
[27] "San Francisco Travel Reports Record-Breaking Tourism in 2016."
[28] Sicola, "The Rise of Experiential Retail | NAIOP."

- **Anecdotally, it appears that many San Francisco districts are seeing an increase in tourism that is helping to support neighborhood businesses.** 2016 was the seventh consecutive year of record-breaking growth for San Francisco's tourism industry. Overnight visitors spent a total of $9.7 billion in San Francisco in 2016, up 3.2 percent from 2015.[29] A 2014 study by SF Travel found that the average out-of-town visitor to San Francisco visited 3.4 neighborhoods. Union Square, Fisherman's Wharf, the Embarcadero, and Chinatown were the top neighborhoods where tourists shopped and dined, but other common destinations included the Mission, Haight-Ashbury, North Beach, Japantown, and the Castro. Updated data on visitation is expected to be available from SF Travel in Spring 2018. Based on discussions with business owners and others, however, it appears visitation to the NCDs has increased since 2014, in part driven by the growth of short-term rental sites such as AirBnb, which disperse overnight stays (previously concentrated in hotels in and around Downtown) throughout the neighborhoods. Interviewees for this report suggested that increased tourism is helping to support businesses in many NCDs, but that tourism alone is rarely sufficient to maintain a successful NCD.

[29] Cushman & Wakefield, "San Francisco Retail Marketbeat, Q1 2017."

Restaurant Industry Trends

Restaurant sales grew rapidly between 2009 and 2015, with San Francisco outpacing the national trend. Data from the National Restaurant Association suggest that total restaurant sales and employment continued to increase through mid-2017. Despite record sales, however, industry surveys suggest that restaurant owners feel uncertainty about future performance. Some of the national trends shaping the restaurant industry today include increased competition for consumers' food dollars; a shortage of skilled labor; growth in certain sectors (particularly fine dining and fast casual) accompanied by a decline in others; a declining lunchtime trade; and an expansion of food delivery services. These trends are playing out nationally, but if anything, the effects are particularly acute in San Francisco and other fast-growing, urban areas. Each of these trends, including the implications for restaurants in San Francisco's NCDs, is described in more detail below.

- **Increased competition:** In addition to competing with other restaurants, restaurants are competing with prepared food sections at grocery stores and meal delivery kits. Restaurants in many of San Francisco's NCDs face especially fierce competition. In 2012, Trulia found that the Bay Area region had more restaurants and bars per capita than any other metropolitan area in the country.
- **Labor shortage:** Over the last several years, restaurant owners in major metropolitan areas have struggled to attract and retain workers, particularly cooks. Restaurants in San Francisco operate in a particularly tight labor market; the City's unemployment rate was less than 3 percent in May 2017. Moreover, corporate kitchens (for example, at Google, Twitter, Facebook, and Apple) are competing with restaurants for skilled labor, and chefs in San Francisco and the Bay Area have excellent access to venture capital and other financing to help them open their own restaurants earlier in their careers. The shortage of labor and high cost of living in the Bay Area push up the wages that restaurants (as well as other businesses) need to pay to recruit and retain workers.
- **Growth of fine-dining, fast casual, and fast food, accompanied by challenges at mid-tier full-service restaurants:** Fast casual restaurants provide higher quality food than traditional fast food restaurants, but do not offer full table service. For example, customers may place an order at a counter or iPad, and bus the tables themselves. In part because of reduced labor costs, the fast casual sector is growing rapidly. The fine dining sector is also doing well, driven by the growth in high-income households. At the low-end, the fast food sector also continues to expand. However, mid-tier, full-service restaurants (also known as casual dining) are struggling, with same-restaurant sales falling at chains like Applebee's, Chili's, and Maggiano's. These restaurants appear to be feeling the brunt of the competition with other stores and services selling prepared foods.

Continued on the following page.

Restaurant Industry Trends *(continued)*

Local observers note similar trends playing out the NCDs (including among non-chain restaurants): growth in fine dining and fast casual sectors, and challenges among mid-tier, full service restaurants. The region's high labor costs likely exacerbate this trend. While fine dining establishments can pass higher labor costs on to diners, and the fast casual format helps reduce labor costs, full-service mid-tier restaurants have fewer options to deal with increased costs.

- **The "end of lunch:"** White collar workers are taking shorter lunch breaks, eating lunch at their desk, or eating in corporate cafeterias. This particularly affects restaurants that rely heavily on lunch trade, for example in San Francisco's Financial District. To the extent that lunch traffic made up a smaller share of their revenues to begin with, restaurants in the NCDs may be somewhat less affected.
- **Expansion of delivery services:** One study found that app-based delivery sales account for only about 2 percent of national restaurant sales today, but are projected to grow 15 times faster than the rest of the restaurant market through 2020. Restaurants in San Francisco's NCDs increasingly see delivery as a critical way to help expand their sales in response to higher costs. However, increased reliance on delivery can also result in reduced gratuities, and lower checks because customers may not add "extras" like beverages or dessert.

Sources: Interview with Gwyneth Borden, Golden Gate Restaurant Association**;** Thompson, "The Paradox of American Restaurants"; Moskin, "Not Enough Cooks in the Restaurant Kitchen"; Kolko, "Eating Towns, Drinking Towns."

6. Retail Stores are Experimenting with New Strategies to Capitalize on Increasing Demand for Experiences

Given the increasing demand for experiences from the U.S. consumer market, retailers are developing new strategies to attract customers. Examples of these strategies include expanding opportunities for customers to interact with products before making a purchase; integrating eating, drinking and wellness into traditional retail stores; and offering community-building activities such as classes, workshops, readings, lectures, or concerts. Successful brick-and-mortar retailers have also focused on training their staff to provide high-quality customer service to better compete with the convenience and lower prices found online. For instance, Best Buy has developed a dual strategy of matching online prices and hiring highly trained staff to increase their sales. [30]

Impacts of National Trends on San Francisco's NCDs

- **A number of retailers in San Francisco's NCDs are incorporating food, drink, events, and other entertainment uses to draw customers and diversify their revenues.** Examples include:
    - San Franpsycho's 9th Avenue location (in the Inner Sunset) is part-clothing retailer, part-pie and ice cream café. The store has periodic parties and other events to showcase new products.[31]

[30] Flemming, "Why the Grim Reaper of Retail Hasn't Come to Claim Best Buy."
[31] Jackson, "A Dish Best Served Gently Warmed."

- Mojo Bicycle Café on Divisadero Street incorporated a café/beer/wine and a bicycle shop for ten years. The owners recently announced that the bicycle business will be closing to allow the bicycle shop owner to do other things, but the café will remain open.[32]
- RS94109 on Larkin Street is a record store, coffee shop, and beer bar that also hosts regular live music performances.[33]
- Bird & Beckett in Glen Park is a book store/record store known for its live music calendar. The bookshop also hosts poetry readings and other literary talks.[34]
- Royal Cuckoo is a specialty grocery store in the Mission District that also includes an 8-seat bar with a food menu. The business was initially issued a permit to serve food and alcohol by mistake, but recently had to obtain a change of use permit (this requirement is discussed below).[35]
- Amado's (previously Viracocha) is under construction on Valencia. The business will include a restaurant, a basement entertainment venue, and retail in the front of the store; with this combination of uses, the space will likely be open 16 hours a day when it launches.[36]

- **However, construction and permitting can be significant challenges for combining different uses in one a space.** Renovating a space to include kitchen, bar, or other facilities can cost tens of thousands of dollars and require a significant construction period. In addition, in order to serve food and beverages in a retail store, a change of use permit is required to reclassify retail space as a restaurant. This process can take months. A liquor license from the California Department of Alcoholic Beverage Control (ABC) is also required to serve alcohol. Finally, in some neighborhoods, residents and merchants have raised concerns about the implications of serving food or alcohol in retail stores. These challenges are discussed in more detail in Issue Brief #3.

7. In a Challenging Retail Environment, Discount Stores are Seeing Continued Growth

While brick-and-mortar retail is contracting overall, some categories are seeing continued expansion. Some of the fastest-growing brick-and-mortar categories include:

- Off-price retailers like Ross and TJ Maxx/Marshalls (which have recently announced 70 and 65 new locations, respectively);
- Dollar stores (which are planning 1,250 new stores in the next year); and
- Discount warehouse and general merchandise stores like Costco (which plans to open 30 new stores in 2017), Target (which plans to open 30 small-format stores in the next year), and Walmart (which is seeing net store growth, despite some closures).
- Discount grocery stores are also expanding rapidly (see text box, above).[37]

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[32] Lee, "Bike Shop At 'Mojo Bicycle Café' Closing, But Eatery To Remain."
[33] Nahmod, "TL Record Store 'RS94109' Returns With Coffee Bar, Events & Soon Beer."
[34] "Bird & Beckett Books and Records."
[35] Pershan, "Signs at Royal Cuckoo Market Explain Bizarre Fight Over Beer and Wine License."
[36] Wenus, "Merchants Balk at Restaurant Addition to Retail (Updated)."
[37] Kline, "These 8 Retailers Are Actually Opening Stores"; JLL, "Bagged or Boxed? The Future of 13 Retail Categories."

These categories have generally faced relatively little competition from e-commerce because consumers value their low prices and the convenience of being able to shop for many brands and/or product categories in one place.[38] (However, Target and other big box discount stores are working to expand their online sales with omni-channel strategies.) Discount stores also appeal to consumers across a broad spectrum of incomes. For example, households with annual incomes above $100,000 account for nearly 20 percent of the revenue at dollar store chains.[39]

While independent retailers can also provide discount goods, formula retailers can leverage economies of scale to provide lower prices. In 2014, the City of San Francisco Office of Economic Analysis (OEA) surveyed prices for a standardized basket of commodities at over 30 non-formula and formula retailers in San Francisco. The OEA found that on average, prices were 17 percent higher at the non-formula retailers than at the formula retailers that were surveyed.[40]

Impacts of National Trends on San Francisco's NCDs

- **San Francisco has attracted new discount retailers in recent years.** Examples include new smaller-format Target locations in Downtown, on Geary and Ocean Avenue, and (most recently) in Stonestown Galleria; Grocery Outlets in the Mission, Portola, Visitacion Valley, and Outer Richmond; and new Daiso Japan Stores in the Mission and Downtown (in addition to the long-established store in Japantown).
- **However, the availability of appropriate space and the City's formula retail controls may slow the spread of chain discount stores in the NCDs.** These retailers generally require relatively large footprints and may not be able to find appropriate space in some NCDs. In addition, Strategic Economics' 2014 analysis of the formula retail controls found that the formula retail conditional use process creates disincentives for formula retailers to locate in San Francisco's NCDs, and that their willingness to do so depends on local market conditions. Formula retailers are more likely to submit applications in neighborhoods with strong market demand for new retail, and when they anticipate a positive community reception.[41] The effects of the City's formula retail controls are discussed in more detail in Issue Brief #3.

8. After Many Years of Growth, Luxury Spending Appears to be Slowing and Luxury Brands are Struggling Nationally

After years of expansion following the end of the recession, luxury spending in the U.S. – the largest market for luxury goods in the world – slowed in 2016 due to a strong dollar and a reduction in trade from foreign tourists, especially from China. U.S. consumers also appear to be reducing discretionary spending on clothing and other personal accessories, in reaction to uncertainty about the direction of federal government policies.[42] Decreased U.S. spending on luxury goods – combined with a challenging environment in other countries, especially China – has created a challenging landscape for luxury brands. Many are struggling to adapt to e-commerce and are feeling the impact of customer preference for experience spending, as opposed

[38] JLL, "Bagged or Boxed? The Future of 13 Retail Categories."
[39] JLL.
[40] Office of Economic Analysis, "Expanding Formula Retail Controls: Economic Impact Report."
[41] Strategic Economics, "San Francisco Formula Retail Analysis."
[42] Deloitte, "Global Powers of Luxury Goods 2017."

to goods.[43] Aspirational luxury brands (such as Michael Kors, Kate Spade, and Coach) appear to be experiencing more challenges than those that cater to the very top of the market (such as Hermès or Chanel).

Impacts of National Trends on San Francisco's NCDs

- **Some of San Francisco's NCDs (for example, Valencia, Upper Fillmore and Hayes Valley) are well-known for luxury clothing and accessories, as well as high-end furniture, home furnishings, and other goods.** The business mix in these districts may include a few national and international chains, but also many local, independent boutiques. Based on discussions with local brokers and merchant associations, the market for high-end goods in these NCDs is supported by the affluent local population, as well as visitation from other neighborhoods in the city, regional shoppers, and national and international tourism.
- **It is unclear what the national (and international) decline in luxury spending means for high-income cities and neighborhoods.** Available data on luxury spending is collected at the national and international level, and focuses on the market for high-end clothing, accessories, and jewelry. Anecdotally, some neighborhood shopping districts in New York City that were home to clusters of national and international luxury stores have recently gone into decline; however, it appears that the primary causes were poor location decisions by the brands and out-of-control real estate speculation.[44] As discussed in the following issue brief, sales tax revenues from Upper Fillmore (one of the case studies described in Issue Brief #2) declined sharply between 2015 and 2016. However, more comprehensive data on sales by type of product or neighborhood district are not available.

9. E-commerce and Retail Industry Consolidation are Shifting Employment Patterns and Driving Demand for Warehousing and Distribution Space

As e-commerce sales continue to increase, demand for warehousing and distribution space is growing and shifting. Industrial brokers report that a few years ago, there was significant demand for regional distribution centers, often located in larger spaces at the urban periphery (e.g., Central Valley or the Inland Empire). However, with a recent increase in next-day and same-day delivery services, brokers are now seeing an emerging trend of businesses searching for "last-mile" distribution centers.[45] These centers are the last facility from which shipped parcels depart to reach their delivery point, and could be as close as 5 to 7 miles of the consumer in some cases.[46]

At the same time, employment attributed directly to e-commerce has doubled in the last five years, while employment in retail overall has remained flat. Initial reporting suggests that this e-commerce employment remains a relatively small share of total retail jobs, in part because e-commerce jobs are less labor intensive than traditional retail.[47] However, these counts may miss employment being created in warehousing and distribution, an employment category that is growing rapidly and may contain the majority of fulfillment

[43] Akan, "Luxury Fashion Industry Scrambling to Adjust to Millennial World"; Dennis, "Luxury Retail Hits The Wall."
[44] Bagli, "In a Thriving City, SoHo's Soaring Rents Keep Storefronts Empty"; Kurutz, "Bleecker Street's Swerve From Luxe Shops to Vacant Stores."
[45] Lane, "E-Commerce Growth A Boon – And Bust – For Local Communities."
[46] Interview with Gary Baragona and Lexi Russell, CBRE, August 2017.
[47] Gebeloff and Russell, "How the Growth of E-Commerce Is Shifting Retail Jobs."

center jobs.[48] According to some economists, e-commerce jobs may pay better wages than the traditional retail jobs they replace, although this claim is still being evaluated.[49] There is also a risk that some e-commerce fulfillment center jobs could be automated in the future.[50]

Impacts of National Trends on San Francisco's NCDs

- **San Francisco has seen an increase in retail jobs since 2009, but this sector is growing more slowly than incomes or the economy overall.** San Francisco added 5,800 new retail jobs between 2009 and 2015, an increase of 14 percent. This is a similar rate compared to Alameda, Santa Clara, and San Mateo counties (Figure 7), but faster than the nine-county Bay Area overall (10 percent). However, the total number of jobs in the city increased by 27 percent between 2009 and 2015, and aggregate personal income increased by 25 percent over the same time period (after accounting for inflation).[51]
- **Slightly more than half of the city's new retail jobs are in "electronic shopping."** Since 2009, 3,035 out of 5,800 new retail jobs in San Francisco were in electronic shopping.[52] San Francisco has attracted many more jobs in this category compared to neighboring counties (Figure 8). In the absence of more detailed, establishment level data, it is unclear what the implications of this job growth in electronic shopping are for land use, job type/quality, or sales tax revenues in San Francisco. However, it appears likely that most of the jobs in electronic shopping in San Francisco are office-based tech jobs, rather than retail fulfillment jobs.
- **San Francisco has very limited employment in warehousing and distribution**. Jobs in San Francisco in the warehousing and transportation sector have declined by almost 50 percent since 2004, to just 2,840 in 2015. Within the broader region, most of the employment growth in this sector appears to be occurring in Alameda County and the Central Valley.[53]
- **Given the scarcity of warehousing space in San Francisco and the high cost of real estate, it will likely be more efficient for last mile distributors to locate on the Peninsula or in the East Bay, rather than in San Francisco itself.** To date, last mile distribution facilities in the Bay Area have primarily located in the Peninsula, Silicon Valley, and Inner East Bay, with spillover demand occurring in Richmond, Livermore, and the Central Valley. These distributors value locations that allow them to access as much of the Bay Area population as possible from one location.[54] While last mile distributors are less price sensitive than traditional industrial tenants,[55] the limited supply of warehousing space in San Francisco and the traffic conditions in the city suggest that last mile distributors will continue to locate in surrounding counties, rather than in San Francisco itself.

