



41ST AVENUE CORRIDOR ECONOMIC DEVELOPMENT/MIXED USE REVITALIZATION STUDY

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City of Capitola

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EXECUTIVE SUMMARY

1. INTRODUCTION

The City of Capitola established the 41st Avenue corridor as the primary regional retail destination in Santa Cruz County by capitalizing on the indoor mall-building trend begun in the 1970s. Capitola benefited from the corridor's ability to attract shoppers from all over Santa Cruz County for nearly three decades, with large retail anchor tenants and the additional of the Auto Mall. Over time, sales tax from the corridor has become an important component of the City's budget, with about 82 percent of the City's retail sales revenue coming from the 41st Avenue corridor and Auto Mall.

However, this study shows that for several years, even before the current recession, sales have been flat or in decline for the 41st Avenue Corridor and Capitola Mall. There are two primary reasons for this. The first is that Capitola faces increased competition from neighboring communities that have developed regional retail uses, which reduces the amount of regional spending that goes to Capitola. This coincided with the rise in the 1990's of "power centers" anchored by big-box retail stores such as Staples, Target, and Home Depot.

The other primary reason is that the retail model for 41st Avenue has become outdated. In recent years, the national trend has moved dramatically away from indoor malls and strip retail development towards "lifestyle" retail centers that follow more upscale retailing, outdoor and pedestrian design, and shared uses such as office, hotel, entertainment, and housing.

The decline in shopping at traditional suburban malls is precipitous: in 2002 just 19 percent of national retail purchases were made in indoor malls, down from 38 percent in 1995.¹ In fact, according to the International Council of Shopping Malls, no new indoor retail malls were built in the United States in 2007. By contrast, since the early 2000s, downtown retail districts and "lifestyle" centers with outdoor shopping, pedestrian focus, and mixed-uses with street-facing storefronts have had increasing sales.

The current recession has served to underscore these underlying issues, with national anchor chains and specific retail segments experiencing significant numbers of store closures. The recent downturn in retail activity and resulting sales tax has a profound effect on the overall economic health of the City of Capitola. While there have been some recent improvements with the addition of Whole Foods and new tenants at King's Plaza, as a whole the 41st Avenue corridor, with increased regional competition and an outdated retail model, is unlikely to provide the same long-term sustainable economic engine as it has in the past. This is a key moment for the City to reconsider its overall approach to the corridor.

¹ Russell Roberts, "Hamilton Marketplace: The Future of Shopping," *Mercer Business*, May 01, 2006.

2. RECENT RETAIL TRENDS

Nationally, the six-month total retail sales for 2009 (through June) showed an overall decline of 11 percent compared to the same time period in 2008.² The largest declines came from four specific retail categories -- gasoline stations (33 percent), automobile dealerships (23 percent), furniture and home furnishings (14 percent), and building materials (11 percent). General merchandise store sales were virtually unchanged, although traditional department stores had a sales loss of 7.7 percent. Grocery store sales were also unchanged. These national trends have clear implications for 41st Avenue, which has a very large concentration of these types of businesses.

Capitola's overall taxable sales base through the first quarter of 2009 showed a year-to-year decline of 26 percent.³ This represents a steep loss that is larger than the taxable sales declines for Santa Cruz County as a whole (14.5 percent), and neighboring cities such as Santa Cruz (12.9 percent) and Scotts Valley (14.5 percent). However, it is closer to some other cities with concentrations of regionally serving retail such as San Jose (21 percent) and Fremont (22 percent).

The 41st Avenue corridor as a whole generated taxable sales of \$368 million in 2008, which represents an 11 percent decline from 2007, and a constant dollar decline of 24 percent from 1999.

It is important to point out that nine out of the top ten sales tax generators in Capitola come from the heavily impacted retail categories of automobile dealerships, gasoline stations, building materials stores, and traditional department stores. Moreover, all of these businesses are located along 41st Avenue. It is also important to note that the stagnation and subsequent sales decline along 41st Avenue began well before the current recession impacted the retail market nationally and regionally.

3. EXISTING CONDITIONS

In order to assess the existing conditions, Applied Development Economics conducted field visits and interviews with businesses, property owners and other local stakeholders. In addition, detailed economic and ownership data has been reviewed by block and parcel. This section summarizes those findings.

VACANCIES

41st Avenue has had several long-term major anchor tenant vacancies, as well as some recent vacancies filled. Long-time vacant spaces at the former Ralph's supermarket and FYE music store sites were recently filled by Whole Foods Market and BevMo, although there are some

² U.S. Department of Commerce; "Advance Monthly Sales for Retail and Food Service"; July 2009.

³ MuniServices LLC.

vacancies or under utilization of some of the smaller spaces. Capitola Mall recently lost two of its anchor stores (Mervyns and Gottschalks), and Kohls will soon move into the former Mervyns site. While the property owner of the Gottschalks site and the City have considered various options for the site including reconfiguration, there has been no offers to lease the site. The mall has also seen a rise in vacancies for their other spaces.

The prevailing perception is that vacancies along 41st Avenue have been consistent for several years. Some vacancies in other shopping centers have been filled by conversions into office spaces. Commercial rents had been holding steady and some interviewees viewed the rents along the corridor as high. Rents have recently gone down in order to maintain occupancy levels. While there were vacancies at King's Plaza in 2007 and 2008, that center is now 100 percent occupied.

AGING PROPERTIES

Most of the commercial centers along 41st Avenue have not had a major renovation in many years, which led to an impression that the corridor was, at the very least, aging in appearance. More recently, Kings Plaza made some façade and roofing improvements, and the new Whole Foods Market has given a new look to its shopping center. Capitola Mall has not had a recent renovation, although the new Kohls department store will help freshen the property's appearance when it opens in late-2009.

PARCEL CONFIGURATIONS

The parcel boundaries along 41st Avenue show most of the properties broken up into multiple lots with multiple owners. This occurs even in shopping centers that appear contiguous. Kings Plaza is the only commercial center where nearly the entire block is controlled by a single property owner. Even Capitola Mall is divided into 14 separate parcels with 9 different owners, which makes major renovations and physical realignments more difficult.

BUILT ENVIRONMENT

The 41st Avenue corridor is primarily designed around accommodating the automobile. In general, the buildings along 41st Avenue are set back with large parking lots in the front. Building heights along the corridor are currently limited to 40 feet, and relatively few buildings currently approach that height. In addition, the street itself does not have a lot of streetscape treatments or other urban design features designed to make the street more pedestrian-friendly.

TRAFFIC CONDITIONS

41st Avenue is a heavily traveled corridor, and although congestion is widely viewed as a problem, the high traffic volume is also viewed as a benefit to retailers. The corridor serves as a primary artery facilitating travel from one end of town to the other, and also serves as a regional public transit route.

TRANSIT

41st Avenue is a primary public transit route that serves both local and regional routes. The primary transit center and transfer point is currently located at Capitola Mall.

ORGANIZATIONS

41st Avenue does not currently have any dedicated business groups or organizations focused on issues specific to the corridor. Previous efforts were not well attended due to the high proportion of out-of-town business owners along 41st Avenue.

CITY REGULATIONS

Property owners generally viewed the City process for obtaining permits as cumbersome. The primary issue is that current land use designations require nearly all businesses to obtain a conditional use permit, which requires a public hearing and Planning Commission approval. Individual respondents also indicated that they would like to see less restrictive signage regulations and a more frequent Planning Commission schedule, given how many uses require conditional use approvals. It should be noted that these responses reflect the respondents' perception of the City's process. Although the City tends to bring projects to the Planning Commission faster than most comparable jurisdictions, the low number of uses allowed by-right slows down the entitlement process.

4. 41ST AVENUE RETAIL CENTER SUMMARIES

Applied Development Economics conducted a block by block analysis of retail trends along the corridor using detailed data from 1999-2008. Below is a summary of those findings. Tables outlining these trends by block are included in a later chapter.

The southern end of 41st Avenue (New Leaf and O'Neill's blocks) saw the most conversions of retail spaces over to office uses. This has led to a steep decline in taxable sales, despite a very low vacancy rate. The major centers along this block include Begonia Plaza and Twin Palms.

The parcels south of Capitola Road include Kings Plaza and Outdoor World blocks. Through 2008, sales at Kings Plaza have shown a consistent downward trend since 2001, while taxable sales at the Outdoor World blocks have had a more variable trend. Generally, these blocks have had very low vacancies and relative stability in the tenants.

The block opposite (east) of Capitola Mall encompasses the commercial parcels anchored by the current Whole Foods Market site. This site has had long-term vacancies for two large sites that were recently filled, as well as other smaller vacancies. The block encompasses 19 separate parcels with 13 different owners. Taxable sales have declined by more than half since 1999, but the recent openings for BevMo and Whole Foods should help to improve that trend.

The Capitola Mall is the single largest generator of taxable sales in Capitola. It encompasses a large contiguous space that has multiple parcels and multiple owners. The long-term sales trend for the mall shows a gradual decline that started in 2001. The loss of Gottschalks with no immediate prospect from replacement will accelerate the sales decline.

The Brown Ranch shopping center is anchored by Trader Joe's and Bed Bath & Beyond. The center has maintained a consistently high occupancy rate, although the overall taxable sales have consistently declined since 2005 when another Trader Joe's location opened in Santa Cruz.

Businesses along the northern end of 41st Avenue generally saw a sales increase through 2006, although specific portions of the corridor have seen very high vacancy rates, while others have had no vacancies.

The Auto Plaza recently lost the Honda dealership, which will add to the long-term decline that has occurred since 2001. The area that encompasses the Auto Plaza is landlocked and does not have room for expansion.

5. POTENTIAL ALTERNATIVE USES FOR 41ST AVENUE

The future viability of traditional commercial corridors has come into question in recent years. As retail development has shifted over time, the market support for linear commercial strips has eroded. This leaves many communities with increasing commercial vacancies, decreasing rents, deferred maintenance of buildings, and less viable retailers moving into corridors that were once thriving shopping districts.

Repositioning these commercial corridors for alternative uses is an option that has attracted significant interest from local governments, businesses and landowners over the last few years. This process entails a multi-faceted approach that involves allowing for greater flexibility in the uses allowed and/or promoted along an existing commercial corridor. It also includes design guidelines aimed at creating a more pedestrian-friendly environment and more consistency in the building frontages. Markets for potential alternative uses include office development as well as housing and mixed use development.

OFFICE MARKET

Despite the recessionary conditions, the office market has remained strong in the Mid-County area. The vacancy rate for office spaces in Mid-County stood at 3.3 percent in the 4th quarter of 2008. This was a substantial increase from the 2.0 percent vacancy rate from one year earlier, but it still remains much lower than the 10.2 percent countywide average.

HOTEL MARKET

Although the regional lodging market has seen a decline in room occupancy, Capitola has historically been undersupplied, relative to its attractiveness as a visitor destination. A local hotel group recently began construction on a new 84-room hotel on 41st Avenue and

Brommer. The project will be operated as a Fairfield Inn by Marriott, and targeted to business and leisure travelers. The project is scheduled for completion in mid-2010.

OUTDOOR/PEDESTRIAN ORIENTATION/COMMUNITY BRANDING

Given the trend towards outdoor, pedestrian-oriented, “lifestyle” retail centers, the Capitola Mall and 41st Avenue corridor could begin a longer-term re-design to become a more walkable retail area by placing a greater emphasis on the outdoor areas, streetscape, and building design. This would work well with Capitola’s temperate weather, flat terrain and the residential areas which are nearby. By better defining 41st Avenue as a destination in its own right, this kind of “place” orientation can make the area more amenable to expanding into uses beyond retail such as lodging and entertainment uses. Communities have begun to create local “brands,” or themes which mark them. Like Capitola Village, which has its own brand and is well-known, 41st Avenue/Capitola Mall could become known as an outdoor, pedestrian-friendly retail environment. This ‘brand’ could include architectural themes, landscaping, sidewalk widening, and infrastructure improvements.

HOUSING AND MIXED USE

Mixed-use developments are designed to combine multiple uses onto a single site in a coordinated way. The common prototype is to locate housing above a ground-floor retail space. Examples along 41st Avenue and in nearby Live Oak have begun to appear. The market for housing has declined with the economy, and has created delays for most projects already underway. Examples of mixed-use projects in the region include Santana Row (San Jose), Capitola Beach Villas, and Opal Cliffs Center at Portola and 41st Avenue.

Mixed Use Opportunities

- Existing parcels that are potentially ready for redevelopment
- Need for additional housing in Capitola
- Meets new trends towards combining housing and retail areas
- Existing projects are already testing and seeding the market for mixed-use
- Strong retail base
- Existing transit center.

Mixed Use Challenges

- Automobile orientation and existing building frontages not attractive to pedestrians
- Fragmented ownership of parcels make assemblage difficult
- No plan to guide new development and encourage housing and mixed use development
- No experience with large-scale mixed use projects in Capitola
- Questions about whether people will live on 41st Avenue or use the units as second homes
- Current economic conditions and existing vacancies

Issues to Consider

- Developer strengths
- Need for financial assistance
- Target market for housing
- Changing retail climate
- Potential for office condominiums
- Overestimating market for potential uses

Possible Mixed-Use Opportunity Sites

Four potential opportunity sites were identified for both short-term and long-term considerations as mixed-use development sites. These properties are listed as follows:

Short-term:

- Blockbuster/Capitola Grille site – This 1.9-acre site encompasses four parcels under a single ownership. It has potential for mixed-use because of its proximity to the Mall, and the ownership has taken an interest in exploring alternative uses.
- O’Neill’s Block – Because of the proximity to other planned mixed use developments, the former Cycle Works and some of the adjacent parcels could be looked at as potential housing or mixed use sites. However, the 0.3-acre site is small.

Long-term:

- Ow Property (Kings Plaza) – This 11.4 acre site is the largest contiguous parcel under a single ownership
- Capitola Mall – This site has potential for a long term transition from indoor shopping mall into more updated outdoor/pedestrian-oriented retail/development model.

FISCAL CONSIDERATIONS

From the standpoint of municipal finances, retail uses are attractive because the majority of their business transactions generate revenue for the City. However, retail is not the only use that potentially generates tax revenues.

