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#1 Study Session

Economic Development Strategic Plan Background Report

Revised Draft Report

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EXECUTIVE SUMMARY

This background report presents the economic data and analysis that will inform Cupertino's Economic Development Strategic Plan. The report describes employment and market trends, identifies local assets, and presents the opportunities and challenges for attracting and retaining businesses in Cupertino.

This executive summary provides an overview of major findings discussed in the report.

ISSUES AND OPPORTUNITIES FOR ECONOMIC DEVELOPMENT

In August 2015, the City of Cupertino hosted a Community Forum to engage community members about the Economic Development Strategic Plan. At the Forum, residents, business owners, City staff, and elected officials identified assets, opportunities, and potential challenges related to economic development in Cupertino.

As discussed at the Forum, Cupertino has many economic assets that position the city well to attract and retain businesses. These include:

- **Location at the heart of Silicon Valley.** Cupertino is located in western Santa Clara County, bordered by Sunnyvale, Santa Clara, San Jose, and Saratoga. The city's location provides excellent access to Interstate 280, a freeway that is relatively less congested compared to other of the region's freeways such as Highway 101. I-280 connects the city to highly skilled workers throughout the South Bay and to the Sand Hill Road Area, the hub of venture capital activity in the region.
- **Highly competitive technology sector.** Cupertino has a large concentration of high-wage jobs, centered on the technology industry. Many technology firms seek to locate in Cupertino in order to do business with Apple – the city's single largest employer and the second largest tech employer in Silicon Valley – and take advantage of the city's location in the region and other assets.
- **Highly educated workforce.** Nearly 80 percent of adults aged 25 and above in Cupertino have a college degree, with 40 percent holding advanced degrees. Most residents are also employed in professional occupations. The city's significant employment base attracts a net weekday inflow of 26,700 workers, who tend to be highly educated workers in professional occupations.
- **Excellent quality of life and first-rate school district.** Cupertino's public schools have been recognized for their excellent quality both by the State of California and in the national media. The excellent public school system and overall quality of life are very attractive for new households, especially families with children.

Key issues identified at the Community Forum include:

- **Limited shopping opportunities for clothing and other specialty goods.** Cupertino has many neighborhood shopping centers where residents can shop for groceries and other daily needs. However, residents must look outside the community – for example, to Westfield Valley Fair and Santana Row in San Jose, or the Stanford Shopping Center in Palo Alto – for destination retail centers where they can access dining and entertainment opportunities and shop for clothing and other “specialty” goods (i.e., goods and services that are purchased on a more infrequent, discretionary basis). While Vallco Shopping Mall used to provide this type of shopping environment, the mall is now largely vacant.
- **Challenges for independent retailers and other small and midsize businesses.** Cupertino's strong economy has driven significant demand for retail and office space, resulting in low vacancies and high rents. As a result, small and midsize businesses of all types struggle to find affordable

space in the city. There is also a concern that traditional retailers selling goods are being replaced with services (e.g., tutoring centers, day cares) that require more parking than some existing shopping centers can provide and may not generate the same level of sales tax revenues.

- **Protecting Cupertino's quality of life.** According to residents polled for the 2014 community survey, the most important issues facing Cupertino were affordable housing (33 percent), traffic (21 percent), and controlling growth (17 percent).¹ Many residents are also concerned about preserving the quality of the public school system as the community continues to grow and change.

KEY FINDINGS FROM THE ANALYSIS

In order to provide a nuanced understanding of the economic trends that currently shape the city's economy, Strategic Economics analyzed local and regional trends in employment and businesses; Cupertino's fiscal position; the office sector; the retail sector; and the hotel sector. Key findings from this analysis are described below.

Business and Employment Trends

Cupertino's employment base has grown quickly relative to the South Bay as a whole. The number of private jobs in Cupertino grew by nearly 20 percent over the last decade and a half, from 27,700 jobs in 1998 to 33,000 jobs in 2013.

Cupertino's economy is driven by a number of major technology employers. Cupertino has nine employers with 250 or more workers, of which five are in technology or biotechnology. These include Apple, Seagate, Pegasystems, and Trend Micro. Other firms seek to locate in Cupertino in order to do business with Apple and the city's other major employers as a vendor, partner, or consultant.

Cupertino also has a high concentration of small and midsize technology firms. Cupertino's strength in technology is not limited to large employers. Approximately 20 percent of the city's small and midsize businesses (defined as those with fewer than 250 employees) are in the technology industry.²

Most of Cupertino's small and midsize businesses are in the professional and technical services sector. In 2012, professional and technical services accounted for 44 percent of Cupertino's firms with fewer than 250 workers, compared to 32 percent of small and midsize firms in the South Bay. Many of the small and midsize professional services firms – such as legal offices and consulting firms – support the technology sector, providing services to Apple and other technology firms.

Cupertino is highly attractive for small firms and start-ups. Businesses with one to four employees accounted for 62 percent of all small and midsize businesses in Cupertino in 2012, compared to 55 percent of businesses in the South Bay as a whole. More than half of Cupertino's businesses with one to four employees are in the professional and technical services sector. Cupertino is attractive for small start-ups because of the highly skilled, entrepreneurial workforce that lives in the city and in neighboring communities.

Cupertino has relatively few small and midsize industrial businesses. The city has relatively few small and midsize businesses in traditional manufacturing, transportation, distribution, or construction.³ This may

¹ City of Cupertino – 2014 Community Satisfaction Survey, Godbe Research, 2014.

² The technology industry includes businesses from several different sectors, including professional and technical services, transportation and distribution, and manufacturing.

³ While Cupertino's largest employer, Apple, is often categorized as a manufacturing business, this report categorizes Apple as a technology firm.

reflect the lack of low-cost industrial space in the city, as well as the competition from professional and technical firms for office and R&D space in Cupertino.

Limited space availability and high real estate costs create a challenging environment for midsize firms. Compared to the South Bay, Cupertino has fewer businesses and employees in firms employing between 10 and 250 workers, and the number of businesses in this size range is declining. Limited space availability may be one contributing factor. Commercial real estate brokers in Cupertino report that many midsize businesses cannot find or afford space in Cupertino, and that growing businesses often leave the city because they cannot find sufficient space for their workers.

Cupertino's Fiscal Position

The City's General Fund revenues have grown steadily over the past several years as a result of economic growth and new real estate investments. Revenue sources that are directly tied to economic growth – including sales taxes, property taxes, and transient occupancy (hotel) taxes – account for more than 60 percent Cupertino's General Fund revenues. These revenue sources have grown steadily over the past several years as the economy has recovered and Cupertino has attracted new investment. Major development projects, such as Main Street and Apple Campus 2, have also generated significant one-time revenues from planning, zoning, engineering, permit processing fees, and other sources.

Cupertino's strong General Fund supports a high level of service for residents. The City has been able to maintain service levels at 2.80 to 3.01 full time equivalent (FTE) staff per thousand residents over the past ten years, even as Cupertino's population grew significantly during that time period.

