THE COMPETITIVE EFFECTS AND FISCAL AND ECONOMIC IMPACTS OF THE PROPOSED TARGET STORE

A Report To

The City of Scotts Valley

From

GRUEN GRUEN + ASSOCIATES
Urban Economists, Market Strategists & Land Use / Public Policy Analysts

December 2008

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APPLYING KNOWLEDGE
CREATING RESULTS
ADDING VALUE

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EXECUTIVE SUMMARY

INTRODUCTION

Target proposes to develop and operate an approximately 143,000-square-foot Target store located at La Madrona Drive in Scotts Valley, California. The site includes approximately 18 acres of land located on the west side of La Madrona Drive, just west of Highway 17. The site is bordered by the Scotts Valley Hilton Hotel to the north, the Monte Fiore residential subdivision to the west, and the Scotts Valley Corners shopping center to the northeast.

PURPOSE

The purposes of the study summarized in this report include identifying whether the development and operation of the Target store in Scotts Valley, California is likely to produce competitive economic impacts likely to result in urban deterioration and decay. Such urban deterioration and decay would potentially occur if the competitive impacts are so severe that stores close as a result of the development and operation of the Target store and the buildings containing the stores are not re-tenanted or reused within a reasonable time, would remain vacant, deteriorate, and lead to the decline of the associated and nearby real estate. Additional purposes of the study include preparing estimates of the likely fiscal and economic impacts of the operation of the Target store. Another purpose of the study is to identify whether any significant spillover property impacts are likely to occur from the operation of the Target store. This report presents the results of the independent, objective research and analysis undertaken to evaluate this issue.

PRINCIPAL FINDINGS AND CONCLUSIONS

PRIMARY TRADE AREA DEFINITION

The primary trade area from which most customers are likely to be attracted is expected to generally extend five to ten miles, slightly more or less in some directions given existing competition and transportation accessibility. The primary trade area represents an approximately 12-minute drive time to the south and east and a 15- to 25-minute drive time to the northwest along Highway 9. The primary trade area includes the communities of Scotts Valley, the San Lorenzo Valley (Felton, Ben Lomond, Boulder Creek), Santa Cruz, Davenport, Capitola and Soquel. The primary trade area definition does not include the coastal towns further east of the proposed Target store in Scotts Valley such as Aptos and Rio Del Mar. These areas have been excluded in the primary trade area definition because households in Aptos and Rio Del Mar are closer to the existing Target store in Watsonville. Such households also have to bypass potentially competitive retail supply options in the Capitola Mall area, Costco Wholesale off Highway 1, and the Gateway Plaza power center[1] in Santa Cruz located between the communities and Scotts Valley.

[1] A power center is a grouping of retail stores without a traditional full-line department store. Power centers are typically dominated by several large anchors, including few if any small shops. Containing three or four category-specific anchors of 20,000 square feet or more, power centers generally emphasize hard goods such as home improvement or houseware goods, consumer electronics, office supplies, pet supplies, or sporting goods.

RETAIL SUPPLY IN SCOTTS VALLEY

The retail centers in Scotts Valley contain approximately 580,000 square feet of space. Most of the existing inventory within Scotts Valley was originally built in the decades of the 1970's and 1980's, with two smaller developments occurring in the past several years. The inventory is extremely well leased. The interviews indicate that sales and rents have increased over time. Based on our discussions with local brokers and property owners and site inspections, fewer than 20,000 square feet of space is currently vacant for an overall occupancy rate of 97 percent. Retail centers within Scotts Valley have historically maintained high occupancy rates. Space that has become vacant has tended to be re-tenanted in a reasonable time.

The existing retail base within Scotts Valley attracts households and shoppers from beyond the community. Largely attributable to the limited availability of shopping alternatives to the north and west along Highway 9, existing retail centers and retailers within Scotts Valley serve a trade area that includes San Lorenzo Valley households located in Felton, Ben Lomond, and Boulder Creek, in addition to local Scotts Valley residents. While local households do much of their day-to-day shopping in Scotts Valley, they travel to alternative destinations within the County and to Santa Clara County to purchase comparison, shopper and destination goods (including general merchandise, apparel, building materials, and home furnishings). These shopping patterns reflect the limited selection of stores offering these goods in Scotts Valley. Scotts Valley's supply of retail space does not include stores offering "comparison", "shopper" or "destination" goods[2] such as Target, Kohl's, Lowe's, The Home Depot, Best Buy, Bed, Bath and Beyond, Office Depot, Staples, and The Sports Authority. Scotts Valley lacks larger-scale comparison or shopper-good retail formats such as regional malls, power centers, or so-called "lifestyle" centers[3].

Scotts Valley retail centers contain an extremely limited supply of apparel stores. For example, with the exception of one small used and new clothing store for children which relocated from Kings Village to Scotts Village, the Safeway-anchored and Kmart-anchored centers contain no other apparel stores. Scotts Valley contains few home furnishings and décor stores.

RETAIL SUPPLY OUTSIDE OF SCOTTS VALLEY WITHIN THE PRIMARY TRADE AREA

The primary shopping locations within the trade area include approximately two million square feet of neighborhood, community, and regional-serving retail space. Including smaller

[2] Comparison or "shopper" goods refer to durable items that are purchased relatively infrequently (televisions, large appliances, jewelry, etc) for which the consumer generally expects to invest time and effort into visiting a variety of retail stores before making a purchase.

[3] According to the International Council of Shopping Centers, a "lifestyle" center is an open-air shopping venue including more than 50,000 square feet of space, occupied primarily by upscale national chain specialty stores. Other elements differentiating lifestyle centers from traditional shopping destinations generally include restaurant and entertainment uses, and design ambience and amenities such as fountains and street furniture that are conducive to casual browsing.

neighborhood centers and freestanding drug stores which are unlikely to directly compete for the expenditures of households for general merchandise offered at the Target store, the primary trade area (outside of Scotts Valley) includes a total of 2.4 million square feet of retail space.

The dominant retail agglomeration including community-and regional-serving retail facilities within the primary trade area, and Santa Cruz County as-a-whole, is concentrated along 41st Avenue in Capitola. This corridor includes the 587,000-square-foot Capitola Mall, which is anchored by Macy's, Sears, and Gottschalk's. Built in 1989, the trade area of the mall includes much of Santa Cruz County. The Mall attracts households from Scotts Valley. Scotts Valley households also shop north in Santa Clara County for higher-end specialty goods. The leasing agent for the Mall does not expect the proposed Target store to directly compete with the Mall's anchors or specialty stores. The department stores at Capitola provide comparison, full-price shopping options, while Target is characterized by its value and convenience orientation.

The second concentration of community- or regional-serving retail space in the primary trade area is located along River Street in Santa Cruz and within Downtown Santa Cruz. Downtown Santa Cruz includes approximately 670,000 square feet of ground floor retail space, most of which is comprised of specialty shops, clothing stores, and restaurants. Downtown Santa Cruz does not have any large general merchandise stores that would compete with Target.

RELATIONSHIP BETWEEN ESTIMATED GENERAL MERCHANDISE DEMAND AND SUPPLY

Demand attributable to primary trade area households for general merchandise goods in a variety of store formats is estimated to support a total of approximates 1.4 million square feet of space. The existing supply of general merchandise space in all formats (including regional mall anchor department stores and drug stores) is estimated to total approximately 913,000 square feet of space. The relationship between estimated demand and supply for general merchandise indicates unmet demand of 459,000 square feet of space. Due to the growth in purchasing power in the primary trade area, even assuming the addition of the proposed Target store, the amount of unmet demand for general merchandise space is estimated to increase to 501,000 square feet by 2013.

Comparing the estimated demand for general merchandise store formats only of 838,000 square feet of space in 2008 to the supply of true general merchandise space, including warehouse membership stores and full-service department stores, produces an estimate of unmet demand of approximately 335,000 square feet in 2008. Assuming the addition of the proposed Target store, the amount of unmet demand for general merchandise store space only is estimated to approximate 305,000 square feet of space by 2013.

ESTIMATES OF SALES LEAKAGE AND SURPLUS

As summarized in Table E-1, consistent with the lack of regional mall, community center, power center, outlet center, and lifestyle retail development formats and the limited supply of comparison and shopper good retailers and ample supply of grocery- and drug-anchored neighborhood shopping centers in Scotts Valley, Scotts Valley attracts in-flow of dollars from non-residents for food uses and experiences out-flows of dollars for other retail categories. The sales leakage is particularly high in the apparel, household furnishings, and building materials categories.

TABLE E-1

Estimated Surplus and Leakage by Retail Category: Scotts Valley 2006

Category	Retail Sales $	Estimated Expenditures[1] $	Surplus/(Leakage) $
Apparel Stores	1,468,000	10,282,000	(8,814,000)
General Merchandise Stores	27,235,000	30,730,000	(3,495,000)
Food Stores[2]	59,240,000	37,790,000	21,450,000
Eating & Drinking Places	18,379,000	25,527,000	(7,148,000)
Home Furnishings & Appliances	2,499,000	9,014,000	(6,515,000)
Building Materials & Other Retail Stores	33,742,000	55,140,000	(21,398,000)
Total	**142,563,000**	**168,483,000**	**(25,920,000)**

[1] Estimates based on expenditure rates that were applied to total household income within Scotts Valley. The expenditure rates were calculated by dividing total household income within the State of California by total retail sales within the State (by category) to derive an estimate of the proportions of household income spent by type of store. The percentages were then applied to the household income of Scotts Valley residents.
[2] Assumes that 30 percent of sales made at food stores are taxable. Comparison of taxable food store sales reported by the BOE to the Census of Retail Trade for the State of California as-a-whole indicates that approximately 30 percent of food store sales are taxable.

Sources: State of California Board of Equalization; California Department of Finance; Census Bureau's American Community Survey; Gruen Gruen + Associates.

The analysis of sales relative to expenditure potential indicates that the convenience and necessity-oriented retail base of Scotts Valley attracts households in communities in San Lorenzo Valley that have not reached sufficient population size thresholds to support grocery- and drug-anchored neighborhood retail centers in their communities. Because of the limited supply of comparison and shopper good retail space in Scotts Valley given its relatively small population base and presence of the regional-serving Capitola Mall and other large-scale retail agglomerations in Santa Cruz and in Santa Clara, where many area residents work, leakage occurs in the comparison and shopper good categories.

RELATIONSHIP BETWEEN ESTIMATED RETAIL DEMAND AND SUPPLY

Within the primary trade area, the estimated amount of supportable retail space of approximately 3.4 million square feet of space is estimated to exceed the total amount of existing retail space of 3.0 million square feet by approximately 354,000 square feet of space.

Assuming that all of the proposed retail supply additions of approximately 500,000 square feet (including the 310,000-square-foot planned Town Center Specific Plan area) are built by 2013, given estimated supportable space demand of 3.8 million square feet of space, unmet demand within the primary trade area would still be available at 305,000 square feet of retail space.

THE OPERATION OF THE PROPOSED TARGET STORE WILL REDUCE OUT-FLOWS OF CONSUMER EXPENDITURE POTENTIAL AND INCREASE IN-FLOWS OF SALES DOLLARS TO THE RETAIL BASE OF SCOTTS VALLEY

The operation of the proposed Target store will reduce sales leakage to general merchandise, apparel, home furnishings, and other comparison or shopper good stores outside of Scotts Valley. Scotts Valley households expend approximately $3.0 million at other Target stores, including the Watsonville store. Given the time-constrained schedules of many people and the commuting patterns that cause members of many area households to take Mount Hermon Road to access Highway 17 to places of work in Santa Cruz and Santa Clara County, and proximity of the site of the proposed Target store to Highway 17, greater in-flows of sales dollars can be expected from the operation of the Target store.

Based on a synthesis of the research and analysis summarized in this report, review of Target's 2007 annual report on its chain-wide sales as well as sales from the operation of 225 stores in California, and other information from Target about customer shopping patterns, we estimate that at stabilization, the Target store will produce gross annual sales of $350 per square foot or $50.0 million.

ASSESSMENT OF POTENTIAL SALES DIVERSION AND COMPETITIVE EFFECTS AS A RESULT OF OPENING THE PROPOSED TARGET STORE

The estimated unmet or excess demand relative to supply is more than enough to support the sales requirements of the proposed Target store without requiring the diversion of sales from other general merchandise stores. While the market conditions suggest that the success of the proposed Target store need not depend upon siphoning off sales from existing stores, some proportion of the sales are likely to represent a shift from other retailers in the primary trade area. The likelihood and extent of sales diversion from existing businesses due to the opening of the proposed Target store will depend upon several primary factors. These include the location and size of stores and degree of differentiation between stores. Many local businesses and centers have a differentiated combination of location, format, product, service and other features that will insulate them from sales diversions due to the entry of the Target store.

The primary store likely to suffer sales diversion is the existing Kmart store in Scotts Valley. This is because of Kmart's location within approximately 1.2 miles of the site of the proposed Target store and its status as a discount general merchandise store operating in the

same "retail space" or category as Target. In addition, as currently presented, the Kmart store is less well organized, less well designed, and appears dated compared to a new Target store. The Kmart store is also smaller and therefore does not offer as many items as will the Target store. Accordingly, the Kmart store is neither as appealing an environment nor as convenient a shopping experience as the Target store is likely to provide.
It is difficult to quantify the amount of potential sales diversion. Kmart could choose to respond to the prod of competition by updating its facility and improving its merchandise mix and service. We assume for the fiscal and economic impact analysis that the opening of the proposed Target store will cause a reduction in Kmart sales of $50 per square foot. The interviews and review of sales data indicate that Kmart currently generates sales of $250 to $275 per square foot. A sales diversion of $50 per square foot or $2,750,000 would equate to a sales decline of approximately 18 percent to 20 percent.

Given the favorable market demand-supply conditions, the desirable location within a vital commercial area, should the Kmart store close due to the chain's struggles as a whole or because of the entry of the proposed Target store, the building would be re-tenanted within a reasonable time.[4] The representative of Scotts Valley Square of which Kmart is a tenant anticipates that it will be feasible to replace Kmart with category-killer and junior big box retailers not present in Scotts Valley that would generate higher sales per square foot and sales spillover to adjoining stores.

The principal competitive effect of the operation of the proposed Target store will be to increase general merchandise shopping opportunities within the primary trade area, reduce leakage out of Scotts Valley, and increase net annual sales in Scotts Valley.

The opening of the proposed Target store will also serve to generate increased sales spillover to the nearby commercial uses such as Scotts Valley Corners and potentially other retail centers because of the attraction of shoppers which otherwise would be unlikely to visit Scotts Valley retailers or which would visit the retail base more often because of the addition of the proposed Target store.

The operation of the proposed Target store is not likely to produce competitive economic impacts that will result in urban deterioration and decay.

NET FISCAL IMPACT OF OPERATION OF PROPOSED TARGET STORE

The operation of the proposed Target store is estimated to produce net annual revenue of $509,200 and estimated annual public service costs of $20,000. The proposed Target store is estimated to generate an annual surplus to the General Fund of approximately $489,200. Net annual sales tax revenue, taking into consideration potential sales diversions from the existing Kmart, is estimated to total $473,000.

[4] Kmart has already closed many stores and analysts indicate concern about the ability of Sears, the owner of Kmart, to continue as a retailer if it has a poor holiday season. See, for example, Chicago Tribune article dated November 18, 2008 entitled "Sears' future hanging on holiday sales".

ECONOMIC IMPACT OF OPERATION OF PROPOSED TARGET STORE

Economic Impact of Construction

The impacts of the construction expenditures associated with the Target store is estimated to result in a total employment impact of 230 added jobs; total annual income of $16.9 million; and total annual output of $31.9 million in Scotts Valley. The employment and income multipliers associated with the construction of the Target store are 1.42 and 1.38 respectively. An income multiplier of 1.38 means every $1.00 paid to the workers constructing the center account for an additional $0.38 in income created elsewhere in Scotts Valley. An employment multiplier of 1.42 means that for every ten jobs supported by the construction of the Target store, demand for an additional four jobs will be created elsewhere in Scotts Valley. The output multiplier associated with construction of the Target store is 1.33. A multiplier of 1.33 indicates that for every $1.00 in output or economic activity directly attributable to the construction of the facility, an additional $0.33 in output or economic activity is created elsewhere in Scotts Valley. The construction of the center is estimated to generate $24 million in direct output and $7.9 million in indirect output for a total output of $31.9 million.

Economic Impact of Retail Sales

The estimated on-going net additional general merchandise sales produced by the Target store result in total annual employment impacts of 292 jobs; total annual income of $8 million; and total annual output of $18.8 million within the Scotts Valley economy. The employment and income multipliers associated with the operations of Target are 1.14 and 1.16 respectively. These economic impacts reflect the potential sales diversion at the existing Kmart.

SPILLOVER IMPACT OF PROPOSED TARGET STORE

Economic place theory indicates the importance of transportation costs or accessibility to land values and that all other factors held equal, residential properties closer to retail uses have higher values than residential properties further away. Microeconomic theory also holds, however, that residential property too close to the commercial use can be affected by negative externalities such as noise or views.

Economic theory and the trend in land use practice to mixed-use land development indicate that the positive effects (such as convenience, time-savings, and environmental benefits) of residential uses with proximity to retail uses tend to offset the negative effects such as views, noise, and traffic congestion. Studies, for example, of the effects of large-traffic generating uses like regional malls on residential property values have found that housing values near regional malls experience greater appreciation than housing located further away and are not negatively impacted by proximity to regional malls.[5] Another study related to concerns about the development of a proposed 9,800-square-foot pharmacy adjacent to residential

[5] "Effects on Nearby Residential Property Values", Clarion Associates, The Mall at Oyster Bay DEIS, December 1999.

properties found that in Henniker, New Hampshire, proximity to commercial development does not negatively impact residential property values.[6]

A study of the effects of externalities such as accessibility and nuisances associated with residential uses located near nonresidential uses on the value of residential properties in the City of Tucson, Arizona found that the advantages of proximity more than offset the negative externalities of noise and traffic.[7] Because of "a net beneficial impact of nonresidential land uses on home values"[8], from a public policy perspective, the analysis suggests that "mixing land uses in residential neighborhoods need not lead to a depression of residential property values."[9]

One of the most recent and rigorous analyses of the effect of proximity of commercial uses on residential property values is summarized in the article, "Retail Proximity and Residential Values or Do Nearby Stores Really Run Down Property Values?" by John W. Matthews, a Senior Research Associate in the Andrew Young School of Public Policies Studies Fiscal Research Center at Georgia State University. The results of the hedonic analysis of the effect of proximity to commercial uses in King County, Washington indicate that in areas in which proximity to retail uses significantly affects residential property values the "positive effect of accessibility tends to outweigh the negative eternality affect from retail sites" and in those areas in which no proximity impact was identified, the "highly segregated land uses and street layouts that result in greater straight-line and travel distances" account for the finding.[10] A key finding from the hedonic analysis is that for the pedestrian-oriented subsample "negative influences rising from retail sites do not extend beyond a short distance." [11] "The net effect of retail proximity is positive – residential prices are enhanced, not diminished-beyond about 235 feet, peaking at about 560 feet, and finally playing out at about 1,260 feet".[12] The empirical findings are consistent with the review of other studies, which indicate that "negative effects dissipate more rapidly over distance than do positive effects" of proximity of commercial uses to residential uses.[13]

To obtain local insight about the potential effects of retail use proximity, especially related to another general merchandise store, we interviewed a local developer which has built housing in Scotts Valley near retail uses. The results of that case study suggest that proximity to commercial services was an advantage in marketing the housing units and that the rate of unit absorption was higher because of the accessibility of commercial services. An interview with another developer suggests that Monte Fiore is a very desirable location within a school district with a positive reputation and in an especially scenic setting. The limited supply of

[6] "The Impact of Commercial Development on Adjacent Residential Properties", John M. Crafts, MAI, SRA, The Appraisal Journal, January 1998.
[7] "Mixed Land Uses, Land-Use Externalities, and Residential Property Values: A Reevaluation", Than Van Cao and Dennis C. Cory, Annals of Regional Science, Volume 16, 1981.
[8] Id. at Page 13.
[9] Id. at Page 15.
[10] Id at Page 13.
[11] Id. at Page 13.
[12] Id. at Page 15
[13] Id. at Page 6.

residentially entitled land also tends to support residential property values in the market area. These factors may be more important determinants of residential property values than the presence of the proposed Target store.