Point of Sale Revenues and Transient Occupancy Tax (Office and Hotel)

On a per square-foot basis, lodging is one of the highest revenue generators for the City because the Transient Occupancy Tax (TOT) is charged at a higher rate than sales tax and the local municipality keeps all of it (rather than sharing it with other governments like sales tax revenues).

Office and industrial uses are not typically considered strong sources for taxable sales. However, they can serve as locations for point-of-sale transactions. These transactions are taxable and can potentially generate very high sales tax revenues. The drawback is that there is no way to immediately tell whether an office or industrial tenant will generate point-of-sale

revenues. However, some types of uses are more likely to generate point-of-sale revenues than others. These business types are listed below.

- Specialty Trade Contractors
- Computer and Electronic Product Manufacturing
- Wholesale Trade, Durable Goods
- Wholesale Trade, Nondurable Goods
- Credit Intermediation and Related Activities
- Rental and Leasing Services
- Professional, Scientific, and Technical Services

Mixed-Use Revenues

In a situation where regional retail uses are contracting, resulting in permanent reductions in sales tax revenues, mixed use may generate approximately the same tax revenues as regional retail, but may also require higher City costs for services to the residential units.

The primary fiscal benefit of retail development is the sales tax that the City receives. Local jurisdictions basically receive one percent of taxable sales within their jurisdiction. By comparison, the main local revenue generated directly by residential development is the property tax. Generally, mixed use development would also generate sales tax, though at a lower rate than regional retail.

Part of the benefit of mixed use development is adding household purchasing power to the local retail market area. The net fiscal effect, factoring in the cost for City services to the two types of development, is likely to show a wider disparity.

Another option for mixed use is to focus on office development over ground floor retail. This can also increase the assessed value of the property compared to single story development and may be less costly for the City to provide services. However, office development provides less market strength for retail sales than does residential development.

If we view the comparison not with regional retail but with single story strip retail center development, the fiscal positive of mixed use development is much more pronounced. By essentially multiplying the development intensity by four (four stores compared to one), plus gaining the sales tax from ground floor retail, mixed use development becomes a very attractive option for the City to replace older, underperforming strip centers along 41st Ave., or elsewhere in the City.

IMPLEMENTATION RECOMMENDATIONS AND STRATEGIC INITIATIVES

This section includes a number of implementation approaches the City should consider in order to enhance the economic viability of the 41st Avenue corridor. The recommendations are in two sections: 1) Planning and Infrastructure, and 2) Retail Attraction/Financing/Organizational Development.

1. PLANNING AND INFRASTRUCTURE

1.1 SHORT-TERM ZONING ORDINANCE CHANGES

The following short-term zoning changes could assist developers with more flexibility and choice along the corridor.

Height

The current zoning along 41st Avenue only allows for maximum building heights of 40 feet, with exceptions allowed at the City Council's discretion. For redevelopment of existing surface-parked strip-center commercial development to projects with underground/structured parking to be financially feasible, the new development will need to be at least three or four stories tall.

Given 41st Avenue's unique scale and larger regional commercial role, increased building height may be appropriate if other infrastructure issues can be concurrently resolved. In the near term, to reduce uncertainty, the City should consider parameters by which it grants height exceptions.

Parking:

The City's parking standard is conservative compared to the standards by the Institute for Traffic Engineers. In the near term, the City should consider changes to its commercial parking standards, particularly for shared parking facilities.

By-Right Uses in the Community Commercial District

While the City of Capitola processes planning permits more quickly than most area jurisdictions, nearly all uses in the 41st Avenue corridor require a Planning Commission hearing. The City should consider making more uses allowed by right in the Community Commercial (CC) District, potentially using the Commercial Neighborhood (CN) District's allowed uses as a template.

1.2 COMPREHENSIVE PLANNING PROCESS FOR 41ST AVENUE CORRIDOR

In order to address the longer-term issues facing the corridor, the City should begin a focused planning effort for the 41st Avenue corridor. This is strongly recommended to

provide an opportunity to comprehensively address the land use, infrastructure, and transportation needs along the corridor. This planning process would allow for strong integration between a long term vision, land use regulations, design direction, and infrastructure improvements, and should be integrated with the coming General Plan Update. The outcome of this planning process could be a General Plan Economic Development Element for the corridor, a Specific Plan with attendant environmental review, and/or long-term revisions for zoning ordinances. Potential issues to be addressed through such a planning process include:

Parcel Consolidation

One of the primary challenges to redeveloping existing commercial areas is the issue of multiple ownerships. Through the planning process, particular groups of properties can be planned together, with incentives and regulations established that encourage cooperative development opportunities on key sites.

Parking

As part of the longer-term planning process the City should examine the feasibility of a parking district. The district could allow for parking requirements to be shared across multiple parcels, instead of confining off-street parking to each individual parcel. This could improve overall area design, facilitate redevelopment, and allow for more efficient land use.

Form Based Zoning

Form-based zoning is an increasingly used alternative for repositioning aging commercial corridors. Form based zoning generally describes the shape of new development, its location on a parcel, and the public spaces that are framed by the private development, rather than dictating particular uses. A form-based zoning approach would potentially evolve 41st Avenue into a more pedestrian-friendly environment with more consistency in the urban design.

Increased Use Definition

The entire 41st Avenue corridor in the City of Capitola is zoned CC, Community Commercial. However this corridor includes a range of different existing land uses, various adjacent land uses, and different forms of access to the regional transportation network. In the longer term, the City could consider a block by block vision for the 41st Avenue corridor that encourages the development of various districts in appropriate locations. This could potentially include defining sets of uses that would be allowed on a by-right basis, rather than the current zoning that technically allows for a wide range of uses, but requires all of them to go through a conditional use approval process.

Fiscal Tradeoffs for Different Land Uses

Capitola faces a situation where diminishing regional retail uses could ultimately result in a permanent reduction in sales tax revenues from these types of uses. Other types of uses

present fiscal tradeoffs. The City needs to account for these tradeoffs in future planning for 41st Avenue.

1.3 INFRASTRUCTURE

Identify Traffic Flow and Transportation Enhancement Options:

41st Avenue serves a major role as a primary arterial corridor. The traffic volume and congestion are frequently cited as a competitiveness issue for 41st Avenue. Identifying options for accommodating vehicular traffic, as well as enhancement activities that invite pedestrian use and better accommodate bicycles will need to be addressed in conjunction with identifying future land use alternatives.

Alternative Locations for Transit Center

Because of Capitola Mall's importance as a regional employment center and commercial destination, the presence of the Transit Center serves a vital regional role. However, the current location for the Transit Center potentially limits opportunities to extend the mall to the sidewalk, enhance outdoor uses at the Mall entrance, and create a more urban and pedestrian-friendly street presence. The City should work with mall management and Santa Cruz Metro to explore alternate locations for the Transit Center that facilitate usage of the transit system while allowing for Mall redevelopment.

Pedestrian Orientation/Community Branding

With the changes in retailing, many communities have discovered that retail centers with a strong 'brand' are stronger than those without a brand. This 'brand' can include strong architectural themes, landscaping, and historic context. Examples of this include the historic Cannery Row in Monterey, the newly created Santana Row in San Jose, and State Street in Santa Barbara. 41st Avenue lacks a positive cohesive brand. The City should consider what this long term vision for 41st might be, and develop public infrastructure improvements to promote it.

2. RETAIL ATTRACTION, FINANCING AND ORGANIZATIONAL DEVELOPMENT – OVERALL EXPANDED ECONOMIC DEVELOPMENT EFFORT

ENSURE CITY PARTICIPATION IN A 41ST AVENUE WORKING GROUP

Communication between City officials and the 41st Avenue business community is vital to all levels of retail marketing and economic development efforts along the corridor. In partnership with the Chamber of Commerce, the City should continue to dedicate resources to help facilitate a 41st Avenue Corridor Working Group as a subcommittee of the Economic Development Committee of the Chamber. This 41st Avenue Working Group

would have the goal to keep communication open between 41st Avenue businesses, property owners, retail center managers, the Chamber and the City. It would provide a forum for key stakeholders to discuss long-term opportunities for the 41st Avenue Corridor, and could also serve as a primary advisory committee for future studies and the General Plan Update process related to the Corridor.

ADDRESS BUSINESS RETENTION AND ATTRACTION PRIORITIES

Work with the Chamber and the Working Group to Leverage New Stores to Complement New Anchor Stores:

Kohl's and Whole Foods represent new market anchors to the 41st Avenue corridor. The City should work with its 41st Avenue partners to explore ways to leverage the new anchor store activity to attract complementary stores for any adjacent vacant spaces.

Identify and Pursue Re-tenanting Options for Other Endangered Anchor Store Sites Along 41st Avenue

With changes to the retail environment and understanding that in the main the decisions necessary to secure new tenants are in the hands of others, the City should nonetheless establish processes to keep aware of vacant commercial properties, and identify and recruit new anchor tenants to replace vacancies. This protocol should be integrated into the City's overall business attraction and retention efforts, with discrete roles assigned to any points of first contact.

Emphasize Economic Development Efforts that Address Evolving Consumer Preferences

Retail preferences can change very quickly, and while these often follow local demographic changes, they also follow national retail trends. As the economy recovers, City staff and the Working Group will need to track how post-recession consumer preferences affect the potential for different retail segments, and direct the business attraction efforts accordingly.

Identify Current and New Funding Resources for Economic Development, Business Retention and Expansion

Since the start of 2009, economic development and funding programs have seen notable change. Many of these changes have potential benefits to business and property owners along 41st Avenue, and the City should work with the Workforce Investment Board, California Department of Transportation, the State of California Community Development Block Grant (CDBG), and other regional economic development agencies to keep current with new and existing programs. In particular, the City should pursue a CDBG Planning and Technical Assistance grant to fund a Comprehensive Re-Visioning Plan for the 41st

Avenue/Capitola Mall. The City should also pursue other Economic Development and Over-the-Counter grant funding possibilities for the Corridor.

CHAPTER 1: EXISTING CONDITIONS AND RECENT TRENDS

1.1 RECENT RETAIL TRENDS

Nationally, the six-month total retail sales for 2009 (through June) showed an overall decline of 11 percent compared to the same time period in 2008.⁴ The largest declines came from four specific retail categories -- gasoline stations (33 percent), automobile dealerships (23 percent), furniture and home furnishings (14 percent), and building materials (11 percent). General merchandise store sales were virtually unchanged, although traditional department stores had a sales loss of 7.7 percent. Grocery store sales were also unchanged. These national trends have clear implications for 41st Avenue, which has a very large concentration of these types of businesses.

**TABLE 1-1
NATIONAL RETAIL SALES TREND (6-MONTH YEAR-TO-DATE
COMPARISON)**

Retail Category	2009 YTD Sales	2008 to 2009 YTD Percent Change
Retail Total	\$1,765,736	-11.1%
Total Retail and Food Service	\$1,993,294	-9.8%
Motor Vehicles and Parts Dealers	\$342,672	-20.8%
Furniture and Home Furnishings Stores	\$44,966	-14.0%
Electronics and Appliance Stores	\$47,905	-8.7%
Building Materials and Home Improvement	\$146,554	11.4%
Food and Beverage Stores	\$287,953	0.2%
Home and Personal Care Stores	\$125,052	2.8%
Gasoline Stations	\$165,497	-33.6%
Clothing Stores	\$94,434	-6.5%
Sporting Goods, Hobby, Book and Music Stores	\$39,136	-2.1%
General Merchandise Stores	\$278,580	-0.8%
Miscellaneous Store Retailers	\$54,789	-4.9%
Nonstore Retailers	\$138,198	-5.5%
Food Service and Drinking Places	\$227,558	1.6%

Source: ADE, Inc., data from U.S. Department of Commerce

For the most recent fiscal year, Capitola's taxable sales declined by 15 percent. Comparing the most recent quarterly data, Capitola's taxable sales through the first quarter of 2009 showed a year-to-year decline of 26 percent.⁵ If this trend holds up, then Capitola's sales tax base will show a larger erosion in the current fiscal year, which would reflect the departure of key businesses such as Mervyns and Gottschalks. The quarterly loss is larger than the taxable sales declines for Santa Cruz County as a whole (14.5 percent), and neighboring cities such as Santa Cruz (12.9 percent) and Scotts Valley (14.5 percent). However, it is closer to other

⁴ U.S. Department of Commerce; "Advance Monthly Sales for Retail and Food Service"; July 2009.

⁵ MuniServices LLC.

some other cities with concentrations of regionally serving retail such as San Jose (21 percent) and Fremont (22 percent).

TABLE 1-2
SALES TAX TRENDS, QUARTERLY AND FISCAL YEAR COMPARISON

Sales Tax Collection Areas	2008/Q1 to 2009/Q1 Quarterly Sales Tax % Change	FY 2007-08 Sales Tax	FY 2008-09 Sales Tax	Fiscal Year % Change
Capitola	-26.7	\$5,225,196	\$4,419,158	-15.4
Santa Cruz	-12.9	\$9,287,890	\$8,630,676	-7.1
Other Santa Cruz County	-10.2	\$8,376,154	\$8,246,690	-1.5
Watsonville	-12.5	\$6,557,974	\$5,993,160	-8.6
Scotts Valley	-14.5	\$2,070,322	\$2,029,273	-2.0
Santa Cruz County Total	-14.5	\$31,517,536	\$29,318,957	-7.0
Monterey County	-16.7	\$56,513,910	\$52,323,549	-7.4
San Francisco Bay Area	-18.5	\$1,214,673,470	\$1,122,673,921	-7.6

Source: ADE, Inc., data from MuniServices LLC and California Board of Equalization.

Notes: Data reflects sales tax collections. The typical local jurisdictional sales tax allocation totals 1% of total taxable transactions.

It is important to point out that nine out of the top ten sales tax generators in Capitola come from the heavily impacted retail categories of automobile dealerships, gasoline stations, building materials stores, and traditional department stores. Moreover, all of these businesses are located along 41st Avenue. It is also important to note that the stagnation and subsequent sales decline along 41st Avenue began well before the current recession impacted the retail market nationally and regionally.