The City depends on a single employer for a significant share of its revenues. In FY 2012-13, Apple contributed total revenues of \$9.2 million, or approximately 18 percent of Cupertino's General Fund budget.⁴ Most of the revenues that Apple generates come from sales, property, and utility user taxes, including approximately 45 percent of Cupertino's sales and use tax revenues in FY 2012-13. Overall, the opening of Apple Campus 2 is expected to increase Apple's share of tax revenue. In addition to the revenues that Apple contributes directly, suppliers, consultants, and other vendors dependent on Apple also add indirectly to the company's impact on the City budget.

Office Sector

Cupertino's Competitive Position

Cupertino is known as a premier office location for businesses in high tech and other professional and technical services. Businesses and real estate brokers in the region recognize Cupertino as a highly prestigious address for corporations locating in the South Bay. The city's office market outperforms most other communities, with the exception of Palo Alto, Mountain View, and Menlo Park.

Compared to other neighboring communities, Cupertino has an unusually high share of Class A office space. Three-fourths of Cupertino's office space is Class A – a higher share than in any other city in Silicon Valley except for Sunnyvale. Moreover, much of the Class B and C stock in Cupertino has been upgraded over time by Apple, the city's largest employer. According to local brokers, Apple occupies 80 percent or more of the city's office inventory.

Cupertino's location provides excellent access to a highly skilled labor pool. Cupertino and surrounding communities in the West Valley, including Campbell, Los Gatos, and Saratoga, enjoy a particularly high

⁴ This does not include one-time revenues from the construction of Apple Campus 2. The fiscal analysis related to Apple and presented here is from Keyser Marston Associates, "Economic and Fiscal Impacts Generated by Apple in Cupertino—Current Facilities and Apple Campus 2", prepared for Apple Inc., 2013.

concentration of highly educated workers. Moreover, commute times on I-280 tend to be shorter than on other, more congested highways such as Highway 101.

Cupertino also has excellent access to venture capital. I-280 provides easy access to the Sand Hill Road area, the hub of venture capital activity in the region, as well as other venture capital firms and high-net-worth individuals funding new startup businesses around the Valley.

Limited supply, as well as competition from Apple, may constrain the city's ability to attract and retain growing companies. A very tight market for office space, combined with the high share of office space occupied by Apple, results in scarce leasing opportunities in the 20,000 to 100,000 square foot range. Although larger spaces are also in short supply, 20,000 to 100,000 square foot spaces are in particularly high demand for growing companies such as midsize technology startups. As a result, many expanding midsize firms have opted to relocate in other nearby communities.

Key Locations within Cupertino

Within Cupertino, office uses are concentrated in three subareas: Stevens Creek Boulevard, North De Anza Boulevard, and Bubb Road (Figure 1). For the purposes of this analysis, the existing Apple Campus was excluded from the North De Anza subarea. The subarea analysis also excluded projects that are planned or under construction, including Apple Campus 2, Main Street, and Vallco.

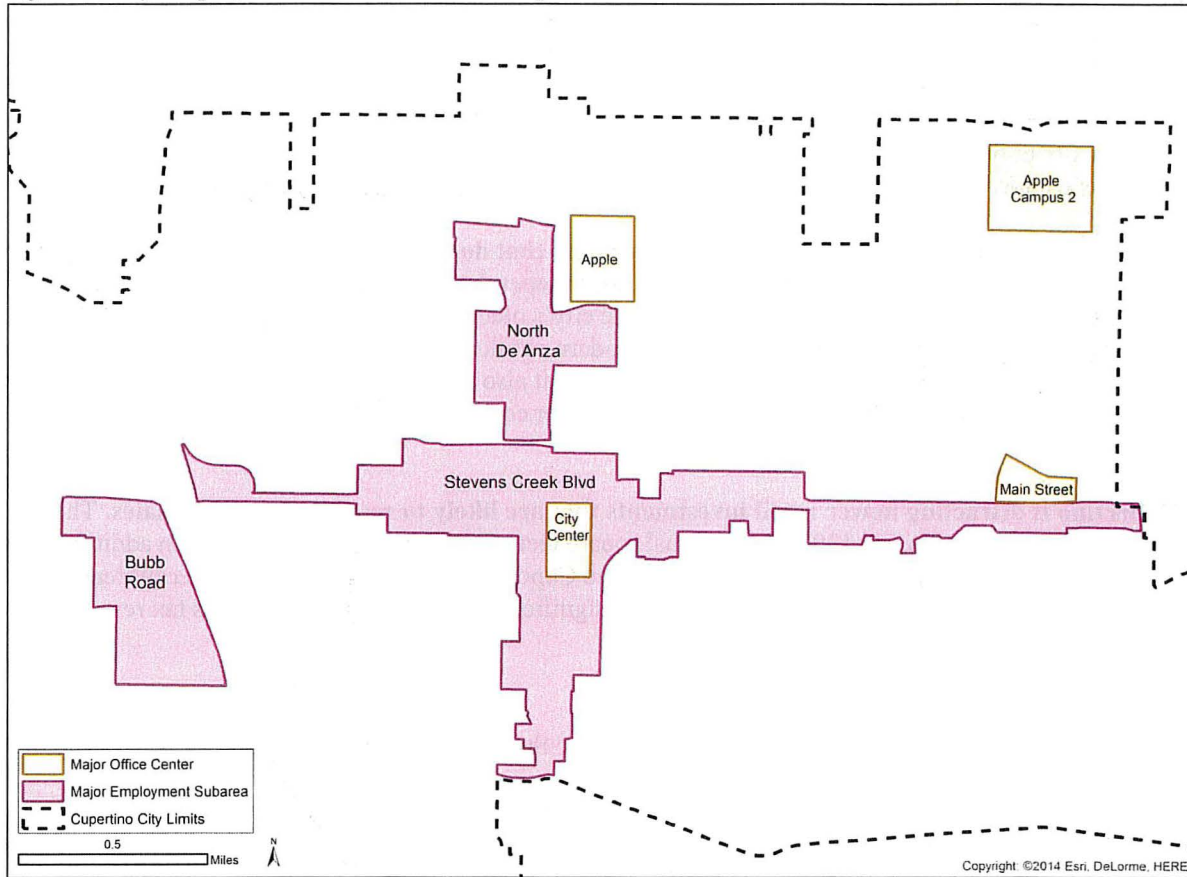
The Stevens Creek Boulevard subarea contains the most office space, including a mix of Class A, B, and C product. Nearly one-third of Cupertino's office inventory is located in the Stevens Creek Boulevard subarea. This includes the approximately 300,000 square foot, Class A Cupertino City Center office complex at the corner of Stevens Creek and North De Anza Boulevard, as well as a mix of smaller Class B and C buildings that have not received significant upgrades.

Within the North De Anza subarea, there is a significant concentration of Class A space and most of the older space has been significantly upgraded. In particular, Bandle Road has seen upgrades of R&D spaces to conventional office spaces. While these upgrades were largely undertaken by Apple for the company's own use, these buildings would be very desirable for other tenants, should they become available.