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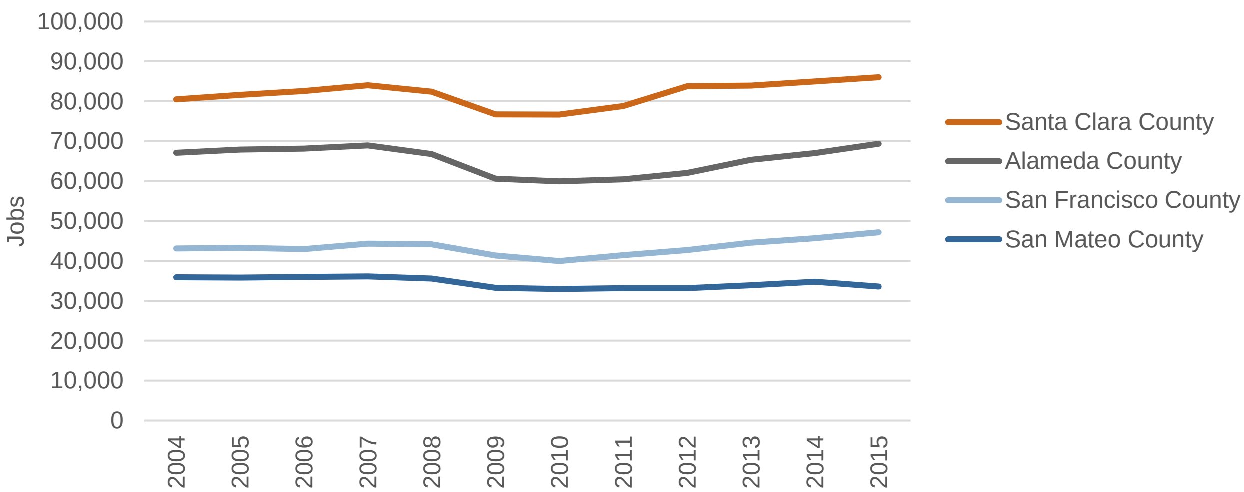
[48] Sorkin, "E-Commerce as a Jobs Engine?"
[49] Mandel, "How E-Commerce Is Raising Pay and Creating Jobs around the Country"; Sorkin, "E-Commerce as a Jobs Engine?"
[50] Wright, "Where Automation in Warehousing Could Be Most Felt."
[51] Strategic Economics analysis of California Employment Development Department's Quarterly Census of Employment and Wages (QCEW) and Bureau of Economic Analysis (BEA) data.
[52] Ibid.
[53] Ibid.
[54] Interview with Gary Baragona and Lexi Russell, CBRE, August 2017; JLL, "E-Commerce in the Bay Area."
[55] Ibid.

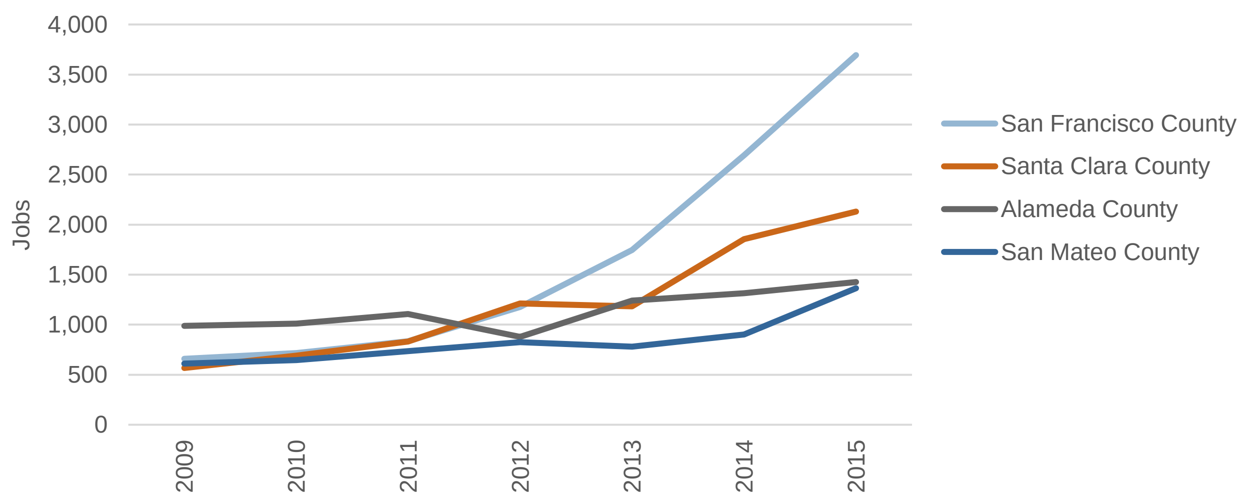
- **However, the NCDs will likely continue to attract other types of small-scale distribution and fulfillment facilities**. For example, Amazon and other companies are opening lockers in businesses and apartment buildings, where customers can pick up packages at their convenience.[56]

Figure 7: Total Retail Employment in San Francisco, Alameda, San Mateo, and Santa Clara Counties, 2004-2015



Sources: California Employment Development Department, Quarterly Census of Employment and Wages, 2004-2015; Strategic Economics, 2017.

Figure 8: Electronic Shopping* Employment in San Francisco, Alameda, San Mateo, and Santa Clara Counties, 2009-2015



*NAICS Code 4541.
Sources: California Employment Development Department, Quarterly Census of Employment and Wages, 2004-2015; Strategic Economics, 2017.

56 Lee, "Amazon Hub Lockers Threaten to Suck Data from Retail Rivals."

ISSUE BRIEF #2: WHAT CONSTITUTES A SUCCESSFUL SAN FRANCISCO NEIGHBORHOOD COMMERCIAL DISTRICT?

ISSUE BRIEF SUMMARY

Purpose and Approach

NCDs play many vital roles in San Francisco, including providing goods and services for residents, workers, and visitors; offering spaces for community building, entertainment, recreation, and leisure activities; providing opportunities for entrepreneurship, employment, and income creation; and generating sales tax and other revenues to support City services. Given these varying roles, there is no one single metric that can be used to measure the success of an NCD. However, a shared understanding of the characteristics that successful NCDs generally share can help the City and its partners better target local economic development initiatives and measure their impacts.

This issue brief is intended to start to create a framework for defining and tracking success that the City can further develop and apply to a broad range of NCDs throughout San Francisco. Potential next steps could include defining more specific, quantitative metrics for success, including tracking sales over time for all the NCDs.

The issue brief incorporates findings from three main sources:

- **Literature review.** This review was aimed at identifying characteristics typically seen as conducive to successful neighborhood or street commercial districts across the U.S., with a focus on urban environments. The review included real estate and broker reports, academic research, and urban planning, urban design, and economic development literature.
- **Interviews with key informants**. As described in the introduction to this report, Strategic Economics conducted more than a dozen interviews in August 2017 with retail brokers; business owners; staff from merchants' associations, community benefit districts, and business assistance providers; and other stakeholders.
- **Selected NCD Case Studies.** The issue brief also draws from case studies of five NCDs: Upper Fillmore, Outer Geary Boulevard, Ocean Avenue, Mission Street, and Calle 24 (or Lower 24th Street).[57] Case studies of these five NCDs were completed as part of previous studies,[58] and updated for this issue brief. These NCDs represent the diversity of NCDs across the city, in terms of trade area characteristics, business mix, physical form and built environment, transportation, and district management capacity. Throughout the issue brief, the case studies are used to illustrate the range of conditions in the City's NCDs. While each of the case studies have at least some elements that support a successful commercial district, they also face a variety of challenges. Examples from other NCDs are also referenced throughout the brief as appropriate.

The discussion also incorporates findings from Issue Brief #1 on the national restructuring of the retail, restaurant, and personal services industries.

[57] The boundaries of the case study areas are as follows: the Upper Fillmore area encompasses Fillmore Street from Bush Street to Jackson Street; the Outer Geary area encompasses Geary Boulevard from 14th Avenue to 28th Avenue; the Ocean Avenue area encompasses Ocean Avenue from Phelan Avenue to Lakewood Avenue; the Mission Street area encompasses Mission Street from Duboce Avenue to Cesar Chavez Street; the Calle 24 area encompasses 24th Street from Bartlett Street to Potrero Avenue.
[58] Strategic Economics, "San Francisco Formula Retail Analysis"; Strategic Economics, "Calle 24 Retail Study: Final Background Report"; Strategic Economics, "Mission Street Corridor Economic Analysis."

Key Findings

Quantitative measures of success from the national literature include strong business sales performance and a healthy ground floor vacancy rate. While sources vary, a vacancy rate in the range of five to 10 percent of storefronts 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; opportunities for community gathering and social interaction; and opportunities for small and independent businesses to thrive.

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

- **Trade area spending power and other drivers of demand.** Most businesses rely on the spending power of households in the surrounding neighborhood (or trade area) to generate demand. Other drivers of retail demand include local employers; cultural, educational, and medical institutions; professional services, medical, and other offices. Cultural events, other special events, and public space programming can also help draw foot traffic.
- **Healthy business mix:** Businesses 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. While there is no single ideal mix of uses, a healthy business mix includes anchors (or clusters of uses) that attract foot traffic, and a diverse mix of retail and non-retail businesses that provide destinations, needed services, and gathering spaces for potential customers.
- **Appealing physical environment:** The quality of the pedestrian environment and of public spaces can help attract (or potentially drive away) potential customers. Some of the components of a successful commercial district include a compact layout with a sufficient concentration of storefronts to create a critical mass; an attractive architectural character; a clean, safe, and welcoming street environment; and appropriately designed storefronts.
- **Convenient, multi-modal access:** Successful urban commercial districts should be conveniently accessible by foot, bicycle, transit, and car. Curb space should be actively managed to balance the needs of different users.
- **High-capacity district management organizations:** These can include Community Benefit Districts (CBDs), Merchant Associations, Community Development Corporations (CDCs), or other types of management organizations.

Organization

Following this introduction, the issue brief is organized into two major sections:

- A discussion of potential ways to measure success in a retail district, including both quantitative metrics (strong sales performance and a healthy vacancy rate) and more qualitative metrics that reflect San Francisco's specific context and values.

- An exploration of the factors that help support successful retail districts, organized in five broad categories: (1) trade area characteristics; (2) anchors and mix of uses; (3) physical form and built environment; (4) transportation and access; and (5) district management and capacity.

Findings from the five case study NCDs are described in text boxes throughout the issue brief.

MEASURING SUCCESS

This issue brief focuses on the factors that help support successful retail districts. However, as context for that discussion, it is important to define "success." This section discusses some of the potential metrics that can be used to define and measure success, including both quantitative and qualitative measures.

Quantitative Metrics

Quantitative measures that are typically used to assess the success of a retail district include:

- Strong sales performance; and
- A healthy ground floor vacancy rate.

While sales performance and vacancy rates are in theory simple to calculate, there are challenges associated with each metric. The two metrics are discussed in more detail below.

Sales Performance

Local retail studies typically use sales tax data to assess business performance. Ideally, the average sales per-establishment in a local commercial district can be calculated for different sales categories (e.g., restaurants, food and drug stores, clothing stores, general merchandise stores, etc.), and compared to citywide averages over time to assess performance. The San Francisco Office of the Controller makes available data on sales tax revenues for the NCDs and other defined geographies.[59] Sales tax data provide the best available information on business performance for NCDs. However, these data are subject to several caveats:

- **Nontaxable goods and services:** Sales of some goods, including prescription drugs and food for consumption at home, are nontaxable. In addition, sales of personal, financial, and other services are not subject to sales tax in California. As a result, sales tax figures significantly undercount food and drug sales, and do not capture sales of services at all.
- **Sales at stores with more than one location in San Francisco:** 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.
- **Confidentiality protections:** The state requires that sales tax data be aggregated to protect the confidentiality of individual taxpayers. For small areas like the NCDs, confidentiality restrictions make it difficult to report data consistently by business category.

[59] Some sales tax data are publicly available at http://sfstax.hdlgov.com/geodata/; however, the data on this website do not include sales from stores with more than one location in San Francisco and are not broken out by business category for local areas.

Vacancy Rates

Various local retail studies and other literature use a range of different benchmarks for what is considered a "healthy" vacancy rate for ground floor storefronts.[60] In part, the range that is considered healthy depends on local real estate market conditions. For example, a recent retail study conducted for the City of Berkeley, CA states that "the typical vacancy rate for a healthy commercial district is somewhere between 4 and 7%,"[61] while a Detroit study found that a rate of 15 percent is acceptable.[62] While few studies cite specific data sources to justify a healthy range, one study by the Urban Land Institute used the national 20-year retail vacancy average (9.8 percent) as a benchmark.[63] In general, a rate of between five and 10 percent is often seen as low enough to support a vibrant corridor, but not so low as to preclude business turnover.

Comprehensive data on vacancies for San Francisco's NCDs does not exist. Reports published by national sources like CoStar and by local real estate brokerage firms primarily track retail in and around Union Square and Downtown San Francisco, with a focus on malls and other buildings that only include commercial uses.[64] OEWD tracks vacancy rates for 24 NCDs that are part of the Invest in Neighborhood program (including Calle 24, Outer Geary, and Ocean Avenue). Data for Mission Street were collected by OEWD for a previous study. However, comprehensive, up-to-date vacancy rate data are not available for other NCDs (including Upper Fillmore).

The text box below discusses the available data on sales performance and vacancy rates from the five case study NCDs.

Qualitative Metrics

While quantitative measures like sales performance and vacancy rates are important for assessing the health of any retail district, San Franciscans also value more qualitative attributes of NCDs. These 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.