41ST AVENUE TAXABLE SALES TRENDS

Much of the detailed data analysis for the 41st Avenue corridor looked at annual trend data through the end of 2008. Throughout 2009, the recession has reduced the sales even further. However, the data clearly demonstrates that the declining retail trend for 41st Avenue predated the current economic recession and that declining sales were occurring even as national retail trends were showing sales increases.

The inflation-adjusted taxable sales trend shows a continuation of the long-term taxable sales decline along the 41st Avenue corridor. As shown in Table 1-3, taxable sales for 2008 totaled \$368 million (tax receipts of \$3.7 million). This represented a 11 percent decline from 2007, and an inflation-adjusted decline of 24 percent from 1999. Very few business categories have shown sales increases.

The largest business categories along 41st Avenue continue to be department stores and new car dealerships, and both of these categories have had long-term and short-term sales declines.

TABLE 1-3
INFLATION-ADJUSTED 41st AVENUE TAXABLE SALES TREND (THOUSANDS), 1999 TO 2008

Taxable Sales Category	1999 Taxable Sales	2003 Taxable Sales	2007 Taxable Sales	2008 Taxable Sales	Percent Change 1999-2008	Percent Change 2003-2008	Percent Change 2007-2008
New Car Dealers	\$113,383.8	\$112,906.2	\$104,186.5	\$94,037.2	-17.1%	-16.7%	-9.7%
Department Stores	\$105,930.9	\$97,574.2	\$81,547.7	\$68,776.8	-35.1%	-29.5%	-15.7%
Specialty Stores/Home Improvement*	\$60,914.4	\$67,943.1	\$64,353.8	\$52,958.8	-13.1%	-22.1%	-17.7%
Family Apparel	\$25,450.2	\$27,573.3	\$24,244.9	\$22,001.9	-13.5%	-20.2%	-9.3%
Service Stations/Auto Parts*	\$20,563.8	\$20,095.1	\$24,691.5	\$25,111.6	22.1%	25.0%	1.7%
Home Furnishings/Drug Stores*	\$20,560.8	\$14,981.3	\$15,734.9	\$13,907.2	-32.4%	-7.2%	-11.6%
Grocery/Liquor/Specialty Food Stores*	\$22,755.1	\$24,352.2	\$17,439.6	\$18,038.7	-20.7%	-25.9%	3.4%
Full Service Restaurants	\$13,758.9	\$18,374.1	\$15,971.3	\$15,126.8	9.9%	-17.7%	-5.3%
Men's And Women's Apparel*	\$18,297.0	\$13,702.3	\$14,712.5	\$12,450.6	-32.0%	-9.1%	-15.4%
Sporting Goods	\$16,430.3	\$15,117.5	\$13,665.5	\$12,250.5	-25.4%	-19.0%	-10.4%
Fast Food Restaurant	\$11,746.5	\$10,719.8	\$10,514.0	\$10,165.9	-13.5%	-5.2%	-3.3%
Shoe Stores	\$6,796.3	\$7,137.5	\$6,683.7	\$6,183.4	-9.0%	-13.4%	-7.5%
Art, Gift, Novelties/ Stationery*	\$13,241.2	\$10,439.2	\$8,691.3	\$7,474.0	-43.6%	-28.4%	-14.0%
Jewelry Stores	\$4,324.6	\$3,320.7	\$2,355.1	\$2,354.3	-45.6%	-29.1%	0.0%
Appliance Stores	\$2,438.8	\$4,142.8	\$3,530.7	\$2,257.3	-7.4%	-45.5%	-36.1%
Personal Services	\$4,396.6	\$3,903.8	\$2,274.3	\$1,997.6	-54.6%	-48.8%	-12.2%
All Other Taxable Sales	\$25,837.7	\$11,483.8	\$3,041.7	\$2,754.6	-89.3%	-76.0%	-9.4%
Total Taxable Sales	\$486,826.9	\$463,766.8	\$413,639.1	\$367,847.2	-24.4%	-20.7%	-11.1%

Source: ADE, Inc., data from City of Capitola and Board of Equalization

Note: Categories marked with asterisks (“*”) are aggregated due to confidentiality restrictions.

1.2 EXISTING CONDITIONS

In order to assess the existing conditions, Applied Development Economics conducted field visits and interviews with local stakeholders, including property owners and managers, business owners, City Council members, and real estate brokers. Each of them were asked a series of questions pertaining to business conditions along 41st Avenue, and identifying existing trends that affect the corridor as a place to do business. This section identifies some of the general findings from the interviews. In addition, detailed economic and ownership data has been reviewed by block and parcel. It should be noted that these responses only reflect the respondents’ perception of the City’s process. This section summarizes those findings.

VACANCIES

41st Avenue has had several long-term major anchor tenant vacancies, as well as some recent vacancies filled. Long-time vacant spaces at the former Ralph’s supermarket and FYE music store sites were recently filled by Whole Foods Market and BevMo, although there are some vacancies or under utilization of some of the smaller spaces. Capitola Mall recently lost two of its anchor stores (Mervyns and Gottschalks), and Kohls will soon move into the former Mervyns site. While the property owner of the Gottschalks site and the City have considered various options for the site including reconfiguration, there has been no offers to lease the site. The mall has also seen a rise in vacancies for their other spaces.

The prevailing perception is that vacancies along 41st Avenue have been consistent for several years. Some vacancies in other shopping centers have been filled by conversions into office spaces. Commercial rents had been holding steady and some interviewees viewed the rents along the corridor as high. Rents have recently gone down in order to maintain occupancy levels. While there were vacancies at King's Plaza in 2007 and 2008, that center is now 100 percent occupied.

AGING PROPERTIES

Most of the commercial centers along 41st Avenue have not had a major renovation in many years, which led to an impression that the corridor was, at the very least, aging in appearance. More recently, Kings Plaza made some façade and roofing improvements, and the new Whole Foods Market has given a new look to its shopping center. Capitola Mall has not had a recent renovation, although the new Kohls department store will help freshen the property's appearance when it opens in late-2009.

PARCEL CONFIGURATIONS

The parcel boundaries along 41st Avenue show most of the properties broken up into multiple lots with multiple owners. This occurs even in shopping centers that appear contiguous. Kings Plaza is the only commercial center where nearly the entire block is controlled by a single property owner. Even Capitola Mall, which from outside appearances looks like a unified single development, is divided into 14 separate parcels with 9 different owners. This makes major renovations and physical realignments more difficult. For example, some property owners control more of the parking areas than others.

In addition, the shopping area that encompasses the new Whole Foods market and the Capitola Station shopping center is also split into multiple ownerships. Again, the shopping area appears to be a physically contiguous area, but the multiple parcel boundaries have made more unified development difficult.

Multiple ownerships along 41st Avenue also come in the form of office condominiums. Four developments along 41st avenue were identified as office condominium, with a total of 64 subdivided parcels.

BUILT ENVIRONMENT

The 41st Avenue corridor is primarily designed around accommodating the automobile. In general, the buildings along 41st Avenue are set back with large parking lots in the front. Very few buildings have their main entrances brought out all the way to the sidewalk frontage along 41st Avenue. Even with buildings that go all the way out to the sidewalk and present a more urban streetscape, many of them still have the main entrance opening out onto the parking areas.

Building heights along the corridor are currently limited to 40 feet, and relatively few buildings currently approach that height. In addition, the street itself does not have a lot of

streetscape treatments or other urban design features designed to make the street more pedestrian-friendly.

TRAFFIC CONDITIONS

41st Avenue is a heavily traveled corridor, and although congestion is widely viewed as a problem, the high traffic volume is also viewed as a benefit to retailers. The corridor serves as a primary artery facilitating travel from one end of town to the other, and also serves as a regional public transit route.

TRANSIT

41st Avenue is a primary public transit route that serves both local and regional routes. The primary transit center and transfer point is currently located at Capitola Mall. Santa Cruz Metro operates five routes that stop at the Capitola Mall transit center (routes 53, 55, 56, 66, and 68).

ORGANIZATIONS

41st Avenue does not currently have any dedicated business groups or organizations focused on issues specific to the corridor. Previous efforts were not well attended due to the high proportion of out-of-town business owners along 41st Avenue. Capitola Village, which has a higher proportion of local and independently owned businesses, has a dedicated business organization and has its own funding used for marketing and other community activities at the Village.

CITY REGULATIONS

Property owners generally viewed the City process for obtaining permits as cumbersome and inefficient. The primary issue is that current land use designations require nearly all businesses to obtain a conditional use permit, which requires a public hearing and Planning Commission approval. The zoning along 41st Avenue does not currently have uses allowed by-right. Individual respondents also indicated that they would like to see less restrictive signage regulations and a more frequent Planning Commission schedule, given how many uses require conditional use approvals.

According to City officials, Capitola tends to bring projects to the Planning Commission faster than other cities. The primary difference between Capitola and other comparable jurisdictions is the few uses allowed by-right, which means that most use permits require Planning Commission review and approval, thereby slowing the entitlement process.

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Block.

TABLE 2-1
41ST AVENUE TAXABLE SALES TRENDS BY BLOCK (THOUSANDS)
1999 TO 2008 (INFLATION-ADJUSTED)

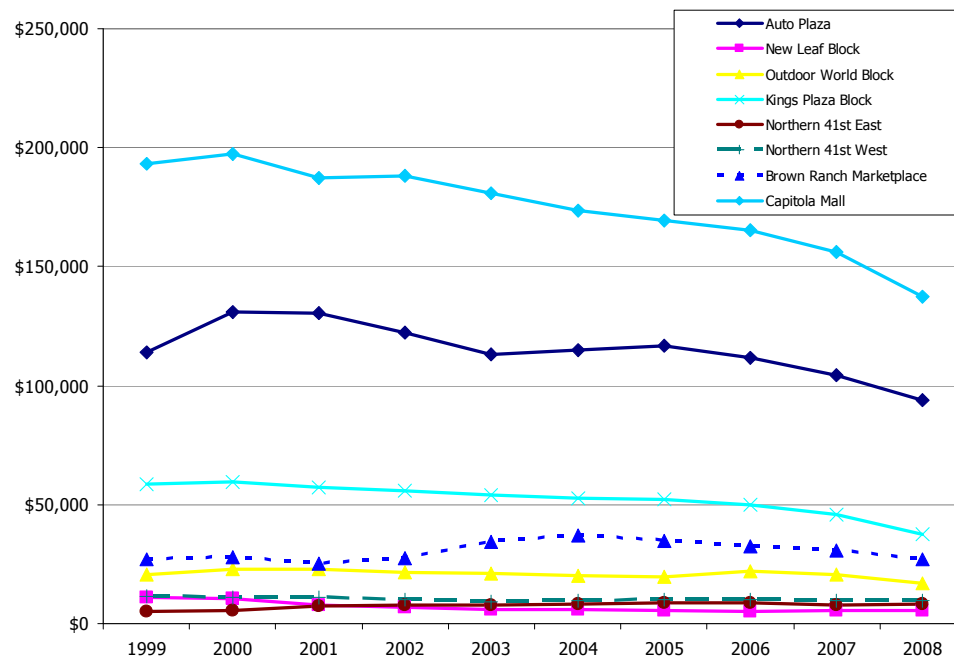
41 st Avenue Block	1999 Taxable Sales	2003 Taxable Sales	2007 Taxable Sales	2008 Taxable Sales	Percent Change 1999- 2008	Percent Change 2003- 2008	Percent Change 2007- 2008
New Leaf Block	\$11,195.3	\$5,934.4	\$5,424.4	\$5,392.3	-51.8%	-9.1%	-0.6%
Outdoor World Block	\$20,422.8	\$21,241.9	\$20,766.1	\$17,095.6	-16.3%	-19.5%	-17.7%
Kings Plaza Block	\$58,729.3	\$54,065.5	\$45,976.3	\$37,668.6	-35.9%	-30.3%	-18.1%
East of Mall	\$23,218.3	\$17,517.7	\$12,038.6	\$12,011.3	-48.3%	-31.4%	-0.2%
Northern 41 st East	\$4,895.7	\$7,990.7	\$7,759.4	\$8,039.5	64.2%	0.6%	3.6%
Northern 41 st West	\$11,240.7	\$9,129.0	\$9,387.0	\$9,569.2	-14.9%	4.8%	1.9%
Auto Plaza	\$114,202.5	\$113,191.0	\$104,186.5	\$94,037.2	-17.7%	-16.9%	-9.7%
Brown Ranch Marketplace	\$27,103.6	\$34,316.4	\$30,724.7	\$26,971.5	-0.5%	-21.4%	-12.2%
Capitola Mall	\$193,099.6	\$180,954.8	\$156,314.0	\$137,389.3	-28.9%	-24.1%	-12.1%
Other 41 st Avenue Corridor*	\$22,719.1	\$19,425.4	\$21,062.2	\$19,672.7	-13.4%	1.3%	-6.6%
Total (Thousands)	\$486,826.9	\$463,766.8	\$413,639.1	\$367,847.2	-24.4%	-20.7%	-11.1%

Source: ADE, Inc., data from City of Capitola and Board of Equalization

Note: The data for the remaining blocks along 41st Avenue is aggregated due to confidentiality restrictions.

Figure 2-2 shows a summary of the taxable sales trend for each of the major blocks along the 41st Avenue corridor.