Households of the Monte Fiore community also benefit from accessibility to Highway 17. We are not in the position to opine about the impacts and mitigations of traffic conditions. Given the locational advantages described in the interviews and on the understanding that the Monte Fiore gated development is far enough away and topographically situated to not be negatively impacted by view effects from the proposed Target store, the review of the relevant literature and case study interviews suggest negative residential property spillover effects will not apply because of the proposed Target store.

It has long been widely recognized in the economic literature and evident even longer in practice that clustering of commercial activities conveys advantages to retailers and property owners. The clustering of stores has market-widening and consumer-attracting effects because consumers like to comparison shop and are attracted by the size and diversity of retailing offerings. Therefore, as suggested by the interviews summarized in Chapter III, positive spillover effects are likely to occur for the Scotts Valley retail base because of the greater visitation and therefore sales potential that can be expected because of the addition of the proposed Target store. Sales spillover for the tenants of the adjoining Scotts Valley Corners is likely to be especially pronounced.

The manager of the Hilton Hotel to the north of the site of the proposed Target store indicated concerns about the operation of the proposed Target store causing traffic congestion as well as affecting the views from the "Wedding Garden" facilities of the hotel. During the work week, the 180-room hotel with 5,000 square feet of meeting space currently maintains an approximately 70 percent occupancy rate due to demands from business travelers. No other hotels in Scotts Valley are geared to serving business travelers. Many of the business travelers select the hotel because of proximity to Seagate, Plantronics, and other businesses. The owner of the hotel previously sold land for the development of the adjoining Scotts Valley Corners and has realized synergies and spillover between the hotel and the Morgan Stanley office and salon/spa at the Scotts Valley Corners. The hotel is dependent on the weekends for attracting leisure travelers. The primary competition for the leisure market is with a facility with beach access in Santa Cruz. The manager indicated that even if the hotel lost wedding/leisure business and had less repeat corporate room-night demand because of negative view and traffic congestion impacts, the loss of business would not cause the hotel to close. Assuming adequate traffic and other appropriate mitigations, and given the limited hotel supply competition especially for the business traveler, and that the manager does not anticipate the hotel closing, any negative property spillover impacts are likely to be more than offset by the positive macro fiscal and economic benefits estimated to apply to the development and operation of the proposed Target store.

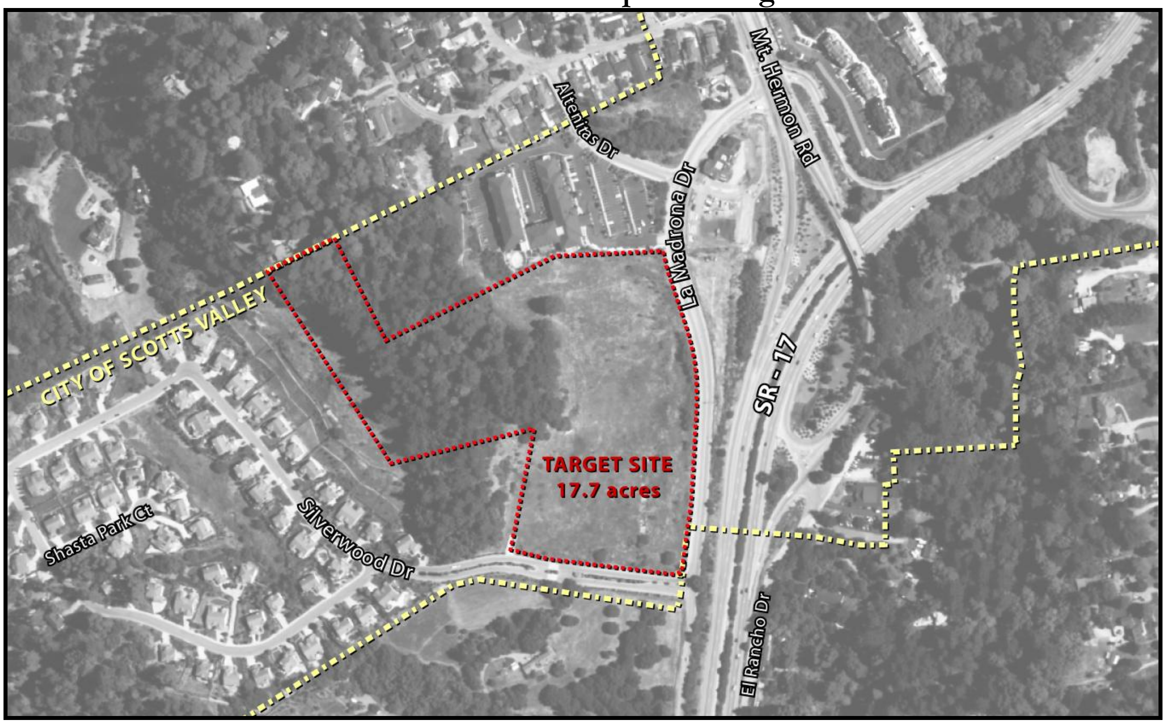
CHAPTER I

INTRODUCTION AND STUDY PURPOSE

INTRODUCTION

Target proposes to develop and operate an approximately 143,000-square-foot Target store located at La Madrona Drive in Scotts Valley, California. The site includes approximately 18 acres of land located on the west side of La Madrona Drive, just west of Highway 17. The site is bordered by the Scotts Valley Hilton Hotel to the north, the Monte Fiore residential subdivision to the west, and the Scotts Valley Corners shopping center to the northeast. Map I-1 shows the location of the proposed Target store.

MAP I-1: Location of Proposed Target Store



PURPOSE

The purposes of the study summarized in this report include identifying whether the development and operation of the Target store in Scotts Valley, California is likely to produce competitive economic impacts likely to result in urban deterioration and decay. Such urban deterioration and decay would potentially occur if the competitive impacts are so severe that stores close as a result of the development and operation of the Target store and the buildings containing the stores are not re-tenanted or reused within a reasonable time, would remain vacant, deteriorate, and lead to the decline of the associated and nearby real estate. Additional purposes of the study include preparing estimates of the likely fiscal and economic impacts of the operation of the Target store. Another purpose of the study is to identify whether any significant spillover property impacts are likely to occur from the operation of the Target store. This report presents the results of the independent, objective research and analysis undertaken to evaluate this issue.

REPORT ORGANIZATION

Chapter II describes the primary trade area definition. Chapter III presents a review of the supply of retail space within the primary trade area. Chapter III also presents the results of the interviews conducted with representatives of the shopping centers and retailers operating within the primary trade area. Chapter IV presents estimates of the demand for general merchandise goods and general merchandise space and reviews the supply of general merchandise space within the primary trade area. Chapter IV presents the relationship between the estimated existing and likely future demand for and supply of general merchandise space within the primary trade area. Chapter V presents estimates of the demand for retail space as a whole and the supply of retail space in the primary trade area and identifies the relationship between existing and potential future demand and existing and potential future supply of retail space in the primary trade area. Chapter VI summarizes the likely competitive effects of the operation of the proposed Target store in Scotts Valley. Chapter VII presents estimates of the fiscal impacts of the operation of the proposed Target store. Chapter VIII presents estimates of the economic impacts of the operation of the proposed Target store. Chapter IX presents a review of potential spillover impacts.

CHAPTER II

DEFINITION OF PRIMARY TRADE AREA

INTRODUCTION

The sales potential of a store or retail development is largely influenced by the geographic area from which customers are drawn, by the disposable income present in that area, and by the share of that disposable income the retail store or retail development will "capture" in retail sales. This chapter delineates the geographic area within which most of the customers of the proposed Target store are likely to be attracted.

PRIMARY TRADE AREA DEFINITION

A primary trade area is defined as the geographic area from which most (i.e., 70 percent or more) customers of a shopping center or store location are drawn. The trade area for any specific store or shopping center is a function of the size and tenant make-up, its accessibility, visibility, and the scale and tenancies of competing locations. The travel time people are willing to expend in order to visit a shopping location varies as a function of both the size of the shopping area and the relative uniqueness of the tenancies and environments available at alternative destinations. Therefore, trade areas are dynamic and tend to change as a function of supply competition. The amount of proximate competition, ease of accessibility, and the local appeal of the store or anchor store tenant are the significant factors influencing the trade area for retail uses. Uniqueness, attraction, and accessibility are not measured in the abstract, but are always relative to the specific competition in the local area. Traffic patterns also help to define the trade area.

To define the primary trade area, we considered the advantages, disadvantages, the locations and amount of the supply of retail space and geographic and transportation access factors that apply. These include the following:

- The supply of directly competitive general merchandise retailers within Santa Cruz County is limited and the Kmart store in Scotts Valley is unlikely to penetrate deeply into trade area general merchandise demand;

- The proposed site for the Target store benefits from a highly visible and accessible location near two of the most heavily traveled roads in the County;

- An estimated 50,000 Santa Cruz County residents commute daily over the Santa Cruz mountains to employment destinations in the Bay Area via Highway 17; and

- San Lorenzo Valley households currently shop in Scotts Valley given the limited availability of shopping alternatives along Highway 9 and that most utilize Mount Hermon Road to reach destinations outside of the local area.

Map II-1 below shows the boundaries of the primary trade area, delineated by zip code, within which the proposed Target store is expected to compete for consumer dollars.

MAP II-1: Primary Trade Area

The primary trade area from which most customers are likely to be attracted is expected to generally extend five to ten miles, slightly more or less in some directions given existing competition and transportation accessibility. The primary trade area represents an approximately 12-minute drive time to the south and east and a 15- to 25-minute drive time to the northwest along Highway 9. The primary trade area includes the communities of Scotts Valley, the San Lorenzo Valley (Felton, Ben Lomond, Boulder Creek), Santa Cruz, Davenport, Capitola and Soquel.

The primary trade area definition does not include the coastal towns further east of the proposed Target store in Scotts Valley such as Aptos and Rio Del Mar. These areas have been excluded in the primary trade area definition because households in Aptos and Rio Del Mar are closer to the existing Target store in Watsonville. Such households also have to bypass potentially competitive retail supply options in the Capitola Mall area, Costco Wholesale off Highway 1, and a power center in Santa Cruz located between the communities and Scotts Valley.

CHAPTER III

RETAIL SPACE SUPPLY WITHIN THE PRIMARY TRADE AREA AND POTENTIAL COMPETITIVE EFFECTS OF THE PROPOSED TARGET STORE

OVERVIEW

Scotts Valley's retail base predominately consists of neighborhood centers with stores providing convenience and necessity-related shopping goods. Scotts Valley contains limited to no community- and regional-scale retail agglomerations. For example, Scotts Valley's supply of retail space does not include stores offering "comparison", "shopper" or "destination" goods such as Target, Kohl's, Lowe's, The Home Depot, Best Buy, Bed, Bath and Beyond, Office Depot, Staples, and The Sports Authority. Scotts Valley lacks larger-scale comparison or shopper-good retail formats such as regional malls, power centers, or so-called "lifestyle" centers.

As described below, based on our interviews with representatives of retail centers within Scotts Valley and a sample of tenants operating stores within the centers, the existing retail base within Scotts Valley attracts households and shoppers from beyond the community. Largely attributable to the limited availability of shopping alternatives to the north and west along Highway 9, existing retail centers and retailers within Scotts Valley serve a trade area that includes San Lorenzo Valley households located in Felton, Ben Lomond, and Boulder Creek, in addition to local Scotts Valley residents.

As also described below, the interviews and review of retail space indicate that many retailers located in Santa Cruz and Capitola capture sales from Scotts Valley households. While local households do much of their day-to-day shopping in Scotts Valley, they travel to alternative destinations within the County and to Santa Clara County to purchase comparison, shopper and destination goods (including general merchandise, apparel, building materials, and home furnishings). These shopping patterns reflect the limited selection of stores offering these goods in Scotts Valley.

The following section reviews the characteristics of the retail supply within Scotts Valley in addition to the supply located elsewhere within the trade area. The inventory was identified based on site inspections and discussions with shopping center owners and managers, and the review of the Scotts Valley Town Center Specific Plan EIR and the National Research Bureau Shopping Center Directory.

RETAIL SUPPLY IN SCOTTS VALLEY

The retail centers in Scotts Valley contain approximately 580,000 square feet of space. Most of the existing inventory within Scotts Valley was originally built in the decades of the 1970's and 1980's, with two smaller developments occurring in the past several years. The inventory is extremely well leased. The interviews indicate that sales and rents have increased over time. Based on our discussions with local brokers and property owners and site inspections, fewer than 20,000 square feet of space is currently vacant for an overall occupancy rate of 97 percent. Retail centers within Scotts Valley have historically maintained high occupancy rates. Table III-1 presents the supply of retail space in Scotts Valley. Map III-1 shows the location of the retail centers in Scotts Valley.

TABLE III-1

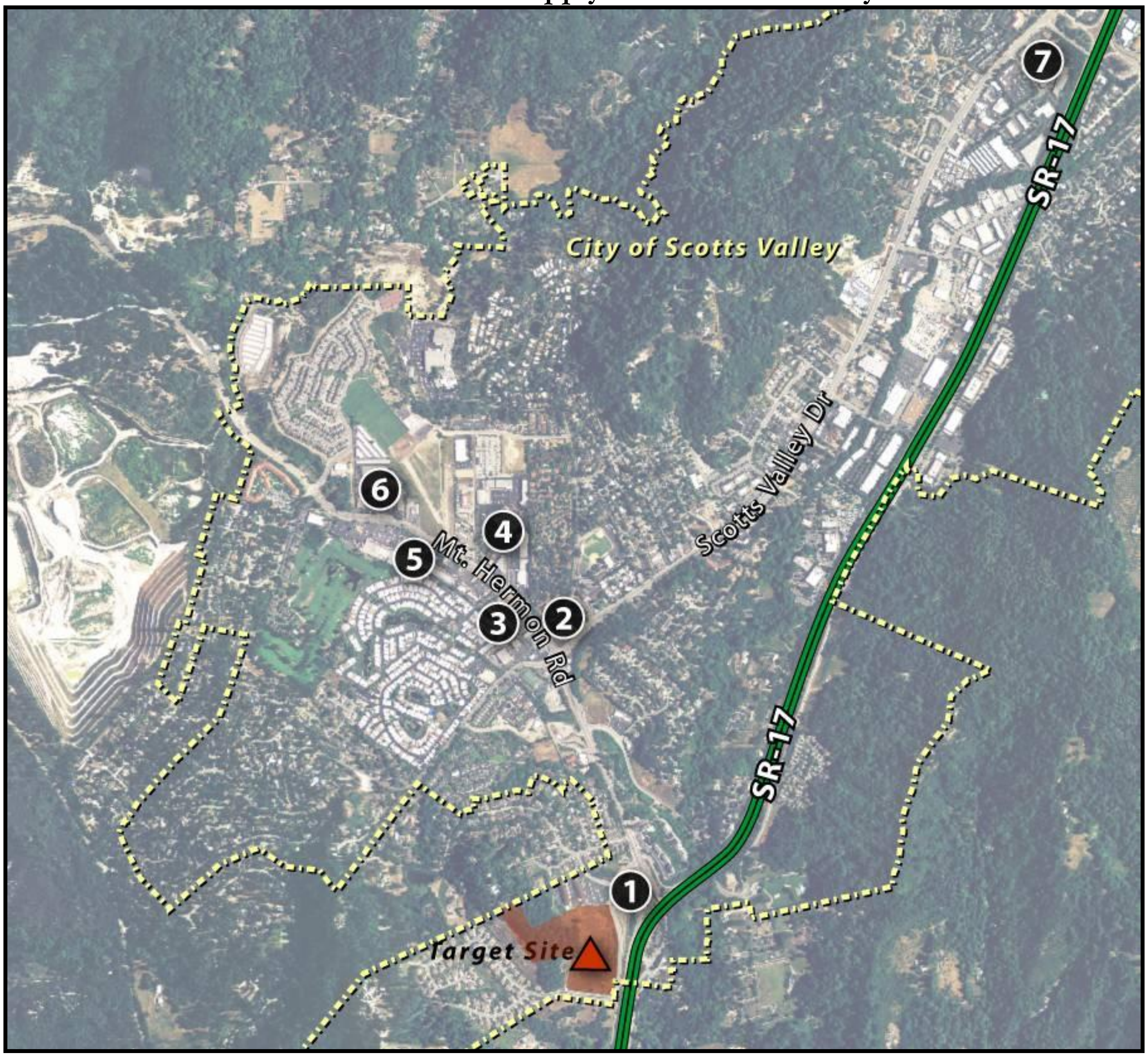
Retail Supply Within Scotts Valley

Key	Retail Center	Distance from Proposed Target Site[1]	Anchor Tenants	Year Opened/ Last Renovated	Size of Center # Sq. Ft	Occupancy %	Monthly Rental Rates $ Per Sq. Ft.
1	Scotts Valley Corners	0.1 miles	Surf City Coffee, Quiznos, Morgan Stanley	2005-2006	16,000	93	2.25-2.75
2	Camp Evers	0.8 miles	Camp Evers Food	1940	30,000	100	
3	Graham Plaza[2]	0.9 miles	Starbuck's	1989/2000	28,600	92	1.58-1.67
4	Kings Village[3]	1.0 miles	Nob Hill Grocery, Walgreen's, Scotts Valley Cinema	1968-2001	225,000	98	1.50-1.75
	Kings Village Outlot	1.0 miles	Peet's Coffee, Jamba Juice	1998	9,000	100	2.08-3.25
5	Scotts Village	1.1 miles	Safeway, Long's Drugs	1983/2006	132,000	95	2.00-2.25
6	Scotts Valley Square	1.2 miles	Kmart, Dollar Tree	1986	90,000	99	2.00
7	Scotts Valley Junction	3.1 miles	Scotts Valley Market, Starbuck's	1982	48,000	94	1.83-2.33
Total Scotts Valley					**578,600**	**97**	**1.50 - 3.25**

[1] Driving distance.
[2] According to the property owner, approximately 50 percent of the space in Graham Plaza is office/service/medical space. Based on our inspection, 10 of the property's 15 tenants are office space using businesses. Only one space is occupied by a retailer while two units are occupied by restaurants/coffee shops.
[3] Kings Village includes approximately 25,000 square feet of office space.