At the same time, it is important to recognize that different neighborhoods have different visions for what a successful NCD looks like, and how to achieve this vision. For example, some neighborhoods (e.g. Japantown, Chinatown, the Mission District) place great value on historic or cultural preservation and have

[60] Note that OEWD distinguishes between "vacant" spaces that are currently empty and being marketed for a new lease, and "inactive" spaces that are being remodeled or otherwise prepared for a new use and are not currently being marketed. For the purposes of this report, vacant space is considered to include inactive space, since residents, visitors, business owners, and other NCD stakeholders do not distinguish between vacant and inactive space.

[61] City of Berkeley, Office of the City Manager to Honorable Major and Members of the City Council, "Retail Incentives in Commercial Districts."

[62] Michigan Community Resources, "Grand River Commercial Vacancy & Market Analysis."

[63] ULI Center for Capital Markets and Real Estate, "ULI Real Estate Consensus Forecast: A Survey of Leading Real Estate Economists/Analysts."

[64] Based on discussions with CoStar representatives and local brokers.

significant concerns about gentrification and displacement. In these neighborhoods, there are concerns that retail and restaurants are increasingly unaffordable to lower-income residents, and that new commercial activity and investment could contribute to loss of cultural identity and displacement of long-time businesses. On the other hand, some residents and businesses in other neighborhoods (e.g., in the Visitacion Valley and Bayview NCDs) would like to see significant change and new investment, such as new businesses offering a wider variety of goods and services offered, more active and welcoming storefronts, or new pedestrian amenities or other changes to the public realm. Even within the same neighborhood, stakeholders often hold different opinions about what constitutes a successful NCD.

The discussion in this issue brief is intended to be widely applicable. However, it is important to note that public and private improvements, land use policies, economic development strategies, and metrics for measuring success in each of San Francisco's commercial districts must to some extent be tailored to reflect existing conditions and specific neighborhood goals.

Measuring Success: Sales Tax Revenues and Vacancies in the Case Study NCDs

Figures 9 and 10 on the following page show:

- Average annual sales tax revenue per establishment, for the five case study NCDs and the City, for 2007 through 2016.
- Vacant storefronts as a percent of total storefronts in four of the five case study NCDs, for 2016 and/or 2017 (as discussed above, these data were not available for Upper Fillmore and citywide data are based primarily on the Union Square/Downtown San Francisco area).

Historically, **Upper Fillmore** has had the highest sales tax revenues on a per-establishment basis, rivalling the citywide average (which is driven upwards by Union Square, Stonestown Galleria, and other non-NCD locations). This presumably reflects the high-end business mix, which includes many luxury clothing and accessories companies. However, between 2015 and 2016, Upper Fillmore sales declined. This may be due to the national and international slowdown in luxury sales (discussed in Issue Brief #1), or other, more local factors.

In contrast to Upper Fillmore, per-establishment sales tax revenues on **Ocean Avenue** have historically been lower than the citywide average. However, revenues increased rapidly over the last several years, likely reflecting the opening of a new Whole Foods in 2013 and Target Express in 2015. It is important to note that because Whole Foods and Target have multiple locations in San Francisco, the sales tax numbers for Ocean Avenue reflect the average sales tax revenues for these businesses based on all locations in the city, not the specific performance of the locations on Ocean Avenue.

Sales tax revenues per establishment on **Outer Geary**, **Mission Street**, and **Calle 24** are all below the citywide average, but have grown steadily since 2009. Previous analysis shows that for Mission Street, at least, this growth was driven almost entirely by increasing restaurant sales.[2] As discussed in Issue Brief #1, this reflects the national and citywide trend of restaurant sales significantly outpacing retail sales.

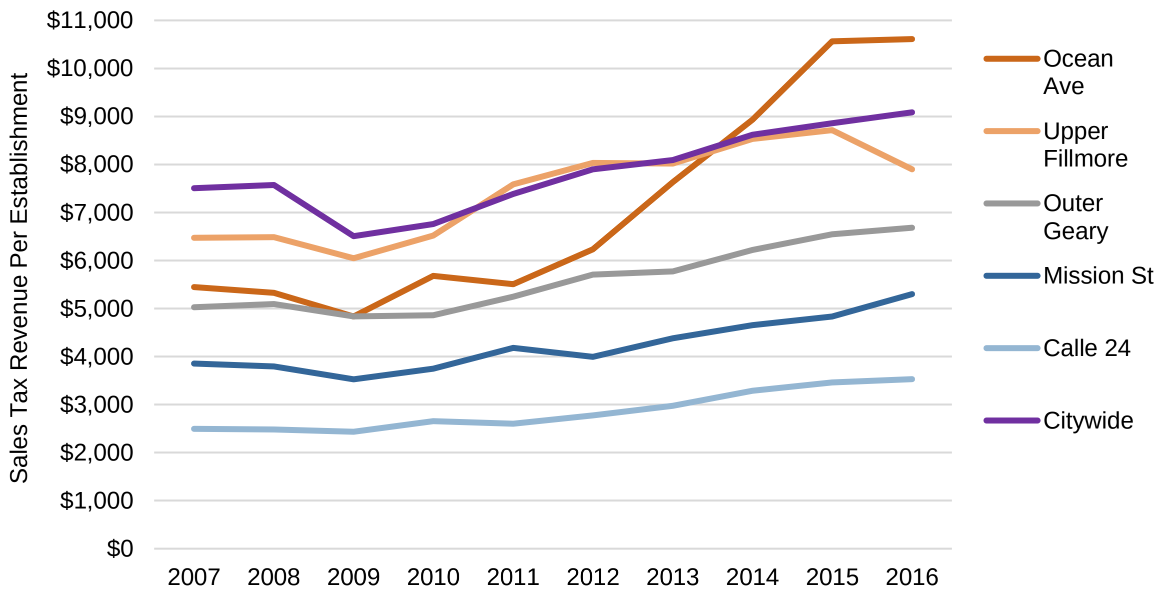
As discussed above, five to 10 percent is generally considered the healthy range for vacancy rates. **Ocean Avenue** and **Calle 24** have rates that are close to 10 percent, while 14 percent of **Mission Stree**t storefronts are vacant. Although complete data is not available, based on observations and the perceptions of stakeholders, vacancies on **Upper Fillmore** are currently very limited.

Continued on the following page.

[2] Strategic Economics, “Mission Street Corridor Economic Analysis.”

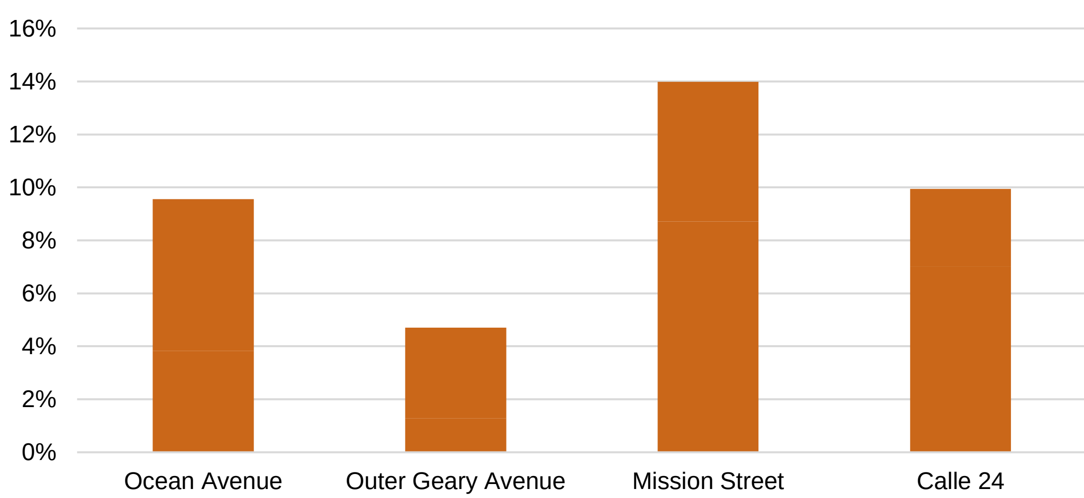
Measuring Success: Sales Tax Revenue and Vacancy Data and the Case Study NCDs *(continued)*

Figure 9. Average Annual Sales Tax Revenue per Establishment: Five Case Study NCDs and the Citywide Average, 2007-2016 (Not Adjusted for Inflation)



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

Figure 10. Vacant Storefronts as a Percent of Total Storefronts, 2016/2017



Comprehensive data for Upper Fillmore are unavailable.
Data for Ocean Avenue and Outer Geary are from Q1 2017. Data for Mission Street and Lower 24th Street are from 2016.
Includes space categorized by OEWD as vacant, inactive, or miscellaneous.
Source: City of San Francisco Invest in Neighborhoods Q1 2017; Strategic Economics, 2017.

FACTORS THAT SUPPORT SUCCESS

This section describes the factors that can help support successful NCDs. The discussion synthesizes key findings from the literature review[65] (which was national in scope) and interviews with San Francisco stakeholders. In general, interviewees and the literature identified a similar set of factors required to support successful commercial districts in an urban setting. However, as discussed below, some of the factors reflect San Francisco's specific values and context.

Figure 11 organizes the factors that are considered supportive of NCD success into five broad categories: (1) trade area characteristics; (2) anchors and mix of uses; (3) physical form and built environment; (4) transportation and access; and (5) district management and capacity. The following discussion describes the factors in each category in more detail. Under each category, examples from the five case studies are used to provide concrete examples of how these factors play out in San Francisco.

Figure 11. Summary of Factors Supporting Success of San Francisco Neighborhood Commercial Districts

Category		Factors that Support NCD Success
1	Trade Area Characteristics	• High spending power (household income and density) in the trade area • Other drivers of demand (e.g., workers, visitors to local service providers and institutions, regional visitation, tourism)
2	Anchors and Mix of Uses	• An anchor or cluster of uses that attract foot traffic • A healthy mix of retail and non-retail uses
3	Physical Form and Built Environment	• Compact layout & sufficient concentration of storefronts • Appealing architectural character • Clean, safe, and welcoming street environment • Appropriately designed storefronts
4	Transportation and Access	• Convenient access by foot, bicycle, transit, and car • Managed parking and curb space
5	District Management and Capacity	• A district management organization with sufficient capacity and resources, including a dedicated funding source

Source: Strategic Economics, 2017.

[65] The main sources that informed this section include: CBRE, "Retail and Placemaking: What Is the Role of Retail in Placemaking?"; Streetsense, "D.C. Vibrant Retail Streets Toolkit"; Easton and Owen, "Creating Walkable Neighborhood Business Districts: An Exploration of the Demographic and Physical Characteristics Needed to Support Local Retail Services"; Easton, Owen, and Atkinson, "Urban Centers: By the Numbers and by Design"; Ortiz, "Improving Tenant Mix: A Guide for Commercial Practitioners"; Moudon et al., "Operational Definitions of Walkable Neighborhood"; National Trust for Historic Preservation, "Older, Smaller, Better: Measuring How the Character of Buildings and Blocks Influences Urban Vitality"; City of New York Department of Transportation, "Economic Benefits of Sustainable Streets"; City of New York Department of Planning, "Resilient Retail"; Roger Brooks International, "The 20 Ingredients of an Outstanding Downtown"; Sasaki Associates, "The State of the City Experience: What Makes a City Great?"; Grant, "Designing at Ground Level"; Slater, "Crafting Authenticity for Retail Destinations"; Beyard, Pawlukiewicz, and Bond, "Ten Principles for Rebuilding Neighborhood Retail"; Lane and McAvey, "Retail in Underserved Communities."

1. Trade Area Characteristics

A trade area is the geographic area from which most of a business' or commercial district's customers are drawn. As discussed below, the size of a trade area varies depending on type of retail in question and the local population density. In general, however, higher incomes and greater population densities support higher sales and lower vacancies, while other sources of demand (workers, tourists, and other visitors) are also helpful in supporting businesses. The text box at the end of this section discusses key characteristics of the trade area for each of the five case study NCDs.

Local Trade Area Spending Power

Of all the factors discussed in this issue brief, local spending power is one of most basic elements that businesses look for in selecting a location. There are a variety of ways of measuring local spending power depending on the context, including:

- **Average or median household income:** Historically, many retailers and retail marketing firms focused primarily on household income in selecting retail locations.
- **Population and household density:** Market research for new suburban shopping centers is often based on set density guidelines. For instance, neighborhood shopping centers, typically anchored by a grocery store and a drug store, require 10,000 to 30,000 people within a one- to three-mile radius.[66] Centers selling more comparison goods (i.e., goods that consumers purchase more infrequently, and usually only after comparing prices and quality, such as clothing, electronics, and furniture) tend to serve much larger trade areas with significantly more population. However, the standard guidelines generally assume lower population densities than found in most San Francisco neighborhoods. Population densities required to support neighborhood retail in more densely populated, urban areas are less well-established.
- **Aggregate income:** Researchers and retail experts over the past several decades have pointed out that methods that focus either on household income or population/household density miss the big picture. For this reason, some real estate professionals now assess aggregate income per square mile – an area's household income multiplied by its population/household density – as a more accurate measure of neighborhood market potential and capacity to support retail.[67] For example, based on household incomes alone, a retailer might prefer a sparsely populated high-income suburban neighborhood over a densely populated lower-income neighborhood; however, looking at aggregate income may make the lower-income neighborhood more competitive.

Given San Francisco's population density and incomes, Strategic Economics has found that a half-mile radius – or roughly a ten-minute walk – appears to capture most of the trade area for the neighborhood- or convenience-serving retail in San Francisco's NCDs. And, as discussed in the text box on the following page, some NCDs – such as Upper Fillmore, and to some extent Mission Street and Calle 24 – also draw substantial customer traffic from outside of this primary local trade area.

It is possible that the amount of retail that neighborhoods can support will change as more purchases are made online. However, no clear conclusions have been reached regarding how population density or income thresholds might change with continued growth in e-commerce, or whether the growth in e-commerce will

[66] Easton, Owen, and Atkinson, "Urban Centers: By the Numbers and by Design."
[67] Pawasarat and Quinn, "Research Brief on ETI Purchasing Power and Economic Drilldowns"; Pawasarat and Quinn, "Exposing Urban Legends"; Social Compact Inc., "San Francisco Neighborhood Market DrillDown: Catalyzing Business Investment in Inner City Neighborhoods."

affect certain neighborhoods more than others (for example, whether low-income neighborhoods will be more affected than high-income neighborhoods).

Other Drivers of Demand

In addition to the local population, other sources of demand in many NCDs include:

- **Workers:** Retail and restaurants can benefit from workers who come out to eat and shop during their lunch hour, or before or after work. NCDs include a diverse range of employers, including hospitals, medical offices, colleges and universities, and retail stores and restaurants.
- **Visitors to local service providers and institutions:** Medical offices, hospitals, colleges, and public institutions such as libraries and community centers draw clients who may stop to dine or shop. For example, Upper Fillmore benefits from its proximity to California Pacific Medical Center, which generates daytime customers (workers and patients).
- **Regional visitation:** For example, Mission Street and Calle 24 are a regional destination for dining and nightlife, while Upper Fillmore is a regional destination for high-end fashion and furnishings.
- **Tourists:** As discussed in Issue Brief #1, anecdotal evidence suggests that many San Francisco NCDs are seeing an increase in tourism. Interviewees for this report suggested that increased tourism is helping to support businesses in many NCDs, but that tourism alone is rarely sufficient to maintain a successful NCD.