FIGURE 2-2
41ST AVENUE BLOCK SUMMARY
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

SUMMARY OF NEW LEAF BLOCK (1100–1200 BLOCK EAST)

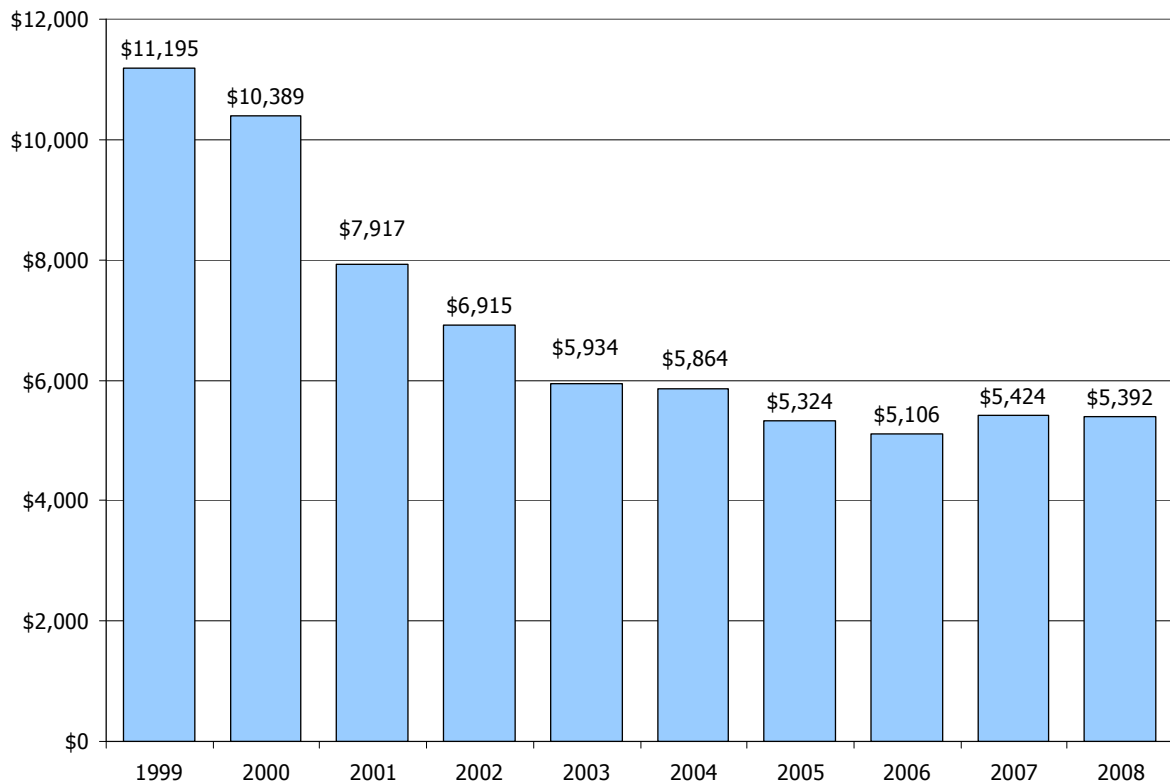
The southern edge of the 41st Avenue corridor is a study in contrasts. The east side of the 1100-1200 block along 41st Avenue is solidly anchored by the New Leaf Community Market and Spa Fitness Center. In addition, the corner lot includes the Twin Palms office building. The vacancy rate is very low.

On the surface, it would appear that this block has fared very well. However, the taxable sales trends indicate that this area has lost more than half of its taxable sales since 1999, although sales have remained stable since 2005. During this time, Begonia Plaza lost prominent retail stores such as Nevada Bob's and Computerland, and many of the current tenants are service providers and nonprofit organizations. Because office uses have moved into Begonia Plaza, and the Twin Palms office building does not have any vacancies, it would appear that office uses have become more prominent in recent years.

Block Summary

- Major Business Centers: Begonia Plaza, Twin Palms office building
- Anchor Businesses: New Leaf Community Market, Way of Life, Spa Fitness Center
- Parcels: 17 (includes 9 parcel office condominium at 1260 41st Avenue)
- Owners: 15 (includes 9 owners at 1260 41st Avenue)

FIGURE 2-3
NEW LEAF BLOCK
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

SUMMARY OF O'NEILL BLOCK (1100–1200 BLOCK WEST)

The west side of the 1100-1200 block along 41st Avenue is anchored by one of Capitola's most visible retail businesses – the O'Neill Surf Shop. In 2007, the Cycle Works bicycle shop closed, leaving a 7,000 square foot vacancy and the space remains vacant. All of the buildings along this block are on individual lots, with no shopping centers. The detailed sales trend data is not shown due to confidentiality restrictions.

Block Summary

- Major Business Centers: none
- Anchor Businesses: O'Neill Surf Shop, Verutti Liquors
- Parcels: 6
- Owners: 5

SUMMARY OF OUTDOOR WORLD BLOCK (1300-1600 BLOCK EAST)

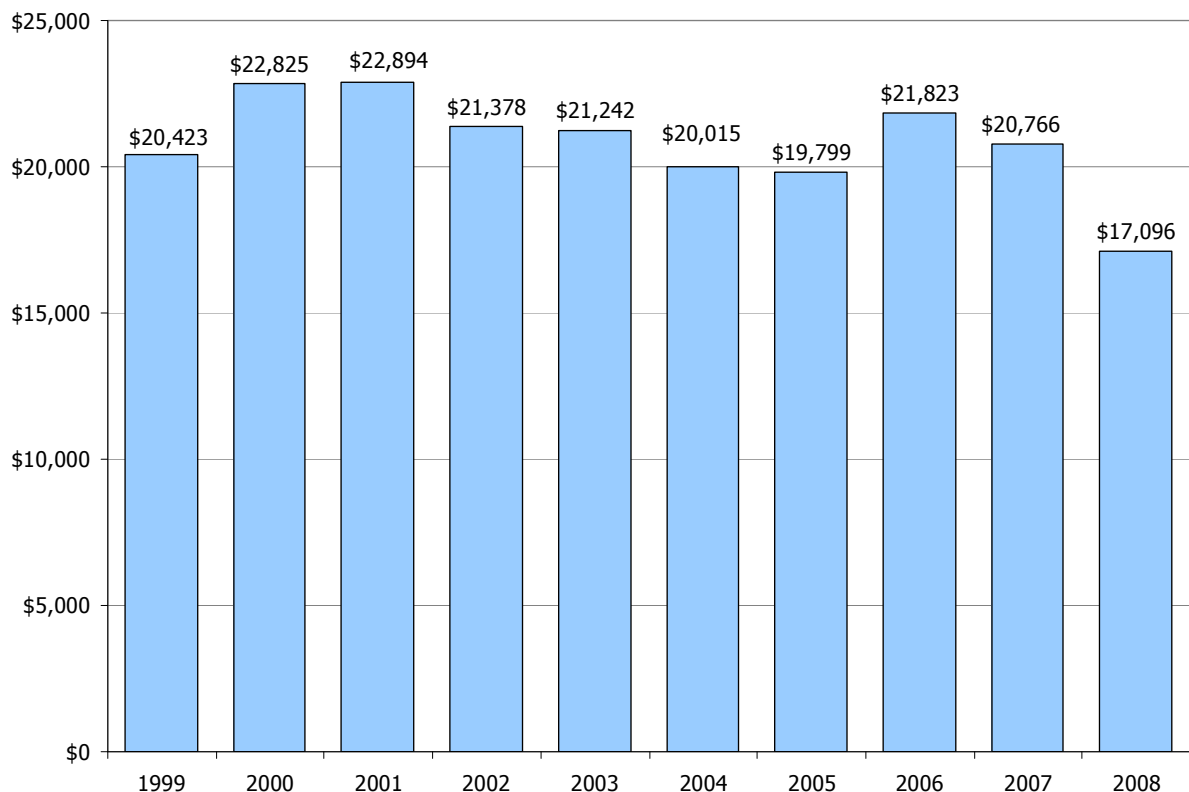
The east side of the 1300-1600 block along 41st Avenue primarily consists of the Four Star Center anchored by Outdoor World, and 30-parcel office condominium at 1500 41st Avenue. During field observations in 2008, this block had only one vacancy.

Taxable sales trends have been scattered since 1999, with sales peaking in 2001 and 2006. However, the retail base has been relatively stable during this time with minimal store failures, although the data for 2008 shows a sales reduction.

Block Summary

- Major Business Centers: Four Star Center
- Anchor Businesses: Outdoor World, Big 5 Sporting Goods, Chevron
- Parcels: 39 (includes 30 parcel office condominium at 1500 41st Avenue)
- Owners: 8 (1500 41st Avenue is listed as one owner)

FIGURE 2-4
OUTDOOR WORLD BLOCK
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

Note: 2008 data has an irregularity that potentially reduced the actual taxable sales.

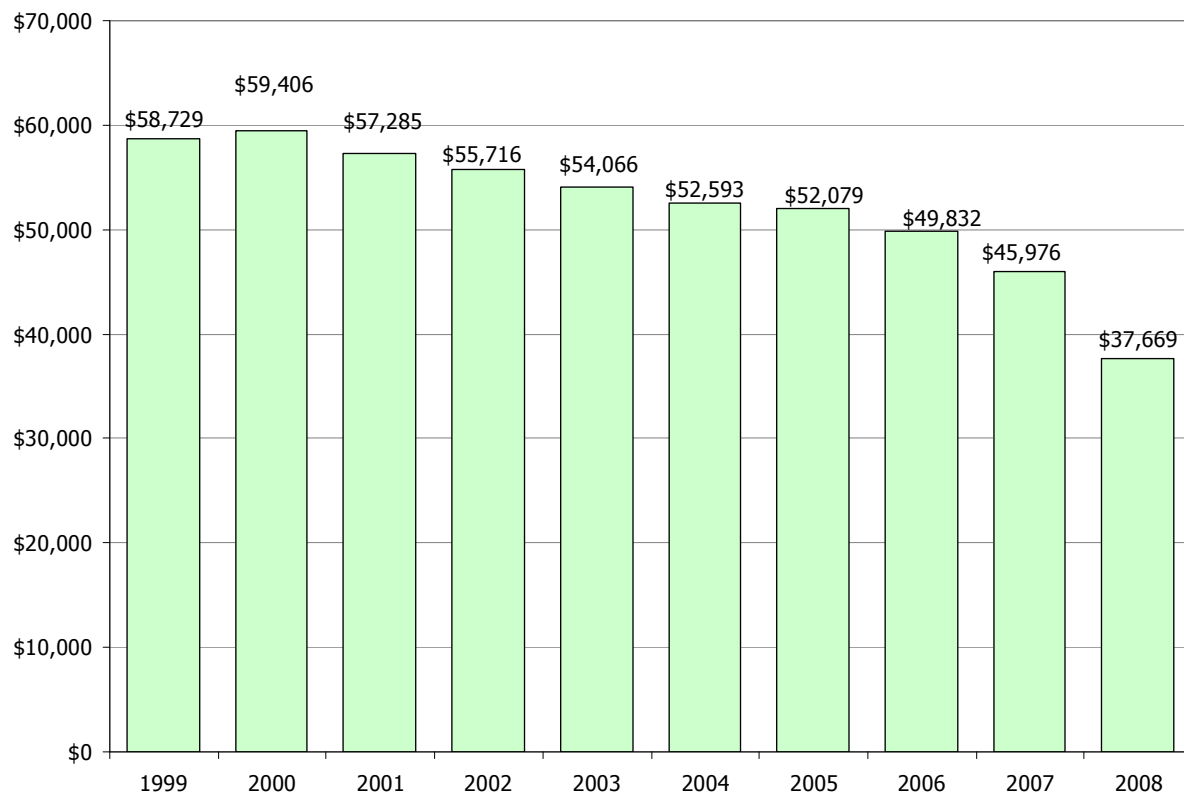
SUMMARY OF KINGS PLAZA BLOCK (1300–1600 BLOCK WEST)

The west side of the 1300-1600 block along 41st Avenue is the location for Kings Plaza. This shopping area has multiple anchor stores. While Kings Plaza is considered small by today's standards, the block has a combined sales level that exceeds Brown Ranch Marketplace. Taxable sales trends have seen a consistent downward trend throughout this decade, with taxable sales declining every year since 2000. While Kings Plaza has had some vacant spaces, the center is completely occupied currently.

Block Summary

- Major Business Centers: Kings Plaza
- Anchor Businesses: Orchard Supply Hardware, Save Mart, Shell, Rite-Aid
- Parcels: 6
- Owners: 4

FIGURE 2-5
KINGS PLAZA BLOCK
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

SUMMARY OF EAST OF MALL BLOCK (1 700–1 900 BLOCK EAST)

The east side of the 1700-1900 block along 41st Avenue is situated across the street from Capitola Mall. The three centers that anchor the block are under multiple ownerships with the parcel designations splitting the centers into multiple parcels. This presents significant obstacles to identifying options for reconfiguring the space to more modern building standards. Prior to BevMo and Whole Foods locating here in 2009, this block had one of the highest concentrations of vacant space along 41st Avenue.

Taxable sales in this block have gone down by more than half since 1999. However, the addition of Whole Foods and BevMo will bring considerable new activity to the site and new interest in the other vacant spaces, while also providing a sales boost to other existing tenants at the shopping center.