Sources: Lomak Group; Meacham Oppenheimer; NAI BT Commercial; Ow Family Trust; Pratt Company; CW Land Consultants; Gruen Gruen + Associates.

MAP III-1: Retail Supply Within Scotts Valley



Kings Village

The largest shopping center within Scotts Valley is the Kings Village. Originally built in 1968, Kings Village has been expanded multiple times throughout the early 1970's and 1980's with the final addition of a Walgreen's store occurring in 2001. Anchored by Nob Hill Grocery and Walgreen's, Kings Village includes approximately 225,000 square feet of space, some of which consists of two-story office space located to the rear of the shopping center. Other major tenants include Ace Hardware and the Scotts Valley Cinema.

An outlot parcel was also developed in 1998 with approximately 9,000 square feet of small shop space. This outlot includes a Jamba Juice and Peet's Coffee & Tea with monthly rents of $3.25 triple net. Within about one month, these tenants replaced the original tenants which had vacated the space. Another original tenant, Blockbuster, continues to occupy space. The real estate broker marketing the retail space indicated an advantage to the location includes a high level of automobile traffic (second highest traffic volume corridor in the region). The broker indicated rents have been increasing for good retail locations in Scotts Valley. Consistent with increasing rents, the broker indicated that demand from trade area residents, workers, and visitors could support additional retail space and that Target can be expected to attract San Lorenzo Valley households which will pass Scotts Valley retail centers to reach the Target store. The addition of the Target store is likely to extend the trade area for the Scotts Valley retail base to include much of Santa Cruz County, exclusive of Watsonville at which a Target store is located.

Figure III-1: Kings Village Shopping Center

According to the representative of the owner of Kings Village, the trade area for Kings Village is estimated to include Scotts Valley, and extends to Pasatiempo, Boulder Creek, and Bonney Doon. Despite its age, outdated design, and inefficient configuration due to separate additions in 1972, 1974, 1976, and 1984, only 10,000 square feet of space is currently vacant at the Kings Village center for an occupancy rate above 98 percent. The occupancy rate of the center has remained high and stable. When space has become vacant, it has usually taken five to six months to release the space. Over time, even with the addition of other retail centers along Mount Hermon Road in Scotts Valley, sales and rents have increased. Net monthly rents vary by location in the center but average $1.50 to $1.75 per square foot.

According to the Kings Village representative, the addition of other retail centers and national retailers has caused the trade area of the retail base in Scotts Valley to expand due to the increased selection of stores. The performance of the shopping center was not negatively affected by the additions of new retail supply.

An inspection of and interview with the owner of a fine jewelry store which has been operating from varying locations in Kings Village for 10 years indicates that Target will not compete with the jewelry store. The store specializes in custom design and high touch service that Target cannot duplicate. The store's trade area is extensive and encompasses Scotts Valley, San Lorenzo Valley, Santa Cruz and beyond.

Scotts Village

Scotts Village, a Safeway- and Long's Drugs-anchored neighborhood center, was built in 1983 directly across from Kings Village. According to the representative of the owner of Scotts Village, the trade area for Scotts Village includes Scotts Valley, Boulder Creek, Felton and an area toward Santa Cruz encompassing an approximately 25 minute drive time. The

132,000-square-foot Scotts Village, the second largest center in Scotts Valley, has undergone a $3 million renovation over the past two years. According to the shopping center owner, the center's sales have steadily increased and the center has maintained a consistently high occupancy. The center is 95 percent leased. Net monthly rents have increased over time, currently averaging $2.00 per square foot. When store turnover occurs, the vacant space is typically released within six to nine months. When Walgreen's opened in Kings Village across the street in 2001, the opening did not adversely impact the sales of Safeway, Long's Drugs, or the sales of the center's other tenants.

Figure III-2: Scotts Village Shopping Center

An interview with the manager of the Radio Shack operating within Scotts Village indicates that sales for the store have steadily increased over the past five years. Radio Shack primarily serves households and workers located in Scotts Valley and the San Lorenzo Valley. According to the manager, Target will not adversely affect the sales of Radios Shack. Radio Shack differentiates itself from Target through unique products and value to its customers, including superior service and product knowledge that Target cannot duplicate in the electronics category. In addition, the site of the proposed Target store is far enough from Scotts Village to not directly impact the operations or trade area of Radio Shack.

The Kragen Auto Parts store also operating from Scotts Village has been a tenant of the center since its inception. Kragen has a long term favorable lease. Sales have been relatively stable in the past few years. The manager and assistant manager of the store do not expect Target to impact the size of the trade area the store serves or its sales performance. The trade area has been stable for many years, consisting of Scotts Valley and San Lorenzo Valley. Because of a Kragen store in Santa Cruz, the Scotts Valley store does not attract customers from Santa Cruz. Kragen competes with the nearby Kmart store for basic automotive supplies such as oil and batteries. However, general merchandise stores like Kmart and Target, do not carry the highest quality products or as comprehensive and specialized parts as Kragen carries. Nor do general merchandise stores like Kmart or Target have staff with as much knowledge and expertise about automotive parts and supplies. Kragen's primary competition for do-it yourself customers is likely to remain Winchester Auto on Scotts Valley Drive. While Target will draw new customers to Scotts Valley, the managers do not expect a significant impact from that added visitation. Given the long-term favorable lease, the managers expect the store to operate from Scotts Village for the foreseeable future.

Scotts Valley Square

Built in 1986, the approximately 90,000-square-foot Scotts Valley Square is anchored by a Kmart consisting of approximating 55,000 square feet of space. Scotts Valley Square is nearly 100 percent leased. According to the representative of the center, the trade area for retail centers in Scotts Valley expanded when the Kmart originally opened. The broad variety of goods offered by Kmart served to draw customers from further away than typical neighborhood center type tenants attract. Kmart operates in owned building space under a ground lease. Kmart sales have declined since 2005 but are estimated by the shopping center owner to currently approximate $250 to $275 per square foot. Should the Kmart store close due to the chain's struggles as a whole or because of the entry of the proposed Target store, the representative of Scotts Valley Square anticipates that it will be feasible to replace Kmart with category-killer and junior big box[14] retailers not present in Scotts Valley that would generate higher sales per square foot and sales spillover to adjoining stores. Dollar Tree replaced a 12,000-square-foot Gottschalk store at Scotts Valley Square and customer traffic to the center increased.

Our inspection of the Kmart indicates it has not been recently updated and is relatively unkept and poorly merchandised[15]. Offerings include large appliances and Craftsman tools that the proposed Target store will not carry. According to the representative of Scotts Valley Square, because of the low cost basis, Kmart could continue to operate its store even at a significantly reduced level of sales. Kmart could choose to aggressively compete with the Target store. The presence of Target with or without Kmart will attract shoppers which would otherwise have limited reasons to visit Scotts Valley. The merchants operating in the existing centers will gain potential sales from Target capturing shoppers from Highway 17 that have historically bypassed the retail base at Scotts Valley to go north to San Jose/Santa Clara County or south to Capitola. In addition, as indicated by our interviews (described in more detail below) with representatives of health-care related and retail businesses in the trade area and review of point-of-sales data from Target, the Target store will attract customers who reside in Santa Cruz to Scotts Valley, which would otherwise shop at the Target store in Watsonville. As a result, the trade area potentially served by the existing retail centers and stores within them can be expected to expand to include much of Santa Cruz County, exclusive of Watsonville.

An interview with the manager of the Payless Shoe store adjoining the Kmart store indicates that Payless generally prefers to be a co-tenant with Target because of the sales spillover Target generates. Kmart stores do not generate the same level of sales spillover as do Target stores. Payless currently faces limited competition. The selection and quality of shoes and service offered by Kmart is inferior to that provided by Payless. Because of the limited

[14] Junior box tenants serve as secondary anchor stores, generally ranging in size from 15,000 to 50,000 square feet of space. Examples of junior big-box tenants include Marshall's, Petsmart, Borders Books, Michaels and Best Buy.

[15] We attempted to interview the assistant store coach but she indicated she was not authorized to comment on the proposed Target store or answer our questions about the Kmart store.

supply competition, Payless serves a relatively wide trade area including Capitola, Santa Cruz, Scotts Valley and San Lorenzo Valley. Sales have increased over the past four years. Dollar Tree generates much more customer traffic than the Gottschalk's store that Dollar Tree replaced. While Target could attract households that would not otherwise come to Scotts Valley, the manager was unsure that Target would be close enough to generate sales spillover. Even if Target does compete for sales of shoes with Payless, the manager does not anticipate the impact being so severe that the store would close.

Figure III-3: Scotts Valley Square Shopping Center

The easier ingress and egress and surface parking alternatives at existing centers and convenience and superior service available from smaller, specialized stores operating within existing centers suggests that other centers and the stores within them could benefit from sales spillover from Target's customers to the extent they pass the centers to access Target or are induced to visit other centers because they are attracted to the proposed Target store via Highway 17.

Scotts Valley Junction

Figure III-4: Scotts Valley Junction

The Scotts Valley Junction retail center is located furthest (approximately three miles) from the site of the proposed Target store. Built in the 1982, the center was extensively remodeled in the past five years. This specialty neighborhood center is anchored by the high-end Scotts Valley Market. Scotts Valley Market features specialty meats, fresh seafood and produce with high levels of service. The center also includes a Starbuck's and multiple restaurants. Located in the north side of the community near office space, Scotts Valley Junction also serves office workers. Consisting of three buildings totaling almost 50,000 square feet, the center has only two small vacant spaces totaling 2,000 square feet. The center has maintained high occupancy rates. Typically, when store turnover occurs, it takes two to four months for the space to be re-tenanted. Asking net monthly rental rates at the center range from $1.95 to $2.25 per square foot. Consistent with the high occupancy and rental rates, sales have increased over time.

The representative of the Scotts Valley Junction indicated that the addition of the Target store would increase the selection and variety of retail goods in Scotts Valley and that if sites become available, the market could support additional stores in categories not well represented in Scotts Valley. Given the relative distance and difference in product types, the representative does not anticipate the proposed Target store adversely impacting the center or its tenants.

Graham Plaza

Graham Plaza was originally built in 1989 and extensively remodeled in 2000. The property contains approximately 28,000 square feet of space. The property contains 2,420 square feet of vacant space. Based on our inspection, 10 of the property's 15 tenants are office space using businesses. Starbuck's, which was very busy during our inspection, two restaurants and a service use (salon/spa) comprise four of the 15 tenants. Only one of the tenants, Zinnia's, which sells home décor items, is a retailer. Asking monthly net rents are $1.65 per square foot. Advantages of the property include a high traffic location with visibility to commuters using Mount Hermon Road to access Highway 17 and therefore employment centers to the north and south of Scotts Valley. The newness and high quality of the center and proximity to other commercial uses are additional advantages.

Figure III-5: Graham Plaza

An interview with representatives of Scotts Valley Oral and Maxillofacial Surgery, a new tenant with frontage on Mount Hermon, indicates that oral and plastic surgery is not an impulse attraction. The addition of the Target store would not negatively impact the practice. To the extent the proposed Target store creates more traffic on Mount Hermon the exposure to additional prospective clients would be beneficial. None of the staff shop at either the Kmart in Scotts Valley or the Target store in Watsonville. The staff desire greater selection of stores in Scotts Valley and will shop at the proposed Target store.

Scotts Valley Corners

Figure III-6: Scotts Valley Corners

The Scotts Valley Corners shopping center is the newest retail supply in Scotts Valley and also very close to the proposed Target site. The development includes two buildings totaling 16,000 square feet of space with smaller tenants such as Surf City Coffee, Quiznos, a variety of service providers, and a large Morgan Stanley office. The land for the development was purchased from the owner of the Hilton Hotel across the street in 2005. The first building of 7,000 square feet was built in 2005 and the second building of 9,000 square feet of space was completed in 2006. One tenant, Taco Del Mar, vacated its space and that space was released within 90 days. The current vacant space of 1,130 square feet has been vacant for 10 months. Significant interest from banks, food service, a health food store, and other uses has been expressed for the space, but the current national economic circumstances have kept prospective tenants from financing location decisions.

Because of the proximity of Scotts Valley Corners to Highway 17, the businesses operating from the building space capture traffic from commuters from San Lorenzo Valley accessing Highway 17 via Mount Hermon. The proposed Target store would generate sales spillover for the tenants of Scotts Valley Corners. The addition of the Target store would result in a trade area for the center including much of Santa Cruz County.

The review of retail supply in Scotts Valley indicates that Scotts Valley retail centers contain an extremely limited supply of apparel stores. Consistent with our inspections of the retail centers in Scotts Valley, as shown in Chapter V, according to the Board of Equalization ("BOE"), Scotts Valley apparel sales in 2006 (the most recent year for which data is available) totaled only $1,468,000. This sales figure is the highest annual sales level since 1996. The inspections indicating limited home furnishings and décor stores is supported by the low sales for Scotts Valley in this retail category reported by the BOE of only $2,499,000.

ADDITIONAL SUPPLY OF RETAIL SPACE WITHIN PRIMARY TRADE AREA

Table III-2 summarizes the major neighborhood, community, and regional-serving centers located outside of Scotts Valley but within the primary trade area. Map III-2 shows the locations of the major shopping centers within the primary trade area outside of Scotts Valley.

TABLE III-2

Retail Supply Within Primary Trade Area But Outside of Scotts Valley

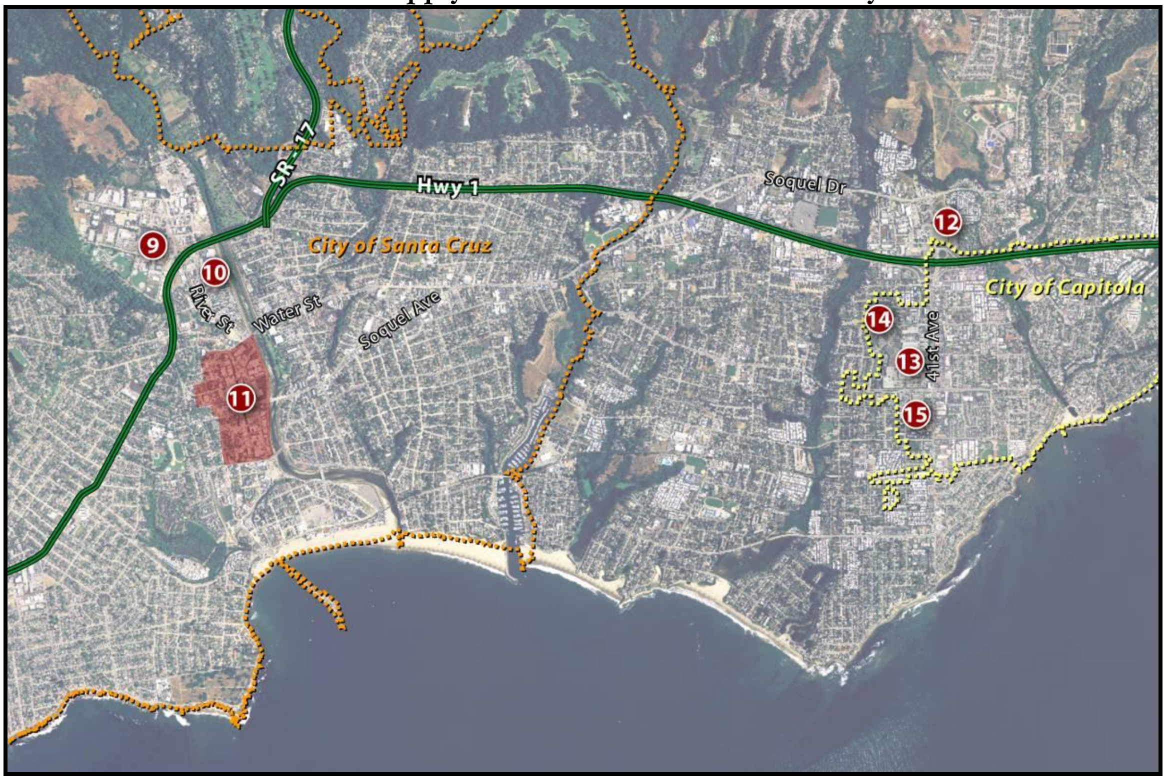
Key	Retail Center	Community	Distance from Proposed Target Site[1]	Type of Center	Anchor Tenants	Year Opened/ Last Renovated	Size of Center # Sq. Ft
8	Felton Fair	Felton	3.8 miles	Neighborhood	Safeway, Long's Drug	1973	80,000
9	Costco Wholesale	Santa Cruz	4.6 miles	Freestanding	N/A		110,000
10	Gateway Plaza	Santa Cruz	4.8 miles	Community	Cost Plus, Ross Dress for Less, Petsmart, Office Max	1998	119,000
11	Downtown Santa Cruz	Santa Cruz	5.1 miles	Regional/ Specialty	Trader Joes, Borders Books, The Gap, Urban Outfitters		670,000
12	Redwood Square	Soquel	7.4 miles	Community	Home Depot, Best Buy, Safeway	2008	218,000
13	Capitola Mall	Capitola	7.5 miles	Regional	Macy's, Sears, Gottschalks	1989	587,000
14	Brown Ranch Marketplace	Capitola	7.7 miles	Neighborhood	Trader Joes, Bed Bath & Beyond, Fresh Choice, Pier 1 Imports	1992	83,000
15	Kings Plaza	Capitola	7.8 miles	Neighborhood	Orchard Supply Hardware, Savemart, Rite Aid	1955	139,000
	Total[2]						**2,006,000**

[1] Driving distance.

[2] The primary trade area is estimated to include an additional 415,000 square feet of retail space not located in the major shopping centers identified above. This additional space is primarily convenience/neighborhood-type space located in small centers or freestanding locations. In addition to the shopping locations identified above, the primary trade area includes four freestanding drug and grocery stores (Long's Drug, Rite-Aid, Walgreen's, and Safeway) totaling 75,000 square feet and six smaller grocery or drug-anchored neighborhood centers totaling 340,000 square feet. This space serves the local neighborhoods.

Sources: NAI BT Commercial; Macerich; NRB Shopping Center Database; GG+A Interviews and Site Visits.