Factor 1: Trade Area Characteristics of the Case Study NCDs

According to some retail professionals, neighborhood retail can be categorized into three types: convenience, comparison, and destination districts.[1] These categories are based primarily on the trade area and the business mix.

Convenience districts offer a limited array of goods and services that are geared towards meeting the needs of local households and workers. Customers are drawn to these districts based primarily on locational convenience. **Ocean Avenue** and **Outer Geary** are examples of NCDs that primarily provide convenience goods and services for neighborhood residents and workers. However, the local trade area for Ocean Avenue has much higher household incomes than the Outer Geary trade area.[2] This may help explain why Ocean Avenue was able to attract a Whole Foods and Target Express, and why the NCD has seen a spike in sales tax revenues in recent years. In addition to serving the local trade area, the Whole Foods may also draw customers from across the City's southwestern neighborhoods, as it is the only location south of 24th Street and is accessible from Highway 280.

Comparison districts offer some general merchandise, apparel, or other soft goods in addition to convenience goods. These districts serve a larger trade area than a convenience district. **Mission Street** and **Calle 24** are examples of comparison districts. Historically, these districts served a local, primarily lower-income, and heavily Latino customer base. However, in recent years the Mission District has attracted more white, affluent, and highly educated residents, leading to concerns about gentrification and displacement. At the same time, the two corridors are increasingly emerging as regional destinations for restaurants, entertainment, and nightlife.

Destination districts draw customers from around the city or region for a unique and/or specialty mix of goods and services. Customers are usually willing to travel longer distances to reach a destination district. **Upper Fillmore** is an NCD that has emerged as a regional destination district for high-end fashion. In addition to significant regional visitation and tourism, the retail on Upper Fillmore is supported by a very affluent, densely populated trade area with small household sizes.

[1] Ortiz, "Improving Tenant Mix: A Guide for Commercial Practitioners."

2. Anchors and Mix of Uses

A diverse mix of businesses and other uses can help define an NCD's unique character, attract a steady stream of foot traffic, and ensure that residents, workers, and visitors can access a range of products and services. At the same time, one or more "anchor" uses are critical for driving sales in a district. This section describes the role of anchor uses, and some of the features that characterize a healthy mix of uses. The text box at the end of the section summarizes the anchors and mix of uses in the five case study NCDs; examples from the case studies and other San Francisco NCDs are also incorporated throughout the text.

Note that because storefronts in the NCDs have many different property owners, it is often a challenge to manage and coordinate the mix of uses. This issue is discussed in more detail under Factor 5 (district management).

An Anchor or Cluster of Uses that Attract Foot Traffic

An anchor is defined as a retail store or other use that drives business to the district, including to smaller businesses in the same commercial district. The presence of an anchor that attracts foot traffic is key to a successful commercial district. Although anchors are typically a retail use, other uses can also be effective in driving traffic. Examples of potential anchors include:

- **Full-service grocery stores and larger chain retail stores.** These larger businesses draw regular foot traffic because customers need to shop at these locations on a recurring basis (e.g., grocery and drug stores), or because they rely on these businesses to find a set of standard items (e.g., basic clothing at a Gap, or general merchandise at a Target). Moreover, these larger businesses often benefit from greater name recognition and more advertising resources compared to small businesses, and can thus draw in more customers to the district. According to the local merchants' association, the Whole Foods and Target Express on Ocean Avenue play this role, drawing customers to the district who also frequent smaller stores.
- **A cluster of related retail stores or restaurants.** Several interviewees cited the concentration of one type of business – such as restaurants or clothing stores – as an alternative type of anchor. Customers are drawn to these clusters knowing they will have many options to choose from within walking distance. Examples of clusters that serve as anchors include high-end women's fashion and accessory stores in the Upper Fillmore, and food and dining establishments on Calle 24 and Mission Street.
- **Civic, cultural, entertainment, or institutional uses.** The presence of uses and activities that attract people to an NCD for reasons other than shopping is a key advantage for a district. Community centers, cultural and entertainment uses, public libraries, colleges, or hospitals all have the potential to act as such "visitation drivers."[68] For example, Calle 24 benefits from a cluster of murals and arts and cultural organizations that contribute to making the district a destination. Patients and staff from San Francisco General Hospital on Potrero Avenue also help drive foot traffic to Calle 24, while California Pacific Medical Center serves the same function for Upper Fillmore.

To some extent, the spread of e-commerce and other retail industry trends may change the type of businesses that can serve as anchors. As discussed in Issue Brief #1, 2017 saw a wave of closures of department stores, clothing stores, sporting goods stores, and other types of retailers that historically anchored malls and shopping centers throughout the United States. However, the daily needs-serving anchors like grocery stores, drug stores, or general merchandisers (e.g., Target) that anchor many NCDs may prove more resilient to the growth of e-commerce because customers value the convenience of accessing products immediately and being able to shop for goods in many product categories at one place. In the future, grocery stores, general merchandise stores, and other brick-and-mortar locations may serve as hubs for both delivery and for customers to pick up pre-orders, while allowing those who prefer to pick out purchases in person to do so. These trends are discussed in more detail in Issue Brief #1.

A Healthy Mix of Retail and Non-Retail Uses

The literature and interviewees agreed that a mix of uses is imperative for the health of a commercial district, but that there is no rule of thumb for an ideal mix. In general, however, the mix should include:

- **A mix of retail store types and products that both serve residents' and workers' daily needs, and provide opportunities for customers to browse or comparison shop.** In general, commercial districts provide two types of goods: "convenience" goods that consumers purchase on a daily or weekly basis (e.g., groceries, personal care products) and "comparison" goods that

[68] Ortiz, "Improving Tenant Mix: A Guide for Commercial Practitioners"; Streetsense, "D.C. Vibrant Retail Streets Toolkit."

consumers purchase more infrequently, and usually only after comparing prices and quality (e.g., clothing, electronics, furniture). Successful districts generally offer a mix of both types of retail, but the balance can vary. As discussed in the text box under Factor 1, some districts primarily serve a local consumer base with convenience goods, while others develop niche retail subsectors that transform the district into a destination.

- **The presence of personal services, restaurants, cafes, entertainment, and nightlife**. Dining, entertainment, and services are essential to creating a diverse and interesting district, and can provide places for communities to gather and shoppers to linger or rest. These uses are becoming more prevalent relative to traditional retail as e-commerce continues to grow and consumers increasingly value unique experiences (such as a good meal in an interesting restaurant). Moreover, certain services, such as laundromats, salons, medical centers, and fitness studios, cannot easily be replaced by online retail options. Issue Brief #1 includes a more detailed discussion of market trends that are supporting the growing prevalence of personal services, dining, and entertainment uses.
- **A mix of chain and small/independent businesses.** Chain retailers can play an important role in a commercial district – for example, by serving as anchors and by providing affordable goods.[69] However, small and independent businesses contribute to the unique character of neighborhood districts. San Francisco residents place a particular value on preserving and supporting independent businesses, as evidenced by the City’s formula retail controls, which require most chain retail and restaurants to receive a conditional use authorization to open in an NCD. Some NCDs prohibit formula retail entirely. The impacts of the City’s formula retail controls are discussed in more detail in Issue Brief #3.
- **Ground floor uses that reflect the community’s distinctive character**. Whether reflective of the NCD’s history, culture, surrounding community, or unique physical form, the mix of ground floor uses should embody some degree of local character. A unique combination of stores and restaurants in an NCD contributes to a perception of a distinct, special place that tends to be more attractive to shoppers.[70] District programming and other activities (such as public concert series, art walks, or Sunday Streets) can also help support a distinctive local culture. For example, Calle 24’s distinctive mix of Latino-oriented food and dining establishments, specialty retail, and cultural uses contribute to a district that is seen by many stakeholders as the Mission’s cultural heart, an area that has retained its authenticity amidst the change that has occurred throughout the neighborhood. The district’s thriving Latino culture and public art, especially in the form of murals, continue to draw former Latino residents who have been priced out of the Mission District, as well many new customers from around the region and beyond. Large events such as Carnaval further contribute to the district’s identity.
- **A subset of neighborhood-serving, affordable goods, services, and experiences.** Access to affordable goods, services, and experiences is considered essential by many San Francisco stakeholders, especially as many neighborhoods undergo rapid demographic change. While affordability is especially important in lower income neighborhoods, all of San Francisco’s neighborhoods are home to households at a variety of income levels who should be able to access goods and services at an affordable price.

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[69] City and County of San Francisco Office of the Controller, “Expanding Formula Retail Controls: Economic Impact Report”; Strategic Economics, “San Francisco Formula Retail Analysis.”
[70] Kent, “A Street You Go To, Not Just Through.”

- **Office and housing uses that may not be open to the general public.** Healthy commercial districts rely on non-retail on office and housing uses to help generate foot traffic and demand for traditional retail stores. In addition, when permitted on the ground floor, these uses may help fill vacant space. At the same time, too much ground floor office and housing may detract from a retail district's vibrancy. These uses may be most appropriate on upper floors, and on the ground floor at the periphery of a commercial district or in other areas with less demand for traditional retail.

Factor 2: Anchors and Mix of Uses in The Case Study NCDs

Figure 12 below summarizes the mix of ground floor uses on Ocean Avenue, Outer Geary, Mission Street, and Calle 24 from surveys performed in 2016 and 2017 by OEWD's Invest in Neighborhoods (IIN) program. Because Upper Fillmore is not part of the IIN program, comprehensive data are not available. As discussed below, the mix of uses in the corridors varies significantly.

Ocean Avenue and **Outer Geary** have a notably higher percentage of services compared to the other corridors (41 percent and 37 percent, respectively), including personal services (e.g., beauty and wellness, fitness, laundry, and dry cleaners) as well as some medical offices and professional services. In general, the retail, personal services, and restaurant uses on these corridors are convenience oriented (i.e., serving a local market). Anchors include grocery stores, general merchandisers, and restaurants: Whole Foods and Target Express on Ocean Avenue, and Grocery Outlet and a number of dim sum and other restaurants on Geary.

Continued on the following page.

Factor 2: Anchors and Mix of Uses in The Case Study NCDs *(continued)*

Mission Street has the highest share of retail stores (34 percent) of any of the case studies, including a variety of businesses serving low-, moderate-, and high-income households. Grocery stores and other types of local-serving retail draw local customers during the day, while bars, restaurants and nightclubs bring in a younger, more affluent clientele at night, from the neighborhood and beyond. Medical and social service providers also serve local residents and attract clients from outside the neighborhood. While the corridor has no one obvious anchor, it includes distinctive clusters of uses that are concentrated in certain segments (such as restaurants and nightlife concentrated between 18th and 24th Streets, and shoe stores concentrated between 16th and 20th Streets).

Calle 24 has a concentration of eating, drinking, and entertainment uses (accounting for a third of all ground floor uses). This cluster, complemented by multiple specialty food stores, cultural institutions, and murals, serves as the anchor for this NCD and helps shape Calle 24's unique cultural identity. While Calle 24 has some higher-end restaurants, many of the dining options and retail stores remain relatively affordable and neighborhood-serving.

While comprehensive, up-to-date data are not available for **Upper Fillmore**, a 2014 study found that of 104 retail, restaurant and personal services businesses, two-thirds were retail stores and a quarter were restaurants and bars. Of the retail stores, more than half were apparel and accessories stores, reflecting the corridor's emergence as a destination for high-end fashion.[1] At the same time, the Upper Fillmore offers other comparison goods (furniture, optometry stores) and some stores offering everyday goods (pharmacy, grocery), as well as places where people can linger, such as cafés, and art-decoration stores. Nearby hospitals, medical offices, and music venues also drive foot traffic.

Figure 12. Business Mix in Case Study NCDs, 2017*

	Ocean Avenue		Outer Geary Blvd		Mission Street		Calle 24	
	Count	**Share**	**Count**	**Share**	**Count**	**Share**	**Count**	**Share**
Retail	29	**18%**	56	**24%**	147	**34%**	47	**27%**
Eating, Drinking, Entertainment	37	**24%**	65	**28%**	89	**20%**	57	**33%**
Services	65	**41%**	87	**37%**	117	**27%**	39	**23%**
Community and Government	11	**7%**	15	**6%**	22	**5%**	11	**6%**
Inactive, Miscellaneous	9	**6%**	8	**3%**	23	**5%**	5	**3%**
Vacant	6	**4%**	3	**1%**	38	**9%**	12	**7%**
Total Storefronts	**157**	**100%**	**234**	**100%**	**436**	**100%**	**171**	**100%**

*Comprehensive data for Upper Fillmore are unavailable.
Data for Ocean Avenue and Outer Geary are from Q1 2017. Data for Mission Street and Lower 24th Street are from 2016.
Source: City of San Francisco Invest in Neighborhoods Q1 2017; Strategic Economics, 2017.

3. Physical Form and Built Environment

A sufficient concentration of storefronts, interesting architectural character, safe and welcoming street environment, and well-designed storefronts are some of the physical characteristics that can help attract business owners, residents, and visitors, encourage local shopping, and make an NCD an appealing place for community gatherings. These factors are discussed below, with examples from the case studies and other San Francisco NCDs. Key attributes of the physical environment for the case studies are summarized in the text box at the end of the section.

Compact Layout & Sufficient Concentration of Storefronts

In general, a relatively high concentration of stores and compact district layout can help create a more appealing destination, in which activity is concentrated enough to be visually interesting, and shoppers can access multiple stores or other destinations within easy walking distance.

However, successful layouts can vary depending on what physical form a district takes. While a few NCDs in San Francisco take the form of a small node or anchored shopping center, most are configured as linear neighborhood shopping streets, major arterials, or corridors within a larger commercial district. The factors that support success in each of these district layout types are discussed below.

- **Urban shopping street:** Urban shopping streets are generally linear in form, and serve as the "main street" for a surrounding residential district. San Francisco's urban shopping streets generally have two to three traffic lanes, and tend to have lower traffic volumes and slower speeds relative to major arterials (discussed below). Some studies have found that urban shopping streets are most successful if retail and other active uses are concentrated within about a quarter mile (or roughly a five-minute walk from end to end).[71] To keep patrons visually engaged, studies recommend a storefront entrance along the main corridor every 25-35 feet, with limited disruptions by non-active uses.[72] Stores and other active uses on both sides of the street also help create the feeling of a destination with a concentration of interesting opportunities for shopping, dining, and other activities. As discussed in the text box below, Upper Fillmore is a good example of an NCD that generally meets the physical criteria for a successful urban shopping street.
- **Major arterial:** Major arterials are defined by their transportation function, serving as key routes for cars, buses, and sometimes streetcars to traverse the city. They are often wide streets (e.g., 4-6 lanes) with relatively high traffic volumes, high speeds, and few pedestrian crossings. From a retail perspective, heavy vehicle traffic can help attract customers; on the other hand, it can be difficult to create a pedestrian-friendly shopping environment (the importance of the street environment is discussed in more detail below). In order to create successful retail environments along major arterials, experts often recommend focusing new retail development (and requirements for ground floor retail) at key nodes, such as major intersections with good visibility and easy vehicle and pedestrian access, where retail is likely to be most successful. Cities can help support the emergence of successful shopping nodes along a corridor by carefully targeting streetscape improvements and other public investments to support these nodes. As described in the text box below, Ocean and Geary Avenues are two examples of major arterials, although they have very different environments.