Currently, the premier location for office space in Cupertino is at the intersection of Stevens Creek and North De Anza Boulevards, and north along North De Anza. Cupertino City Center and the Apple Campus have historically anchored the prime North De Anza office corridor, which benefits from excellent access to Interstate 280. In the future, brokers expect that the most desirable location for office space will shift eastwards as major new office projects at Main Street and Apple 2 are completed.

Bubb Road is smaller than Stevens Creek or North De Anza and characterized by a mix of R&D uses and older buildings. Bubb Road contains a number of older industrial buildings, some of which have been upgraded to office or research and development (R&D) space by Apple.

Figure 1. Key Employment Locations within Cupertino



Sources: City of Cupertino, 2015; Strategic Economics, 2015.

Retail Uses

Cupertino's Competitive Position

Cupertino is located in a trade area that is highly desirable to retailers. High household spending power, excellent freeway accessibility, growing employment, and the significant inflow of daily commuters create significant demand for retail in Cupertino and surrounding communities. Reflecting these factors, western Santa Clara County has some of the highest retail rents and lowest vacancies in the country.

The city is located in a highly competitive trade area. In addition to Vallco, Cupertino's trade area contains several large retail shopping centers, including Westfield Valley Fair and Santana Row. The proximity of these competing centers, which feature many regional and national anchor tenants, restaurants, and entertainment options, limits the potential to locate the same types of tenants in Cupertino. Many Cupertino residents regularly shop and dine at these other retail centers, creating a significant amount of retail "sales leakage" that results in lower sales tax revenues for the City.

Cupertino has many neighborhood- and business-serving retailers that serve residents' and workers' daily needs. The city is well-served by grocery stores, mid-priced restaurants, personal services, and other retailers that serve residents' daily needs. Cupertino's restaurants and personal services also serve the city's workforce. The city's highest performing retail categories are food and beverage stores, and food services and drinking places.

Retail sales in Cupertino have declined over time, making the City's revenue sources less diverse Between 2005 and 2014, total retail sales in Cupertino declined by 17 percent after adjusting for inflation. This reflects the gradual decline of the Vallco Shopping Mall, as well as the rise of online shopping and other industry trends that have weakened in-store sales. The loss of major business-to-business sales tax producers (including Hewlett-Packard), has also reduced taxable sales in Cupertino. Although the City has partially offset the decline in sales tax by renegotiating an existing sales tax rebate agreement with Apple, these trends have decreased the diversity of revenue sources for the City's General Fund.

The city has many older strip retail shopping centers that do not meet the needs of modern retailers, but may provide relatively affordable space for independent retailers. The majority of Cupertino's retail was built between 1960 and 1980. Some of the city's older strip retail shopping centers do not provide the wide storefronts, visibility, and parking that modern retailers typically require. These strip centers also tend to be located on relatively small, shallow parcels that also create challenges for redevelopment. At the same time, however, older shopping centers provide lower cost retail spaces that may work well for smaller, independent retail and services.

Cupertino is attracting newer retail investments that are likely to result in increased sales. The Main Street project is slated to add 130,500 additional square feet of retail in its lifestyle center. In addition, some existing retail centers, such as Homestead Square and Cupertino Village, have received recent renovations. The renovations at Homestead Square resulted in a significant increase in sales and sales tax revenues after the first phase of the project opened in 2014.

Key Locations within Cupertino

Retail in Cupertino is concentrated along two corridors: Stevens Creek Boulevard and Homestead Road.

Stevens Creek Boulevard serves as Cupertino's main commercial corridor, accounting for 63 percent of total retail sales in 2014.⁵ The retail mix in the Stevens Creek subarea is highly diversified, and serves both local residents and workers from businesses throughout Cupertino.

In contrast to Stevens Creek Boulevard, the Homestead Road corridor is primarily neighborhood-serving. Homestead Road runs along Cupertino's northern border with Sunnyvale, and the shopping centers on this corridor serve residents in both cities. The corridor accounted for six percent of Cupertino's retail sales in 2014. Homestead Road contains mostly restaurants, grocery stores, and other food and food service establishments.

Cupertino's highest-performing retail nodes are on Stevens Creek Boulevard, between North Stelling Road and North De Anza Boulevard. The highest sales (\$250-\$350 per square foot per year) are found in centers anchored by the national retailers Whole Foods and Target.

While the smaller, strip shopping centers on Stevens Creek Boulevard have generally been successful at attracting new tenants, many have not been upgraded in years. The eastern segment of Stevens Creek Boulevard – extending from North De Anza Boulevard to the city border – is characterized by relatively small, shallow lots with limited visibility and parking. These centers are relatively underperforming, typically achieving less than \$100 a square foot in annual sales.

⁵ Excluding Vallco Shopping Mall.

Hotel Uses

As in other South Bay communities, demand for hotels in Cupertino is driven by business travel. Cupertino currently has 785 hotel rooms across five properties. Approximately 70 to 75 percent of demand is from business travelers. Strong job growth in Cupertino, along with Apple's expansion, suggests that business traveler demand for hotel rooms in Cupertino will remain strong for the foreseeable future.

Cupertino currently has two hotels under construction and two more proposed. The Marriott Residence Inn at Main Street and the Hyatt House Hotel, north of Vallco, are currently under construction and together will add 328 rooms to Cupertino's hotel inventory. Two mixed-use development proposals, at Marina Plaza and The Oaks shopping centers, both contain hotel components together comprising an additional 322 rooms. Together, these four hotel developments would nearly double Cupertino's current hotel inventory.

CONCLUSION

Cupertino's economy is shaped by the community's location at the heart of the South Bay's innovation economy. Moreover, the city benefits from a strong employment base, a family-friendly environment, high-quality municipal services, and a well-educated, highly skilled workforce. These assets position the city well to continue to attract and retain businesses, especially in the region's fast-growing technology sector. At the same time, the Economic Development Strategic Plan will need to consider the issues raised by residents, business owners, and other stakeholders. These include retaining small and local businesses, maintaining a healthy City budget that relies on a diverse range of revenue sources, providing access to a range of goods and services, and protecting the city's excellent quality of life.

I. INTRODUCTION

The City of Cupertino is creating an Economic Development Strategic Plan (EDSP) that will guide the City's efforts to support Cupertino's economic prosperity. The EDSP will focus on strengthening existing businesses, fostering a healthy economy, and maintaining a healthy fiscal position, rather than on new development or land use changes.⁶

This background report presents the economic data and analysis that will inform Cupertino's Economic Development Strategic Plan. The report describes employment and market trends, identifies local assets, and presents the opportunities and challenges for attracting and retaining businesses in Cupertino.

Following this introduction, this report is organized into five sections:

- Summary of findings.
- Issues and opportunities for economic development.
- Industry and employment trends, focused on understanding Cupertino's small and midsize businesses.
- Office sector, including a review of the market for existing office space in Cupertino, and a discussion of the relative competitiveness of employment locations within Cupertino.
- Retail and hotel uses, including discussions of national and regional retail trends, mobile services, the strength of existing retail and hotel uses in Cupertino, and the competitive position of different retail subareas within the city.