MAP III-2: Retail Supply Located Elsewhere in Primary Trade Area



The primary shopping locations within the trade area include approximately two million square feet of neighborhood, community and regional-serving retail space. Including smaller neighborhood centers and freestanding drug stores (referred to in footnote 2 of Table II-2 above) which are unlikely to directly compete for the expenditures of households for general merchandise offered at the Target store, the primary trade area (outside of Scotts Valley) includes a total of 2.4 million square feet of retail space. While drug stores offer some general merchandise, they carry a limited selection of soft goods. The general merchandise inventory of drug stores is not nearly as broad and as well priced as goods carried by Target. Drug stores lack comparison and shopper-goods needed to attract customers from beyond the immediate neighborhoods in which they are located. In contrast, Target emphasizes convenience for time-constrained shoppers seeking a broader range of well-priced, quality products under one roof that satisfy their changing tastes and budgets. The high percentage of women in the labor force has created the catalyst for retailers like Target to offer an ever-expanding product mix.

The closest retail center to Scotts Valley is Felton Fair, a 35-year-old grocery and drug-store anchored neighborhood center in Felton. While not updated, the center is 100 percent occupied. According to the store manager, the Long's Drugs store opened in 2006, replacing a Rite-Aid store. The Safeway has operated from the center for many years. While the center has had store turnover, the occupancy of the center has remained high and vacant space has been re-tenanted in a reasonable time. The opening of Walgreen's and Safeway stores in

Scotts Valley has not caused the Safeway and Long's Drugs stores to close at Felton Fair.

The dominant retail agglomeration including community-and regional-serving retail facilities within the primary trade area, and Santa Cruz County as-a-whole, is concentrated along 41st Avenue in Capitola. This corridor includes the 587,000-square-foot Capitola Mall, which is anchored by Macy's, Sears, Gottschalk's, and Ross Dress for Less. Built in 1989, the trade area of the mall includes much of Santa Cruz County. The Mall attracts households from Scotts Valley. Scotts Valley households also shop north in Santa Clara County for higher-end specialty goods. The leasing agent for the Mall does not expect the proposed Target store to directly compete with the Mall's anchors or specialty stores. The department stores at Capitola provide comparison, full-price shopping options, while Target is characterized by its value and convenience orientation. The Target store would have competed with Mervyn's, a former anchor tenant, but Mervyn's is being liquidated.

Figure III-7: Brown Ranch Marketplace

Across the street from the Capitola Mall is a specialty neighborhood center, Brown Ranch Marketplace. Built in 1992, the 83,000-square-foot center is anchored by a Trader Joes and the only Bed, Bath & Beyond in Santa Cruz County. The trade area for Bed, Bath, & Beyond extends from Aptos to the east to Scotts Valley to the north. The trade area has been stable and sales have increased over time. According to the representative of Brown Ranch Marketplace, when Gateway Plaza in Santa Cruz opened with stores such as Cost Plus, Ross Dress for Less, and Office Max, the occupancy rate and sales of the Brown Ranch Market were not negatively impacted.

According to the manager of the approximately 30,000-square-foot Bed, Bath & Beyond, the store has been operating from Brown Ranch Marketplace for approximately six years. The primary competition is Macy's store in the Capitola Mall. But Bed, Bath & Beyond carries a broader and more specialized product line than Macy's. The trade area of the store encompasses Watsonville, Aptos, and the San Lorenzo Valley. The store attracts households from Scotts Valley. The manager believes given the limited supply competition, sufficient demand exists to support Target without negatively affecting the sales of Bed, Bath & Beyond.

The second concentration of community- or regional-serving retail space in the primary trade area is located along River Street in Santa Cruz and within Downtown Santa Cruz. Downtown Santa Cruz includes approximately 670,000 square feet of ground floor retail space, most of which is comprised of specialty shops, clothing stores, and restaurants. Downtown Santa Cruz does not have any large general merchandise stores that would compete with Target. Downtown Santa Cruz is pedestrian friendly and benefits from University of California at Santa Cruz related demand and other visitors. The Target store is designed to attract customers using automobiles to visit the store and then leave.

Near Downtown Santa Cruz on River Street is also the 119,000-square-foot Gateway Plaza shopping center which includes a Cost Plus World Market, Ross Dress for Less, Petsmart, and Office Max. This center contains no vacant space. According to the store supervisor for Cost Plus, the store has been opened for about eight years. Cost Plus attracts households from Watsonville, Aptos, Scotts Valley and the San Lorenzo Valley. The store offers unique brands and merchandise. Sales are reported to be strong and increasing over time. While the opening of the Target store would create potential competition for serving demands from trade area households for basic home furnishings and décor items, because of the limited overlap in merchandise and deeper and more specialized product lines carried by Cost Plus, the impact of the Target store is likely to be limited. The manager noted that because of the limited supply competition, trade area demand is more than sufficient to support the addition of the Target store.

Figure III-8: Gateway Plaza

The approximately 110,000-square-foot membership Costco Warehouse store is located on Sylvania Avenue north of Highway 1 in Santa Cruz. The site is difficult to access. It adjoins train tracks and an industrial area. Costco Warehouse stores include a wholesale component and a retail component. The wholesale component serves businesses members which may purchase the Costco goods for resale. The Costco carries a limited number of general merchandise, supermarket, and drug products and the products carried vary from week-to week.

Redwood Square located on 41st Avenue in Soquel is an approximately 218,000-square-foot community center anchored by Safeway, Home Depot and Best Buy. The center is a redevelopment of a dilapidated Kmart center. The Kmart store was demolished and replaced with the new retailers. The Safeway grocery store was demolished and rebuilt.

CHAPTER IV

THE DEMAND FOR GENERAL MERCHANDISE SPACE AND THE RELATIONSHIP BETWEEN GENERAL MERCHANDISE SPACE DEMAND AND SUPPLY WITHIN THE PRIMARY TRADE AREA

INTRODUCTION

This chapter presents estimates of the potential demand for general merchandise retail space within the primary trade area for 2008 and 2013. Retail demand depends primarily upon the disposable income present in the trade area and the proportion of income spent on retail goods. Not all internally generated demand is satisfied in a primary trade area. Some potential demand within the trade area is lost to retailers outside the trade area. As indicated by the interviews, Scotts Valley households currently leave Scotts Valley for comparison or shopper goods. Conversely, retail sales in the trade area will be made to customers such as nonresident workers and visitors to Scotts Valley. The potential demand estimates are based on the estimated present and forecast households and average income of the primary trade area households.

ESTIMATE OF RESIDENTS AND INCOME WITHIN THE PRIMARY TRADE AREA

We obtained estimates of population, households, household income, and per capita income for the primary trade area from Claritas, Inc., a national demographic information vendor. We compared these estimates to demographic and economic data reported in the 2000 Census and have also reviewed secondary estimates and forecasts prepared by government agencies (such as the California Department of Finance and the Association of Monterey Bay Area Governments) to evaluate whether or not the forecasts and estimates prepared by Claritas are reasonable to use. Table IV-1 presents an estimate of the population, number of households, average household income, and total available household income in the primary trade area for 2000, 2008, and 2013[16].

[16] The primary trade area definition corresponds to zip code areas including 95005, 95010, 95018, 95062, 95065, 95073, 95006, 95017, 95060, 95064, and 95066.

TABLE IV-1

Demographic and Income Estimates for Residents in the Primary Trade Area: 2000 – 2013[1]

	2000	2008	2013	Change from 2000 – 2008 #	Change from 2000 – 2008 %	Change from 2008 – 2013 #	Change from 2008 – 2013 %
Population	154,694	151,781	151,488	-2,913	-1.9	-293	-0.2
Households	59,695	59,590	60,170	-105	-0.9	580	1.0
Average Household Income	$73,639	$89,534	$100,614	$15,895	21.6	$11,080	15.1
Total Available Household Income[2]	$4,395,880,100	$5,335,331,100	$6,053,944,400	$939,451,000	21.4	$718,613,300	16.4

[1] Primary trade area based on aggregated data from zip codes 95066 (Scotts Valley), 95018 (Felton), 95006 (Boulder Creek), 95017 (Daveport), 95005 (Ben Lomond), 95010 (Capitola), 95073 (Soquel), 95062, 95065, 95060, and 95064 (Santa Cruz).
[2] Figures are rounded.

Sources: 2000 Census; Household Trend Report, Claritas, Inc.; Gruen Gruen + Associates.

Claritas forecasts little growth in the number of households in the primary trade area over the next five years. This low growth forecast is consistent with the regional forecast of the Association of Monterey Bay Area Governments ("AMBAG"). AMBAG forecasts 1,418 new housing units in Scotts Valley, Capitola, and Santa Cruz between 2010 and 2030, or on average 71 new units per year. As of November 2008, according to the City of Scotts Valley, approximately 650 residential units are planned in projects that have either been approved, submitted or in preliminary planning stages.

In 2000, the primary trade area included approximately 59,700 households and a population of 154,694. The average household income of primary trade area residents (in 1999 dollars) approximated $73,600. Accordingly, primary trade area household income totaled approximately $4.4 billion. Between 2000 and 2008, the population within the primary trade area declined by an estimated two percent or 2,193 people to approximately 151,800. Between 2000 and 2008, the number of households declined by approximately 105 or 0.9 percent to about 59,600. The number of households is forecast to grow by an additional 580 or one percent between 2008 and 2013 to total nearly 60,170.

Average 2008 household income within the primary trade area is estimated to approximate $89,534, an increase of nearly 22 percent from the $73,639 average household income in 2000. In 2000, total household income approximated $4.4 billion. In 2008, total household income is estimated at $5.3 billion, an increase since 2000 of approximately 21 percent or $939.5 million. Not taking into account the effects of inflation, average household income levels in the primary trade area are expected to increase by 15.1 percent over the next five years to approximately $100,614. Total household income is forecast to grow by $718.6 million or 16.4 percent between 2008 and 2013 to $6.1 billion.

RETAIL GENERAL MERCHANDISE EXPENDITURE POTENTIAL WITHIN PRIMARY TRADE AREA

Table IV-2 shows that, excluding food and grocery items[17], approximately 11 percent of total household income is spent on goods typically sold at Target stores and other general merchandise or warehouse-type stores. Many of the categories described in Table IV-2 are also available at grocery and drug stores and category-killer retailers.

TABLE IV-2

Average Annual Consumer Expenditures on Goods Typical Available at General Merchandise Stores for Western Region Households: 2006

	Average Annual Expenditures For All Households (2006)[1] %	Average Annual Expenditures For Higher-Income Households (2006)[2] %
Laundry /cleaning supplies and other household products	0.7	0.5
Postage / stationery	0.3	0.2
Household textiles and floor coverings	0.4	0.3
Furniture	1.0	1.0
Small appliances and housewares	0.2	0.2
Miscellaneous household equipment	1.3	1.2
Women's, men's and children's apparel	2.1	1.6
Footwear	0.5	0.3
Television, radio and sound equipment	1.5	1.1
Pets, toys, hobby and playground equipment	0.7	0.6
Other entertainment equipment/services	1.0	1.1
Personal care products	1.0	0.8
Reading	0.2	0.2
Total	**10.9**	**9.0**

[1] Income before taxes for all Western Region households is reported at $66,955. Figures represent percentage of before-tax income spent on the various goods and services listed.
[2] Income before taxes for higher-income ($70,000 and above) Western Region households is reported at $132,448.

Sources: 2006 Consumer Expenditure Survey, Bureau of Labor Statistics; Gruen Gruen + Associates.

Because the Bureau of Labor Statistics Consumer Expenditure Survey only reports retail expenditures by type of product or merchandise and not by type of store, we reviewed characteristics of households, income, and general merchandise sales for the entire State of California over the past several years. We did so to estimate the proportion of household income specifically spent at general merchandise *stores* as compared to the proportion of household income that is spent on *goods* that are available at general merchandise stores. We use the State of California as-a-whole as a benchmark to reduce the potential for significant

[17] Groceries and alcoholic beverages are not included because the proposed Target store is not expected to include a significant grocery component.

leakage of sales dollars to occur. Table IV-3 summarizes the proportion of household income that is spent at general merchandise stores within California, assuming that any leakage or exporting of sales dollars outside the State is offset by sales dollars captured from nonresident visitors.

TABLE IV-3

Proportion of Household Income Spent at General Merchandise Stores Within California (Constant 2008 Dollars)

	2000	2002	2004	2006
General Merchandise Sales per Household[1]	$4,480	$4,405	$4,624	$4,709
Average Household Income	$83,658	$79,520	$80,361	$83,828
General Merchandise Spending Per Household as Percentage of Average Household Income	5.36%	5.54%	5.75%	5.62%

[1] The Board of Equalization groups general merchandise retailers and drug stores into one "general merchandise" category. Drug store sales have been removed so the per household sales estimates are representative of true general merchandise store sales only. The estimates presented above are based on taxable sales, thus excluding most if not all food-related sales that may occur at general merchandise stores which include grocery components.

Sources: California Board of Equalization; U.S. Census Bureau, American Community Survey; Gruen Gruen + Associates.

The results of the comparison between household income and general merchandise sales indicate a "general merchandise store" expenditure rate of 5.4 to 5.8 percent of household income since 2000.

Estimated Expenditure Potential for General Merchandise Goods at Alternative Expenditure Assumptions

Below, we present estimates of expenditure potential for general merchandise goods based on the broader range of store formats and categories in which such goods can be purchased and based on the narrowly defined category of general merchandise stores.

Table IV-4 shows estimates of demand for the type of goods typically sold at a Target store, including apparel and accessories, home furnishings and décor, electronics, entertainment items, sporting goods, toys**,** personal care products, and reading materials. The estimates reflect the assumption that approximately 5.5 percent to 9.0 percent of household income is spent on general merchandise goods in the primary trade area.

TABLE IV-4

Estimate of Demand for General Merchandise Goods in Primary Trade Area: 2008 and 2013[1]

	2008 $	2013 $
Assuming Expenditure Rate of 9.0 Percent of Household Income at General Merchandise and Other Stores[2]		
Estimated Total Household Income	5,335,331,000	6,053,944,000
Potential Purchasing Power for General Merchandise Goods Available at General Merchandise and Other Stores	480,180,000	544,855,000
Total Additional Purchasing Power for General Merchandise Goods	---	64,675,000
Assuming Expenditure Rate of 5.5 Percent of Household Income at General Merchandise Stores Only		
Potential Purchasing Power for General Merchandise Goods Available at General Merchandise Stores Only	293,433,000	332,967,000
Total Additional Purchasing Power for General Merchandise Stores Only	---	39,534,000

[1] Figures are rounded.
[2] Includes laundry/cleaning supplies and other household products, postage/stationary, household textiles and floor coverings, furniture, small appliances and housewares, miscellaneous household equipment, women's, men's and children's apparel, footwear, television, radio, and sound equipment, pets, toys, hobby and playground equipment, other entertainment equipment/services, personal care products, and reading materials.

Sources: Claritas, Inc., Household Trend Report; Bureau of Labor Statistics, Consumer Expenditure Survey 2006; Gruen Gruen + Associates.

Based on the estimated total household income within the primary trade area of $5.3 billion and an expenditure rate of nine percent for general merchandise goods available from a variety of store formats, potential demand for general merchandise goods is estimated to total $480.2 million in 2008 within the primary trade area. Applying the expenditure rate estimate to the forecast $6.1 billion total household income for 2013 produces a demand estimate for general merchandise goods of $544.9 million. This equates to an increase in demand between 2008 and 2013 of 13.5 percent, or $64.7 million.

Using the lower 5.5 percent estimated household income expenditure rate at general merchandise stores only produces an estimate of demand for general merchandise goods at general merchandise stores such as Target of $293.4 million in 2008 and nearly $333.0 million in 2013. Demand for general merchandise stores goods within the primary market area is forecast to increase by $39.5 million between 2008 and 2013, using the 5.5 percent expenditure rate.

ESTIMATED SUPPORTABLE SPACE DEMAND

Sales Thresholds for All Types of Retail Goods and Services

In order to convert estimates of expenditure potential or purchasing power into estimates of the amount of on-the-ground retail space which can be supported, an assumption must be made as to the average or range of sales per square foot required for tenants to viably operate and landlords to obtain high enough rents to amortize development costs and provide an acceptable return on investment. Table IV-5 presents the average size and average sales per square foot productivity of shopping center formats found within the primary trade area. Table IV-5 also summarizes the national averages for many major retailers located within the primary trade area.

TABLE IV-5

Sales Per-Square-Foot Averages by Type and Size of Shopping Center and for Individual Retailers

	Average Store Size # Square Feet	Average Sales $ Per Square Foot
2006 Dollars & Cents of Shopping Centers [1]		
Neighborhood Center	66,851	343
Community Center	225,878	322
Regional Center	622,452	300
2005 Shopping Center Census [2]		
Less than 100,000 square feet	48,332	284
100,000 – 200,000 square feet	136,875	202
200,000 – 400,000 square feet	271,812	172
Individual Retailers		
Target	130,700	318
Kohl's	76,000	256
Bed Bath & Beyond	31,300	239
Ross Dress for Less	21,100	301
Office Depot	24,400	229
Costco	140,000	543
Staples	20,400	356
Petsmart	23,000	208
Office Max	37,000	255
Rite Aid	12,700	361
Walgreen's	11,200	797
Long's Drug	23,000	615

[1] Taken from the Urban Land Institute's 2006 Dollars and Cents of Shopping Centers survey. Figures are for the Western United States.
[2] Taken from the 2005 NRB CoStar National Shopping Center Census. Figures are for the State of California.

Sources: Urban Land Institute; National Research Bureau; CoStar; Annual 10-K Reports of Individual Retailers Listed; Gruen Gruen + Associates.

The shopping center size and sales productivity data are drawn from the Urban Land Institute's Dollars & Cents of Shopping Centers 2006 edition, CoStar's 2005 National Shopping Center Census, and annual reports for the individual retailers listed.

As shown above, according to the Urban Land Institute survey, neighborhood, community and regional centers in the Western United States obtain annual sales ranging from approximately $300 to $343 per square foot. In 2005, CoStar estimates that centers ranging in size from approximately 50,000 to 400,000 square feet obtain sales ranging from $172 to $284 per square foot. Both surveys indicate that as the size of the shopping center increases, overall sales decrease on a per square foot basis. This is likely attributable to the tenancies of smaller neighborhood shopping centers which are often anchored by grocery and/or pharmacy retailers. Anchor grocery stores typically need to generate higher sales because of low per unit margins. Grocery and pharmacy retailers such as Safeway, Rite Aid, Long's Drug and Walgreen's obtain higher annual sales ranging from approximately $361 to $797 per square foot. Sales for pharmacy retailers tend toward the higher end of the range because a majority of sales are prescription drugs and because of the high volume of transactions for convenience and necessity items in a relatively small amount of space.[18]

Table IV-5 also presents estimates of the average store size and sales per square foot productivity for some of the major broad-line retailers already operating within the primary trade area as described above in Chapter III. The major big box retail stores generate sales ranging from $189 to $615 per square foot. To estimate the amount of general merchandise space the estimated expenditure potential or demand for general merchandise goods can support, we use a required sales threshold of $350 per square foot.