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[71] Beyard, Pawlukiewicz, and Bond, "Ten Principles for Rebuilding Neighborhood Retail"; Roger Brooks International, "The 20 Ingredients of an Outstanding Downtown"; Easton and Owen, "Creating Walkable Neighborhood Business Districts: An Exploration of the Demographic and Physical Characteristics Needed to Support Local Retail Services."
[72] City of New York, "Active Design: Shaping the Sidewalk Experience"; Zack, "Strategies for Good Urban Retail."

- **Corridors within a larger commercial district:** Larger commercial districts include a network or grid of multiple neighborhood shopping streets and/or arterials. For a larger commercial district to be successful, the different corridors should be complimentary, creating a unified cohesive sense of place. The Mission District includes commercial areas where the corridors are generally complimentary (see text box discussion).

Appealing Architectural Character

Shoppers are drawn to areas with a diverse, distinctive architectural character. Many business owners also prefer to locate in these neighborhoods as well. Some of the components of an attractive built environment include:

- **Distinctive architectural character:** Architectural "character," "charm," or "authenticity" can help make an NCD feel unique and attractive for shoppers. While these characteristics are qualitative and subjective, they are often related to a place's historic nature, the presence of specific architectural styles, or other idiosyncratic details.[73]
- **Mix of storefront sizes, architectural styles, and building ages.** A study of Washington D.C., Seattle, and San Francisco's built environment found that neighborhoods with a mix of building styles often performed well from an economic and retail perspective. A mix of building ages and architectural styles creates visual diversity that people find attractive, while a mix of large and small storefronts allows for a diverse range of businesses (large and small; independent and chain; restaurants, retail, and personal services) to locate in the district.[74]

Storefront Size and Business Mix

A comparison of Mission Street and Calle 24 shows how different built forms can lead to different types of businesses. Calle 24 has relatively small, narrow retail spaces, with an average storefront size of 2,600 square feet. According to local brokers, these smaller spaces are easy to rent, as they are more affordable overall than larger spaces. They can serve either new, independent businesses with lower profit margins, or more established businesses that do not require much space.

In comparison, Mission Street's storefronts are generally larger, with an average size of 3,480 square feet. The larger storefronts have made the corridor more attractive for retailers and restaurants that require larger spaces to display inventory or provide seating for diners, including some formula retailers. However, some of the largest, deepest spaces on Mission Street are challenging to rent, because they appeal to a limited number of tenants and are difficult to subdivide. Some of the larger spaces also require substantial rehabilitation.

Source: Strategic Economics, "Calle 24 Retail Study: Final Background Report."

Clean, Safe, and Welcoming Street Environment

In addition to a district's architectural character, research has found that a welcoming pedestrian environment contributes to higher retail sales and, in some cases, increased commercial rents.[75] Some components of a welcoming street environment include:

[73] Slater, "Crafting Authenticity for Retail Destinations"; Sasaki Associates, "The State of the City Experience: What Makes a City Great?"
[74] National Trust for Historic Preservation, "Older, Smaller, Better: Measuring How the Character of Buildings and Blocks Influences Urban Vitality."
[75] Hack, "Business Performance in Walkable Shopping Areas"; Alfonzo and Leinberger, "Walk This Way: The Economic Promise of Walkable Places in Metropolitan Washington, D.C."; City of New York Department of Transportation, "Economic Benefits of Sustainable Streets."

- **Urban design features that contribute to a human-scale street design.** Street design elements that contribute to a safe and attractive walking environment include: relatively slow vehicular traffic, wide sidewalks, narrow streets, and safe and frequent pedestrian crossings.[76] Other urban design features that can support a pedestrian-friendly environment include street lighting, a full tree canopy, other landscaping, painted pavements or pedestrian crossings, street furniture, and parklets
- **High-quality public spaces.** High-quality public spaces can help make NCDs desirable places for residents and visitors to spend time. In addition to creating opportunities for community gatherings, public spaces can help attract increased foot traffic and encourage spontaneous shopping. Public parks, plazas, and other public spaces may also host outdoor events.
- **Cleanliness and safety**. A clean, safe environment can make NCDs more welcoming for shoppers. For example, business owners in some NCDs cite the presence of homeless people, mentally ill people, and persons with substance use disorders as a challenge in attracting customers and employees, especially for businesses that offer outdoor seating areas.

Appropriately Designed Storefronts

A successful urban retail district also requires the availability of appropriately designed retail space. Extensive literature has documented preferred design features for retail space.[77] Key features from these reports are summarized below:

- **Sufficient ground floor ceiling height**. Typically, floor-to-ceiling heights of 15 feet at minimum are preferred for ground floor retail. Higher ceilings foster visibility from the street and give light and a sense of openness to the retail space.
- **Transparent frontage and visibility from the street.** One of the most frequently cited characteristics of well-designed ground-floor retail is a transparent façade. Façade transparency creates an interesting visual experience for pedestrians, fosters "eyes on the street," allows businesses to display their products and services to passers-by, and provides more natural light for businesses. While guidelines differ from place to place, many cities prescribe ample window area to create open and welcoming spaces for passers-by.
- **Sufficient store depth and width**. Typically, façade-to-rear wall depths of 60-65 feet are considered optimal, with a minimum of 30 feet. Preferred widths are often not specified, but 18 feet is seen as a minimum required width.[78] However, small, independently owned businesses may be able to thrive in smaller spaces.

[76] National Association of City Transportation Officials, *NACTO Urban Street Design Guide*.
[77] Grant, "Designing at Ground Level"; Gehl Architects, "Public Spaces and Public Life: Recommendations"; Alameda County, California, "Design Guidelines for Residential Mixed-Use Projects"; City of New York, "Active Design: Shaping the Sidewalk Experience"; Kent, "A Street You Go To, Not Just Through"; City of New York Department of Housing Preservation and Development and Design Trust for Public Space, "Laying the Groundwork: Design Guidelines for Retail and Other Ground-Floor Uses in Mixed-Use Affordable Housing Developments"; City of San Francisco Planning Department, "Standards for Storefront Transparency: Planning Code Requirements for Commercial Businesses."
[78] City of New York Department of Housing Preservation and Development and Design Trust for Public Space, "Laying the Groundwork: Design Guidelines for Retail and Other Ground-Floor Uses in Mixed-Use Affordable Housing Developments."

- **Appropriate signage and exterior lighting.** Stores should display signs that are visible from the street and sidewalk, legible, and interesting. Exterior lighting is often recommended to foster a sense of safety and to keep the street inviting into the evening hours.
- **Appropriate utilities, heating/cooling, and ventilation infrastructure**. Different types of businesses have different infrastructure needs. Restaurants in particular require appropriate ventilation.

Older buildings often have lower ceilings, deeper storefronts, smaller windows, and more limited ventilation and other infrastructure than is typically found in well-designed, modern retail spaces. Despite these drawbacks, many business owners still find San Francisco's older, mixed-use retail buildings attractive because of their architecture, history, and location. However, the tenant improvements required to make some spaces suitable for new uses can be significant. The costs associated with renovating older storefronts are discussed in Issue Brief #3.

Factor 3: Physical Form and Built Environment in the Case Study NCDs

The case study NCDs illustrate the range of district configurations (urban shopping street, major arterials, and multiple corridors within a broader commercial district). They also vary significantly in their architectural character and street environment. These factors are described below.

The physical form of **Upper Fillmore** has contributed to the NCD's emergence as one of the most successful ***urban shopping streets*** in San Francisco, and a citywide and regional destination. The distance between Bush and Clay Streets – the heart of the district, where the concentration of retail and restaurants is the highest – is roughly a five-minute walk. The corridor includes a mix of historic Victorian buildings and newer structures, as well as smaller and larger store space, creating visual diversity. Both sides of the street are lined with active storefronts. Several establishments along the corridor have outdoor seating, which brings activity onto the sidewalk, and portions of the corridor are lined with a canopy of trees. The street is relatively narrow, with slow traffic. All these elements contribute to a welcoming, interesting, and intimate environment for foot traffic

Ocean Avenue and **Outer Geary** are both major, historically car-oriented ***arterials***, with very different pedestrian environments. Ocean Avenue has three to four lanes and relatively fast-moving traffic, but the City and Ocean Avenue Association have worked together to invest in improved façades, plant sidewalk gardens and trees, add new pedestrian crossings, and widen the sidewalk, creating a welcoming pedestrian environment. Nodes of activity have emerged around key anchors, including in the few blocks around the new Ingleside Branch Library and Whole Foods Market. In contrast, Outer Geary Boulevard is wider (four to six lanes) with heavier traffic. Outer Geary attracts significant foot and vehicle traffic, but faces many physical challenges including poorly maintained sidewalks, buildings, and signage, as well as many long-term small businesses that could benefit from façade and other tenant improvements, and there are few distinct nodes of activity.

The commercial corridors within the Mission District make up a ***larger commercial district*** with a unique identity. Visitors will often spend time on multiple corridors during one trip (for example, to visit restaurants and bars on Mission and Valencia, or shop on Mission and Calle 24). **Mission Street** functions as the neighborhood's commercial spine and is also a regional arterial, connecting San Francisco's downtown to its most southern neighborhoods. Within the neighborhood, Mission Street functions as a wide boulevard with a vibrant pedestrian atmosphere, which is reinforced by the presence of two major BART stations at 16th and 24th Streets, and several major bus lines***.*** The retail mix serves both the daily needs of resident workers, and offers comparison shopping and eclectic dining opportunities. **Calle 24** is the Mission's cultural heart, with many arts and cultural institutions as well as restaurants and retail. The street itself is narrow, with relatively narrow sidewalks and a lively pedestrian atmosphere.

4. Transportation & Access

Accessibility is a critical component of a successful retail location. In more suburban environments, excellent vehicle access and ease of parking are typically considered critical features of successful retail districts. In San Francisco's NCDs and other urban commercial districts, many customers do use private vehicles for shopping trips, but other modes of transportation are equally – and in some cases, more – important. The importance of convenient access by a range of transportation modes, and of managing parking and curb space, are discussed below.

Convenient Access by Foot, Bicycle, Transit, and Car

As described in the previous section, a safe, welcoming pedestrian environment can help draw foot traffic from the local trade area and other nearby neighborhoods, and result in increased sales. Bicycle infrastructure (including bicycle lanes and parking) have also been shown to support increased sales and other measures of success in urban shopping districts.[79]

Excellent access to BART and Muni can also support successful NCDs, helping a district draw customers from a citywide or regional trade area. For example, the Mission Street and Calle 24 corridors benefit from excellent accessibility both by car and from the two BART stations at 16th Street and 24th Street, which has helped these districts emerge as regional destinations for dining and nightlife. However, other regional-serving districts rely more on the automobile. For example, Upper Fillmore is not served by rail transit, but draws citywide and regional customers by car (for example, from Marin County). The district is also easily accessible from San Francisco's northeastern neighborhoods by foot.

Managed Parking

Parking in urban commercial districts is by necessity limited, and subject to the needs of many competing uses (including shoppers, workers, residents, and other visitors). There is no consensus on how much on-street and off-street parking is required in urban retail streets. The topic has been written about extensively (e.g., evaluations of the impact of replacing parking with parklets, or of new bicycle lanes on business performance), and findings tend to vary by place and by retail environment.[80] In general, places that are centrally located with reliable and frequent transit options may not require as much off-street parking as more auto-oriented neighborhoods.

Given the unevenness of transit accessibility across San Francisco, different NCDs likely require different parking strategies. Even in NCDs with excellent BART or Muni access (e.g. the Mission, the Castro, Hayes Valley, Ocean Avenue), some merchants perceive convenient customer parking as critical to their business performance.

In general, transportation experts recommend comprehensively managing on-street and off-street parking in urban commercial corridors, using time management and/or pricing strategies. In urban commercial districts, best practices include treating the most desirable on-street parking spaces differently than off-

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[79] Drennen, "Economic Effects of Traffic Calming on Urban Small Businesses"; Kent, "A Street You Go To, Not Just Through."

[80] Jaffe, "The Complete Business Case for Converting Street Parking Into Bike Lanes"; Jaffe, "4 Reasons Retailers Don't Need Free Parking to Thrive"; Beyard, Pawlukiewicz, and Bond, "Ten Principles for Rebuilding Neighborhood Retail"; Gibbs, *Principles of Urban Retail Planning and Development*; McCahill and Rhodes-Conway, "Urban Parking: Rational Policy Approaches for Cities and Towns."

street parking or on-street neighborhood parking located further away. For example, to encourage turnover, prime on-street spaces can be assigned shorter time restrictions or higher hourly prices. Taking this a step further, innovative demand-responsive priced parking has recently been implemented in cities such as New York and San Francisco. The aim of these new technologies is to maintain parking occupancy rates steadily at 60-80 percent.[81] This outcome can support merchants, who tend to value easily accessible, convenient parking in close proximity to their stores.[82] Finally, the establishment of a parking benefit district can be an effective complementary strategy to priced parking. This type of district redirects a share of revenues towards improving the area's streets and infrastructure. This is also seen as a benefit to local business owners and merchants.[83]

Other Curb Space Management

In urban commercial districts, already-limited curb space and streets are needing to accommodate a growing number of new, competing users. In addition to buses, taxis, and on-street parking, curb space users include a proliferating number of "transportation network company" (TNC) vehicles (see text box below); delivery vehicles (trucks and vans delivering products to stores, and private vehicles delivering goods and services to households via companies like Caviar, UberEats, Amazon, Instacart, etc.); and employer-run buses and shuttles. These competing needs can create conflict, especially in dense, congested areas or narrow streets – as when TNCs or delivery trucks park in bicycle lanes, at bus stops, or in traffic lanes because of the lack of loading zones.[84] Several interviewees mentioned the need to better manage these growing conflicts in San Francisco's NCDs.

As these issues are emerging in response to relatively new technologies, comprehensive curb management best practices have not yet been established.[85] However, some examples of curb management strategies include: increased on-street loading bays, "flex" on-street loading zones that vary by time of day, or initiatives to encourage bicycle and pedestrian deliveries.[86]

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[81] McCahill and Rhodes-Conway, "Urban Parking: Rational Policy Approaches for Cities and Towns."
[82] Downing, "Castro Merchants Talk Demand-Responsive Parking Meter Pricing, Set To Roll Out Citywide In 2017"; Shoup, "The Price of Parking on Great Streets."
[83] McCahill and Rhodes-Conway, "Urban Parking: Rational Policy Approaches for Cities and Towns"; Litman, "Parking Management: Strategies, Evaluation, and Planning"; Shoup, "The Price of Parking on Great Streets."
[84] Urban, "With Online Shopping on the Rise, Cities Look to Address Congestion Impacts of Deliveries"; Fitzgerald Rodriguez, "Mayor Lee to Tackle Uber, Lyft Traffic Congestion through Pilot Program."
[85] SFCTA, "TNCs Today: A Profile of San Francisco Transportation Network Company Activity (DRAFT)."
[86] City of San Francisco, "Better Market Street: Loading and Delivery Management Best Practices"; Holguin-Veras et al., "Improving Freight System Performance in Metropolitan Areas."

Transportation Network Companies (TNCs) and NCDs

Transportation Network Companies (TNCs), such as Uber and Lyft, are emerging as an important way that some customers access San Francisco's NCDs. Several interviewees mentioned that the increasing reliance on TNCs may reduce parking needs in NCDs, and might also facilitate visitation, especially for restaurants, bars, and venues that operate in the evening.