As part of the preparation of this background report, the City of Cupertino hosted a Community Forum in August 2014 that was facilitated by MIG. This analysis draws on the community input provided at the Forum (summarized in the appendix) as well as additional interviews with Cupertino business leaders and local real estate experts, and a variety of other data and information sources that are described throughout the report. The report also builds on existing economic studies including the 2014 Market Study prepared by BAE Urban Economics, and the 2014 Retail Strategy Report prepared by Greensfelder Commercial Real Estate.

⁶ The City is addressing development allocations and land use changes separately, through the General Plan Amendment process and specific plans.

II. ISSUES AND OPPORTUNITIES FOR ECONOMIC DEVELOPMENT

Cupertino has many economic assets that position the city well to attract and retain businesses. At the same time, residents, business owners, City staff, and elected officials have concerns related to Cupertino's ability to recruit and retain an appropriate mix of businesses over time while also maintaining the city's excellent quality of life. This section provides an overview of the key opportunities and issues that inform Cupertino's economic competitiveness. The section incorporates assets, opportunities, and potential challenges related to economic development as identified from the Community Forum, additional stakeholder interviews, and a review of existing reports. See the appendix for a complete summary of community comments from the Forum.

CUPERTINO'S ECONOMIC ASSETS AND OPPORTUNITIES

Cupertino is located at the heart of Silicon Valley. Cupertino is located in western Santa Clara County, bordered by Sunnyvale, Santa Clara, San Jose, and Saratoga. The city's location provides excellent access to Interstate 280, a freeway that is relatively less congested compared to other freeways such as Highway 101. I-280 connects the city to highly skilled workers throughout the South Bay and to the Sand Hill Road Area, the hub of venture capital activity in the region.

The city is home to a highly competitive technology sector. Cupertino has a large concentration of high-wage jobs, centered on the technology industry. Many technology firms seek to locate in Cupertino in order to do business with Apple – the city's single largest employer and the second largest tech employer in Silicon Valley – and take advantage of the city's location in the region and other assets.

Residents in Cupertino and surrounding communities in the West Valley are highly educated. Nearly 80 percent of adults aged 25 and above in Cupertino have a college degree, with 40 percent holding advanced degrees (Figure II-1). Most residents are also employed in professional occupations. Seventy-eight percent of Cupertino residents are employed in management, business, science, or arts, compared with 50 percent of workers who live in Santa Clara County (Figure II-2). The city's significant employment base also attracts a net weekday inflow of 26,700 workers, who tend to be highly educated workers in professional occupations.⁷

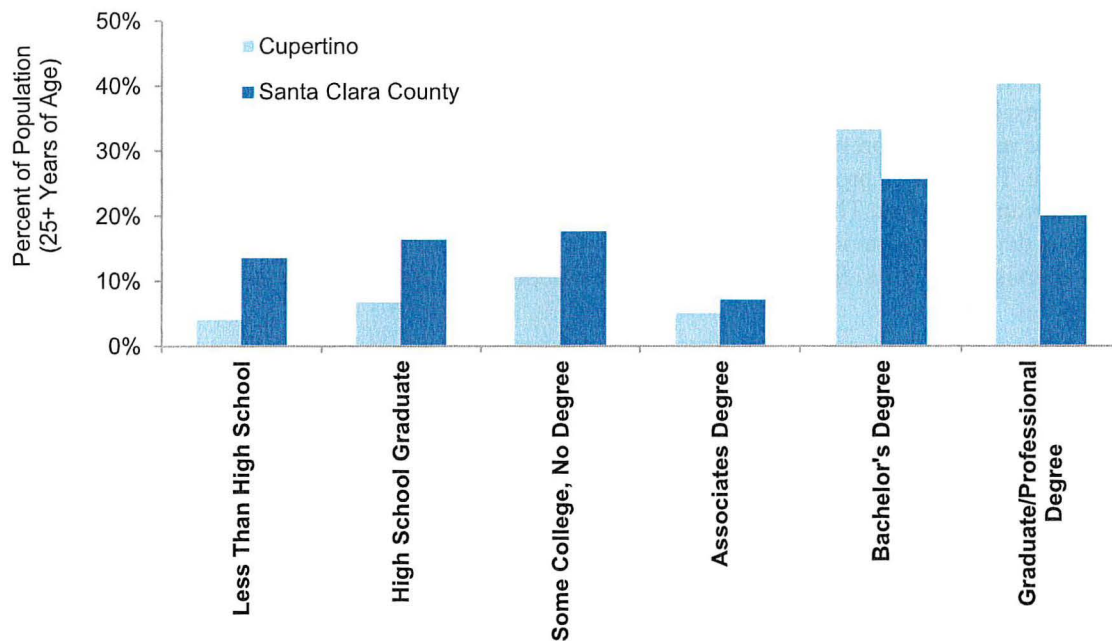
Cupertino also benefits from a high quality of life and first-rate school district. Cupertino's public schools have been recognized for their excellent quality both by the State of California and in the national media. In a 2014 community survey, the school system was the most commonly cited reason that residents chose to live in Cupertino.⁸ The excellent public school system and overall quality of life are very attractive for new households, especially families with children. Average household size in Cupertino increased from 2.75 persons in 2000 to 2.87 in 2010, and the share of households with children increased from 43 percent to 47 percent.⁹

⁷ BAE Urban Economics, "City of Cupertino General Plan Amendment Market Study," February 2014.

⁸ Godbe Research, "City of Cupertino – 2014 Community Satisfaction Survey," 2014.