Estimated Amount of Supportable General Merchandise Space Within Primary Trade Area

Table IV-6 shows the estimated amount of supportable general merchandise space in the primary trade area from 2008 to 2013 based on the estimates of expenditure potential or demand for general merchandise goods.

[18] According to Walgreen's 2007 Annual Report, approximately 25 percent of its sales were attributable to general merchandise items. Rite-Aid reports in its 2007 Annual Report that 33 percent of its sales were attributable to items other than prescription drugs.

TABLE IV-6

Estimated Amount of Supportable General Merchandise Space in the Primary Trade Area[1]: 2008-2013

	2008	2013
Assumes 9.0 Percent Expenditure Rate of Household Income at General Merchandise and Other Stores		
Potential Purchasing Power for General Merchandise Goods Available at General Merchandise and Other Stores	$480,180,000	$544,855,000
Amount of Supportable General Merchandise Space in Square Feet @ $350 per Square Foot	1,372,000	1,557,000
Assumes 5.5 Percent Expenditure Rate of Household Income at General Merchandise Stores Only		
Potential Purchasing Power for General Merchandise Goods Available at General Merchandise Stores Only	$293,433,000	$332,967,000
Amount of Supportable General Merchandise Space in Square Feet @ $350 per Square Foot	838,000	951,000

[1] Figures are rounded.

Source: Gruen Gruen + Associates

Under the sales threshold of $350 per square foot (and the 9.0 percent household income expenditure rate estimate), demand for general merchandise-type goods in a variety of store formats within the primary trade area is estimated to currently support approximately 1.4 million square feet of space. The amount of general merchandise space in a variety of store formats supported by demand from primary trade area households is estimated to increase by 184,800 square feet of space by 2013 to 1.6 million square feet of space.

Under the sales threshold of $350 per square foot (and the 5.5 percent household income expenditure rate estimate), demand for general merchandise-type goods in general merchandise stores only within the primary trade area is estimated to currently support approximately 838,000 square feet of space. The amount of general merchandise store space supported by demand from primary trade area households is estimated to increase by 113,000 square feet of space by 2013 to 951,000 square feet of space.

ESTIMATED SUPPLY OF GENERAL MERCHANDISE SPACE WITHIN PRIMARY TRADE AREA

Table IV-7 presents an estimate of the amount of general merchandise supply based on tours of the area, interviews with retailers and property owners, and review of secondary supply data. We have included only individual stores and shopping centers that provide goods similar to those available at the proposed Target store. Thus, we do not include grocery stores because the proposed Target will not include a significant grocery component and because the expenditure potential estimates presented above do not include expenditures for groceries. Only approximately 25 percent of drug store space is devoted to general merchandise items. Many of the drug stores are located far from the proposed Target store. Therefore, these store are unlikely to directly compete with the Target store.

To be conservative however, we include all of the drug stores in the supply identification. We also include category-specific big-box retailers such as Best Buy and Bed Bath & Beyond because (although they are not general merchandise retailers) they are likely to compete with Target for sales dollars attributable to consumer electronic and houseware goods. In addition, we include all of the Costco space even though approximately 31 percent of sales from Costco stores are for grocery related items.

TABLE IV-7

General Merchandise Supply Within Primary Trade Area

Center / Store	Location	Estimated Amount of Space # Square Feet
General Merchandise Stores		
Kmart	Scotts Valley	55,000
Dollar Tree	Scotts Valley	12,000
Costco[2]	Santa Cruz	110,000
Dollar Tree	Santa Cruz	11,000
Capitola Mall Department Stores (Macys, Sears, Gottschalk's)	Capitola	315,000
Drug and Other Potentially Competitive Stores		
Long's Drug[1]	Scotts Valley	25,000
Walgreen's[1]	Scotts Valley	15,000
Long's Drug[1]	Felton	25,000
Rite-Aid[1]	Felton	12,000
Gateway Plaza (Cost Plus, Ross, Office Max, Petsmart)	Santa Cruz	119,000
Long's Drug – Mission Street[1]	Santa Cruz	24,000
Long's Drug – Downtown[1]	Santa Cruz	22,000
Rite-Aid [1]	Santa Cruz	23,000
Walgreen's[1]	Santa Cruz	39,000
Best Buy	Soquel	30,000
Bed Bath & Beyond	Capitola	30,000
Long's Drug[1]	Capitola	24,000
Rite-Aid[1]	Capitola	22,000
Total Primary Trade Area		**913,000**

[1] According to Walgreen's 2007 Annual Report, approximately 25 percent of its sales were attributable to general merchandise items. Rite-Aid reports in its 2007 Annual Report that 33 percent of its sales were attributable to items other than prescription drugs.
[2] According to Costco's 2007 Annual Report, grocery and food-related sales accounted for 31 percent of their total sales.

Source: Gruen Gruen + Associates

The primary trade area is estimated to include approximately 913,000 square feet of general merchandise space and community-serving space including department stores and categories of goods such as electronics, home furnishings and décor, apparel and accessories that will be available in the proposed Target store. The supply of true general merchandise space is estimated to total approximately 500,000 square feet. As indicated above, the Kmart store in Scotts Valley is the only "full service" general merchandise store. The other existing general merchandise retailers in Scotts Valley consist of Dollar Tree with only items with a one dollar price point and drug stores offering convenience items with a limited array of soft goods. While the leasing agent for Capitola Mall does not expect the proposed Target to directly compete with the full-service department stores at the regional-serving Mall, we have included the 315,000 square feet of department store space in the supply.

RELATIONSHIP BETWEEN SUPPLY AND DEMAND FOR GENERAL MERCHANDISE GOODS

Table IV-8 shows the relationship between estimated household demand for and supply of goods found at general merchandise stores in the primary trade area.

TABLE IV-8

Relationship Between Estimated Demand for and Supply of General Merchandise Space

	2008 Square Feet #	2013 Square Feet[1] #
Amount of Supportable General Merchandise Space in Square Feet @ $350 per Square Foot @ 9.0 Percent Expenditure Rate Estimate	1,372,000	1,557,000
Total Primary Trade Area General Merchandise Space of All Types of Stores	913,000	1,056,000
Unmet Demand for General Merchandise Space	**459,000**	**501,000**
Amount of Supportable General Merchandise Space in Square Feet @ $350 per Square Foot @ 5.5 Percent Expenditure Rate Estimate	838,000	951,000
Total Primary Trade Area General Merchandise Store Space	503,000	646,000
Unmet Demand for General Merchandise Space	**335,000**	**305,000**

[1] Supply of General Merchandise space in 2013 includes the proposed Target store of 143,000 square feet.

Source: Gruen Gruen + Associates

Comparing demand for general merchandise goods in a variety of store formats of approximately 1.4 million square feet to the existing supply of general merchandise space in all formats (including regional mall anchor department stores and drug stores) of approximately 913,000 square feet of space indicates unmet demand of 459,000 square feet of space. Due to the growth in purchasing power in the primary trade area, the amount of unmet demand is estimated to increase to 501,000 square feet by 2013. We have included in the 2013 estimate of supply the proposed Target store. This raises the supply of general merchandise space by 143,000 square feet of space to 1.1 million square feet of general merchandise space of all types of stores.

Comparing the estimated demand for general merchandise store formats only of 838,000 square feet of space in 2008 to the supply of true general merchandise space, including warehouse membership stores and full-service department stores, produces an estimate of unmet demand of approximately 335,000 square feet in 2008. Assuming the addition of the proposed Target store, the amount of unmet demand for general merchandise store space only is estimated to approximate 305,000 square feet of space by 2013.

The implications of the demand-supply analysis for the competitive effects of the development of the proposed Target store in Scotts Valley are described in Chapter VI.

CHAPTER V

LEAKAGE OF RETAIL EXPENDITURE POTENTIAL IN SCOTTS VALLEY AND THE RELATIONSHIP BETWEEN RETAIL SPACE DEMAND AND SUPPLY WITHIN THE PRIMARY TRADE AREA

PURPOSE OF ANALYSIS OF RETAIL SALES

The analysis of Scotts Valley sales by retail category relative to the estimated expenditure potential by Scotts Valley residents presented below provides general perspective on the direct and indirect impacts that the proposed Target store is likely to have on leakage, or the dollars spent outside of Scotts Valley for retail goods, and in-flows to Scotts Valley. The results of the analysis support the findings drawn from the interviews and field research described above that some sales dollars leak out of the community for general merchandise, apparel, home furnishings and appliances, building materials, and other retail stores. Information on sales in Target stores outside the trade area attributable to households within the primary trade area also point to leakage of sales dollars out of Scotts Valley in the general merchandise category. Point-of-sale survey data indicates that approximately $3 million[19] in annual sales at Target stores in the region, primarily Watsonville, are attributable to Scotts Valley residents.

ANALYSIS OF TAXABLE RETAIL SALES IN SCOTTS VALLEY

Table V-1 presents annual taxable retail sales in the City of Scotts Valley, in constant 2008 dollars, from 1996 through 2006. In other words, the sales dollars have been adjusted to take into account inflation.

[19] According to Target, in 2006, Scotts Valley residents made 48,000 credit card transactions at Target stores. According to Target, given credit card purchases account for approximately 60 percent of sales, and the average transaction value approximated $37, this would indicate that Scotts Valley residents alone spent approximately $2.96 million at existing Target stores last year.

TABLE V-1

Taxable Retail Sales in City of Scotts Valley: 1996-2006 (Constant 2008 Dollars)[1]

Category	1996 $000	1997 $000	1998 $000	1999 $000	2000 $000	2001 $000	2002 $000	2003 $000	2004 $000	2005 $000	2006 $000	Change 1996-2006 $000	Average Annual Growth Rate 1996-2006 %
Apparel stores	1,133	1,208	1,145	1,042	1,244	1,012	991	1,169	1,390	1,597	1,487	354	2.8
General merchandise stores[2]	N/A	20,269	20,921	21,313	22,895	25,654	25,122	28,756	26,970	27,929	28,602	8,333	3.9
Food stores[3]	15,848	16,387	15,364	16,063	15,676	17,973	17,355	16,838	16,519	17,853	19,428	3,580	2.1
Eating & drinking places	18,809	16,892	18,426	17,789	19,102	19,478	17,646	18,361	18,455	18,174	19,672	863	0.4
Home furnishings & appliances	1,148	1,791	3,032	3,036	3,713	2,425	2,781	2,395	2,320	2,293	2,505	1,357	8.1
Building materials	5,384	5,879	5,833	6,892	7,663	6,731	7,612	N/A	N/A	N/A	N/A	N/A	N/A
Other retail stores	45,033	30,125	27,307	25,184	33,296	34,404	32,611	53,037	49,287	50,748	35,435	-9,598	-2.4
Total non-automotive[4]	**87,355**	**92,550**	**92,028**	**91,319**	**103,589**	**107,677**	**104,118**	**120,557**	**114,941**	**118,594**	**107,129**	**19,774**	**2.1**
Auto dealers / supplies	17,283	16,712	18,826	19,377	16,653	12,250	10,268	N/A	N/A	N/A	8,504	-8,779	-6.8
Service stations	41,506	40,420	38,744	38,592	38,175	37,577	37,381	33,676	30,495	34,566	36,020	-5,486	-1.4
Total including automotive	146,145	149,682	149,598	149,288	158,418	157,504	151,767	154,233	145,436	153,160	151,653	5,508	0.4

[1] "N/A" designates sales that were not reported due to disclosure requirements. Categories for which sales were not reported in certain years (such as general merchandise, building materials or auto dealers) were classified under "other retail stores".

[2] Includes drug stores.

[3] Not all food store sales are taxable. Thus, reported sales figures are lower than actual sales. Comparison of taxable food store sales reported by the BOE to the Census of Retail Trade for the State of California as-a-whole indicates that approximately 30 percent of food store sales are taxable.

[4] For years in which automotive dealer and supplier sales were not reported individually, they are included in this total. Thus, total non-automotive sales for 2003 through 2005 are overstated because some automotive sales are actually included.

Sources: California State Board of Equalization, Research and Statistics Division; Bureau of Labor Statistics; Gruen Gruen + Associates.

Total non-automotive retail sales within Scotts Valley grew at an annual rate of approximately two percent, increasing by $19.8 million between 1996 and 2006. Much of the sales growth can be attributed to the general merchandise category which increased by $8.3 million or 41 percent between 1997 and 2006. General merchandise (which includes drug stores) and "other" or miscellaneous retailers comprise the two largest sources of taxable sales within Scotts Valley, collectively accounting for approximately 60 percent of total non-automotive sales. Food stores and eating and drinking establishments comprise the third and fourth largest source of taxable sales at $19.4 million and $19.7 million respectively. Apparel and household furnishings and appliances each account for less than four percent of the total taxable sales base. This is to be expected because few individual apparel and home furnishing stores operate in Scotts Valley. The food category sales reported are lower than actual sales because grocery sales for non-consumption are not taxed in California. We estimate the food store taxable sales of $19.4 million in 2006 account for approximately 30 percent of total food store sales (See Table V-1). Therefore, it is likely the food stores sales approximated nearly $65 million in 2006.

COMPARISON OF EXPENDITURE POTENTIAL TO RETAIL SALES

To identify whether more sales are secured from non-residents than sales are lost to retailers outside Scotts Valley (the net "surplus" or "leakage"), we compared the estimated expenditure potential by major retail categories to the sales for the same categories in Scotts Valley. Table V-2 presents the comparison of the actual sales by retail category in 2006 (the most recent year for which sales data is available) for Scotts Valley to the estimated expenditure potential of Scotts Valley households by retail category. Table V-2 below presents actual reported sales in 2006 (i.e., sales have not been adjusted for inflation).

TABLE V-2

Estimated Surplus and Leakage by Retail Category: Scotts Valley 2006

Category	Retail Sales[1] $	Estimated Expenditures[2] $	Surplus/(Leakage) $
Apparel Stores	1,468,000	10,282,000	(8,814,000)
General Merchandise Stores	27,235,000	30,730,000	(3,495,000)
Food Stores[3]	59,240,000	37,790,000	21,450,000
Eating & Drinking Places	18,379,000	25,527,000	(7,148,000)
Home Furnishings & Appliances	2,499,000	9,014,000	(6,515,000)
Building Materials & Other Retail Stores	33,742,000	55,140,000	(21,398,000)
Total	**142,563,000**	**168,483,000**	**(25,920,000)**

[1] Actual sales (not adjusted for inflation).
[2] Estimates based on expenditure rates that were applied to total household income within Scotts Valley. The expenditure rates were calculated by dividing total household income within the State of California by total retail sales within the State (by category) to derive an estimate of the proportion of household income spent by type of store. The percentages were then applied to the household income of Scotts Valley residents.
[3] Assumes that 30 percent of sales made at food stores are taxable. Comparison of taxable food store sales reported by the BOE to the Census of Retail Trade for the State of California as-a-whole indicates that approximately 30 percent of food store sales are taxable.

Sources: State of California Board of Equalization; California Department of Finance; Census Bureau's American Community Survey; Gruen Gruen + Associates,

Consistent with the lack of regional mall, community center, power center, outlet center, and lifestyle retail development formats and the limited supply of comparison and shopper good retailers and ample supply of grocery- and drug-anchored neighborhood shopping centers in Scotts Valley, the analysis indicates that Scotts Valley attracts in-flow of dollars from non-residents for food uses and experiences out-flows of dollars for other retail categories. The sales leakage is particularly high in the apparel, household furnishings, and building materials categories.

Consistent with the results of the analysis of the make-up of Scotts Valley retail space supply and interviews, the analysis of sales relative to expenditure potential indicates that the convenience and necessity-oriented retail base of Scotts Valley attracts households in communities in San Lorenzo Valley that have not reached sufficient population size thresholds to support grocery- and drug-anchored neighborhood retail centers in their communities. Because of the limited supply of comparison and shopper good retail space in Scotts Valley given its relatively small population base and presence of the regional-serving Capitola Mall and other large-scale retail agglomerations in Santa Cruz and in Santa Clara, where many area residents work, leakage occurs in the comparison and shopper good categories.

Estimates of expenditure potential are derived based on (1) estimating 2006 household income in Scotts Valley; and (2) multiplying the estimated household income in Scotts Valley by the estimated percentages of income expended on varying retail categories for the State as-a-whole. The estimates of expenditure rates are drawn from an analysis of State of

California Board of Equalization sales data, California Finance Department household estimates and American Community Survey income data.[20]

ESTIMATED DEMAND FOR RETAIL SPACE IN THE PRIMARY TRADE AREA

This section extends the demand analysis presented in Chapter IV about general merchandise goods and space to cover retail demand as a whole in the primary trade area.

Expenditure Rate for Retail Goods

Based on the Bureau of Labor Statistics' *Consumer Expenditure Survey* 2006 for the Western region, Table V-3 shows that approximately 20 to 25 percent of income is spent on most retail goods and services.

TABLE V-3

Average Annual Expenditures as a Function of Before-Tax Income for Western Region Households: 2006

Type of Good	Average Annual Expenditures For All Households (2006)[1] %	Average Annual Expenditures For Higher-Income Households (2006)[2] %
Food at Home (Groceries)	6.0	3.9
Food Away From Home	4.7	3.5
Alcoholic Beverages	1.0	0.7
Housekeeping Supplies[3]	1.0	0.7
Household Furnishings & Equipment	3.4	3.0
Apparel & Services [4]	3.2	2.4
Entertainment [5]	4.4	4.2
Personal Care Products & Services	1.0	0.8
Reading	0.2	0.2
Tobacco Products & Smoking Supplies	0.4	0.2
TOTAL	**25.4**	**19.6**

[1] Income before taxes for all Western Region households is reported at $66,955.
[2] Income before taxes for higher-income ($70,000 and above) Western Region households is reported at $132,448.
[3] Includes lawn and garden supplies.
[4] Includes clothing items, footwear, jewelry, and laundry services.
[5] Includes television, radios and sound equipment, pets, toys, hobbies, and services, in addition to admission fees to sporting events, amusement parks, movies, etc.

Sources: 2006 Consumer Expenditure Survey, Bureau of Labor Statistics; Gruen Gruen + Associates.

[20] The comparison of Statewide sales by retail category to household income as a whole indicates that households in California expend approximately 2.1 percent of income on apparel, 6.3 percent of income on general merchandise, 7.7 percent on food, 5.2 percent on easting and drinking places, 1.9 percent on household furnishings and appliances, 3.9 percent on building materials, and 7.5 percent of income on other retail stores.

These goods and services include groceries, food and beverages, drugs, household supplies, lawn and garden supplies, personal care products and services, tobacco products, apparel, household furnishings and equipment, books and magazines, pet supplies, and entertainment.