Because the TNC companies are reluctant to distribute their data, limited research has been conducted on TNC travel patterns. Nonetheless, two recent reports provide some preliminary insights on how TNCs might impact urban retail districts.

- A survey conducted in 2016 by the American Public Transportation Association found that TNCs were most commonly used for recreation/social trips, especially on weekends and at times when transit service was less frequent or unavailable (i.e. between the hours of 10 pm and 4 am). Respondents suggested that TNCs were often the preferred mode of travel when recreation/social trips involved alcohol consumption. Respondents were less likely to use TNCS for commutes and shopping/errands trips.[1]

- Recent research conducted by the San Francisco County Transportation Authority provides preliminary trends of TNC usage in San Francisco.[2] The study found that TNCs had a relatively wide geographic coverage in the city. The highest densities of TNC pickups/drop-offs were in central areas like Downtown (Union Square, Market/Van Ness, Transbay Terminal, Embarcadero) and South of Market, and the northeast quadrant of the city (Chinatown, North Beach). However, several other corridors also had relatively high pickup/drop-off density, including Geary Boulevard, Mission Street, Valencia Street, and smaller pockets along neighborhood streets like 19th Avenue in the Sunset, 3rd Street in Dogpatch, San Bruno Avenue, and Ocean Avenue. This report also found that TNC usage was highest on Fridays and Saturdays, especially in the afternoon and evening hours.

[1] 54 percent of respondents reported using TNCs for recreation/social trips, versus only 16 percent for shopping/errands. Shared-Use Mobility Center, "Shared Mobility and the Transformation of Public Transit."

[2] SFCTA. "TNCs Today: A Profile of San Francisco Transportation Network Company Activity (DRAFT)."

Factor 4: Transportation & Access in the Case Study NCDs

The **Mission Street** and **Calle 24** corridors benefit from excellent accessibility both by car and from transit, including several bus lines and two BART stations at 16th Street and 24th Street. BART accessibility has helped the corridors emerge as regional destinations for dining and nightlife. The corridors are also very centrally located within the City, well served by bus, and easily accessible by bicycle from Downtown and the City's relatively flat, southeastern neighborhoods.

The **Ocean Avenue** case study area is located near a BART station and a Muni rail station, but separated from the stations by I-280 and the Community College of San Francisco campus. The local merchants' association is working on developing stronger partnerships with BART to facilitate and accelerate improvements to the streets and infrastructure connecting the corridor to Balboa Park BART station.

Upper Fillmore is not served by BART or Muni rail. However, Fillmore Street is served by the 22 Fillmore bus and the NCD is very walkable, and surrounded by high density neighborhoods from which customers can easily walk. Shoppers will also often walk in from surrounding neighborhoods such as the Fillmore District and Japantown, or take the bus from other neighborhoods in San Francisco. The corridor also sees many customers from the outside the City – especially from the North Bay, from which it is most easily accessible – arriving by car and using the nearby public parking lots. Anecdotally, the merchants' association has also noticed increased use of TNCs, especially for customers visiting the corridor in the evening for eating, drinking and entertainment.

Outer Geary is a busy arterial served by bus (but no rail transit) service. Many drivers and transit riders perceive Geary as an urban freeway, not a place to slow down, stop, and shop.[1,2] Discussions of a new Bus Rapid Transit (BRT) line have been ongoing for several years, and the San Francisco Board of Supervisors approved the final environmental report in 2017. While some stakeholders are enthusiastic about the prospect of better connections to the rest of the city, others – including some business and property owners – are concerned about the impacts construction will have in the short-term, and about rent increases in the long-term.

[1] City and County of San Francisco Office of Economic and Workforce Development, "Geary Boulevard: Neighborhood Profile".
[2] City and County of San Francisco Planning Department, "Supervisor District 1: Community Needs Assessment;" City and County of San Francisco Planning Department, "Supervisor District 1: Existing Conditions."

5. District Management and Capacity

Engaged leadership from a merchants' association or other district management organization can make a significant difference in the trajectory of an NCD, particularly when the organization has a dedicated funding source (such as property or business special assessments, grants, or special event income).

District Management Organization

District management organizations are typically non-profit organizations such as merchants' associations, property and business improvement districts (known in San Francisco as Community Benefit Districts or Business Improvement Districts), neighborhood economic development agencies, or community development corporations (CDCs). Depending on their financial and staffing capacity, district management organizations can fulfill one or more of the following roles:

- Create unity and a shared vision among tenants and property owners, and coordinate efforts around meeting that vision. For example, this could take the form of coordinating business hours to ensure that a majority of businesses are open at similar hours, and that those hours match the time of day when people are likely to frequent the corridor.
- Represent and advocate on behalf of business and property owners.
- Build partnerships on behalf of the district with community groups, residents, and customers.
- Help shape the district's business mix by working with local brokers to fill vacant storefronts.
- Program events (e.g., street fairs, concert series, movie nights).
- Market on behalf of the district.
- Improve public safety (e.g., by hiring public safety ambassadors to work with the homeless or address other challenges).
- Provide additional street or sidewalk cleaning.
- Advocate for and/or fund landscaping and streetscape improvements.
- Provide small business assistance.

Many of these efforts require significant capacity, including a dedicated revenue source and staff. In San Francisco, potential funding mechanisms for these activities include Community Benefit District (CBD) or Business Improvement District (BIDs) special assessments; grants funded by the City, banks, or foundations; and other self-generated funds such as special events. An ongoing, reliable revenue stream can be of significant assistance to neighborhoods that wish to fund improvements in their NCDs,[87] although even district management organizations with dedicated funding may not have sufficient financial or staffing resources to meet all identified needs. The following section discusses the role of CBDs and BIDs in more detail.

Dedicated Funding Source

One of the key funding mechanisms for many district management organizations is a CBD or BID. CBDs or BIDs are public/private partnerships in which commercial property owners and/or business owners agree

[87] Ortiz, "Improving Tenant Mix: A Guide for Commercial Practitioners."

(by majority vote) to pay a special assessment. Revenue from the special assessment creates an ongoing funding source for the provision of economic development activities and services such as street cleaning, public safety, beautification, streetscape improvements, marketing, and advocacy. CBDs are managed by non-profit organizations, formed by representatives of the business and property owners who pay the assessment. In addition to collecting assessments, these non-profit organizations are also able to receive donations and grants, and to generate additional funds through special events and other activities.

Establishing a CBD typically requires a multi-year effort to build support among businesses and property owners, and develop district boundaries, budgets, and management plans, among other steps. San Francisco currently has 15 CBDs in place, including in Ocean Avenue, the Castro, and Japantown.

The formation of CBD/BIDs has generally been shown to have positive economic and community impacts on commercial districts, including higher property values,[88] lower crime rates,[89] and improved community satisfaction with the area. A study led in 2013 by San Francisco's OEWD compared equivalent CBD and non-CBD corridors, and found that CBD-corridors had higher levels of cleanliness and experienced less sales revenue loss and lower commercial vacancy rates during the 2007-2009 recession, compared to similar non-CBD corridors.[90]

[88] Furman Center for Real Estate & Urban Policy, "The Benefits of Business Improvement Districts: Evidence from New York City."
[89] Han, "Impacts of Business Improvement Districts on Crime Outcomes in the City of Philadelphia: Dynamic Panel Data Analysis"; MacDonald et al., "Neighborhood Effects on Crime and Youth Violence: The Role of Business Improvement Districts in Los Angeles."
[90] City of San Francisco OEWD, "Impact Analysis of Community Benefit Districts."

Factor 5: District Management and Capacity in the Case Study NCDs

Of the five case study NCDs, **Ocean Avenue** is the only one with a CBD. The Ocean Avenue CBD was established in 2010 and is managed by the Ocean Avenue Association (OAA). This funding source has enabled the OAA to implement improvements and provide services, including streetscape improvements, beautification, cleaning, and maintenance. The OAA is also playing a role in supporting small businesses along the corridor, including providing façade improvement grants. In addition, the organization is an active advocate for the corridor. OAA pushed for the Avalon Ocean Avenue development to include a grocery store, which had previously been missing from the corridor (the resulting Whole Foods opened in 2013), and is advocating for the needs of small businesses to be considered on the ground floor of recently proposed development projects. Finally, OAA is working towards the creation of a culture & arts initiative, and is programming the new Unity Plaza.

Upper Fillmore and **Outer Geary** have active merchants' associations (the Fillmore Merchants Association and Greater Geary Blvd Merchants Association), but no CBDs. As a result, their efforts are focused primarily on public programming and advertising, rather than capital improvements or small business support. For example, the Fillmore Merchants Association is involved with organizing and promoting the annual Jazz Festival and Shop Out Day, and has developed a social media presence on Facebook and Instagram to keep customers and neighbors up-to-date on sales and events.

The **Calle 24** Latino Cultural District (LCD) is an example of a non-profit, community-based district management organization that is comprised of residents, merchants and property owners. Currently the LCD has a full-time staff corridor manager for Calle 24. The Mission Economic Development Agency (MEDA) is a local community development corporation that has worked on merchant and local economic development issues on **Mission Street** and in the Mission district since 1973. Currently MEDA runs a program to assist business owners with the purchase of their properties to help retain and expand local retail.

ISSUE BRIEF #3: COSTS AND CHALLENGES FOR RETAIL, RESTAURANTS, AND PERSONAL SERVICES IN SAN FRANCISCO'S NEIGHBORHOOD COMMERCIAL DISTRICTS

ISSUE BRIEF SUMMARY

Purpose and Approach

This issue brief explores the specific opportunities, costs, and challenges for retail, restaurants, and personal service businesses located in San Francisco's NCDs, and summarizes adaptations that businesses are making in response to these challenges and the broader industry trends discussed in Issue Brief #1. The findings in this issue brief are based primarily on interviews conducted for this study, including discussions with San Francisco retail brokers, business owners, staff from merchants' associations, community benefit districts, business assistance providers, and other stakeholders. Findings from recent news articles and other literature, as well as other relevant data, are also incorporated where appropriate.

Key Findings

While San Francisco has many competitive advantages for retail, restaurants, and personal services, businesses located in the city also face many challenges. These include:

- **Employee recruitment and retention challenges** associated with low regional unemployment rates, high local and regional housing costs, and competition with other industries offering better compensation or more flexible hours.
- **High cost of doing business.** These include high labor costs related to competition for labor, high cost of living, and the unintended consequences of San Francisco's progressive labor laws; and high rents, including lease structures with automatic rent escalations.
- **Lengthy and complex permitting process** that can add significant cost and time to the process of opening a new business. In addition, some laws intended to protect traditional retail by limiting other uses may limit retailers' flexibility to adapt to changing economic conditions (e.g., by serving food and beverage), or restrict complementary uses that could drive foot traffic to businesses (e.g., restaurants, personal services, professional services, or medical or office uses).
- **Challenges adapting to a changing market,** such as the loss of long-time customer base due to demographic change, and increasing competition from other brick-and-mortar locations (such as the proliferation of grocery stores and restaurants) as well as e-commerce. For some business owners, these challenges are compounded by a 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.
- **Public realm challenges,** including real and perceived issues around cleanliness, order, and safety, which may deter customers; and long-term vacancies, which contribute to a sense of disinvestment.

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 (for example, by selling products online or expanding online marketing); reduce costs or pass costs on to customers; and/or diversify revenue streams (for example, by serving food or alcohol at stores and galleries).

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).

Organization

The issue brief is organized in three sections:

- A brief review of San Francisco's main competitive advantages for retail and restaurants;
- A discussion of the major costs and challenges that businesses in retail, restaurant, and personal service industries in San Francisco face, based on findings from the interviews; and
- A summary of the diverse ways that businesses are adapting to the challenges discussed in this issue brief, as well as to the broader industry trends and other factors discussed in previous issue briefs.

SAN FRANCISCO'S COMPETITIVE ADVANTAGES FOR RETAIL, RESTAURANTS, AND PERSONAL SERVICES

The City of San Francisco remains a prime location for retail, restaurants, and personal services due to its unique competitive advantages. As discussed in Issue Brief #1, retail and restaurant sales in San Francisco have grown rapidly since the end of the recession, and the City's retail sector appears to have been protected (at least until recently) from some of the challenges affecting the retail industry nationally.

The opportunities for retail, restaurants, and personal service businesses in San Francisco include:

- **Strong economy, high household incomes, and low unemployment rates.** San Francisco has seen rapid job growth since the end of the last recession, driven by the expansion of the tech industry. The City's unemployment rate reached a low of 2.7 percent in May 2017, substantially lower than the state and national rates.[91] Citywide, the median income was $81,000 in 2015, with over one third of households making over $125,000.[92] The City is also densely populated in many neighborhoods. These factors translate into overall high spending power and significant demand for retail, restaurants, and personal services.
- **Significant regional and international tourism.** As discussed in Issue Brief #1, San Francisco benefits from significant regional, national, and international visitation, as well as travel for conventions and trade.[93] Many visitors come to shop and dine: a recent survey of tourists found that "restaurants and cuisine" was one of the top reasons for visiting San Francisco, while "dining in restaurants" and "shopping" were the top two activities of visitors.[94] Union Square is considered one of the most successful retail districts in the country,[95] while visitation to the NCDs appears to be increasing as well.
- **A local culture that values shopping local and eating out**. While difficult to quantify, many aspects of San Francisco culture support neighborhood retail, including a desire for unique urban experiences, the value that many residents' place on supporting small and local businesses, and a "foodie" culture that places great significance on dining out.

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[91] California Employment Development Department, 2017.
[92] U.S. Census ACS 5-year estimates, 2011-2015.
[93] San Francisco Travel Association, "San Francisco Fact Sheet."
[94] San Francisco Travel Association, "San Francisco Fact Sheet."
[95] Buxton, "Top 10 Most Sought-After U.S. Retail Streets"; JLL, "City Retail: Understanding North America's Prime Urban Corridors."

- **The quality of the built environment in many of San Francisco's NCDs:** Many of the City's NCDs have interesting and diverse architecture, historic buildings, and pedestrian-oriented streets. As discussed in Issue Brief #2, these factors are conducive to more successful urban retail.

COSTS AND CHALLENGES FOR RETAIL, RESTAURANTS, AND PERSONAL SERVICES IN SAN FRANCISCO'S NCDS

The opportunities described above provide a strong economic foundation for businesses in the retail, restaurant, and services industries in San Francisco. At the same time, however, businesses located (or searching for a location) in San Francisco face many challenges. This section focuses on the challenges that are specific to economic, regulatory, and socioeconomic conditions in San Francisco, but also references some of the challenges associated with the broader industry trends described in Issue Brief #1.

These challenges are organized in the following eight categories:

1. Employee recruitment and retention;
2. San Francisco labor laws;
3. Land use regulations and permitting requirements;
4. Real estate conditions;
5. Increasing competition with online sales and other sources;
6. Demographic changes;
7. Lack of technical expertise or capital; and
8. Public realm challenges.