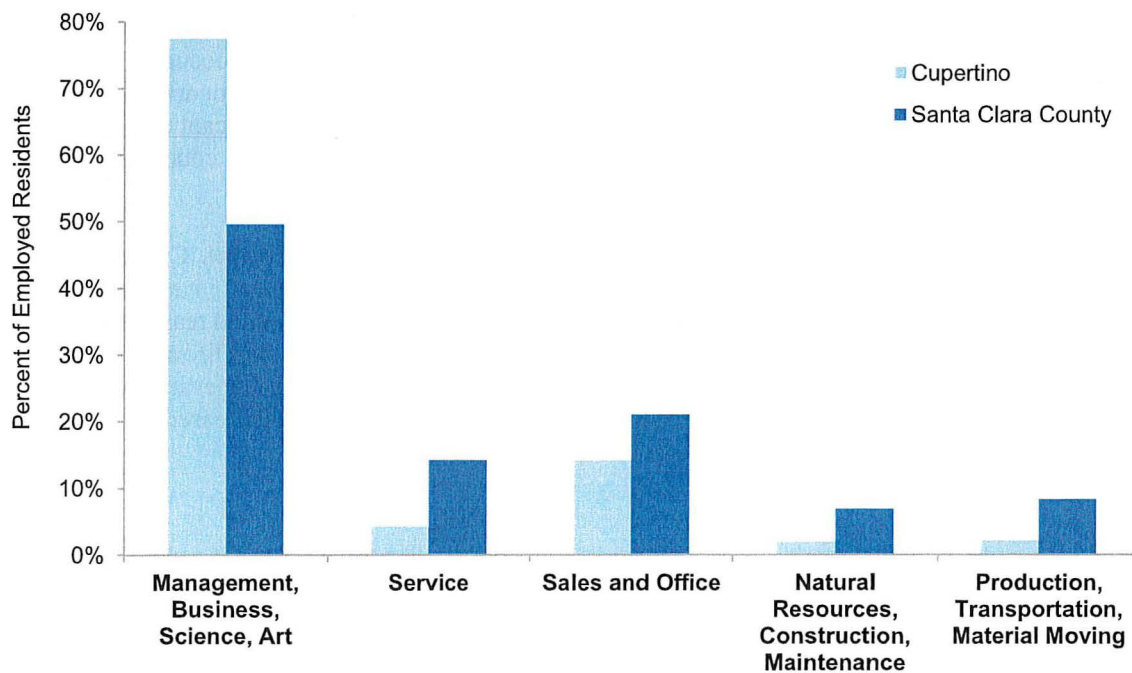
⁹ BAE Urban Economics, "City of Cupertino General Plan Amendment Market Study," February 2014.

Figure II-1. Educational Attainment for Population 25+ and Older: Cupertino and Santa Clara County, 2011



Sources: U.S. Census Bureau, American Community Survey, 2007-2011; BAE, Market Study, 2014.

Figure II-2. Employed Residents by Occupation: Cupertino and Santa Clara County, 2011

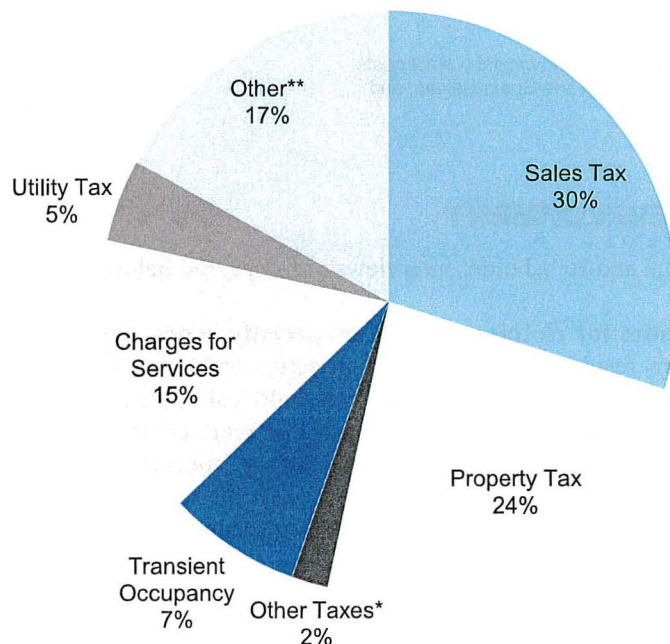


Sources: U.S. Census Bureau, American Community Survey, 2007-2011; BAE, Market Study, 2014.

The City's General Fund revenues have grown steadily over the past several years as a result of new real estate investments and other economic activity. Figure II-3 shows revenue sources for Cupertino's General Fund, the City's primary operating fund, for fiscal year (FY) 2015-16. Revenue sources that are directly tied to economic activity – including sales, property, and transient occupancy (hotel) taxes – account for the majority of Cupertino's General Fund revenues. These revenue sources have grown steadily over the past several years as the economy has recovered and Cupertino has attracted new investment. "Other" revenue sources have experienced fluctuations due to one-time revenues associated with major development projects, such as Main Street and Apple Campus 2. For example, in FY 2015-16, the City received 15 percent of its General Fund budget from charges for services, a category that includes planning, zoning, engineering, and permit processing fees associated with new development. Charges from service revenues are expected to decline significantly in the next several years as the new development projects are completed.

Cupertino's strong General Fund supports a high level of service for residents. Figure II-4 shows the Cupertino's General Fund expenditures in FY 2015-16. The General Fund pays for basic services such as public works, law enforcement, recreation, and planning and community development.¹⁰ The City has been able to maintain service levels at 2.80 to 3.01 full time equivalent (FTE) staff per thousand residents over the past ten years, even as the population grew significantly during that time period.

Figure II-3. Cupertino General Fund Revenues, FY 2015-16 (Budgeted)



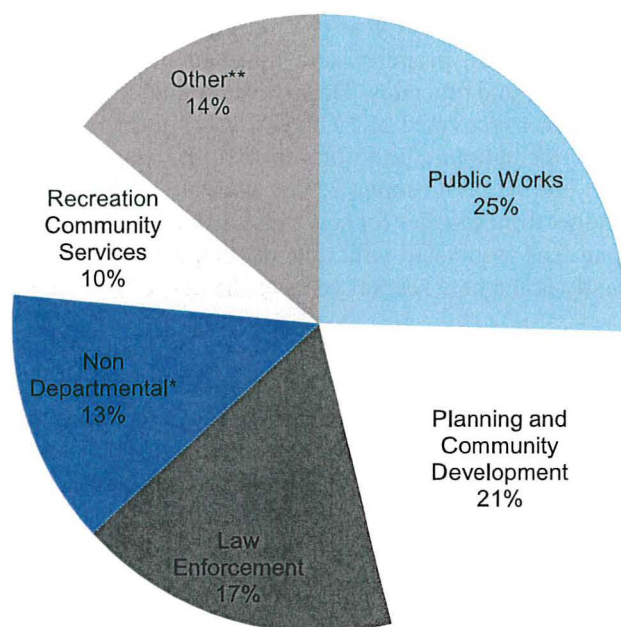
*Includes business license taxes, construction taxes, and property transfer taxes.

**Includes franchise fees, licenses and permits, use of money and property, fines and forfeitures, intergovernmental, and miscellaneous revenues.

Source: City of Cupertino 2014-15 Adopted Budget

¹⁰ Note that General Fund resources are used only to fund operations that do not have other dedicated (restricted) funding sources. Operations that rely heavily on non-General Fund resources, such as street maintenance, solid waste collection, and recreation are accounted for in other funds. The General Fund also does not include funding for schools or other services that are provided by agencies other than the City.

Figure II-4. Cupertino General Fund Expenditures, FY 2015-16 (Budgeted)



*Includes debt service and transfers to other funds, primarily to fund capital project costs.

**Includes Administration, Administrative Services, City Council and Commissions, and Public Affairs.

Source: City of Cupertino 2015-16 Adopted Budget.

KEY ISSUES FOR ECONOMIC DEVELOPMENT

Key issues identified in the Community Forum and stakeholder interviews are discussed below.