Estimated Primary Trade Area Retail Expenditure Potential for All Retail Goods

To estimate retail demand or expenditure potential for all retail goods within the primary trade area, given the average household income of primary trade area residents and the results of the Consumer Expenditure Survey, we apply an expenditure rate of 22 percent to the total household income estimate first presented in Table IV-1. Table V-4 presents the demand estimates for all retail goods for 2008 and 2013.

TABLE V-4

Estimate of Retail Demand for Primary Trade Area[1]: 2008 and 2013

	2008 $	2013 $
Estimated Total Household Income	5,335,331,000	6,053,944,000
Potential Purchasing Power for Retail Goods Assuming Expenditure Rate of 22 Percent of Household Income	1,173,773,000	1,331,868,000
Total Additional Dollars Available for Retail Goods	------	158,095,000

[1] Figures are rounded.

Sources: Bureau of Labor Statistics, *Consumer Expenditure Survey 2006* Western Region; Gruen Gruen + Associates.

Multiplying the estimated total 2008 household income of $5.3 billion within the primary trade area by the estimated expenditure rate of 22 percent produces an estimate of 2008 expenditure potential or retail demand of approximately $1.2 billion. Based on the estimated number of primary trade area households of 59,590, the total expenditure potential estimate approximates $19,700 per household. Due to the forecast growth in the number of households and the anticipated increase in average household income, by 2013 estimated expenditure potential or retail demand within the primary trade area is forecast to increase by about 13.5 percent or $158 million to over $1.3 billion.

Estimated Amount of Supportable Retail Space

In order to convert estimates of potential retail demand or expenditure potential into estimates of supportable on-the-ground retail space, an assumption must be made as to the average sales per square foot required to support viable retail uses. To reflect the need to obtain higher rents to amortize higher development costs associated with new retail facilities, and given that many of the existing neighborhood centers in Scotts Valley contain grocery stores, which because of their low margins need to obtain higher sales to be viable, we use the $350 per square foot sales threshold used above to evaluate demand for general merchandise. This sales threshold converts potential purchasing power into an estimate of the amount of space the projected retail expenditure potential can support in the primary trade area. Table V-5 shows that at a required sales threshold of $350 per square foot, the primary trade area is estimated to be able to support approximately 3.4 million square feet of space in 2008. In 2013, using the $350 per square foot sales threshold, the primary trade area is estimated to be able to support approximately 3.8 million square feet of space, an increase of 450,000 square feet of retail space from 2008.

TABLE V-5

Estimated Supportable Retail Space in the Primary Trade Area: 2008 and 2013[1]

	2008	2013
Estimated Expenditure Potential or Retail Demand	$1,173,773,000	$1,331,868,000
Estimated Total Supportable Retail Space in Square Feet @ $350 Per-Square-Foot Sales Threshold	3,354,000	3,805,000
Additional Supportable Retail Space in Square Feet 2008 - 2013	------	451,000

[1] Figures are rounded.

Source: Gruen Gruen + Associates

ESTIMATED SUPPLY OF RETAIL SPACE IN THE PRIMARY TRADE AREA

EXISTING RETAIL SPACE SUPPLY

As described in Chapter III, the primary trade area is estimated to include approximately 579,000 square feet of retail space in Scotts Valley and approximately 2,420,000 square feet of additional retail space located elsewhere in the primary trade area (including Downtown Santa Cruz and the Capitola Mall) for a total supply of approximately 3.0 million square feet of space. This supply includes grocery stores and other stores outside of Scotts Valley unlikely to be competitive with the proposed Target store.

POTENTIAL FUTURE RETAIL SPACE SUPPLY

We obtained information from the communities of Scotts Valley, Capitola, and Santa Cruz about potential retail space development The primary potential future supply of retail space consists of the proposed Target store of 143,000 square feet. The other primary potential future retail supply is the planned Town Center described in the Town Center Specific Plan. The Specific Plan indicates a potential project size of 310,000 square feet of space. The representative of the developer with which Scotts Valley is currently working, Stanbery Development, indicated that the proposed Target store is a very different product than the specialty "lifestyle" center the developer is pursuing. The lifestyle center would feature specialty merchants offering nonessential goods and higher-end restaurants than currently available in Scotts Valley. According to the developer, the marketing rationale for the project is to attract households which currently leave the area to shop in Santa Clara County and to attract Santa Cruz County residents seeking a different shopping environment and higher-end merchandise mix than available from the Capitola Mall. The would-be developer of the potential Town Center project does not view the proposed Target store as competition, but expects that the Target store would help to attract customers to the Town Center project that would otherwise not come to Scotts Valley.

According to the City of Scotts Valley, another approximately three potential developments including approximately 47,000 square feet of commercial space are proposed or in various phases of the planning process.

RELATIONSHIP BETWEEN ESTIMATED RETAIL DEMAND AND SUPPLY

Table V-6 presents the relationship between the estimated square feet of all retail space the forecast demand from households within the primary trade area can support in 2008 and 2013 and the current and potential future supply of retail space in the primary trade area.

TABLE V-6

Relationship Between Retail Supply and Demand in the Primary Trade Area: 2008 and 2013

	2008 # Square Feet	2013 # Square Feet
Estimated Total Supportable Retail Space in Square Feet @ $350 Per-Square-Foot Sales Threshold	3,354,000	3,805,000
Estimated Existing Supply of Retail Space	3,000,000	
Estimated Amount of Unmet Retail Space Demand	**354,000**	
Estimated Existing Plus Potential Future Supply of Retail Space		3,500,000[1]
Estimated Amount of Unmet Retail Space Demand		**305,000**

[1] Includes proposed Target store, the proposed Town Center development and 47,000 square feet of other planned commercial space.

Source: Gruen Gruen + Associates

Within the primary trade area, the estimated amount of supportable retail space of approximately 3.4 million square feet of space is estimated to exceed the total amount of existing retail space by approximately 354,000 square feet of space.

Assuming that all of the proposed retail supply additions (including the Town Center) are built by 2013, unmet demand within the primary trade area would still be available at 305,000 square feet of retail space.

CHAPTER VI

AN ESTIMATE OF THE EFFECT THAT THE TARGET STORE WILL HAVE ON THE RETAIL SALES BASE OF SCOTTS VALLEY

INTRODUCTION

This chapter presents a synthesis of the property inspections, interviews, and quantitative demand-supply analysis to assess the likely competitive effects of the operation of the proposed Target store in Scotts Valley.

THE OPERATION OF THE PROPOSED TARGET STORE WILL REDUCE OUT-FLOWS OF CONSUMER EXPENDITURE POTENTIAL AND INCREASE IN-FLOWS OF SALES DOLLARS TO THE RETAIL BASE OF SCOTTS VALLEY

The operation of the proposed Target store will reduce sales leakage to general merchandise, apparel, home furnishings, and other comparison of shopper good stores outside of Scotts Valley. As indicated above, Scotts Valley households expend approximately $3.0 million at other Target stores, including the Watsonville store. Given the time-constrained schedules of many people and the commuting patterns that cause members of many area households to take Mount Hermon Road to access Highway 17 to places of work in Santa Cruz and Santa Clara County, and proximity of the site of the proposed Target store to Highway 17, greater in-flows of sales dollars can be expected from the operation of the Target store.

Based on a synthesis of the research and analysis described above, review of Target's 2007 annual report on its chain-wide sales as well as sales from the operation of 225 stores in California, and other information from Target about customer shopping patterns, we estimate that at stabilization, the Target store will produce gross annual sales of $350 per square foot or $50.0 million.

ASSESSMENT OF POTENTIAL SALES DIVERSION AND COMPETITIVE EFFECTS AS RESULT OF OPENING OF THE PROPOSED TARGET STORE

As indicated in the review of demand and supply conditions as to general merchandise space and retail space as a whole (excluding automotive-related), the magnitude of market demand is sufficient to support the proposed Target store without causing other general merchandise stores to close. That is, the estimated unmet or excess demand relative to supply is more than enough to support the sales requirements of the proposed Target store without requiring the diversion of sales from other general merchandise stores.

While the market conditions suggest that the success of the proposed Target store need not depend upon siphoning off sales from existing stores, some proportion of the sales are likely to represent a shift from other retailers in the primary trade area. Those merchants and retail centers unable to adapt to the constantly changing tastes and preferences of consumers and the retail environment will lose sales. This will occur, irrespective, however, of whether the proposed store is built. The likelihood and extent of sales diversion from existing businesses due to the opening of the proposed Target store will depend upon several primary factors. These include the location and size of stores and degree of differentiation between stores. As indicated by the interview findings summarized in Chapter II, many local businesses and centers have a differentiated combination of location, format, product and service and other features that will help to insulate them from sales diversions due to the entry of the Target store.

The field research, interviews, and review of supply suggest that the primary store likely to suffer sales diversion is the existing Kmart store in Scotts Valley. This is because of Kmart's location within approximately 1.2 miles of the site of the proposed Target store and its status as a discount general merchandise store operating in the same "retail space" or category as Target. In addition as currently presented, the Kmart store is less well organized, less well designed, and dated looking compared to a new Target store. The Kmart store is also smaller and therefore does not offer as many items as will the Target store. Accordingly, the Kmart store is neither as appealing an environment nor as convenient of shopping experience as the Target store is likely to provide. It is difficult to quantify the amount of potential sales diversion. Kmart could choose to respond to the prod of competition by updating its facility and improving its merchandise mix and service. We have estimated for the fiscal and economic impact analysis presented in the next two chapters that the opening of the proposed Target store will cause a reduction in Kmart sales of $50 per square foot. The interview with the owner of the shopping center and review of sales data indicate that Kmart currently generates sales of $250 to $275 per square foot. A sales diversion of $50 per square foot or $2,750,000 would equate to a sales decline of approximately 18 percent to 20 percent.

As indicated in Chapter II, given the favorable market demand-supply conditions, the desirable location within a vital commercial area, should the Kmart store close due to the chain's struggles as a whole or because of the entry of the proposed Target store, the building would be re-tenanted within a reasonable time.[21] The representative of Scotts Valley Square anticipates that it will be feasible to replace Kmart with category-killer and junior big box retailers not present in Scotts Valley that would generate higher sales per square foot and sales spillover to adjoining stores.

The principal competitive effect of the operation of the proposed Target store will be to increase general merchandise shopping opportunities within the primary trade area, reduce leakage out of Scotts Valley, and increase net annual sales in Scotts Valley. The opening of the proposed Target store will also serve to generate increased sales spillover to the nearby commercial uses such as Scotts Valley Corners and potentially other retail centers because of the attraction of shoppers which otherwise would be unlikely to visit Scotts Valley retailers or which would visit the retail base more often because of the addition of the proposed Target store. The operation of the proposed Target store is not likely to produce competitive economic impacts that will result in urban deterioration and decay.

[21] Kmart has already closed many stores and analysts indicate concern about the ability of Sears, the owner of Kmart, to continue as a retailer if it has a poor holiday season. See, for example, Chicago Tribune article dated November 18, 2008 entitled "Sears' future hanging on holiday sales".

CHAPTER VII

FISCAL IMPACT OF THE PROPOSED TARGET STORE

INTRODUCTION

This chapter summarizes the evaluation by GG+A of the net fiscal impacts to the City of Scotts Valley likely to result from the development and operation of the proposed 143,000-square-foot Target store. To evaluate the net fiscal impact of the proposed development on the City's General Fund, we estimated the revenues the proposed store is likely to generate. We then estimated the General Fund expenditures the proposed store is likely to induce. We then compared the estimated annual revenues and annual operating expenditures associated with the proposed Target development.

Because this analysis addresses the long-run rather than the short-run fiscal effects of the proposed development, this analysis excludes all short-run fiscal impacts associated with infrastructure and other capital items, including one-time property transfer tax. The revenues and costs associated with the process of development are excluded. In other words, permit, plan checking, building inspection and other development process fees are assumed to be set at rates that will offset service costs. The net fiscal impacts presented in the following section are representative of the first full year in which the Target store is expected to be open and operating.

METHODOLOGICAL APPROACH

This fiscal impact analysis is based on a review of the Scotts Valley Budget, interviews with representatives of departments of the City of Scotts Valley, information obtained from representatives of Target, and a review and analysis of secondary data sources. For categories such as property taxes and sales taxes that can be attributed to the specific characteristics of the proposed development, we draw on these specific characteristics in making the revenue estimates. The specific methodologies used to estimate each cost or revenue item are discussed in the appropriate section of this chapter.

2008 CONSTANT DOLLARS

All cost and revenue projections in this report are expressed in constant 2008 dollars. That is, the possible effects of inflation or deflation on both municipal revenues and costs are ignored.

DEMOGRAPHIC AND EMPLOYMENT BASELINE ASSUMPTIONS

In estimating revenues, we have assumed that current tax and fee structures remain constant (with the exception of Measure C which is assumed to expire prior to the opening of the proposed Target store). Table VII-1 presents estimates of current population, housing, and employment (jobs) within the City of Scotts Valley from which some of the municipal revenue and expenditure estimates in this chapter are derived.

TABLE VII-1

Baseline Assumptions

	2008 Estimate #
Population	11,700
Households	4,490
Employment (Jobs)[1]	11,000

[1] Association of Monterey Bay Area Government projections indicate total employment of 10,843 in 2005, and projected employment of 11,839 in 2010.

Sources: California Department of Finance; Association of Monterey Bay Area Governments; Gruen Gruen + Associates.

Scotts Valley's population is estimated at 11,700 persons in 2008. Scotts Valley is estimated to contain approximately 4,490 households. Based on Association of Monterey Bay Area Government projections, employment in 2008 in Scotts Valley is estimated to approximate 11,000 jobs.

ESTIMATE OF GENERAL FUND REVENUES LIKELY TO BE GENERATED BY THE PROPOSED TARGET DEVELOPMENT

General Fund revenues are derived from a wide variety of sources, including taxes, fees, fines, state subventions, and other forms of revenue. The primary General Fund revenues that will be induced by the development of the proposed Target store include:

- Sales tax;
- Property tax;
- Utility users tax;
- Franchise fees (refuse, electric, and gas); and
- Business license tax.

Indirect revenue sources such as fines and forfeitures may result, but these are not estimated. As indicated above, building permits and other revenues from fees designed to cover the costs of the services to which they apply are excluded from the net financial calculations presented in this chapter, as are the services they cover.

Table VII-2 summarizes the estimated municipal net General Fund revenues (net of estimated potential lost sales at Kmart) likely to be generated by the operation of the proposed Target store. Overall, the proposed store at stabilization is estimated to contribute approximately $509,200 in total annual revenues to the City of Scotts Valley General Fund.

TABLE VII-2

Estimated Annual General Fund Revenues Induced by Proposed Target Development[1]

Revenue Source	Estimated Annual Revenue $
Sales Tax[2]	473,000
Property Tax	8,400
Utility Users Tax (gas and electric)	13,000
Franchise Fees (refuse, gas and electric)	8,100
Business License Tax	6,700
Total Annual Revenues Attributable to Proposed Target Store	**509,200**

[1] Figures are rounded.
[2] As described below in Table VII-3, the net sales tax estimate reflects an estimated reduction in the sales of the existing Kmart store.

Sources: City of Scotts Valley; Gruen Gruen + Associates.

The following sections of this chapter present the estimates of the revenues summarized above that the proposed Target store is estimated to generate for the City of Scotts Valley through sales taxes and other revenues.

SALES TAX

As described in Chapter VI, we estimate that in its first full year of stabilized operations, the Target store will produce sales of approximately $350 per square foot, or total sales of $50 million. As also described in Chapter IV and Chapter V, the results of the demand-supply market analysis indicate sufficient demand exists to support the proposed Target store without requiring the Target store to siphon sales from existing retailers in order to succeed. The operation of the Target store, however, may siphon off sales from the existing 55,000-square-foot Kmart store because the Kmart store is relatively small, old, poorly-merchandised and part of a struggling national chain. We assume that because of the limited supply competition relative to demand for general merchandise goods, the impact of Target will not be so severe so as to cause the existing Kmart store to close. If the Kmart store were to close, this would permit the landlord to bring in more consumer responsive retailers capable of generating higher sales than the Kmart store. The interviews indicate that Kmart currently generates sales of $250 to $275 per square foot. We assume that sales diversion from Kmart of approximately $50 per square foot will occur. This would equate to a sales decline of approximately 18 percent to 20 percent. Table VII-3 summarizes the estimated annual net sales tax revenues likely to be produced by Target for the General Fund in its first full year of stabilized operation.

TABLE VII-3 Net Annual Sales Tax Revenue Produced by Proposed Target Development	
Gross Sales Generated by Target @ $350 Per Square Foot	$50,050,000
Potential Sales Diversion from Existing Kmart at $50 Per Square Foot	$2,750,000
Net Additional Sales Generated by Target	$47,300,000
Net Additional Sales Tax Revenue @ 1% of Net Sales	**$473,000**
Sources: City of Scotts Valley; Gruen Gruen + Associates.	

We make an estimate of the net incremental new sales tax generated by the opening of the Target store by reducing the annual gross sales estimate of $350 per square foot or $50,050,000 by the estimated potential sales diversion from Kmart of $2,750,000 (55,000 square feet multiplied by $50 per square foot). This equates to a net annual sales impact of approximately $47,300,000. To be conservative, we do not consider the potential for the Target to generate sales spillover for other retailers in Scotts Valley.

According to the City of Scotts Valley, the General Fund receives one percent of sales made within the City. The temporary Measure C sales tax levy is assumed to expire prior to the first year in which the proposed Target store begins operating. Multiplying the estimated annual net sales of $47,300,000 by the one percent sales tax rate results in estimated sales tax for the General Fund of Scotts Valley of $473,000.

PROPERTY TAX

Property tax revenues received by the General Fund depend upon: (a) the assessed valuation of the property in the development; and (b) the allocation of the tax rate. Table VII-4 summarizes the estimated annual property tax revenue likely to be produced by the development of the Target store for the General Fund.

TABLE VII-4 Estimated Annual Property Tax Revenue Generated by the Development of the Proposed Target Store	
Total Estimated Construction/Development Costs[1]	$24,000,000
General Fund Property Tax Revenue @ 3.5% of One Percent Property Tax Rate	**$8,400**
[1] Includes site improvements (parking garage) but excludes development fees and soft costs.	
Sources: Target Corporation; City of Scotts Valley; Gruen Gruen + Associates.	

Based on construction cost information provided by Target, we estimate the total taxable assessed value for the Target store will approximate $24 million. According to the City of Scotts Valley, the General Fund receives between approximately 3.5 to 4.0 percent of the total one percent property tax rate. Assuming a General Fund property tax rate of 0.035% (3.5 cents per $100 of assessed value), the development of the proposed Target store is likely to produce annual property tax revenues of approximately $8,400.

UTILITY USERS TAX

The City of Scotts Valley collects utility user taxes on revenues for utilities that are provided by private companies. Utility users taxes covered include natural gas and electricity provided by Pacific Gas & Electric Company ("PG&E"). The General Fund receives four percent of the total revenues collected by PG&E.