Block Summary

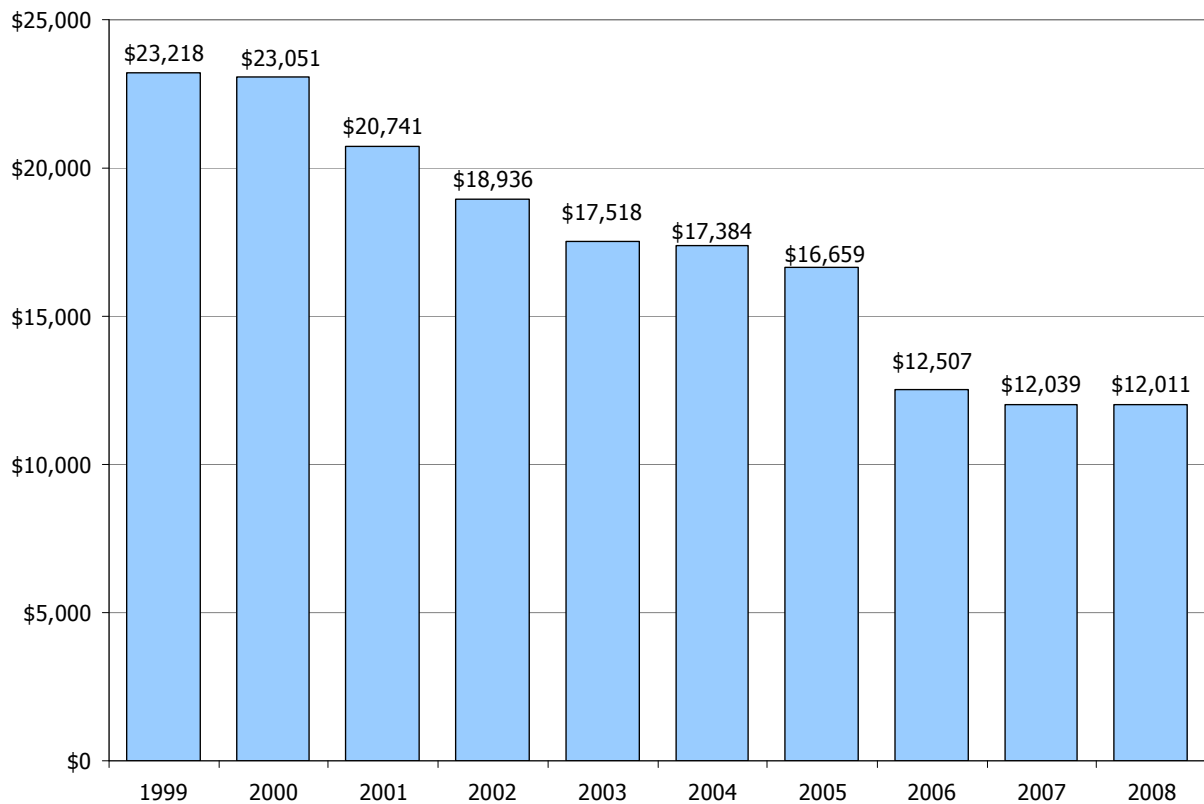
- Major Business Centers: former Ralphs (current Whole Foods) Center, Capitola Station, 41st Avenue Executive Plaza
- Anchor Businesses: Longs Drugs, McDonald's, BevMo, Whole Foods
- Parcels: 19

OWNERS: 13

FIGURE 2-6

EAST OF MALL BLOCK

INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

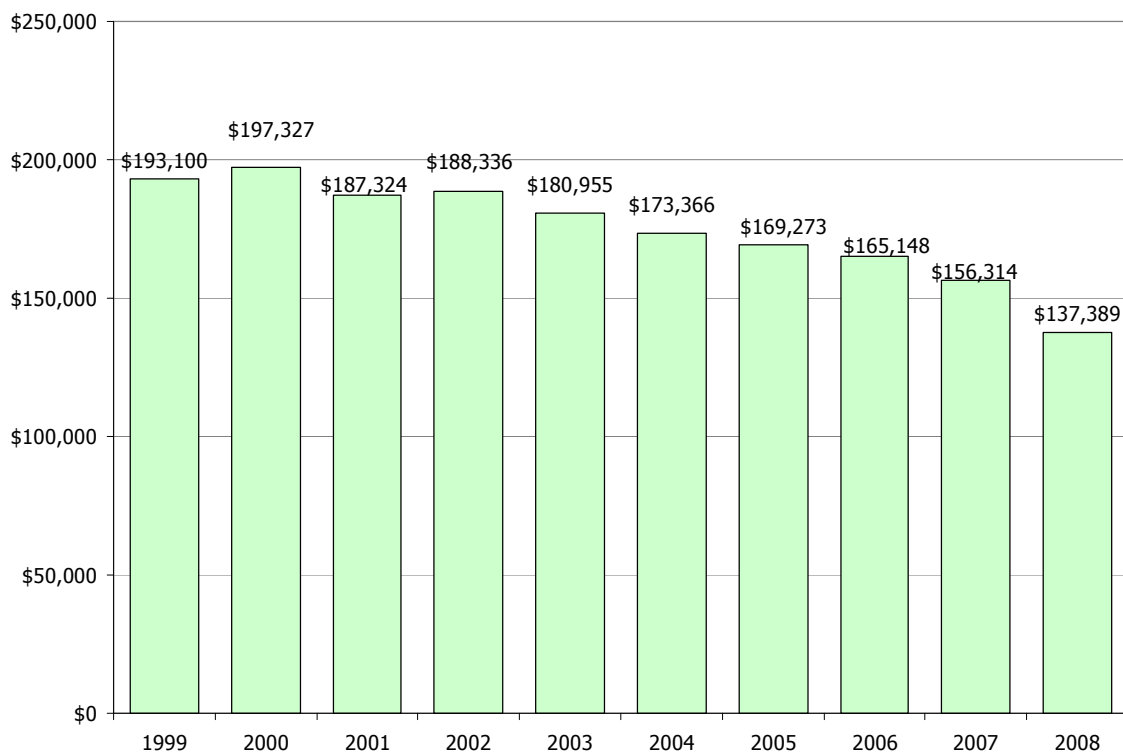
SUMMARY OF CAPITOLA MALL

Capitola Mall remains the most prominent retail center in Capitola, and houses by far the largest number of retail stores of any center along 41st Avenue. While the mall appears to be a single contiguous development, the site itself has 14 separate parcels owned by 9 different owners. Some of the parcels have a higher proportion of land areas used for parking, while others have a higher proportion used as building space. The mall has had a relatively low vacancy rate, however the number of vacancies has increased over the past year. The most significant vacancies are two of the four anchor store spaces. Taxable sales at Capitola Mall have seen a consistent decline since 2000, however the rate of decline had not been as steep as some other areas along the 41st Avenue corridor through 2007. The loss of Mervyn's in 2008 and the recent closure of Gottschalks will likely create a very steep sales decline through 2009. The opening of Kohl's in late-2009 will help to recover some of the sales losses.

Block Summary

- Major Business Centers: Capitola Mall
- Anchor Businesses: Macy's, Mervyn's (closed), Sears, Gottschalks (closed), Ross
- Parcels: 14
- Owners: 9

**FIGURE 2-7
CAPITOLA MALL
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)**



Source: ADE, Inc., data from City of Capitola and Board of Equalization

SUMMARY OF NORTHERN 41ST EAST BLOCK (2000–2200 BLOCK EAST)

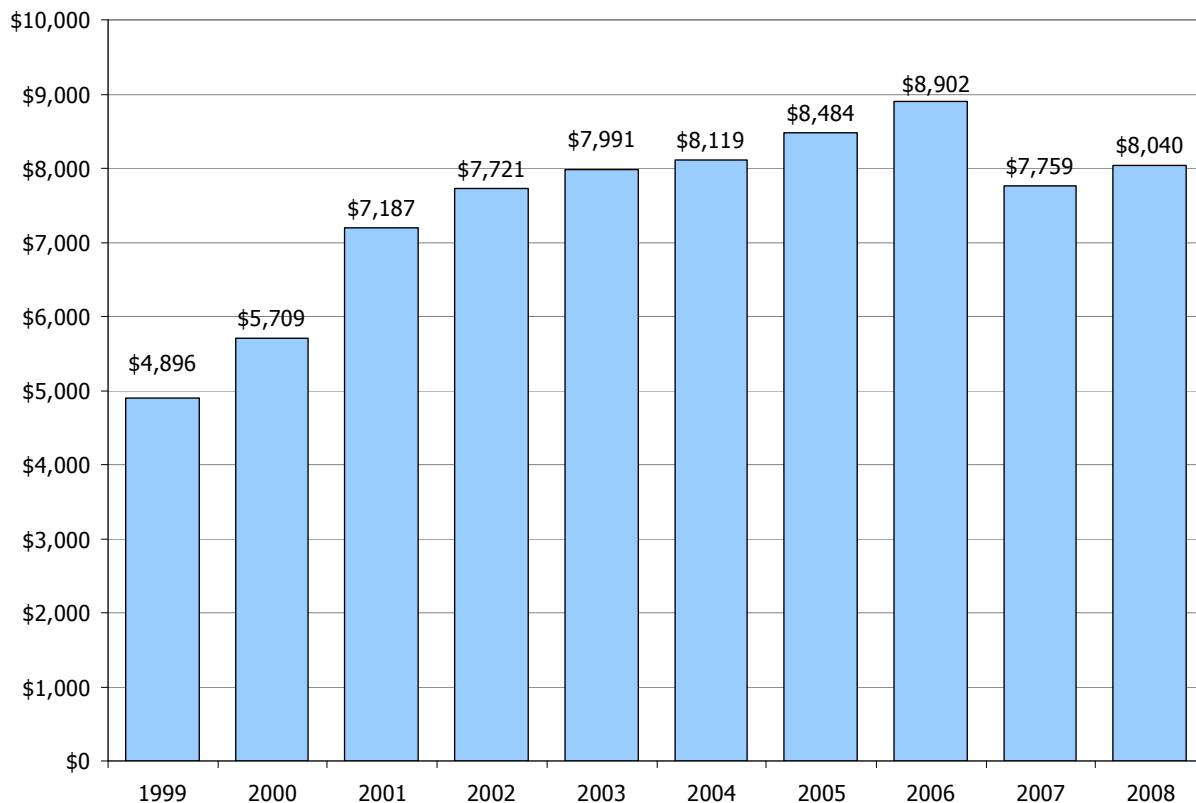
The 2000-2200 block on the east side of 41st Avenue consists entirely of standalone buildings. All of the buildings along this block up to and including Armadillo Willy's are occupied.

Unlike other sections along 41st Avenue, the Northern 41st East block saw a consistent rise in taxable sales between 1999 and 2006, with taxable sales nearly doubling during this period. However, the taxable sales trends in 2007 saw a retreat back to 2002 levels.

Block Summary

- Major Business Centers: none
- Anchor Businesses: Union 76, Mattress Discounters, Armadillo Willy's
- Parcels: 17 (includes 7-parcel office condominium at 2160 41st Avenue)
- Owners: 8 (2160 41st Avenue is assumed to have one owner)

FIGURE 2-8
NORTHERN 41ST EAST BLOCK
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

SUMMARY OF NORTHERN 41ST WEST BLOCK (2000–2200 BLOCK WEST)

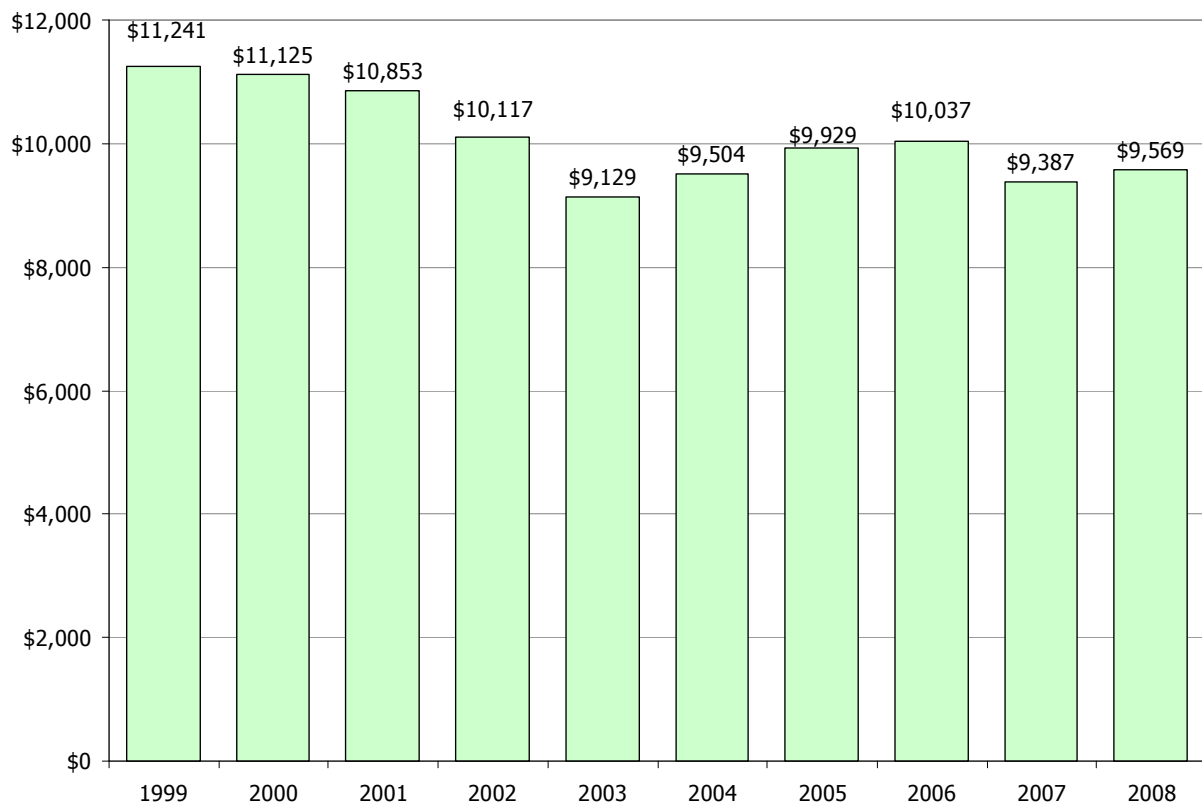
The northern end of 41st Avenue on the west side is dominated by the three-story 2121 41st Avenue building. This building primarily consists of office condominiums, with some taxable revenue coming from personal service establishments. The vacancy rate at 2121 41st Avenue was relatively high with six existing vacancies observed during field visits in 2008.

Taxable sales among the businesses located on the 2000-2200 east side block has had a long-term decline, although sales tax receipts bottomed out in 2003 and increased every year through 2006. This is partly due to the relatively high business turnover along the block, and the high concentration of vacancies.