Cupertino has limited shopping opportunities for clothing and other specialty goods. Cupertino has many neighborhood shopping centers where residents can shop for groceries and other daily needs. However, residents must look outside the community – for example, to Westfield Valley Fair and Santana Row in San Jose, or the Stanford Shopping Center in Palo Alto – for destination retail centers where they can access dining and entertainment opportunities and shop for clothing and other “specialty” goods (i.e., goods and services that are purchased on a more infrequent, discretionary basis). While Vallco Shopping Mall used to provide this type of shopping environment, the mall is now largely vacant.

Mom-and-pop retailers and other small and midsize businesses may struggle to find or maintain affordable locations in Cupertino. Cupertino’s strong economy has driven significant demand for retail and office space, resulting in low vacancies and high rents. As a result, small and midsize businesses of all types struggle to find affordable space in the city, especially given the competition with larger or better established businesses. For example, small independent retailers may not be able to compete with chain retailers, which typically have better credit and are in a position to sign longer-term leases. There is also a concern that traditional retailers selling goods are being replaced with services (e.g., tutoring centers, day cares) that require more parking than some existing shopping centers can provide and may not generate the same level of sales tax revenues.

The City depends on a single employer for a significant share of its revenues. In FY 2012-13, Apple contributed total revenues of \$9.2 million, or approximately 18 percent of Cupertino’s General Fund

budget.¹¹ Most of the revenues that Apple generates come from sales, property, and utility user taxes, including approximately 45 percent Cupertino's sales and use tax revenues in FY 2012-13. Overall, the opening of Apple Campus 2 is expected to increase Apple's share of tax revenue. In addition to the revenues that Apple contributes directly, suppliers, consultants, and other vendors dependent on Apple also add indirectly to the company's impact on the City budget.

Protecting Cupertino's quality of life is an overriding concern for residents. According to residents polled for the 2014 community survey, the most important issues facing Cupertino were affordable housing (33 percent), traffic (21 percent), and controlling growth (17 percent).¹² Many residents are also concerned about preserving the quality of the public school system as the community continues to grow and change.

CONCLUSION

Cupertino's economy is shaped by the community's location at the heart of the South Bay's innovation economy, family-friendly environment, high-quality services, and well-educated, highly skilled workforce. These assets position the city well to continue to attract and retain businesses, especially in the region's fast-growing technology sector. At the same time, the Economic Development Strategic Plan will also need to consider the issues raised by residents, business owners, and other stakeholders, including the need to maintain a healthy fiscal position in the long-term while retaining small and local businesses, providing access to a range of goods and services, and protecting quality of life.

¹¹ This does not include one-time revenues from the construction of Apple Campus 2. The fiscal analysis related to Apple and presented here is from Keyser Marston Associates, "Economic and Fiscal Impacts Generated by Apple in Cupertino—Current Facilities and Apple Campus 2", prepared for Apple Inc., 2013.

¹² City of Cupertino – 2014 Community Satisfaction Survey, Godbe Research, 2014.

III. INDUSTRY AND EMPLOYMENT TRENDS

This section discusses trends in Cupertino's employment base in the context of the South Bay's evolving economy. The section builds on the 2014 Market Study, which provided an overview of economic activity in Cupertino. However, this analysis includes a more detailed analysis of businesses by industry and firm size, in order to provide a more nuanced understanding of the economic trends that currently shape the city's economy, the industries that are likely to drive future economic growth, and the types of businesses and industries may require additional support from the city in order to thrive.

The section begins with a discussion of recent economic trends in the South Bay, followed by a more detailed analysis of Cupertino's businesses and employment base.

ECONOMIC TRENDS

South Bay Region

The South Bay region (San Mateo County and Santa Clara County) is experiencing rapid economic growth. In 2014, employment reached its highest level since 2000, approximately nine percent higher than the pre-recession peak in 2008 (Figure III-1). The South Bay's strong job growth has driven a steep decline in the unemployment rate, from a high of 9.9 percent in 2009 to 4.9 percent in 2014. According to Joint Venture Silicon Valley, employment growth in the South Bay counties has outpaced all other counties in the nine-county Bay Area region except San Francisco since at least 2007. Average wages in the South Bay and San Francisco have also risen to pre-recession levels, while wages in the rest of the Bay Area region remain below 2010 levels.¹³

The South Bay's growth in employment and income has been driven primarily by the technology sector and other jobs in the professional, technical, and financial services. Professional and technical services jobs represent one-third of employment in the South Bay (Figure III-2). Software now accounts for over 50 percent of venture capital funding in Silicon Valley, the highest share ever for this industry.¹⁴

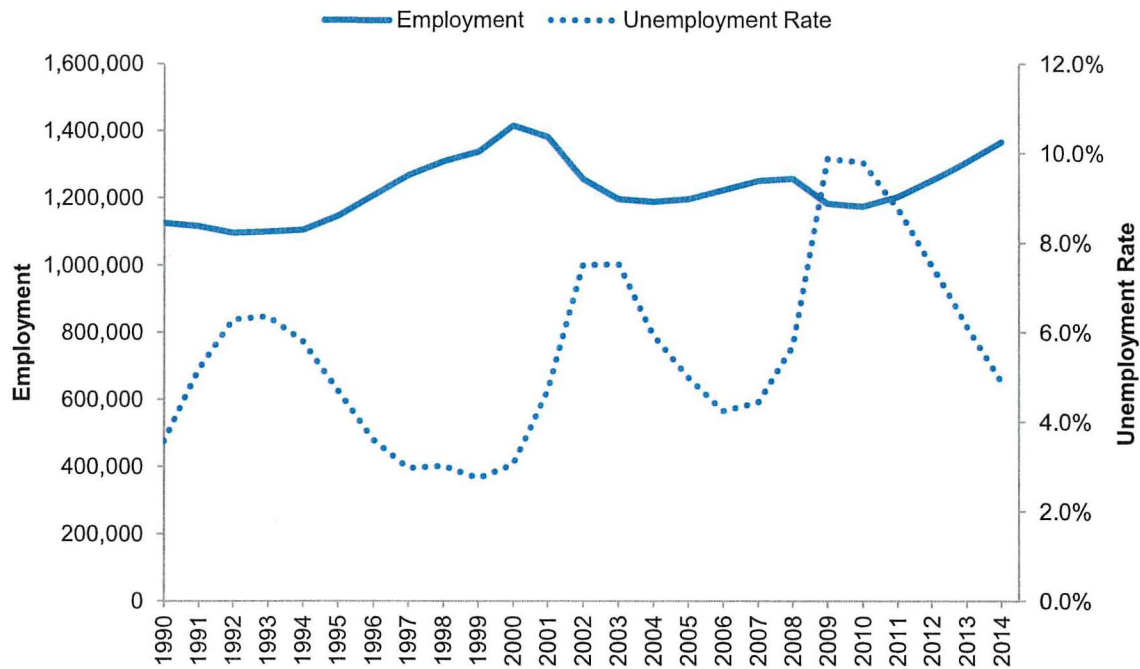
However, employment in other sectors has not kept up with growth in technology and the professional services. While employment in technology firms has recovered from the recession of 2008-2009, employment in other sectors such as traditional manufacturing, arts and entertainment, and local government administration have fallen in recent years. Consistent with this trend, the region has seen the most job and income growth in higher skill job sectors, while middle and lower skill employment growth has been more sluggish.¹⁵

¹³ Joint Venture Silicon Valley Index, 2015.