Electricity

Because electricity consumption and costs are relatively straightforward to calculate, we use estimates of consumption and electric rates obtained from Target and PG&E. A typical Target store (averaging approximately 130,000 square feet of space) consumes approximately 150,000 kilowatt-hours of electricity each month[22]. On a per-square-foot basis, this equates to approximately 14 kilowatt-hours each year. Thus, the total annual electric consumption by the proposed 143,000-square-foot Target store is estimated to approximate two million kilowatt-hours. According to the current and forecast PG&E commercial rate schedule, the average total rate approximates 15 cents per kilowatt-hour[23]. Table VII-5 summarizes the estimated annual utility users tax revenue likely to be produced by the electricity consumption of the proposed Target store for the General Fund.

TABLE VII-5

Utility User Tax Revenue Attributable to Electricity Consumption of Proposed Target

Average Annual Electric Consumption Per Square Foot	14 kWh
Total Annual Electric Consumption for 143,000-Square-Foot Target Store	2,002,000 kWh
Average Service Rate	$0.15 /kWh
Total Annual Electric Bill	$300,300
Annual General Fund Revenues[1]	**$12,012**
[1] Four percent tax rate.	
Sources: City of Scotts Valley; Pacific Gas & Electric; Target; Gruen Gruen + Associates.	

Multiplying the estimated total consumption by the applicable rate produces an estimate of costs of electricity consumption of approximately $300,300. Multiplying the electricity costs of $300,300 by the four percent tax rate produces an estimate of annual General Fund electricity user tax revenues attributable to the operation of the Target store of approximately $12,000.

Gas

According to Target representatives, the proposed Target store is expected to have a peak natural gas load of approximately 5,000 cubic feet per hour (or approximately 50 therms per hour). A representative of PG&E indicated that big-box retail facilities generally require minimal basic service to provide hot water and heat in the winter months. According to the PG&E representative, depending upon the season, a typical gas bill for a larger big-box store

[22] Target Developer Guide, Edition 2.8, Section 3.1.
[23] A-10 rate schedule for large commercial users (www.pge.com/nots/rates/tariffs/electric.shtml).

may approximate $800 to $1,000 per month to $2,000 to $2,500 per month in the winter. Retail buildings throughout the U.S. consume an average of approximately 31 cubic feet (0.31 therms) of natural gas per square foot of building space per year. Thus, a 143,000-square-foot retail store would consume an average of approximately 44,000 therms of natural gas annually. However, to be conservative given that Target stores on the west coast typically require less gas and heat than most other stores throughout the country, we assume the proposed Target store will consume an average of 0.2 therms per square foot annually (or approximately 29,000 therms). Table VII-6 summarizes the estimated annual utility users tax revenue likely to be produced by the natural gas consumption of the proposed Target store for the General Fund.

TABLE VII-6

Utility User Tax Revenue Attributable to Gas Consumption of Proposed Target

Average Annual Gas Consumption Per Square Foot	0.2 therms
Total Annual Gas Consumption for 143,000-Square-Foot Target Store	28,600 therms
Average Service Rate (for first 4,000 therms of gas consumption)	$0.9863 / therm
Average Service Rate (consumption in excess of 4,000 therms)	$0.7896 / therm
Surcharge[1]	$0.0514 / therm
Total Annual Natural Gas Bill	$24,840
Annual General Fund Revenues[2]	**$994**

[1] Public purpose program surcharge.
[2] Four percent tax rate.

Sources: City of Scotts Valley; Pacific Gas & Electric; Target; Gruen Gruen + Associates.

Based on PG&E's current commercial gas service rate schedule of $0.79 to $0.99 per therm, the proposed Target store is estimated to generate approximately $1,000 in General Fund revenues attributable to its gas consumption.

FRANCHISE FEES

The City of Scotts Valley also collects franchise fees from gas, electric, and refuse service providers within the City. Refuse franchise fees are imposed at a rate of 20 percent of total receipts. Gas and electric franchise fees are imposed at a rate of one-to-two percent of gross receipts or gross receipts per mile, depending upon the computation method. To calculate refuse franchise fees, we utilize information provided by Target and Greenwaste Recovery (the service provider for Scotts Valley). To calculate gas and electric franchise fees, we apply a one percent franchise fee rate to the estimates of total electric and gas consumption (as summarized previously in Tables VII-5 and VII-6). Table VII-7 summarizes the estimates of annual franchise fees attributable to the proposed Target store.

TABLE VII-7

Estimated Annual Franchise Fee Revenues Attributable to Proposed Target

Cost to Collect 42-cubic-yard garbage compactor	$1,337
Annual Collections	18
Annual Refuse Service Costs	$24,066
Annual Refuse Franchise Fee @ 20% of Gross Receipts	$4,813
Total Electricity Bill	$300,300
Additional Electric Franchise Fee Revenues @ 1% of Gross Receipts	$3,003
Total Gas Bill	$24,840
Additional Gas Franchise Fee Revenues @ 1% of Gross Receipts	$248
Total Annual Franchise Fees Attributable to Proposed Target	**$8,064**

Sources: City of Scotts Valley; PG&E; Greenwaste Recover; Target; Gruen Gruen + Associates.

According to Target, a typical store utilizes one 42-cubic-yard refuse container and compactor. The containers are generally filled once or twice a month. According to Greenwaste Recovery (the service provider for Scotts Valley), the cost to collect and dispose of a 42-yard compactor is $1,337 per pick-up. Assuming the Target store fills 18 containers per year, annual refuse franchise fees would total $4,800.

At one percent of gross receipts, annual franchise fees for electric and gas consumption by the proposed Target store are estimated to approximate $3,000 and $250 respectively[24].

BUSINESS LICENSE TAX

The City of Scotts Valley collects license fees from businesses operating within the City. The collection fee for a business is determined by a flat rate and the number of full-time employees (or the full-time employment equivalent) working at the business location. According to the City of Scotts Valley, the flat fee imposed is $50 per business establishment. An additional fee of $40 per full-time employee is also collected.

According to Target, the proposed store is anticipated to employ approximately 200 to 300 workers, one-third of which are expected to be full-time employees. We assume that Target will employ a total of 250 people. We further assume that 84 of these workers will be employed full-time. We also assume that two part-time workers are the equivalent of one full-time worker. Thus, the proposed Target will include a total FTE (full-time equivalent) employment of 167. Table VII-8 shows the estimated annual business license tax revenues attributable to the operation of the proposed Target store.

[24] We assume future franchise fee revenues will be calculated based upon gross receipts within the City (as they were in 2007). Accordingly, the franchise fee rate is one percent. If calculated per mile of utility transmission and distribution lines, the applicable franchise rate would be two percent.

TABLE VII-8

Estimated Annual Business License Tax Revenues Attributable to Proposed Target

Flat Fee	$50
FTE Employment of Target	167
Fee per Full Time Employee	$40
Total Annual Business License Tax	**$6,730**
Sources: City of Scotts Valley; Target; Gruen Gruen + Associates.	

Total annual business license tax revenues attributable to Target, assuming FTE employment of 167 workers, is estimated to approximate $6,700.

ESTIMATED COSTS OF PROVIDING CITY SERVICES INDUCED BY THE PROPOSED TARGET STORE TO THE CITY OF SCOTTS VALLEY

Based on our interviews with municipal staff and analysis of the Budget, the General Fund costs that the City of Scotts Valley will potentially incur in providing public services to the proposed Target development include the following categories:

- Public Safety (Police);
- Public Works; and
- General Government.

Table VII-9 presents the 2008/2009 budgeted expenditures by department for the City of Scotts Valley's General Fund.

TABLE VII-9

2008/2009 City of Scotts Valley General Fund Budgeted Expenditures

Department	2008/2009 Budgeted Expenditures $	2008/2009 Budgeted Expenditures % of Total
General Government	2,569,589	31.0
Public Safety	4,122,030	50.0
Public Works	1,577,844	19.0
Total Departmental Expenditures	8,269,463	100.0

Sources: City of Scotts Valley, 2008/2009 Preliminary Budget; Gruen Gruen + Associates.

According to the City of Scotts Valley, departmental budgeted expenditures for the 2008/2009 fiscal year are estimated to total $8.3 million. Public Safety accounts for the largest source of expenses at approximately 50 percent. General Government and Public Works account for approximately 31 and 19 percent of total expenditures respectively. We use the fiscal year 2008/2009 projected expenditures presented above as a benchmark for estimating General Fund costs likely to be induced by the proposed Target store.

To estimate potential future costs attributable to Target, we also utilize an employee-to-resident service demand metric based on the assumption that every two employees working within the City generate the same level of demand for public services as one resident. Therefore, under this assumption, the City of Scotts Valley currently includes the equivalent of 17,200 residential "service units" (i.e., residential population plus one-half of employment).

Table VII-10 summarizes the estimated total annual costs likely to be induced by the operation of the proposed Target store.

TABLE VII-10

Summary of Estimated Annual Service Costs Induced by the Operation of the Proposed Target Store[1]

Service	Estimated Annual Cost $
General Government	6,240
Public Safety	10,010
Public Works	3,740
Total Costs Attributable to Proposed Target Store	**19,990**

[1] Figures are rounded.

Sources: City of Scotts Valley; Gruen Gruen + Associates.

The following section present the estimates of the expenditures associated with the proposed Target store.

General Government

The cost of providing general government services to the proposed Target store is a function of the increased burden placed on the City's administrative and support services. Typically, general government services contain a significant fixed cost that does not change as the result of new development. Our interviews with the City Manager confirm that much of general government costs are fixed and will not be increased by the addition of the proposed Target store. The development of the proposed Target will not require the City, for example, to increase its level of legislative, administrative, or support staff and salaries. Based on our review of the Budget, salaries and benefits account for approximately 70 percent of 2008/2009 budgeted general government expenditures (excluding affordable housing). Staffing among legislative, administration, and finance departments has not increased in the past four years. We conservatively assume that only 50 percent of general government costs are fixed and do not vary with changes in employment or changes in the number of business establishments. Table VII-11 shows the estimated general government costs associated with the development of the proposed Target under the assumptions that 50 percent of general government costs are fixed and that every two Target employees create the demand for general government services equivalent to one resident.

TABLE VII-11 Estimated Annual Costs of Providing General Government Services	
2008-2009 General Government Budget	$2,569,589
General Government Costs Adjusted by 50% Fixed Costs	$1,284,795
2008 Scotts Valley Service Units[1]	17,200
Average Cost per Service Unit	$74.70
Estimated Additional Full-Time Equivalent Target Store Employment	167
Estimated Additional Resident Equivalent Employment at Target[2]	83.50
Total Cost Attributable to Propose Target Store	**$6,237**
[1] Residential population + ½ employment equals resident equivalent service unit. [2] One half of estimated Target store employment equals resident equivalent unit.	
Sources: City of Scotts Valley; Gruen Gruen + Associates.	

To estimate the cost of providing general government services, we adjusted the 2008 General Government by 50 percent to account for fixed costs. Dividing the adjusted cost figure of $1,284,795 by the total number of residents in the City plus one-half of the estimated number of employees produces an estimate of general government costs per "service unit" of nearly $75. Conservatively assuming that no Target employees also live in the City of Scotts Valley, the estimated full-time equivalent Target store employment of 167 equates to 83.5 service units. Multiplying the per service unit cost estimate of $75 by the estimated 83.5 service units of the Target store produces an estimate of general government costs induced by the proposed Target store of approximately $6,240.

Public Safety

The Scotts Valley Police Department has the capacity to provide public safety services to the proposed Target store without adding staff or equipment. As Table VII-12 shows, to conservatively estimate the average costs of providing pubic safety services, we assume only 50 percent of the public safety costs are fixed and that two full-time equivalent Target employees create the demand for public safety services equivalent to one resident.

TABLE VII-12 Estimated Annual Cost of Providing Public Safety Services	
2008-2009 Public Safety Budget	$4,122,030
Public Safety Costs Adjusted by 50% Fixed Costs	$2,061,015
2008 Scotts Valley Service Units[1]	17,200
Average Cost per Service Unit	$119.83
Estimated Additional Full-Time Equivalent Target Store Employment	167
Estimated Additional Resident Equivalent Employment at Target[2]	83.50
Total Cost Attributable to Proposed Target Store	**$10,005**
[1] Residential population + ½ employment equals resident equivalent service unit. [2] One half of estimated Target store employment equals resident equivalent service unit.	
Sources: City of Scotts Valley; Gruen Gruen + Associates.	

To be extremely conservative, we do not exclude costs attributable to animal control and assume only 50 percent of the total public safety budget of $4,122,030 is fixed. Dividing the resulting $2,071,015 public safety cost figure by the 17,200 service units produces a public safety cost estimate of nearly $120 per service unit. Multiplying this per service unit cost by the expected number of service unit equivalents attributable to Target results in an estimate of total annual police service costs induced by the operation of the proposed Target store of approximately $10,000.

Public Works

The Public Works Department provides the following services to the residents and businesses of Scotts Valley:

- Street maintenance;
- Engineering services;
- Maintenance of municipal vehicles, equipment, buildings, and parks;
- Maintenance, collection, treatment and disposal of wastewater; and
- Development and operation of parks and trails and recreational programs.

Our interview with the Director of Public Works indicates that development of the proposed Target store will not induce additional service costs associated with engineering, wastewater/storm drainage, parks, recreation, or building and equipment maintenance. Any infrastructure or capital costs associated with the development will be incurred by Target, including the installation of any necessary traffic signalization or related equipment.

Additional roadways and public right-of-way will not result from the development of the proposed Target. Truck deliveries to the proposed Target store will generate demand for street maintenance. According to our interviews, however, Public Works expects to maintain the nine-year repaving and surface treatment cycle, irrespective of the proposed Target store. As Table VII-13 shows, to be conservative, we estimate the average cost of street maintenance induced by the Target store by dividing the $460,403 street maintenance budget by 50 percent to reflect the extremely conservative assumption that only 50 percent of street maintenance costs are fixed.

TABLE VII-13 Estimated Annual Cost of Providing Street Maintenance Services	
2008-2009 Street Maintenance Budget	$460,403
Street Maintenance Costs Adjusted by 50% Fixed Costs	$230,202
2008 Scotts Valley Service Units[1]	17,200
Average Cost per Service Unit	$13.38
Estimated Additional Full-Time Equivalent Target Store Employment	167
Estimated Additional Resident Equivalent Employment at Target[2]	83.50
Total Cost Attributable to Proposed Target Store	**$1,118**

[1] Residential population + ½ employment equals resident equivalent service unit.
[2] One half of estimated Target store employment equals resident equivalent service unit.
Sources: City of Scotts Valley; Gruen Gruen + Associates.

Dividing the adjusted for fixed cost street maintenance figure of $230,202 by the 17,200 service units (population plus one half employment) equates to a per service unit cost of $13.38. Multiplying the per service unit cost estimate of $13.38 by the estimated 83.5 service units attributable to the Target store produces an estimate of street maintenance costs induced by the proposed Target store of $1,118.

An additional traffic signal may also be installed as mitigation. Public Works would incur the cost of maintaining the signal (power usage, monthly inspections, etc). While this cost is inherently included in the estimate of street maintenance expenditures as presented above in Table VII-13, we assume the addition of a traffic signal will produce additional costs beyond those associated with the average per service unit street maintenance expenditures. According to the City of Scotts Valley's 2007 Annual Financial Report, the City currently maintains 16 traffic signals. The 2008/2009 budget indicates "traffic signal maintenance costs" of $42,000. The annual cost associated with maintaining an additional traffic signal is estimated to approximate $2,625.

NET FISCAL IMPACT

Table VII-14 presents a comparison of the forecast annual General Fund revenues and annual service costs likely to be induced by the development of the proposed Target store. Based on the estimated annual revenue of $509,200 and estimated annual service costs of $20,000, the proposed Target will generate an annual surplus to the General Fund of approximately $489,200.

TABLE VII-14

Comparison of Forecast Annual Revenues and Services Costs to City of Scotts Valley General Fund[1]

	First Full Year of Operation $
Annual Revenues (see Table VII-2)	509,200
Annual Service Costs (see Table VII-10)	20,000
Estimated Positive Balance	**489,200**

[1] Figures are rounded.

Source: Gruen Gruen + Associates

CHAPTER VIII

ECONOMIC IMPACT OF THE PROPOSED TARGET STORE

INTRODUCTION

This chapter provides a quantitative assessment of the economic impacts of the proposed Target development in terms of the creation of additional economic activity, jobs, and income in the City of Scotts Valley as the result of: (a) the construction of the project; and (b) the on-going operation of the Target store. The construction impact will last for the duration of the construction period (approximately one year) and may be classified as a "one-time" impact. The day-to-day operations of Target will generate a recurring impact on the Scotts Valley economy and can be thus classified as an "on-going" impact.

ECONOMIC IMPACTS OF THE CONSTRUCTION AND RETAIL OPERATIONS OF THE PROPOSED TARGET

The proposed Target will cause an economic impact beyond the direct expenditures associated with its construction and the retail sales generated on-site. Secondary or "multiplier" effects result from increased production in industries affected by the direct construction expenditures and retail sales. For example, the direct sales generated by Target, and the resulting secondary or induced effects of these dollars, will help to increase the scale of other stores, restaurants, and services that can be supported in Scotts Valley. The <u>direct</u> and <u>indirect</u> economic impacts are presented in terms of:

(1) employment added;

(2) labor income (employee compensation and proprietors' income) associated with the added jobs; and

(3) economic output[25] (the value of all goods and services produced or sold).

Direct Economic Impacts

Direct economic impacts are the number of jobs, income, and output produced in the directly effected industries or businesses by the development and operation of the proposed Target store. For the <u>one-time construction expenditures</u>, the direct impact is measured by the number of jobs, income, and output in the economic sectors directly related to the development process such as Construction and Architects and Engineers. The direct impact can be quantified in terms of the total value or cost associated with developing the building and site. Accordingly, based on information provided by Target, we use a direct construction impact of $24 million. This includes expenditures for the development of the 18-acre site, the 143,000-square-foot store, and the parking deck. This estimate does not include the cost of land or development-related fees or expenses (permit/impact fees,

[25] The output impact relates to the total change in the value of production or sales in all businesses in the local economy because of a change in sales and production in one or more businesses.

financing costs, etc). For the on-going retail operations of the Target store, the direct impact is measured by the number of jobs, income, and sales in the directly effected retail sectors. As described previously in Chapter VI, we estimate a net sales impact attributable to the Target store of $47.3 million. Because Target is classified as a general merchandise retailer, although some sales made at Target will be attributable to retail goods such as apparel or household furnishings, we use a direct impact of $47.3 million of annual sales in the General Merchandise retail sector.