Block Summary

- Major Business Centers: 2121 41st Avenue
- Anchor Businesses: Union 76, Men's Wearhouse, Burger King
- Parcels: 25 (includes 18-parcel office condominium at 2121 41st Avenue)
- Owners: 6 (2121 41st Avenue is assumed to have one owners)

FIGURE 2-9
NORTHERN 41ST WEST BLOCK
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

SUMMARY OF BROWN RANCH MARKETPLACE

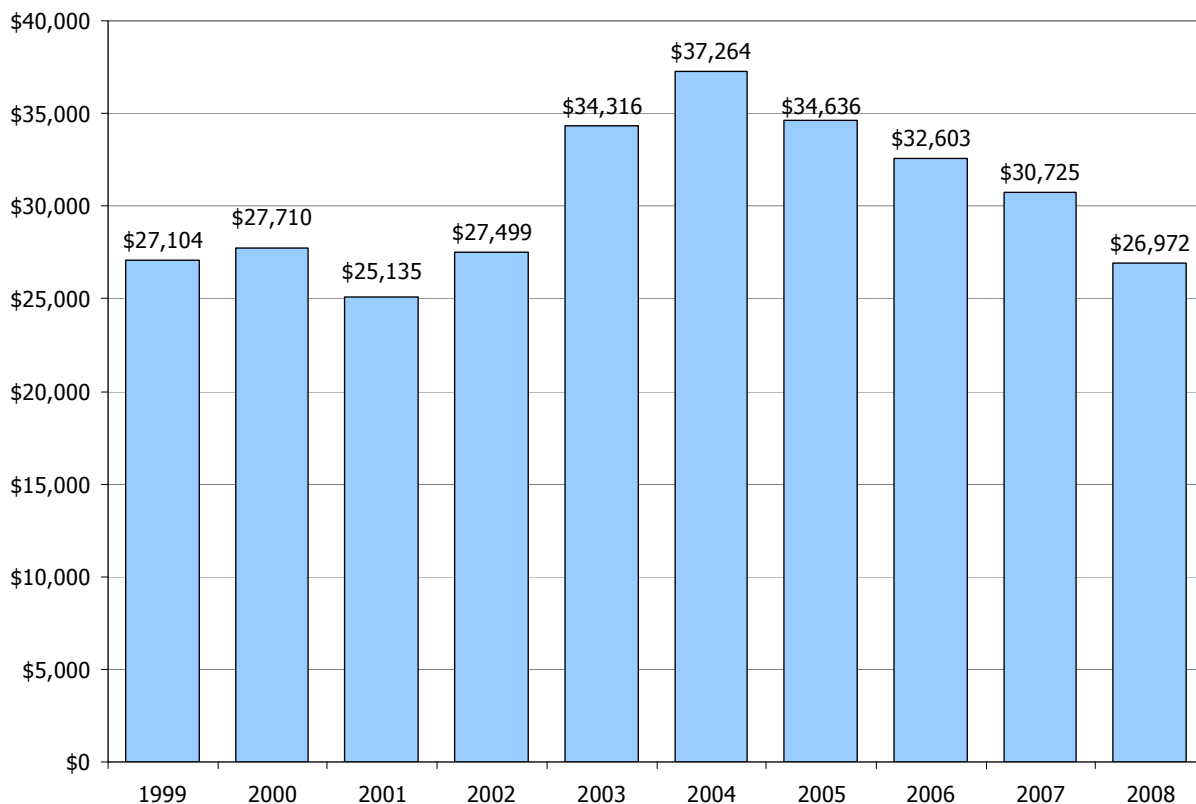
Brown Ranch Marketplace is newer than the other shopping centers along 41st Avenue. The center has consistently had strong demand for spaces, with no vacancies observed during field visits in 2008. Aside from the closure of Drug Emporium and the opening of Bed Bath & Beyond, Brown Ranch has had relatively low turnover of businesses. However, its reliance on big box power center anchors leaves it vulnerable to regional competition.

Taxable sales at Brown Ranch Marketplace showed strong inflation-adjusted growth through 2004. In 2005, a Trader Joe's location opened in Santa Cruz, and the overall sales at Brown Ranch have declined every year since that time.

Block Summary

- Major Business Centers: Brown Ranch Marketplace
- Anchor Businesses: Bed Bath & Beyond, Trader Joe's, Water Street Stereo, Pier One Imports
- Parcels: 4
- Owners: 2

FIGURE 2-10
BROWN RANCH MARKETPLACE
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)



Source: ADE, Inc., data from City of Capitola and Board of Equalization

AUTO PLAZA

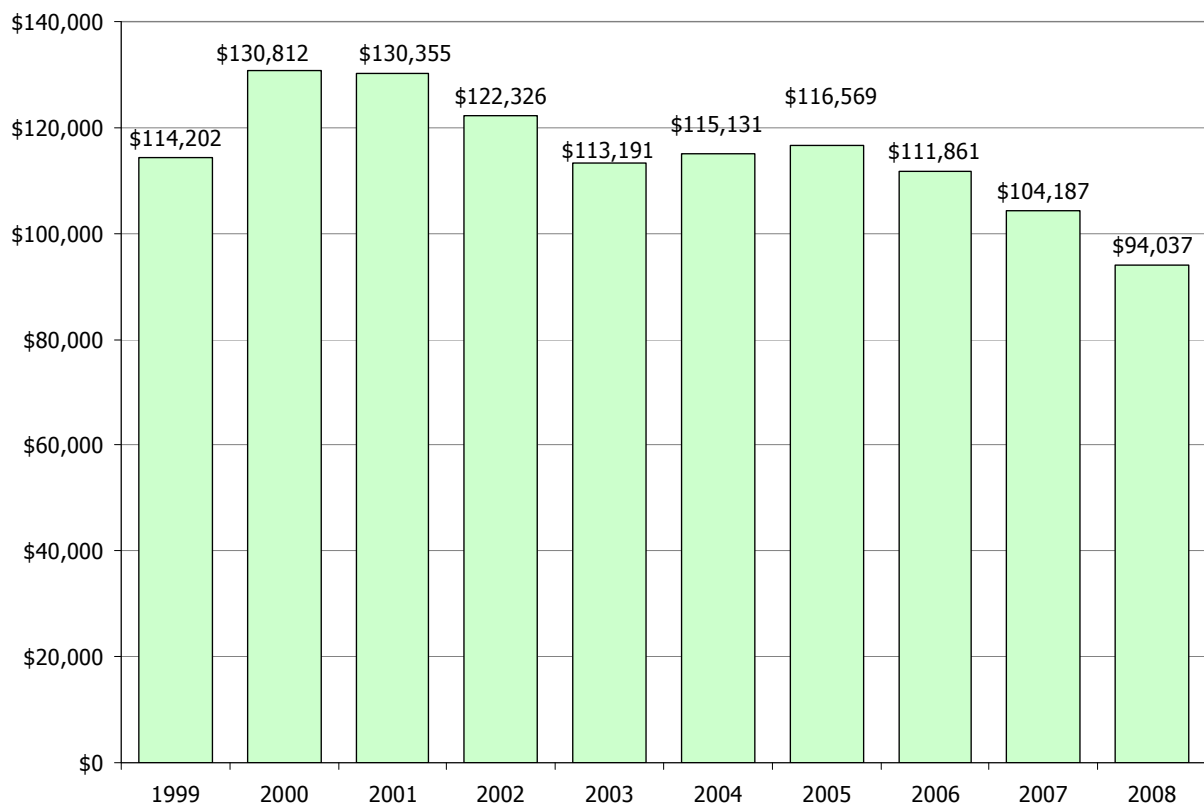
The Auto Plaza is the second largest source of taxable sales revenue in Capitola. The auto dealerships are currently landlocked and have limited space for expansion. A self-storage facility is located adjacent to the dealerships. There is also a vacant space formerly occupied by Straw Hat Pizza, and another large space formerly occupied by China Motors. The Auto Plaza faces numerous competitive threats as the modern auto dealership prototype has grown progressively larger. Partly due to lack of space, the Honda franchise that shared a dealership with Chevrolet has moved to a standalone location in unincorporated Santa Cruz County.

Taxable sales at the Auto Plaza show slight consistent declines since 2005.

Block Summary

- Major Business Centers: Auto Plaza
- Anchor Businesses: Toyota of Santa Cruz, Ocean Chevrolet, Marina Motors

**FIGURE 2-11
AUTO PLAZA
INFLATION-ADJUSTED TAXABLE SALES TREND, 1999 TO 2008 (THOUSANDS)**



Source: ADE, Inc., data from City of Capitola and Board of Equalization

CHAPTER 3: POTENTIAL ALTERNATIVE AND MIXED USES

The future viability of traditional commercial corridors has come into question in recent years. As retail development has shifted over time, the market support for linear commercial strips has eroded. This leaves many communities with increasing commercial vacancies, decreasing rents, deferred maintenance of buildings, and less viable retailers moving into corridors that were once thriving shopping districts.

Repositioning these commercial corridors for alternative uses is an option that has attracted significant interest from local governments, businesses and landowners over the last few years. This process entails a multi-faceted approach that involves allowing for greater flexibility in the uses allowed and/or promoted along an existing commercial corridor. It also includes design guidelines aimed at creating a more pedestrian-friendly environment and more consistency in the building frontages. Markets for potential alternative uses include office development as well as housing and mixed use development.

3.1 OFFICE MARKET

In addition to 41st Avenue's role as a major commercial center, the corridor is also one of the primary locations for office spaces in Capitola. The corridor has numerous parcels that have been developed into small-scale office buildings, as well as other buildings developed as office condominiums.

Despite the recessionary conditions, the office market has remained strong in the Mid-County area. The vacancy rate for office spaces in Mid-County stood at 3.3 percent in the 4th quarter of 2008. This was a substantial increase from the 2.0 percent vacancy rate from one year earlier, but it still remains much lower than the 10.2 percent countywide average.⁶

In addition to dedicated office space, 41st Avenue has seen several retail spaces converted into offices, which further confirms the strong market for office space in Capitola.

3.2 HOTEL MARKET

Although the regional lodging market has seen a decline in room occupancy, Capitola has historically been undersupplied, relative to its attractiveness as a visitor destination. For the Monterey Bay area as a whole, the occupancy rate has generally stayed above 60 percent on an annual basis since 2003, and the average room rates have steady increased every year. However, for the year-to-date through July 2009, the occupancy rate for the region has dipped below 60 percent, and the average room rate has declined by about 12 percent.⁷

⁶ NAI BT Commercial; *Santa Cruz Office Report*, Fourth Quarter 2008.

⁷ Smith Travel Research.

A local hotel group recently began construction on a new 84-room hotel on 41st Avenue and Brommer. The project will be operated as a Fairfield Inn by Marriott, and targeted to business and leisure travelers. The project is scheduled for completion in mid-2010.

3.3 OUTDOOR/PEDESTRIAN ORIENTATION/COMMUNITY BRANDING

Given the trend towards outdoor, pedestrian-oriented, “lifestyle” retail centers, the Capitola Mall and 41st Avenue corridor could begin a longer-term re-design to become a more walkable retail area by placing a greater emphasis on the outdoor areas, streetscape, and building design. This would work well with Capitola’s temperate weather, flat terrain and the residential areas which are nearby.

By better defining 41st Avenue as a destination its own right, this kind of “place” orientation can make the area more amenable to expanding into uses beyond retail such as lodging and entertainment uses. Communities have begun to create local “brands,” or themes which mark them. Like Capitola Village, which has its own brand and is well-known, 41st Avenue/Capitola Mall could become known as an outdoor, pedestrian-friendly retail environment. This ‘brand’ could include architectural themes, landscaping, sidewalk widening, and infrastructure improvements.

Even though lifestyle centers have been built as standalone shopping centers and retail districts, mall developments around the country have also begun to retrofit outdoor “lifestyle wings” onto existing shopping mall properties. These new additions often incorporate upscale retail stores, restaurants, and entertainment uses, with themed The space is often created by replacing former anchor store locations and/or building wings with outdoor-oriented spaces.

In some cases, the space for a lifestyle wing opened up because of the large-scale consolidation that has occurred with traditional department stores in recent years, leaving malls with a smaller number of potential anchor tenant options. This trend has affected Capitola Mall with the demise of the Mervyns and Gottschalks department store chains. Examples of retrofitted malls in California include Del Amo Center in Torrance, Topanga Plaza in Woodland Hills, and the Fashion Fair Mall in Fresno. These examples potentially point to directions for addressing future design and tenanting options for Capitola Mall.

The configuration of the lifestyle wing at Fashion Fair Mall in particular presents some examples of how Capitola Mall can be reconfigured to help create a more urban and pedestrian-friendly street presence along 41st Avenue. In this case, a lifestyle wing was extended out from a formerly setback mall entrance, with the building frontages brought out to the sidewalk.

C.3 HOUSING AND MIXED-USE DEVELOPMENT

The City of Capitola Economic Development Strategic Plan recommended consideration of zoning changes to allow mixed use development, including housing along the 41st Avenue corridor. This could increase the attractiveness of the area, bring potential customers to the retailers and increase the supply of housing in the City. The inclusion of housing would help the City in identifying sites to accommodate affordable housing as part of future Housing Elements.

This section includes case studies from other communities and addresses specific opportunities for 41st Avenue

DEFINITION OF MIXED USE DEVELOPMENT

Mixed use developments are developments that combine several uses on one site in a coordinated way. A common prototype is housing located above retail development, which is on the ground floor. A variation is to have the different uses located in separate buildings on the same site. Along 41st Avenue, the recently completed Capitola Beach Villas combines retail on the ground floor with residential units above in one building. The other buildings in the development are residential only.

Mixed use can also include office development with retail or housing. A few developments include all three uses together. Some developments are combined with public uses as well, such as a branch library or a public health clinic.

One of the challenges of mixed use development is to recognize the needs of the different users. For example, how are project entrances and parking addressed to that so that the uses do not conflict? If the retail space will be available for a restaurant, how will potential cooking odors be mitigated? Can parking be shared so that the total number of required spaces is reduced? If there is a bar or nightclub, how will the potential noise at late hours affect residents? On the other hand, there are many retail uses, such as coffee bars, apparel stores and others that would likely be compatible with residential units.

MIXED-USE CASE STUDY: SANTANA ROW (SAN JOSE)

Santana Row in San Jose is often cited as an example of how mixed use development can rejuvenate an area. This is a much larger development than most of the other examples included in this chapter. However, Santana Row does provide some insight into the possibilities of a successful housing/retail/office/entertainment mixed-use center with a “Main Street” theme. In particular, this section examines the Santana Row residential units in comparison to the retail and commercial space (which has been highly successful). Data was obtained from a residential leasing agent at Santana Heights (rental project) and from three brokers actively selling resale units at Santana Row. Based on this information, it is apparent that residential vacancies are low and that there are few problems with renting or selling units. Additional information on the Santana Row residential market is summarized below.

Rental Units

There are 295 rental units (townhouse, lofts and flats above ground floor retail). City Heights provides 256 units, VIA provides three units and there are 36 townhouse units in the Serrano Building.