1. Employee Recruitment and Retention

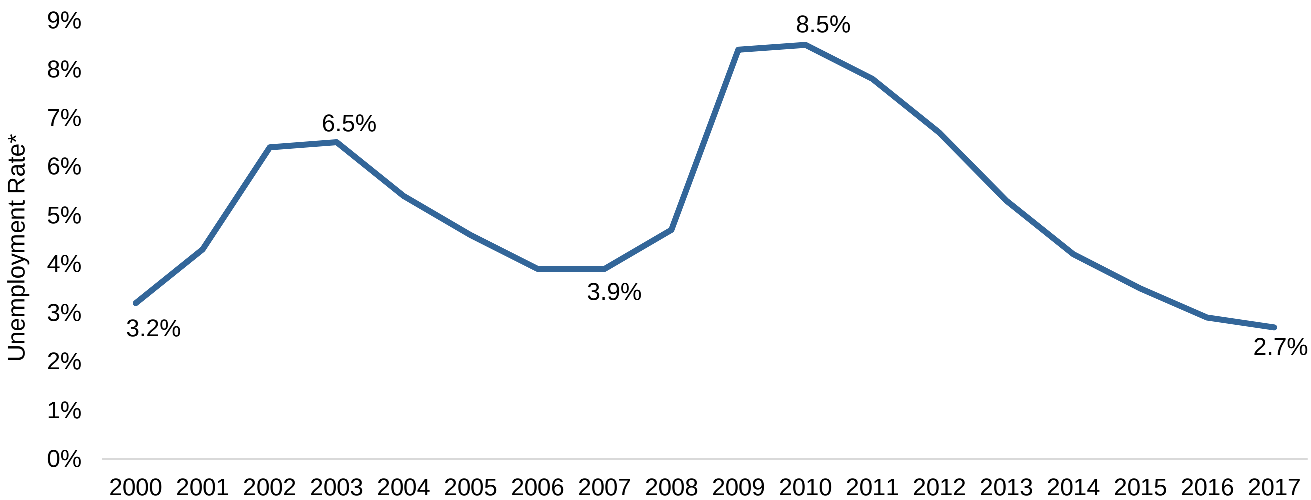
The difficulty of recruiting and retaining appropriately qualified employees was consistently brought up by interviewees as one of the top challenges that San Francisco businesses face. This trend, which appears to have accentuated in recent years, appears to be related to a variety of local and regional economic conditions, including:

- **Low unemployment rates.** Very low unemployment rates are creating challenges for Bay Area employers in many industries. As shown in Figure 13, San Francisco's unemployment rate has steadily declined since recovery from the Great Recession, reaching a low of 2.7 percent in May 2017. The Bay Area's unemployment rate was at just 3.3 percent in July 2017, compared to 5.4 percent for California and 4.6 percent for the nation. It is important to note that unemployment is cyclical, and that the labor shortage is related to the strong city and regional economy.
- **Growing competition from industries offering higher pay or more flexible hours.** The retail, restaurant, and service industries generally offer relatively low-wage jobs, although some business owners report offering higher wages to attract and retain workers. Nonetheless, in a tight labor market, workers may have other options, including in the growing freelance, gig, and sharing economy. Other industries may offer higher-wages or more appealing work conditions including more flexible hours, schedules that employees control, and/or easier commutes. For example, a few interviewees speculated that driving for Uber/Lyft – a very flexible type of work that can be picked up easily full-time or part-time, and where workers can set their own hours – was becoming a

source of employment for workers who might otherwise be employed in the retail, restaurant, or personal services industries.

- **High cost of living.** As rents have increased dramatically over the last several years, low and even middle-income households are increasingly struggling to afford living in San Francisco. Business owners report that many of their workers are commuting long distances to reach jobs in San Francisco and end up seeking employment closer to home. The limitations of the transportation system (i.e., BART does not run late at night or in the early morning) adds to the challenge of filling very early or late shifts. Business owners also indicated that some long-term employees have left the Bay Area entirely because of the cost of living.

Figure 13. Unemployment Rate in the City of San Francisco, 1990-2017 (May of Each Year)



*Data is displayed for the month of May of each year.
Source: California EDD, 2017.

Note that labor recruitment and retention challenges affect different firms in different ways. For example, in addition to the general challenges described above, restaurants are also dealing with a shortage of chefs and other skilled labor related to a variety of industry specific factors (described in Issue Brief #1). The labor shortage is driving the industry to shift towards less labor-intensive business models. On the other hand, some very small businesses are insulated from the labor shortage either because they exclusively employ family members, or because they have a few, long-term workers and have not experienced significant employee turnover.

2. San Francisco's Labor Laws

Businesses operating in San Francisco must abide by the City's progressive labor laws, which are generally aimed at "improving pay, access to health care, and paid sick leave for all workers, particularly lower-wage workers."[96] Figure 14 summarizes the laws currently in effect.

The City's minimum wage applies to all workers in San Francisco, except for individuals who are the parents, spouses, domestic partners, or children of the employer. Other laws impose different requirements

[96] Reich, Jacobs, and Dietz, *When Mandates Work: Raising Labor Standards at the Local Level*.

on businesses depending on the number of workers they employ. For example, the Paid Sick Leave Ordinance applies to all employees, but employees at firms with 10 or more workers can accrue more hours of sick leave. The Health Care Security Ordinance and Family Friendly Workplace Ordinance both apply only to firms with 20 or more workers nationwide, and larger firms are required to provide more generous health care benefits.

Previous studies of minimum wage increases have found that in cities and regions with low unemployment, high incomes, and a high cost of living, minimum wage increases do not generally lead to job losses or fewer hours worked. Rather, the increased cost of labor associated with a minimum wage increase is typically passed on to customers through higher prices on goods and services, recouped in savings from reduced worker turnover, or absorbed by businesses in the form of reduced profits. While some businesses with low profit margins may close due to higher costs, the resulting job losses may be absorbed by other businesses expanding (see additional discussion of findings from the literature in the text box below).

Anecdotally, many interviewees report that San Francisco retail, restaurant, and service businesses have increased employee wages and benefits in recent years. However, interviewees almost universally agreed that the increase in compensation has occurred primarily in response to the tight labor market, the high cost of living, and competition from other industries – rather than in direct response to the City’s increasing minimum wage or other labor laws. That said, some interviewees believed that the City’s minimum wage still results in higher wages, especially for the lowest paid workers. In addition, complying with the City’s labor laws can require significant time and effort.

It is important to note that increased labor costs – whether they result from economic conditions or regulations – affect different types of businesses differently. Businesses with high profit margins, or with customers who are not particularly price sensitive, may be able to pass the costs on to consumers relatively easily. On the other hand, low-margin businesses with price-sensitive customers may be affected more significantly. Compliance costs can also be particularly burdensome for smaller and lower-margin businesses, which often have no human resources staff. For example, these dynamics appear to be playing out in the restaurant industry: fine dining establishments have reportedly been able to pass increased labor costs on to diners, often in the form of a surcharge (i.e., a charge that is added at the end of a transaction and is not reflected in the prices for individual items). In contrast, lower- and middle-tier establishments have struggled more with the rising cost of labor. Increased labor costs also appear to be one factor driving the restaurant industry towards less labor-intensive business models, such as fast casual concepts.

The Impact of Minimum Wage Increases on Businesses

A significant body of research has explored the effects of minimum wage on workers, businesses, consumers, and overall employment levels. The effect of minimum wage on businesses in particular – including factors such as where businesses locate, how much they charge for their goods and services, how many employees they hire, and the type of employees they hire – has been a frequent topic of debate over the last twenty years.[1]

Increasingly, research is finding that minimum wage increases do not automatically lead to overall job loss or decreases in hours worked (including in lower-wage industries, like retail and restaurants).[2] This is especially the case in cities and regions where unemployment is low, incomes are high, and the cost of living is high.[3] Instead, it appears that the increased cost of labor is often passed on or absorbed through other avenues, such as higher prices on goods and services, savings from reduced worker turnover, and/or lower profits for businesses.[4]

Much of the literature has focused on the impacts on restaurants. Studies have estimated 1-2 percent increases in restaurants' operating costs following the implementation of a 10 percent minimum wage increase.[5] Studies have also found that restaurants increase prices in response to minimum wage increases (1 percent price increase for a 10 percent wage increase). [6] And, a recent paper on San Francisco's labor laws found that minimum wage increases are impacting restaurant closures in the city – but only for restaurants with low ratings on websites such as Yelp (the effect was not correlated with price point). The author speculates that "employment losses resulting from the closing of bad restaurants might be at least partially absorbed by the survival of better restaurants, which might have to hire more workers to meet demand."[7]

In most cases, however, research finds conclusive evidence of net positive effects on workers at the lowest wage levels.

[1] Reich, Jacobs, and Bernhardt, "Local Minimum Wage Laws: Impacts on Workers, Families and Businesses."
[2] Cengiz et al., "The Effect of Minimum Wages on the Total Number of Jobs: Evidence from the United States Using a Bunching Estimator"; Schmitt and Rosnick, "The Wage and Employment Impact of Minimum-Wage Laws in Three Cities."; Dube, Naidu, and Reich, "The Economic Effects of a Citywide Minimum Wage."
[3] Dube, "Proposal 13: Designing Thoughtful Minimum Wage Policy at the State and Local Levels."
[4] Reich, Jacobs, and Bernhardt, "Local Minimum Wage Laws: Impacts on Workers, Families and Businesses."
[5] Ibid
[6] Allegretto and Reich, "Are Local Minimum Wages Absorbed by Price Increases?"; Reich, Jacobs, and Bernhardt, "Local Minimum Wage Laws: Impacts on Workers, Families and Businesses."
[7] Luca and Luca, "Survival of the Fittest."

Figure 14. San Francisco Labor Laws, 2017

Law	Description
Minimum Wage Ordinance	All employees who work in San Francisco more than two hours per week, including part-time and temporary workers, are entitled to the San Francisco minimum wage* ($14.00 per hour as of July 2017). The minimum wage has been increasing gradually since voters approved the ordinance in 2014 and is scheduled to reach $15.00 an hour in July 2018. After 2018, the minimum wage will increase annually with the Consumer Price Index.
Paid Sick Leave Ordinance	All employees who work in San Francisco, including part-time and temporary workers, are entitled to paid time off from work when they are sick or need medical care, and to care for their family members or designated person when those persons are sick or need medical care. Employers with 10 or more employees must allow workers to accrue more sick leave.
Lactation in the Workplace Ordinance (effective January 2018)	All employers are required to provide employees breaks and a location for lactation and must have a policy regarding lactation in the workplace that specifies a process by which an employee will make a request for accommodation.
Consideration of Salary History Ordinance (effective July 2018)	All employers, including City contractors and subcontractors, are prohibited from considering current or past salary of an applicant in determining whether to hire an applicant or what salary to offer the applicant. The ordinance prohibits employers from asking applicants about their current or past salary or disclosing a current or former employee's salary history without that employee's authorization, unless the salary history is publicly available.
Health Care Security Ordinance	Employers with 20 or more employees (in any location), as well as and non-profit employers with 50 or more employees, must spend a minimum amount set by law on health care for each employee who works eight or more hours per week in San Francisco.
Family Friendly Workplace Ordinance	Employers with 20 or more employees (in any location) are required to consider employees' requests for flexible or predictable work arrangements to assist with caregiving responsibilities.
Fair Chance Ordinance	Employers with 20 or more employees (in any location) are required to follow new rules regarding applicants' and employees' criminal history.
Paid Parental Leave Ordinance	Employers are required to provide up to 6 weeks of supplemental compensation to employees who receive California Paid Family Leave benefits, including part-time and temporary workers. This currently applies to employers with 35 or more employees worldwide (and as of January 1, 2018, to employers with 20 or more employees).
Formula Retail Employee Rights Ordinances	Formula retail establishments must follow two new laws on scheduling, hours, and retention of employees.**

* The San Francisco Minimum Wage Ordinance does not cover individuals who are the parents, spouses, domestic partners, or children of the employers.
** Also known as the "Retail Workers Bill of Rights." Full details on the ordinance is available here: http://sfgov.org/olse/formula-retail-employee-rights-ordinances. Example of these requirements include: employers must offer any extra work hours to current qualified part-time employees before hiring new employees or using contractors or staffing agencies; if the establishment is sold, successor employer must retain employees, who worked for the former employer for at least six months, for at least 90 more days after sale; employers must provide employees with their schedules two weeks in advance; etc.
Source: City and County of San Francisco Labor Standards Enforcement, 2017.

3. Land Use Regulations and Permitting Requirements

Nearly every interviewee commented on the impact of land use regulations and permitting requirements, both on business start-up and operations, and on the overall economic health and sustainability of NCDs.

Some of the challenges associated with the City's land use and permitting requirements for individual businesses include:

- **Significant time and cost associated with opening a new business.** Depending on the combinations of permits and renovations required, the time and cost of opening a new business in San Francisco can be very significant. Depending on the lease agreement between the property owner (landlord) and the business (tenant), the tenant may be required to pay rent during the permitting process. Brokers, developers, and business assistance providers cited examples of permitting processes that took six to nine months, sometimes resulting in the applicant going bankrupt before they could open.

  Businesses can face an especially time-consuming process if they are required to obtain a change of use permit (for example, a new restaurant going into a space formerly occupied by a retail store), obtain a conditional use authorization (required, for example, for new formula retail uses), or comply with historic preservation requirements. The challenges associated with navigating the permitting process can also be particularly acute for small businesses, especially if they do not utilize technical assistance resources. One business assistance provider noted that OEWD's Small Business Acceleration Program (Open in SF) can substantially shorten the process for businesses that receive assistance.

- **Costs and disruptions to existing businesses associated with the soft-story retrofit program.** San Francisco's Mandatory Soft Story Retrofit Program (MSSP) requires seismic retrofit for "older, wood-framed, multi-family buildings with a soft-story condition."[97] The renovation costs associated with this program can be very high, and depending on lease terms, may be passed on to tenants. Extended renovations can also have a financial impact on businesses if they lead to temporary closures or decreased foot traffic. The number of businesses affected by the MSSRP is unknown.

- **Limited flexibility to adapt to changing economic conditions.** As described in Issue Brief #1, many retailers are experimenting with creative strategies such as co-locating with other businesses, combining multiple uses within a single business (e.g., serving food or drinks), or offering more events, classes, or other experiences to draw customers. The City's regulations can sometimes get in the way of this experimentation.

  For example, the San Francisco zoning code was only recently updated to allow retail uses to be combined with production, distribution, and repair (PDR) uses in NCDs.[98] Retailers seeking to serve food and/or drinks have also faced a number of hurdles, including the need for a new use permit, confusion over the type of permit required, and the time and cost associated with obtaining permits. In some cases, neighborhood residents and merchants have opposed retailers seeking to serve food and beverages.[99] In addition to the permitting challenge, renovating a retail space to include kitchen or bar facilities can be costly and require a long construction period

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[97] City of San Francisco Department of Building Inspection, "Mandatory Soft Story Retrofit Program | Department of Building Inspection."
[98] Grant, "Designing at Ground Level."
[99] Recent controversial examples include Amado's and the Royal Cuckoo Market in the Mission, which are discussed in Issue Brief #1.

- **Specific restrictions on alcohol:** To serve alcohol, a liquor license from the California Department of Alcoholic Beverage Control (ABC) is required. However, ABC limits the number of licenses available in each county. In general, the agency is not issuing new licenses in San Francisco, so businesses wishing to serve alcohol must find one to buy from an existing licensee. Resale values can run between $250,000 and $300,000, especially for a liquor license that allows for hard liquor in addition to wine and beer. Some neighborhoods also have enacted additional local restrictions on liquor stores and licenses.[100]

  In 2017, ABC began issuing a limited number of new licenses for exclusive use within specific neighborhoods, including San Bruno Avenue, Ocean Avenue, Third Street in the Bayview, Mission Street in Excelsior, Taraval Street, Noriega Street, and areas of Visitacion Valley. The new licenses were made available under a new state law, with the intent of attracting economic development to these neighborhoods. OEWD is also providing technical assistance to help retain and attract full service restaurants to the corridors.