Indirect Economic Impacts

Indirect impacts, sometimes referred to as "multiplier effects", relate to changes in the number of jobs, income, and output produced, based on interdependencies among economic sectors. Businesses buy products and services from each other, creating indirect impacts on other businesses. In other words, a change in one industry or business "ripples" through other industries or businesses. In addition to these indirect or spillover effects, indirect impacts also include what is sometimes referred to as induced impacts, or the impacts of increased household spending, that result from the creation of additional jobs and income. The one-time construction expenditures and the on-going retail operations of Target will each generate different indirect impacts because of the specific interdependencies among industries within the differing economic sectors. For example, a portion of the wages paid to construction workers (direct employment) and a portion of the wages paid to suppliers (indirect employment) will then be spent locally to purchase goods and services (induced effect) in the Scotts Valley economy. Similarly, Target will use some of the expenditures made by shoppers at the store to pay wages to employees, who in turn will spend some of their wages in Scotts Valley for the purchase of additional goods and services.

To estimate the indirect or multiplier impacts, we used IMPLAN Professional® ("IMPLAN"), a widely used input-output modeling software for impact analysis. Input-output model analysis is used to quantify interactions between or trace the linkages of inter-industry purchases and sales within a given geographic area such as a county or region. In this study, we use IMPLAN to quantify the indirect impacts due to the changes in local economic activity that will occur as a result of the one-time construction expenditures and the on-going retail sales activity. Because IMPLAN data is unavailable by city or municipal boundary but is available by county or zip code boundary, the study area for the impact analysis presented in this chapter is defined by the boundary of the 95066 zip-code-area. The magnitude of multipliers depend upon the extent to which businesses purchase their inputs from other businesses located in the same area, as contrasted with the purchase of inputs from businesses located outside the geographic area. Multipliers vary among industries and among regions. Larger and more diverse geographic areas will tend to have larger industry multipliers because of a greater likelihood of linkages within the area; in other words, an industry's inputs will be provided by other businesses within the geographic area. Because the Scotts Valley zip-code represents a relatively small area, the area is missing some economic or industrial sectors present in the larger economic region, and therefore, the multiplier effects are lower than would be expected for Santa Cruz County as-a-whole.

ONE-TIME IMPACT OF CONSTRUCTION

Table VIII-1 shows the estimated annual direct and indirect (including induced) economic impacts attributable to construction of the proposed Target development on the Scotts Valley economy in terms of: (1) employment; (2) income; and (3) economic output. The income and output impacts are presented in 2008 dollars.

TABLE VIII-1

Estimated Direct and Indirect Economic Impacts of the Construction of the Proposed Target on the Scotts Valley Economy[1]

	Employment	Income	Output
Direct	162	$12,241,000	$24,000,000
Indirect[2]	68	$4,671,000	$7,932,000
Total	230	$16,912,000	$31,932,000
Multiplier	1.42	1.38	1.33

[1] Dollar figures are rounded.
[2] Includes induced effects.

Sources: Target; Minnesota IMPLAN Group; Gruen Gruen + Associates.

The impacts of the construction expenditures result in total employment impacts of 230 added jobs; total annual income of $16.9 million; and total annual output of $31.9 million. As shown on Table VIII-1, the employment and income multipliers associated with the construction of a 143,000-square-foot Target store are 1.42 and 1.38 respectively. An income multiplier of 1.38 means every $1.00 paid to the workers constructing the center account for an additional $0.38 in income created elsewhere in Scotts Valley. An employment multiplier of 1.42 means that for every ten jobs supported by the construction of the Target, demand for an additional four jobs will be created elsewhere in Scotts Valley. The output multiplier associated with construction of the Target store is 1.33. A multiplier of 1.33 indicates that for every $1.00 in output or economic activity directly attributable to the construction of the facility, an additional $0.33 in output or economic activity is created elsewhere in Scotts Valley. The construction of the center is estimated to generate $24 million in direct output and $7.9 million in indirect output for a total output of $31.9 million.

ON-GOING ANNUAL IMPACT OF RETAIL SALES

Table VIII-2 shows the estimated direct and indirect economic impacts attributable to the operation of the proposed Target on the Scotts Valley economy in terms of: (1) employment; (2) income; and (3) economic output.

TABLE VIII-2

Estimated Direct and Indirect Economic Impacts Attributable to Net Additional Retail Sales of the Proposed Target on the Scotts Valley Economy[1]

	Employment	Income	Output
Direct	256[3]	$6,878,000	$14,449,000
Indirect[2]	36	$1,110,000	$4,314,000
Total	292	$7,988,000	$18,763,000
Multiplier	1.14	1.16	1.30

[1] Dollar figures are rounded.
[2] Includes induced effects.
[3] The estimated direct ("on-site") employment of the Target store is a result of the sales estimate ($47.3 million) that has been directly entered into the input-output model. IMPLAN is built such that either direct employment or direct sales (output) may be utilized as the basis for the impact analysis, but not both. The direct employment estimate of 256 jobs indicates that – based on historical trade accounts and commodity flows for the Scotts Valley zip code - a change in final demand (sales) equivalent to $47.3 million in the general merchandise retail sector would produce 256 new jobs. As summarized in Chapter VII, this is consistent with estimates provided by Target, but we conservatively assume a slightly lower estimate of employment of 250 jobs when estimating municipal revenues and costs.

Sources: Target; Minnesota IMPLAN Group; Gruen Gruen Gruen + Associates.

The estimated on-going net additional general merchandise sales produced by Target result in total annual employment impacts of 292 jobs; total annual income of $8 million; and total annual output of $18.8 million within the Scotts Valley economy. The employment and income multipliers associated with the operations of Target are 1.14 and 1.16 respectively. That is, for every one job and one dollar of income paid to the workers of Target, an additional 0.14 jobs and $0.16 in income is supported elsewhere in Scotts Valley. The total income gain and employment generated equates to an average income per additional job of approximately $27,350.

The output (or sales) multiplier associated with the Target operations is 1.30. Direct output is estimated at $14.4 million and indirect output is estimated at $4.3 million for a total impact of $18.8 million. The reader should note that the direct output ($14.4 million) is not equivalent to the total net sales impact of $47.3 million. The net sales volume of $47.3 million is typically known as the "purchaser" price. However, retail transactions and activity within the local Scotts Valley economy are measured in "producer" prices. Thus, the direct sales estimates must be converted to producer prices and distributed to the appropriate industries. To do so, gross margins are assigned to individual industry sectors within the input-output model. A margin is simply the mark-up that a retailer applies to a product over and above the initial wholesale cost. The margins effectively split the purchase price of a commodity into the proportion of the sale that will end up going to the retailer, wholesaler, transporter, and manufacturer. When studying a small geographic area such as Scotts Valley, it is not uncommon that the entire proportion of the purchase price allocated to the wholesalers, transporters, and manufacturers will transfer out of the local economy. Thus, not all retail sales made at Target will actually impact the local economy.

CHAPTER IX

THE NATURE OF POTENTIAL SPILLOVER IMPACTS OF THE OPERATION OF THE PROPOSED TARGET STORE

INTRODUCTION

The fiscal and economic analysis presented in the preceding two chapters present estimates of the macro economic and fiscal spillover impacts of the development and operation of the proposed Target store. In this chapter, the nature of the potential micro spillover impacts of the proposed Target store is considered. The spillover impacts identified are based on a review of the relevant literature and case study interviews reviewed below.

Information from representatives of the City of Scotts Valley indicates concerns about potential spillover effects related to residential property values and the commercial base generally. The entrance of Monte Fiore, a gated 62-unit residential development, is located approximately 850 feet from the site of the proposed vehicle entrance of the Target store[26]. Our inspection of the community revealed that it is surrounded by dense woods and many housing units contain significant amounts of landscaping.

THE EFFECT OF PROXIMITY OF RETAIL STORES ON RESIDENTIAL PROPERTY VALUES

Economic place theory indicates the importance of transportation costs or accessibility to land values and that all other factors held equal, residential properties closer to retail uses have higher values than residential properties further away. Microeconomic theory also holds, however, that residential property too close to the commercial use can be affected by negative externalities such as noise or views.[27] Economic theory and the trend in land use

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[26] Estimated driving distance, based on review of proposed Target site plan prepared by DES Architects and Engineers.

[27] The modern model of residential location and urban land values initially developed by Christaller (1933) described urban land values as a function of transportation costs from the central place. Subsequent urban economists, particularly Alonso (1964), Muth (1969) and Mills (1972) have augmented and refined classic housing land value theory. These analysts built urban residential land market models, assuming a central place, to which residents seek to travel at a minimum of time and cost. In addition to this travel function, there are other determinants of land value such as physical factors, amenity factors and preferences for housing size. The housing models have been since expanded to determine residual location patterns and values as a function of the trade-offs among transportation costs, housing size, other housing attributes, and social factors, where the transportation cost variable applies to multiple activity nodes rather than just the central business district. The "hedonic" approach to compare price variations across multiple properties as a function of distance or proximity to a particular attribute such as a transit station or store permits researchers to identify and explain variations in property values as a function of differences in the levels and combinations of structural, neighborhood, accessibility and amenity level characteristics of houses. Hedonic pricing models permit researchers to estimate the marginal contribution of each of the attributes to the total price (value) of a house.

practice to mixed-use land development indicate that the positive effects (such as convenience, time-savings, and environmental benefits) of residential uses with proximity to retail uses tend to offset the negative effects such as views, noise, and traffic.

Studies, for example, of the effects of large-traffic generating uses like regional malls on residential property values have found that housing values near regional malls experience greater appreciation than housing located further away and are not negatively impacted by proximity to regional malls.[28] Another study related to concerns about the development of a proposed 9,800-square-foot pharmacy adjacent to residential properties found that in Henniker, New Hampshire, proximity to commercial development does not negatively impact residential property values.[29]

In an empirical study, Than Van Cao and Dennis C. Cory of the University of Arizona, constructed a model that incorporates the positive and negative effects of neighborhood land use externalities and employ hedonic price analysis to estimate the effects of externalities such as accessibility and nuisances associated with residential uses located near nonresidential uses on the value of residential properties in the City of Tucson, Arizona.[30] (Hedonic models are used to estimate the marginal contributions of both negative and positive factors influencing property values). Confirming the well established economic theory, the empirical analysis finds that the advantages of proximity more than offset the negative externalities of noise and traffic.[31] The results of the hedonic analysis indicate "a net beneficial impact of nonresidential land uses on home values."[32] From a public policy perspective, the analysis suggests that "mixing land uses in residential neighborhoods need not lead to a depression of residential property values."[33]

One of the most recent and rigorous analyses of the effect of proximity of commercial uses on residential property values is summarized in the article, "Retail Proximity and Residential Values or Do Nearby Stores Really Run Down Property Values?" by John W. Matthews, a Senior Research Associate in the Andrew Young School of Public Policies Studies Fiscal Research Center at Georgia State University.[34] In Matthews' empirical study of the effect of proximity of commercial uses on residential property values in King County, Washington, he improves on technical or data limitations of prior studies using hedonic price analysis to estimate the effect of proximity to commercial uses on residential property values by using actual travel distances to measure convenience to retail uses and actual distance from

[28] "Effects on Nearby Residential Property Values", Clarion Associates, The Mall at Oyster Bay DEIS, December 1999.
[29] "The Impact of Commercial Development on Adjacent Residential Properties", John M. Crafts, MAI, SRA, The Appraisal Journal, January 1998.
[30] "Mixed Land Uses, Land-Use Externalities, and Residential Property Values: A Reevaluation", Than Van Cao and Dennis C. Cory, Annals of Regional Science, Volume 16, 1981.
[31] Id. at Page 12
[32] Id. at Page 13.
[33] Id. at Page 15.
[34] "Retail Proximity and Residential Values or Do Nearby Stores Really Run Down Property Values?", John W. Matthews, Georgia Statue University, Working Paper 07-21, April 2007, Andrew Young School of Policy Studies Research Paper Series, Department of Public Administration and Urban Studies Fiscal Research Center.

individual housing units to the nearest retail uses to capture the effect of disamenities. The analysis also captures the effects of views of commercial uses from the housing units.[35]

The study area consists of different areas in King County, Washington including parts of pedestrian-oriented, relatively dense parts of Seattle and an "edge city" side consisting of lower density, auto-oriented development patterns.[36] Housing units in the more urban subsample are more likely to be impacted by negative spillovers from retail uses such as noise and light pollution while more housing units in this subsample are within walking distance to the retail uses.[37]

The results of the hedonic analysis indicate that in areas in which proximity to retail uses significantly affects residential property values the "positive effect of accessibility tends to outweigh the negative eternality affect from retail sites" and in those areas in which no proximity impact was identified, the "highly segregated land uses and street layouts that result in greater straight-line and travel distances" account for the finding.[38] A key finding from the hedonic analysis is that for the pedestrian-oriented subsample "negative influences rising from retail sites do not extend beyond a short distance." [39] "The net effect of retail proximity is positive – residential prices are enhanced, not diminished-beyond about 235 feet, peaking at about 560 feet, and finally playing out at about 1,260 feet".[40] The empirical findings are consistent with the review of other studies, which indicate that "negative effects dissipate more rapidly over distance than do positive effects" of proximity of commercial uses to residential uses.[41]

PRIMARY RESEARCH ON EFFECTS OF RETAIL STORES ON RESIDENTIAL VALUES AND COMMERCIAL VALUES

In addition to the literature review, we conducted case study interviews, including an interview about the effects of a Target store near a single-family neighborhood in a suburb of Minneapolis, Minnesota. We also considered the effect of the Kmart-anchored center in Scotts Valley on housing in the area drawing from information obtained from a housing builder and gained insights on the circumstances of the nearest local residential community, the gated Monte Fiore development, including its vulnerability to negative effects and the likelihood of residential property values benefiting from gaining proximity to a Target store. Finally, we interviewed the manager of the Hilton Hotel that adjoins the site of the proposed Target store.

In order to obtain perspective on the spillover effect of proximity to Target stores, we conducted an interview with the Community Development Director of Plymouth, Minnesota in which a Target store was renovated and expanded into a Target Greatland

[35] Id. at Page 9.
[36] Id. at Page 10.
[37] Id. at Page 11.
[38] Id at Page 13.
[39] Id. at Page 13.
[40] Id. at Page 15
[41] Id. at Page 6.

store approximately four years ago at 4175 Vinewood near Interstate 494. Some single-family housing units off of 43rd Avenue are within approximately 400 feet of the store. Information from Zillow.com, a real estate value information service, indicates that single family housing units in the immediate vicinity of the Target store are currently valued between $340,000 and $460,000. This compares to a median housing value in the community of approximately $289,000. Additional housing units have been built and occupied after the store renovation and expansion was completed. This suggests that the Target store did not negatively affect demand for single-family housing in the area. The Community Development Director indicated that proximity to the highway which is positive in terms of accessibility to workplaces and activity centers but a nuisance in terms of noise is a more important factor than the proximity to the Target store. The store is at a higher elevation than the adjoining residential neighborhood and the noise effects are therefore muted and insignificant relative to the effects of proximity to the highway. While not viewed negatively, the school district east of Interstate 294 is not considered as strong as the school district west of Interstate 294. The Community Development Director expects that the school district quality is a more important factor in determining housing values than the presence of the Target store. As a whole, the Community Development Director believes the availability of the Target store favorably influences housing values due to the convenience of having a major general merchandise store in the community and housing values have not been negatively affected by the expansion and operation of the Target Greatland store.

To obtain local insight about the potential effects of retail use proximity, especially related to another general merchandise store, we interviewed a local developer which has built housing in Scotts Valley near retail uses. Proximity to commercial services was an advantage in marketing the Skypark residential community and Blue Bonnet condominium project and that the rate of housing unit absorption was higher because of the accessibility of services. The developer currently is planning to develop 46 townhome units as part of the planned Town Center development. This project is also proximate to the Kings Village and other retail centers. The proximity to the base of retail uses is expected to be a primary selling point for the townhome development. The developer anticipates obtaining a 10 percent price premium on the townhome units because of the proximity.

Obviously, some neighborhoods are perceived by housing consumers to be more desirable than others. The quality of public schools, the local crime rate, the level of recreational amenities, the quality of the homes, the setting of the homes as well as the level of congestion and noise, are examples of determinants of housing values unrelated to transportation access or accessibility factors. An interview with another developer suggests that Monte Fiore is a very desirable location within a school district with a positive reputation and in an especially scenic setting. The limited supply of residentially entitled land also tends to support residential property values in the market area. These factors may be more important determinants of property values than the presence of the proposed Target store, which would adjoin hotel, retail, and office uses already present.

Households of the Monte Fiore community also benefit from accessibility to Highway 17.

We are not in the position to opine about the impacts and mitigations of traffic conditions. Given the locational advantages described in the interviews and on the understanding that the Monte Fiore gated development is far enough away and topographically situated to not be negatively effected by view effects from the proposed Target store, the review of the relevant literature and interviews does not suggest negative property spillover effects will apply to the Scotts Valley residential base because of the proposed Target store.

It has long been widely recognized in the economic literature and evident even longer in practice that clustering of commercial activities conveys advantages to retailers and property owners.[42] The clustering of stores has market-widening and consumer-attracting effects because consumers like to comparison shop and are attracted by the size and diversity of retailing offerings. Therefore, as suggested by the interviews summarized in Chapter III, positive spillover effects are likely to occur for the Scotts Valley retail base because of the greater visitation and therefore sales potential that can be expected because of the addition of the proposed Target store. As indicated above, sales spillover for the tenants of the adjoining Scotts Valley Corners is likely to be especially pronounced.

The manager of the Hilton Hotel to the north of the site of the proposed Target store indicated concerns about the operation of the proposed Target store causing traffic congestion as well as affecting the views from the "Wedding Garden" facilities of the hotel. During the work week, the 180-room hotel with 5,000 square feet of meeting space currently maintains an approximately 70 percent occupancy rate due to demands from business travelers. No other hotels in Scotts Valley are geared to serving business travelers. Many of the business travelers select the hotel because of proximity to Seagate, Plantronics, and other businesses. The owner of the hotel previously sold land for the development of the adjoining Scotts Valley Corners and has realized synergies and spillover between the hotel and the Morgan Stanley office and salon/spa at the Scotts Valley Corners. The hotel is dependent on the weekends for attracting leisure travelers. The primary competition for the leisure market is with a facility with beach access in Santa Cruz. The manager indicated that even if the hotel lost wedding/leisure business and had less repeat corporate room-night demand because of negative view and traffic congestion impacts, the loss of business would not cause the hotel to close. Given the limited hotel supply competition especially for the business traveler and that the manager does not anticipate the hotel closing, any negative property spillover impacts are likely to be more than offset by the positive macro fiscal and economic benefits estimated to apply to the development and operation of the proposed Target store.

[42] One of the earliest theoretical analyses of clustering by Hotelling (1929) indicated why two or more competitive operators (in his model, ice cream vendors) tend to cluster at a central location within a market, while two or more operators within the same chain (or franchise) would locate separately within distinct sub-markets. Because increasing scale and selection increases consumer attraction positive spillover occurs between retailers in proximity so that the total sales of two retailers located next to each others are likely to be greater than if the two stores are located significantly further apart. Hotelling, H. 1929. "Stability and Competition", Economic Journal, 39: 41-57.

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