¹⁴ Ibid.

¹⁵ Ibid.

Figure III-1. South Bay Employment Trends, 1990-2014



Source: State of California Employment Development Department, 2015; Strategic Economics, 2015.

Figure III-2. South Bay Employment by Industry Category, 2014

Category	Employment	% of Total
Professional and Technical Services (a)	423,847	33%
Manufacturing	180,593	14%
Other Industrial (b)	153,040	12%
Health	143,924	11%
Retail	119,298	9%
Restaurants	97,814	8%
Other (c)	87,545	7%
Education	46,071	4%
Accommodation & Entertainment	34,701	3%
Total	1,286,833	100%

(a) Includes Information, Finance and Insurance, Real Estate, Rental, Leasing, Professional, Scientific, Technical Services, and Management of Companies and Enterprises

(b) Includes Construction, Wholesale Trade, and Transportation and Warehousing

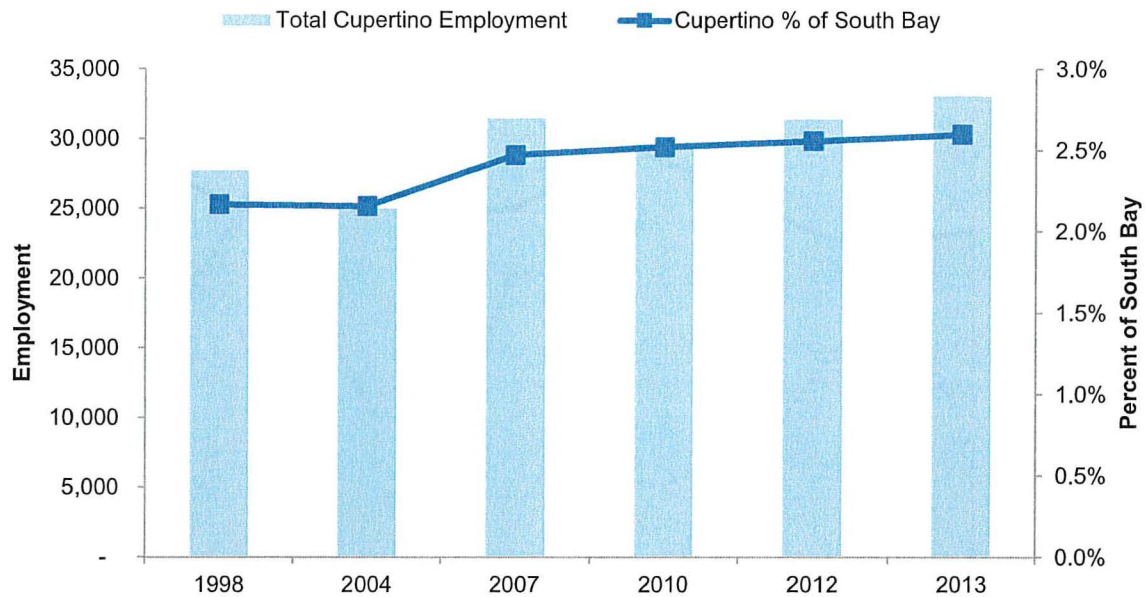
(c) Includes Natural Resources, Utilities, Administrative and Support, Waste Management and Remediation, Other Services (except Public Administration) and Unclassified

Source: Quarterly Census of Employment and Wages, 2014; Strategic Economics, 2015.

Cupertino

Reflecting the recent trends in the South Bay, Cupertino has experienced a strong recovery from the recession of 2008-2009. As of 2013, employment had exceeded 2007 levels (Figure III-3). Over time, the city has become an increasingly competitive location for employment. In 2013, Cupertino accounted for 2.6 percent of all jobs in the South Bay, up from 2.2 percent in 1998.

Figure III-3: Total Private Employment in Cupertino and as a Percent of South Bay Employment



Excludes self-employed and government workers.

Source: US Census ZIP Code and County Business Patterns, 2013; Strategic Economics, 2015.

BUSINESSES AND INDUSTRIES IN CUPERTINO

This section describes the types of businesses and industries in Cupertino. Because the city is home to Apple and other large companies, the data on employment by industries tends to reflect the dominance of these employers. In order to provide a more complete portrait of all businesses in Cupertino, this analysis begins with an overview of the city's major employers (those with 250 or more workers) and then provides more detail on the characteristics of small and midsize businesses.

Large Businesses

Almost all of the city's major employers are in the technology or education sectors. Figure III-4 lists businesses in Cupertino that employ 250 or more workers. Almost all of the privately owned large employers are in the high tech or biotech industries. The city's largest employers also include the local school and community college districts and a private health care center that serves a local retirement community.

Apple Inc. is Cupertino's single largest employer and the second largest technology employer in Silicon Valley. Apple employs approximately 15,000 workers in office and research and development buildings across the city, representing approximately 47 percent of its workforce. Following the completion of Apple's second campus in 2016, the company's total employment in Cupertino is projected to increase to 23,400.¹⁶

¹⁶ Keyser Marston Associates, "Economic and Fiscal Impacts Generated by Apple in Cupertino—Current Facilities and Apple Campus 2", prepared for Apple Inc., 2013.

Figure III-4: Businesses in Cupertino with more than 250 Employees, 2013

Employer	Sector	Employees
Apple	Technology	15,000
Cupertino Union School District	Education	1,597
Foothill/DeAnza Community College District	Education	1,183
Fremont Union High School District	Education	961
Seagate Technology LLC	Technology	500
Affymax Inc	Biotechnology	304
Pegasystems (formerly Chordiant)	Technology	285
Trend Micro Inc	Technology	250
Health Care Center at the Forum	Health Services	250
Total		20,330

Source: Cupertino 2012-2013 Comprehensive Annual Financial Report, 2013; Strategic Economics, 2015.