The effect of land use and permitting regulations on the overall health of the NCDs is controversial. For example, some stakeholders see significant value in conditional use authorization, discretionary review, and other processes that allow residents to limit certain unwanted uses or obtain specific concessions from developers. Others see these processes as expensive and time consuming and argue that the lengthy process for opening new businesses may contribute to long-term vacancies. Some interviewees also cited regulations on non-retail uses as being potentially problematic for the health of NCDs. For example, the City's zoning code does not allow office uses that do not directly serve the public to locate in NCDs (even on the second floor). Under this regulation, uses like medical or law offices that are considered open to the public are allowed, while uses like co-working spaces are not. Some brokers and other stakeholders argue that co-working spaces and other office uses could generate significant daytime foot traffic for retail, restaurants, and personal services, and help fill vacancies in the NCDs.

[100] City of San Francisco Planning Department, "Mission Alcoholic Beverage Special Use District."

San Francisco's Formula Retail Regulations

Since the 2000s, San Francisco has regulated formula retail, defined as "a type of retail sales activity or retail sales establishment that has eleven or more other retail sales establishments […] located anywhere in the world" and maintains certain standardized features. In most NCDs, formula retail is required to obtain a conditional use authorization; in some NCDs, formula retail (or certain types of formula retail) are prohibited. The regulations are intended to protect San Francisco's "diverse retail base" and the "distinct neighborhood retailing personalities" of the city's different neighborhood commercial districts.[1]

A 2014 study by Strategic Economics[2] assessed the impacts of formula retail and the formula retail regulations on San Francisco's NCDs. Some of the key findings from the study are summarized below.

- **The concentration of formula retail in the NCDs is relatively low compared to national averages.** This suggests that the controls are successfully limiting the amount of formula retail, although other factors may also be at play.
- **While formula retail can contribute to a "cookie cutter" feel, it can also have positive effects on the NCDs.** For example, formula retail can serve as an anchor for an NCD, drawing foot traffic to small businesses; provide more affordable goods compared to independent retail;[3] and provide employment.
- **The impact of formula retail and the formula retail controls on rents in the NCDs is unclear.** The study did not find a consistent relationship between the approval of a new formula retail conditional use application and the subsequent direction of local rents and vacancies. Anecdotally, the study did find that in some highly desirable NCDs, such as Upper Fillmore, formula retailers may be willing and able to pay higher rents compared to independently owned businesses. On the other hand, the formula retail regulations may create an incentive for national or international businesses that do not yet meet the definition of formula retail, but anticipate rapid expansion, to locate in San Francisco as quickly as possible (i.e., before they reach the threshold of eleven or more worldwide locations) – contributing to higher rents.
- **In some neighborhoods, formula retail regulations may contribute to long-term vacancies by making it more difficult to lease spaces, particularly larger storefronts.** Formula retailers can generally fill more floor space than independent retailers, and can more often afford to make needed tenant improvements and pay the rents required to lease larger storefronts. Brokers report that large, deep spaces may sit empty for extended periods of time if a formula retail CU application is disapproved or withdrawn. The conditional use authorization process also discourages some formula retailers from even proposing to locate in the NCDs. However, while the formula retail controls may make leasing some spaces more challenging, obsolete building designs, significant maintenance needs, and challenging locations also likely contribute to long-term vacancies in many cases.

[1] Ordinance Number 62-04, Board File 031501, available online at: http://sfgov.legistar.com/LegislationDetail.aspx?ID=473759&GUID=A83D3A84-B457-4B93-BCF5-11058DDA5598&Options=ID|Text|&Search=62-04
[2] Strategic Economics, "San Francisco Formula Retail Analysis."
[3] Office of the Controller, "Expanding Formula Retail Controls: Economic Impact Report."

4. Real Estate Conditions

Many challenges mentioned by interviewees related to the age and quality of storefronts, rents and lease agreements, and to broader issues of neighborhood vacancies.

Age and Quality of the Physical Space

San Francisco's older building stock, including many historic buildings, is attractive for many business owners as well as customers. However, the cost of building improvements can be very high. Substantial upgrades to gas, electric, water, and sewer utilities, as well as to a space's ventilation and light, are often required to meet the needs of modern retail or restaurants. The cost of internet connections and other IT needs can also be significant. Under most lease agreements, businesses pay for these tenant improvements themselves. Additional costs are incurred when landlords require tenants to use union labor. The limited availability of contractors to do the work can be a challenge for completing improvements and contributes to high construction costs.

Tenant improvements can represent a particular cost hurdle for new restaurants, which often require upgraded kitchen facilities and new or improved ventilation systems (in part because the City prohibits external ventilation). Restaurants and bars that require kitchens often prefer spaces that have already been renovated for food and beverage preparation, and do not require extensive work.

Rents & Lease Agreements

Several interviewees listed high rents as a central challenge that businesses are facing in NCDs. Reliable, longitudinal data on rents in NCDs is not available. Brokers interviewed for this study observed that after rising steadily rents since the last recession, rents have begun to stabilize or decline in the past few months to a year. However, most lease agreements are at least five years in length (often with an option for a five- to ten-year extension), so any decrease in rents is unlikely to benefit existing tenants in the short-term.

Lease agreements in San Francisco's NCDs are typically structured to include automatic rent escalations (usually 2-3 percent a year). This type of lease structure requires tenants to increase sales annually in order to keep up with rent escalation. As discussed above, leases generally require businesses to cover the costs of tenant improvements, and often to pay rent during renovations (prior to opening). Under this lease structure, permitting or other delays can create a substantial challenge for small businesses with limited capital. Some of these terms may be negotiable; however, small businesses in particular may not have the experience required to negotiate a favorable lease unless they take advantage of small business assistance services.

Long-Term Vacancies

A healthy vacancy rate (in the range of 8-10 percent) allows for turnover and expansions. As discussed in Issue Brief #1 and #2, the vacancy rate in most San Francisco NCDs is low (less than 10 percent), and some spaces that appear vacant are actually undergoing renovation for a new use. However, long-term vacancies can affect the success of neighboring businesses, and the overall health of NCDs, by creating a sense of disinvestment or blight. Some interviewees noted that long-term vacancies are a problem in some NCDs, and described the following factors as possible contributors to these vacancies:

- **Mismatch between storefront layout and current market demand.** For example, this includes larger, deeper storefronts that once functioned as department stores, theaters, or other uses, but now appeal to a limited number of tenants and are challenging to subdivide**.**
- **Buildings that require substantial rehabilitation,** including buildings that are subject to historic preservation restrictions.

- **New ground floor retail space that is poorly designed for tenant needs.** In some neighborhoods, merchants and neighborhood activists have observed that ground floor retail space in new buildings sits empty because it is designed with larger storefronts that meet the needs of national retailers, but are too large for smaller, local businesses.
- **Landlords holding space vacant while waiting for higher rents or specific tenants.** Neighborhood organizers, merchants, and some recent articles[101] have observed that some long-standing vacancies are caused by landlords holding out for higher rents or a desired type of tenant. In some cases, property owners may have to plan for a certain rent in order to obtain financing, and may risk going into default or being required to put additional equity into the building if they accept less than the projected rent.[102] Alternatively, financing for a mixed-use project may not assume any retail rent revenue at all, which limits the incentive for the property owner to find a tenant. However, it is unclear whether landlords being unwilling to rent their properties is limited to a few highly visible cases. Brokers interviewed for this study do not believe this trend is widespread, if it happens at all.
- **Time-consuming and expensive permitting processes.** As discussed above, the length, complexity, and cost of obtaining permits may contribute to long-term vacancies by making it more difficult to open a business.

5. Increasing Competition from E-Commerce and Other Sources

As discussed in Issue Brief #1, business owners in many sectors are facing increased competition from online sales and – in some cases – from other brick-and-mortar locations. For example, grocery stores and restaurants in many San Francisco NCDs are seeing more competition from a proliferation of brick-and-mortar locations (many of which offer delivery), as well as meal delivery kits. The clothing industry is another example of a sector dealing with more competition, including from online stores (e.g. Amazon Prime Wardrobe and Zappos), hybrid online companies that also have brick-and-mortar locations (e.g. Reformation, on Valencia Street), and companies offering digital personalized shopping services (e.g. Stitch Fix delivers personalized and free-return items to subscribers; Le Tote delivers rental clothing to be worn by subscribers, with the option to return or purchase the items after a set period of time).[103] In some cases, brick-and-mortar stores may also be competing with mobile vendors (e.g., food trucks competing with restaurants).

6. Demographic Change

Many San Francisco neighborhoods are experiencing significant demographic change, including an influx of upper-income households. In general, higher spending power supports increased sales for retail, restaurants, and personal services businesses. However, in some neighborhoods, long-standing businesses are struggling to adapt to changes in their customer base. For instance, in the Mission District, long-standing businesses and mom-and-pop retail shops that historically served the predominantly Latino population have reported challenges in adapting as the neighborhood's demographic becomes wealthier and whiter.[104] The

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[101] Park and Downing, "It's A Fact."
[102] This dynamic has been observed in New York's SoHo neighborhood; see Bagli, Charles V. "In a Thriving City, SoHo's Soaring Rents Keep Storefronts Empty." *The New York Times*, August 23, 2017. https://www.nytimes.com/2017/08/23/nyregion/soho-empty-storefronts.html.
[103] McKinsey & Company, "The State of Fashion 2017."
[104] Strategic Economics, "Mission Street Corridor Economic Analysis"; Strategic Economics, "Calle 24 Retail Study: Final Background Report," 24.

Castro is facing a similar issue, with a seemingly growing number of lesbian, gay, bisexual, and transgender (LGBT) bars and other institutions closing in response to changing demographics.[105]

7. Lack of Technical Expertise or Capital

In some cases, small business owners lack the technical expertise or financial resources required to help them adapt to a changing market. For example, the small business assistance providers interviewed for this report noted that some long-standing business owners have operated for many years without a business plan. The lack of a business plan can be a particular barrier when a business seeks new space; a business plan is essential both for helping the business owner determine how much they can afford to pay in rent, and for negotiating a reasonable rate with the property owner. In other cases, small business assistance providers have observed entrepreneurs who choose locations based primarily on the rent, without doing sufficient research on local consumer characteristics or building conditions. In some cases, these businesses may end up in in spaces with very high tenant improvement costs, or in neighborhoods where there is too much competition or not enough of a market to sustain a viable business.

Some small businesses are also struggling to expand their marketing. While some small businesses in San Francisco's NCDs have a robust online presence, with daily posts on Instagram or Facebook, this kind of marketing strategy requires dedicated staff time. Some small businesses struggle to maintain a basic presence on websites such as Yelp, Facebook, and Trip Advisor. For example, fewer than half of businesses on the Calle 24 corridor currently have hours of operation clearly posted either on their storefront or online.[106] Performing needed tenant or façade improvements is another challenge for many cash-strapped businesses.

San Francisco's Office of Economic and Workforce Development, and the small business assistance providers that the City funds, offer technical assistance, grants, and loans that can help businesses with many of these activities, including creating business and marketing plans, negotiating leases, and investing in façade or other capital improvements. Some of these services (such as capital funding assistance) are targeted to specific neighborhoods and are not available citywide.

8. Public Realm Challenges

As discussed in Issue Brief #2, an attractive, clean, and safe environment is considered a key factor for supporting successful urban retail. An attractive public realm helps position an NCD as a retail destination, especially for customers from outside the neighborhood. Business owners in some NCDs believe that customers are deterred by concerns around cleanliness, disorder, and safety. For example, business owners cited the presence of homeless people, mentally ill people, and persons with substance use disorders as a challenge in attracting customers and employees, especially for businesses that offer outdoor seating areas.

BUSINESS ADAPTATIONS

As discussed throughout this and previous issue briefs, many businesses are adopting creative strategies in response to the challenges discussed above. These include strategies to reduce costs or pass costs on to

[105] Bowles and Levin, "San Francisco's Tech Bros Told: Quit Changing the Gayborhood"; James, "There Goes the Gayborhood."
[106] Strategic Economics, "Calle 24 Retail Study: Final Background Report," 24.

customers; expand sales of current products; and diversify their revenue streams. Examples of these strategies are summarized below.

- Strategies to **reduce costs or pass additional costs on to customers** include:
  - **Adopting less labor-intensive business models.** For example, fast casual dining is expanding in San Francisco in part because it uses less labor than restaurants that provide traditional table serve. Some businesses are also experimenting with automation to further reduce labor costs, such as self-checkout kiosks at grocery stores or automats (like 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 businesses.
  - **Relocating to lower-cost areas** either within San Francisco, or in some cases outside of the City.
  - **Increasing prices,** or in the case of restaurants, adding surcharges to the final bill to reflect the high cost of doing businesses.

- Strategies for **expanding sales of existing products** include:
  - **Taking advantage of online apps and marketplaces.** Many restaurant owners in San Francisco's NCDs see delivery through third-party delivery apps as an essential way to expand sales, while some service providers are using online booking platforms. Some small retailers are experimenting with selling online as well, either through their own websites or third-party platforms.
  - **Developing a stronger presence on social media.** In addition to maintaining a presence on Google Maps and Yelp, many business owners take advantage of social media (Facebook, Instagram, Twitter) to keep customers engaged.
  - **Hosting events to draw in foot traffic,** such as tastings, classes, workshops, or lectures.

- Strategies for **diversifying revenue streams** include:
  - **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**.

In some cases, policies or programs can help facilitate these kinds of adaptations. For example, land use policies may need to be modified to provide retailers more flexibility in experimenting with combining uses and expanding services (e.g., serving food and beverages or incorporating "maker" or PDR space). Some businesses may benefit from increased technical and financial support in expanding their online presence or adjusting their inventories for a changing customer base. However, it is important to recognize that change is challenging, and some businesses will not be able to adapt to a changing market. Policies and programs cannot force change on an unwilling business owner or overcome fundamental challenges such as a lack of sufficient market demand for products or services.

APPENDIX: INTERVIEWEES AND BIBLIOGRAPHY

LIST OF INTERVIEWEES

This study was informed in part by interviews with the following experts and stakeholders, conducted in August 2017:

- Carol Gilbert, CGI
- Chris Foley, Polaris Pacific
- Christine Johnson, SPUR
- Chris Wright, Planning Association for the Richmond
- Dan Safier, Prado Group
- Dan Weaver, Ocean Avenue Association
- David Catania, Greenberg Traurig LLP (counsel for Starship Technologies)
- Gwyneth Borden, Golden Gate Restaurant Association
- Iris Lee, Working Solutions
- Lexi Russell and Gary Baragona, CBRE
- Miriam Zouzounis, Arab American Grocer's Association
- Pam Mendolsohn, Cushman Wakefield
- Sam Mogannam and Calvin Tsay, Bi-Rite
- Tom Radulovich, Livable City
- Valerie Camarda, Marketing Sense
- Vas Kiniris, Fillmore Merchants Association
- Vikrum Aiyer and Summet Marwaha, Postmates

The study was also informed by interviews conducted with business owners on 24th Street and Mission Street, and real estate brokers representing properties in the Mission District, for studies conducted for OEWD in 2016 and 2017.[107]

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