The leasing agent said that there is 98.2% occupancy. The project attracts a broad spectrum of residents. Renters move to Santana Row because they like the unique urban life style. She said this was the only development in northern California that was similar to Rodeo Drive. She said that there was not much turnover. When asked about the potential conflict between the residential units and late night operations of restaurants and bars, she pointed out that there is an addendum to the lease that covers this. Residents have to acknowledge that they are aware of the commercial uses, including late hours for some.

For Sale Units

There are 219 homes in three buildings: the Villa Cornet, the DeForest Building, and the Margo Building. Homes range from pied-a-terre flats to open lofts and townhomes. The lofts and flats have a modern industrial feel, while the villas are designed to invoke Tuscan styling on the inside, with Mediterranean themes in its architecture. Most are lofts.

All of the ownership units were rented for the first two years of the project. After that, sales occurred as leases ended. There was a waiting list for buyers. As of October 2008, there were 17 active listings for Santana Row properties. This includes a variety of unit types. Listing prices ranged from \$464,000 to \$3,300,000.

Other Observations from Brokers

The Intero Realty broker specializes in Santana Row sales and lives there as well. He said that the project attracts young professional couples from nearby areas such as Saratoga and Los Gatos. The nightlife is one of the attractions. He also pointed out that some of the homes are second homes. One example of this is someone who works in Silicon Valley, lives at Santana Row during the week and commutes home on weekends, for example to Arizona. On the other hand, some owners do not live at Santana Row themselves but rent their units. Between rentals, these homes would be unoccupied, as would the units of second homeowners for the time that they are living elsewhere.

The project attracts young professionals, who are attracted to the loft units. The villas are larger (three bedrooms) and higher end. There are some rules regarding the closing time for restaurants closer to the residential units (12 PM) compared to those farther from the residential units (1 PM).

A Silicon Valley Real Estate broker who specializes in Santana Row properties identified some disadvantages of Santana Row residential units on his website as follows:

- While the units (in any of the buildings) facing Santana Row's main road feel like they're in a city and are in higher demand, there are some units that are considered less-desirable. In the case of the DeForest Building, some condos face the above-ground parking structure; in the case of the Margo Building, some may be located above a

service entrance; or in the case of the Villa Cornet, several villas face the hills and San Jose but also overlook a parking lot.

- You pay for the atmosphere. The per-square-foot price of homes here is higher than average.
- Some units in the Margo Building face the Straits Cafe, others in the DeForest Building are located directly above it. On weekends, the party goes on until closing time the next morning. Some units in the Villa Cornet overlook the V Bar at the Hotel Valencia. From a real estate perspective, these locations are good. If you live there, there's no escaping the party on weekends in these locations.
- Santana Row is not the place for school-aged children to live because there are not that many activities for them, though it is not uncommon to see babies in strollers, particularly on weekends. The schools which Santana Row feeds into are not highly rated.

MIXED USE DEVELOPMENT IN THE SANTA CRUZ COUNTY AREA

Capitola Beach Villas is the first mixed use project in Capitola on the 41st Avenue corridor. There are several other mixed use projects, completed or approved, located in nearby unincorporated Santa Cruz County that provide additional examples of mixed use development.

Capitola Beach Villas

Capitola Beach Villas, 1066 41st Avenue, was recently completed. This is the first mixed use development in Capitola on 41st Avenue and is on the site of a former used car lot. It is located across from the O'Neill Surf Shop. The site is 1.9 acres, with density at approximately 30 units per acre. There are 55 residential units (8 are inclusionary) and 3 retail spaces. The buildings have three stories. The project has a mix of unit types including studios, one- and two-bedroom units. Much of the initial interest in the units came from potential second home buyers rather than area residents. However, the downturn in the market and the poor short-term outlook for sales delayed officially opening the project for sale.

In addition to the residential units, there are three retail spaces (approximately 2,909 SF total) located on the first floor of the residential building that fronts on 41st Avenue. The three retail spaces (872 SF, 960 SF and 1,077 SF) are being marketed separately or jointly. The space may be rented or purchased (commercial condo). The asking price was \$2.25-\$2.50/SF triple net. To purchase one of the spaces, the price was \$495-\$525/SF.

**FIGURE C-1
CAPITOLA BEACH VILLAS**



Source: ADE, Inc.

Opal Cliffs Center

This project, located at 800-840 41st Avenue and 4105-4145 Portola Drive in the Live Oak area, was built in 2004. It includes eight commercial units and seven one bedroom apartments on 1.62 acres. There are 114 parking spaces. The rents for the apartment units range from \$1,541 to \$1,886 per month. According to a local broker, both the residential and commercial components of the project have been successful. The project was recently sold.

**FIGURE C-4
OPAL CLIFFS CENTER**



Source: ADE, Inc.

Live/Work Row Houses, Green Valley Corporation (Barry Swenson)

The County approved this project for the southwest corner of Brommer Street and 17th Avenue in the Live Oak Planning Area. The project planned seven residential units (two bedrooms) on the second floor, which would be sold as condominiums, and commercial spaces on the ground floor. The projected price range was \$350,000 to \$450,000. The downstairs spaces would be sold separately, with prices in the same price range depending on the size of the commercial space (1,100 SF average). The developer expect that some of the commercial spaces will be bought by the residential owners who will use them for their businesses, while some may be bought separately. Because of poor market conditions, the developer delayed starting construction.

3911 Portola Drive, Abbas Haghshenas

This project is located at 3911 Portola Drive on the north side about 150 feet west of 41st Avenue. The County approved this project to remove two structures and construct an approximately 25,500 SF mixed use building with two stories. The building will contain 28 residential units and retail/office condominium space on the lower level. The building permit application is still in process.

Scotts Valley Town Center Specific Plan

The City of Scotts Valley has been going through an extensive planning and public participation process to develop the Town Center Specific Plan, which focuses on creating a

central village mixed use area. The proposed plan includes two- to three-story mixed use building that would have commercial retail on the first floor and residential or office above other non mixed use multifamily housing and commercial retail structures. In addition, the plan would include development of civic uses including a town green.

According to the EIR, *a primary goal is to create an identifiable and inviting place with an intimate streetscape lined with storefronts and a mix of uses that promote an environment where people can live, work and play. The Plan proposed new commercial development (retail and office), residential development, and civic uses to create a place that thrives from morning to night.*

In some areas, there will be a horizontal mix of uses (stand alone residential and stand alone commercial adjacent to each other on a given site) and in other areas a vertical mix (residential or office above retail or commercial on the same building).

It is assumed that implementation of this ambitious plan will require a number of years.

Other Examples

- **Mixed Use Development, Wharf Road and Porter Street, Soquel** – The County has approved this project for five residential units with ground floor commercial. The developer has not applied for building permits yet.
- **E. C. Rittenhouse, 1367-1387 Pacific Avenue, Santa Cruz** - This mixed use project in downtown Santa Cruz was just completed and is being marketed now. This 4-story building includes ground floor retail (14,945 SF, divisible to 4,500 SF) and office space above.
- **1010 Pacific Apartments, Santa Cruz** – This 5-story building is located in downtown Santa Cruz and contains 113 rental units, 43 of which are affordable. The project offers subterranean parking, a fitness center and a Resident Service Center. There is a mix of one to three bedroom units, including some penthouses. There are six retail suites on the ground floor, including a yogurt shop, two clothing stores, a sunglasses store, a sandwich shop, and a blown glass store.

MIXED-USE DEVELOPMENT EXAMPLES FROM OTHER CITIES

This section lists some additional examples of mixed use projects in other areas and shows examples of other mixed use combinations.

- **Tierra de Paraiso, Pismo Beach** – This seven-unit luxury condominium project was recently completed. All of the units have three bedrooms except one with two bedrooms. The units are large, ranging from 1,468 SF to 2,050 SF. Prices start at \$1,199,000. The target market is second home buyers. In addition to the residential units, there are two retail spaces that will be rented. There is a furnished model and a website; however, the developer is not expecting much interest from potential buyers during the current downturn.
- **University Village at San Pablo and Monroe Street, Albany** – This proposed mixed use development on a 4.2-acre site includes a 55,000 SF grocery store with below grade parking below the store, 175 assisted living units and 30,000 SF of retail space.

- **Glen Park Marketplace, San Francisco** – This project includes a branch library, a neighborhood grocery store and 15 two-bedroom apartments, two of which are designated for low income households. The site, 16,000 SF, is a block from a BART station and within a few blocks of five bus lines.
- **The Bookmark Apartments, Portland, Oregon** – This project combines in one building a public library, café and 47 apartments. Nineteen of the apartments are affordable to low-income households with incomes up to 60 percent of AMI.
- **Museum Place Lofts & Townhouses, Portland, Oregon** – This project includes 140 apartments atop and behind a Safeway.
- **Belmont Dairy** – Developers converted an abandoned building into 66 apartments, 19 residential lofts, and 26,000 SF of retail, including a grocery.

EL CAMINO REAL – GRAND BOULEVARD INITIATIVE

Communities along the Peninsula in the Bay Area developed the “Grand Boulevard” initiative along El Camino Real. This initiative involves multiple counties, cities, and public agencies in an effort to promote mixed-use development, transit-orientation, pedestrian-friendly spaces, and other initiatives aimed at creating a sense of place along a commercial corridor.

Among the communities participating in the initiative, Redwood City has oriented its General Plan around these principles and the initial mixed-use projects emerging out of this process have already been built. The Villa Montgomery and Franklin Street Apartments mixed-use projects serve as two prominent examples of the type of development envisioned for the El Camino corridor.

Villa Montgomery

The Villa Montgomery project is a 58-unit rental project along El Camino Real built by First Community Housing, with assistance from the Redwood City Redevelopment Agency. The project consists of are studios, one bedroom, two bedroom and three bedroom apartments. All are affordable (20 percent AMI to 50 percent AMI) and the building is LEED certified. The density of this project comes out to more than 90 units per acre. There is also one ground floor retail space that is occupied by a nail salon. The project opened in September 2007.

Franklin Street Apartments

The Franklin Street Apartments include a total of 208 rental units with more than 8,000 square feet of ground level retail space. This project has won multiple awards and has a density of about 40 units per acre. The initial phase of the project opened in 2002.

FIGURE C-11
FRANKLIN STREET APARTMENTS



Source: ADE, Inc.

FIGURE C-12
FRANKLIN STREET APARTMENTS



Source: ADE, Inc.

POTENTIAL FOR MIXED USE DEVELOPMENT ALONG 41ST AVENUE

The 41st Street corridor offers some good opportunities for mixed use development, while at the same time there are a number of challenges. The area's current strengths for mixed use development include the following:

- A number of the parcels appear to be in decline and would thus appear to be ready for redevelopment.
- There has been some mixed use development in the area, including Capitola Beach Villas.
- There are several other planned mixed use projects in the Live Oak area as well.
- There is already a strong retailing base, with a variety of retailers.

Current weaknesses for mixed use development include the following:

- The area is oriented to automobiles even though the City's transit center is located on 41st Avenue. Most of the parking lots at the various shopping centers are located along the frontage of 41st Avenue. The retail buildings are set back from the street. This does not make the area attractive to pedestrians. Nor does the fact that there are four lanes of traffic (though it does narrow to two lanes).
- The ownership of the existing retail centers is fragmented, making it challenging to encourage redevelopment/new development of the area on a larger scale.
- The current downturn in the real estate market as well as in retail sales makes this a difficult time to plan for new development.

MIXED-USE OPPORTUNITY SITES ALONG 41ST AVENUE

ADE identified four opportunity sites on 41st Avenue where it appears that the City could begin to encourage mixed use development. The sites are listed below:

Short term:

- Blockbuster/Capitola Grille site – This 1.9-acre site encompasses four parcels under a single ownership. It has potential for mixed-use because of its proximity to the Mall, and the ownership has taken an interest in exploring alternative uses.
- O'Neill's Block – Because of the proximity to other planned mixed use developments, the former Cycle Works and some of the adjacent parcels could be looked at as potential housing or mixed use sites. However, the 0.3-acre site is small.

Long term:

- Ow Property (Kings Plaza) – This 11.4 acre site is the largest contiguous parcel under a single ownership
- Capitola Mall – This site has potential for a long term transition from indoor shopping mall into more updated outdoor/pedestrian-oriented retail/development model.

Rough estimates of the housing development potential of these sites could be developed, assuming gross densities of 20 or 30 units per acre, and taking into consideration the proposed development mix. Note that the density of the Capitola Beach Villas project is approximately 30 units per acre. Housing densities above 30 units per acre would increase the development potential.

IMPLEMENTATION CONSIDERATIONS

The 41st Avenue Corridor is a large area and the existing development is diverse. There is some new development underway, such as the transformation of a used car lot into the new Capitola Beach Villas project. While piece-meal or parcel-by-parcel redevelopment may be the only approach initially, redevelopment on a wider scale will be necessary to transform and unify the area. Such redevelopment should be based on a holistic approach, preferably based on an overall vision that is supported by the community. Next steps for the City include the following:

- Continue to explore possibilities for mixed use development with current property owners, such as the owners of the opportunity sites identified.
- Begin the planning process to develop an overall vision to guide development of the Corridor with a unified attractive design over the next twenty years.
- Consider the use of a form-based code to guide development and allow flexibility.

Potential goals for the redevelopment could include the following:

- Reinvigorate and enhance retail uses along 41st Avenue
- Encourage transit oriented development
- Support the existing transit center
- Increase the housing supply, both ownership and rental housing and both market rate and affordable

Other Issues to Consider

- **Need for Financial Assistance** - Potential developers may need financial assistance. The City/Redevelopment Agency should assess their resources and the kind of assistance that they would be willing to offer. This may be especially important for the housing component.
- **Changing Retail Climate** – Besides the current downturn in retail sales, it is important to recognize the ways in which consumers' habits, such as shopping via Internet sites, may affect the viability of existing or potential retailers.
- **Office Condominiums** – Office condominiums, which can be part of a mixed use development with residential, appear to becoming a larger part of the market, especially for small businesses.
- **Overestimating Potential Uses** - For some projects, there can be a problem with the developer overestimates the amount of retail space that can be absorbed. However, this may not be such a problem for the 41st Avenue Corridor because of the current retail

orientation. This is more likely to be a problem for projects where retail has not been customary, such as residential areas.

MIXED-USE RESOURCES

As already discussed, mixed use development is a popular concept that cities have been incorporating into their planning, from single projects to large areas. Cities often contract with planning and design firms to assist with their vision of mixed use development. In many cities, there are individual mixed use projects, often adding housing units to a downtown area. Some cities take a more comprehensive approach by developing specific plans that encourage mixed use development.

Some potential resources for Capitola include the following:

Freedman Tung and Bottomley, *Transforming Obsolete Strip Development into Community Assets*

Pyatok Architects, *Cozy By Design: Communities for the 21st Century* (electronic copy already provided)

Local Government Commission, *Form-Based Codes: Implementing Smart Growth*
(www.lgc.org)

Form-Based Codes Institute (www.formbasedcodes.org)

SPUR, *Housing Above Retail, Creating Incentives for the Replacement of Single-Story Retail Sites with Mixed-Use Projects*, February 18, 2004
(www.spur.org/documents/040218_report_01.shtm)

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CHAPTER 4: FISCAL ISSUES

4.1: TARGET INDUSTRIES BASED ON TAXABLE REVENUE POTENTIAL

The taxable revenue generated by 41st Avenue retail stores has served as a vital source of municipal revenue for the City of Capitola. As retail sales decline, the City's finances have taken a severe hit. While reversing the declining taxable sales should remain an economic development priority for Capitola, there are other types of businesses that can also generate taxable sales revenue. Indeed, the office market has remained steady in the Mid-County area and along 41st Avenue. Businesses that occupy those spaces could potentially make up for at least some of the revenues lost due to declining retail sales.

In identifying potential business attraction and expansion opportunities with non-retail uses, ADE identified these opportunities based on their taxable revenue potential. From information developed from previous studies throughout California, the potential for taxable sales from non-retail businesses can vary considerably from sector to sector.

NON-RETAIL TAXABLE SALES POTENTIAL

In general, the highest potential for taxable sales from non-retail businesses comes from manufacturing, distribution, rental/leasing services, professional services, and construction contractors. Many of these industry sectors are consistent with those industries that have shown strong economic performance across the region. Other strong economic sectors that have somewhat less potential for taxable sales include educational services, health care, and most financial services, real estate, and insurance categories. Table E-1 lists those industries that have the strongest taxable sales potential, and others with more moderate taxable sales potential. It should be noted that not all businesses in these categories will necessarily generate taxable revenue, and many do not conduct any taxable transactions.

TABLE 4-1
NON-RETAIL SECTORS WITH TAXABLE SALES POTENTIAL

NAICS Code	Description
NON-RETAIL SECTORS WITH HIGHEST TAXABLE SALES POTENTIAL	
238	Specialty Trade Contractors
334	Computer and Electronic Product Manufacturing
423	Wholesale Trade, Durable Goods
424	Wholesale Trade, Nondurable Goods
522	Credit Intermediation and Related Activities
532	Rental and Leasing Services
541	Professional, Scientific, and Technical Services
OTHER NON-RETAIL SECTORS WITH HIGH POTENTIAL FOR TAXABLE SALES	
Construction and Utilities	
211	Oil and Gas Extraction
221	Utilities
237	Heavy and Civil Engineering Construction
Manufacturing	
325	Chemical Manufacturing
332	Fabricated Metal Product Manufacturing
333	Machinery Manufacturing
335	Electrical Equipment, Appliance, and Component Manufacturing
339	Miscellaneous Manufacturing
Information	
511	Publishing Industries
561	Administrative and Support Services
Health Care	
621	Ambulatory Health Care Services
Entertainment	
711	Performing Arts and Related Industries
713	Amusement and Recreation Industries
Accommodations	
721	Accommodation
Repair Services	
811	Repair and Maintenance

Source: ADE, Inc.

NON-RETAIL INDUSTRY SECTORS WITH THE HIGHEST TAXABLE SALES POTENTIAL

Specialty Trade Contractors

Construction activity by itself is not taxable, but building materials, equipment, and fixtures purchased by contractors can be taxable if the business serves as a designated point-of-sale. Specialty trade contractors can generate significant product and equipment sales because they include categories such as door hanging, concrete work, bathroom and kitchen remodeling, flooring, roofing, and heating and air conditioning. All of these construction categories involve purchases of high value items that are taxable.

Computer and Electronic Products Manufacturing

Because of the high concentration of headquarters and high value back-office activity in nearby Silicon Valley and elsewhere in Santa Cruz County, related to computer and electronic product manufacturing, these types of businesses have a high potential to generate taxable sales as a point-of-sale transaction. Products include computers, networking

equipment, computer components, semiconductors, communications equipment, electronic parts, and other similar devices. In addition, businesses classified as computer and electronic product manufacturers have a multitude of different functions, from research and development to distribution and sales and marketing. Activities that involve product sales directly to end users are often taxable transactions.

Wholesale Trade – Durable and Nondurable Goods

Wholesale trade businesses typically entail distribution of goods to other businesses, with a few of them also open for sale to general consumers. They serve as a middleman in a distribution supply chain, and include both taxable and nontaxable transactions. The taxable transactions typically include business-to-business sales in which the product will not be resold. In this case, the wholesaler serves as the point-of-sale. Products for resale would not be taxable by wholesalers. Examples of durable goods distributed by wholesalers include air conditioning equipment, construction materials, industrial machinery, electronic parts, flooring, furniture, janitorial supplies, metal products, medical supplies, office equipment, restaurant supplies, and merchant fixtures and supplies. Examples of nondurable goods distributed by wholesalers include food products, beverages, petroleum products, books, and chemicals.

Credit Intermediation and Related Activities

The taxable portion of credit and consumer lending is usually tied to automobile sales. Credit intermediation businesses designated as a point-of-sale usually include the lending divisions of auto manufacturers, as well as banks. Communities with a high proportion of tax revenues from credit intermediation businesses usually also have a high volume of automobile sales.

Rental and Leasing Services

The taxable sales from rental and leasing services typically comes from businesses that rent and/or lease automobiles, construction machinery, and trucks. Many rental transactions generate sales tax, and the businesses can generate other taxable revenues from other point-of-sale transactions.

Professional, Scientific, and Technical Services

This business category encompasses a broad range of different professional service categories. However, the business types that potentially generate taxable sales generally include those businesses whose services include installing capital equipment or acquiring other business supplies as part of the services offered. Professional service types that can potentially generate taxable sales include architects, interior designers, advertising and marketing agencies, network system consultants, computer programmers, and telecommunications consultants.

These service providers will often function as a point-of-sale for equipment installers or construction contractors, and sell products such as software packages directly to their

business customers. For example, as part of their services, interior design firms can sell the appliances and fixtures in addition to their design services. Also, network system and telecommunications consultants will often include the equipment costs as part of their services. These equipment purchases are taxable, with the revenue designated to the jurisdiction where these businesses have their point-of-sale.

OTHER NON–RETAIL SECTORS WITH POTENTIAL FOR TAXABLE SALES

Utilities and Construction

This group of business types includes petroleum businesses, utilities, and heavy construction. Taxable sales from petroleum producers usually entail some form of distribution directly to transportation companies or other business-to-business end user transactions.

Utilities include point-of-sale transactions from power generators as well as companies that distribute or produce alternative energy such as solar or wind power. Some communities with power plants under construction have also had point-of-sale accounts established by the power company so that the sales tax from the capital equipment installed on-site is designated to the community where the facility is constructed.

As with specialty contractors, heavy construction contractors can serve as a point-of-sale for construction materials. In general, the taxable sales collected from heavy construction is less than for specialty trades.

Manufacturing

Manufactured goods typically pass through wholesalers and retailers before a transaction becomes a taxable sale. This limits the taxable sales potential for many manufacturers, however many manufacturers that distribute directly to end users can collect considerable sales tax receipts. For example, chemical manufacturing includes potential taxable revenues from products such as industrial gases, plastic products, and cosmetics. Sheet metal manufacturing includes direct sales to other businesses, while machinery manufacturing includes a wide range of potential transactions such as industrial machinery, optics, and tool manufacturing. Other manufacturing sectors with taxable sales potential include medical equipment, furniture, and window coverings.

Publishing

Businesses in publishing include book, newspaper, and software publishers. As with the other categories, taxable transactions in this category come from direct sales to end users.

Administrative Support Services

Businesses in administrative support services that generate taxable sales include building maintenance services such as janitorial services, pest control, and other commercial cleaning services. The taxable sales would likely come from sales of consumable items such as cleaning products and pesticides, which are used as part of the maintenance services.

Health Care Services

Generally, health care providers do not generate a large volume of taxable sales, compared to drug store sales. However, they do potentially generate a moderate volume of taxable sales from limited product sales conducted at the place of business. The taxable sales do not include prescription drugs because that category is exempt from California sales tax.

Entertainment

Entertainment businesses will typically generate taxable sales from product sales or concessions. Ticket revenues or entertainment fees are not subject to sales tax, but might have other facility fees or local ticket taxes attached. Businesses in this category include arts organizations, movie theaters, golf clubs, bowling alleys, skating rinks, amusement centers, and health clubs.

Accommodations

Hotels and other lodging facilities can generate sales tax revenues from product sales and on-site restaurants and catering services. The taxable sales at hotels will vary depending on the market segment that they serve. Full-service hotels can usually generate substantially more sales tax revenues than lower market motels or midmarket hotels, because of the higher revenue that they receive from restaurants and catering. However, the primary revenue collected by local government from accommodations is the transient occupancy tax (TOT). Unlike sales taxes, which are shared with state and county governments, TOT collections stay entirely within a municipality. This makes hotel and transient lodging development more lucrative on a per-square-foot basis than retail stores.

Repair Services

As with many other service categories, repair services can potentially generate considerable taxable sales from sales of parts and consumable items that are sold in conjunction with the repair services. Many repair categories such as automobile repair are more similar to retail businesses in that most of their patrons are usually household consumers rather than other businesses. Other repair services primarily cater to business customers.

4.2: FISCAL TRADE-OFF BETWEEN MIXED USE AND REGIONAL RETAIL USES

If the City of Capitola is faced with a situation where regional retail uses are contracting, resulting in permanent reductions in sales tax revenues, what is the prospect that mixed use development can help replace the lost tax base? The answer is that mixed use may generate approximately the same tax revenues as regional retail, but may also require higher City costs for services to the residential units.

The primary fiscal benefit of retail development is the sales tax that the City receives. Local jurisdictions basically receive one percent of taxable sales within their jurisdiction. On average, regional retail businesses generate \$350 per square foot in taxable sales annually,

which yields \$3.50 in sales tax to the local jurisdiction. Retail development does also pay property tax based on the assessed value of the buildings. If the assessed value averages \$250 per sq.ft., the City would receive about \$0.19 annually in property tax (one percent base rate multiplied times 7.62 percent City share).⁸ Therefore, regional retail generates about \$3.69 per sq.ft. in these two main tax revenues for the City. This analysis is based on single story regional retail development. Some of the anchor space in the Capitola Mall is two story, which doubles the fiscal benefit of these buildings.

The main local revenue generated directly by residential development is the property tax. (Sales taxes are indirectly generated by household spending, but the City's share is dependent on retail businesses to provide a point of sale within the City's jurisdiction). In the case of mixed use development in Capitola, we may imagine three stories of residential over ground floor retail. If the residential units are 1,000 sq.ft. and create an assessed value of \$350,000 each, then the assessed value per sq.ft. is \$350 multiplied by three units, which equals \$1,050. The base property tax is one percent of assessed value, of which the City of Capitola gets 7.62 percent. The development would therefore generate \$0.80 in property tax per vertical sq.ft. in the building footprint. If we add in the ground floor commercial space at \$250 per sq.ft., the total property tax to the City is about \$1.00.

The mixed use development would also generate sales tax, though at a lower rate than regional retail. If the ground floor retail is occupied by neighborhood serving businesses, the taxable sales would likely be about \$200 per sq.ft. Restaurant and upscale boutique businesses would generate more than that, but other neighborhood serving uses such as beauty salons or convenience stores generate much less in taxable sales.

Part of the benefit of mixed use development is adding household purchasing power to the local retail market area. In addition to providing retail space, the residents contribute to retail spending in the local area. Three households on top of the ground floor retail would be expected to spend about \$60,000 per year in taxable sales. If that is all captured in Capitola, the City would see an increase of \$600 per year in sales tax. Divided by the 1,000 sq.ft. of floor space for the residential units, this would add \$0.60 to the per sq.ft. total for the mixed use development (20 cents for each unit times 3). Combined with the ground floor retail at \$2.00 per sq.ft., there would \$2.60 per sq.ft. of building footprint in sales tax for the City.

The property tax and the sales tax for the mixed use development total about \$3.60 per vertical sq.ft., which is slightly less than the comparable figure for the regional retail. Thus, using conservative assumptions about development values and taxable sales levels, the mixed use development is slightly less remunerative than is the regional retail, although the difference is probably within the margin of error for these calculations, meaning that the two could easily be about equivalent under slightly different assumptions.

⁸ If the property is within the redevelopment area, then the Capitola Redevelopment Agency would receive a higher share of the one percent base tax.

The net fiscal effect, factoring in the cost for City services to the two types of development, are likely to show a wider disparity. Residential development usually requires a higher level of service than does commercial development. This fiscal disparity can be mitigated to some extent by requiring certain services to be funded through Home Owners Associations, Landscape and Lighting Districts or other special assessments.

Another option for mixed use is to focus on office development over ground floor retail. This can also increase the assessed value of the property compared to single story development and may be less costly for the City to provide services. However, office development provides less market strength for retail sales than does residential development.

If we view the comparison not with regional retail but with single story strip retail center development, the fiscal positive of mixed use development is much more pronounced. By essentially multiplying the development intensity by four (four stores compared to one), plus gaining the sales tax from ground floor retail, mixed use development becomes a very attractive option for the City to replace older, underperforming strip centers along 41st Ave., or elsewhere in the City.