Small and Midsize Businesses

Cupertino's major employers are well known, but the city's smaller employers are less well understood. This section focuses on small and midsize firms, defined here as those with fewer than 250 employees, including trends by 1) industry and 2) business size. The findings in this section are based on data from the US Census County and ZIP Code Business Patterns for the years 1998 and 2012 (the most recent year available at the time of the analysis).¹⁷

Industry Trends

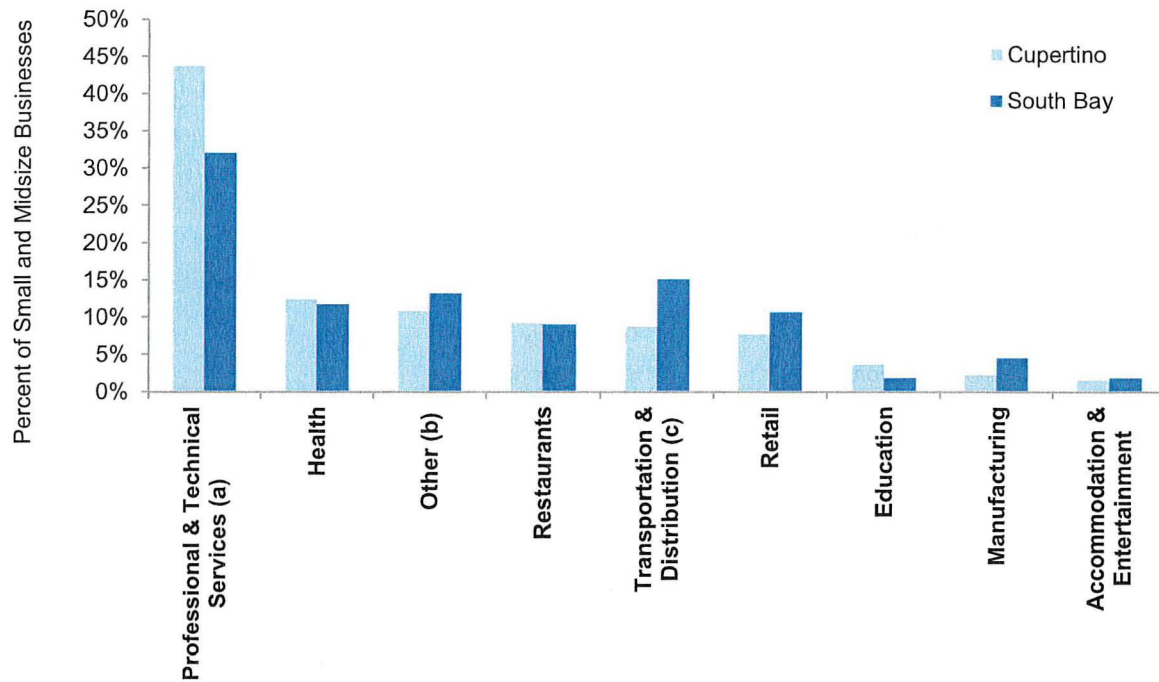
Most of Cupertino's small and midsize businesses are in the professional and technical services. In 2012, professional and technical services accounted for 44 percent of Cupertino's small and midsize firms, compared to 32 percent of small and midsize firms in the South Bay (Figure III-5). These professional and technical services firms employed 32 percent of workers employed in firms with fewer than 250 workers in Cupertino, compared to 27 percent of South Bay workers employed in businesses of this size (Figure III-6).

Cupertino has relatively few small and midsize firms in the manufacturing and transportation and distribution sectors. As shown in Figure III-5, the manufacturing sector accounted for 2 percent of total small and midsize businesses in Cupertino in 2012, compared with 5 percent for the South Bay. The transportation and distribution sector made up 9 percent of total small and midsize businesses in the city, compared with 15 percent for the South Bay.

Compared to the South Bay, Cupertino generally has a similar concentration of small and midsize firms in service sectors such as health, education, retail, and accommodation. As shown in Figure III-5, Cupertino has a similar share of small and midsize businesses in the restaurant, health, and accommodation (hotel) sectors compared to the South Bay. The city also has a relatively high share of educational establishments, even excluding the school and community college districts (which all employ 250 or more workers). This may reflect the tutoring and after-school centers that serve Cupertino's many families with children. However, compared to the South Bay, Cupertino has a relatively low share of retail businesses, in part reflecting significant vacancies at Vallco.

¹⁷ Note that the County and Zip Code Business Patterns data exclude self-employed workers, as well as employees of private households, railroad employees, agricultural production employees, and most government employees.

Figure III-5: Small and Midsize Businesses by Sector: Cupertino and the South Bay, 2012 (Businesses with Fewer than 250 Employees)



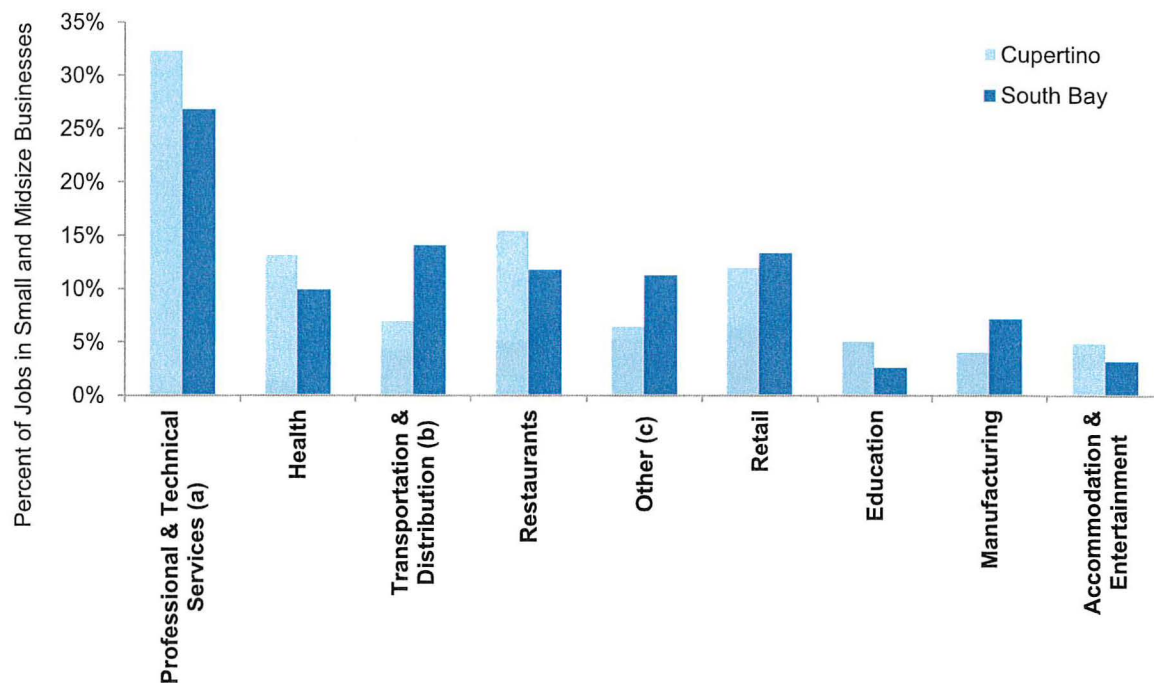
(a) Includes Information, Finance and Insurance, Real Estate, Rental, Leasing, Professional, Scientific, Technical Services, and Management of Companies and Enterprises

(b) Includes Natural Resources, Utilities, Administrative and Support, Waste Management and Remediation, Other Services (except Public Administration) and Unclassified

(c) Includes Construction, Wholesale Trade, and Transportation and Warehousing

Source: US Census ZIP Code and County Business Patterns, 2012; Strategic Economics, 2015.

Figure III-6. Jobs in Small and Midsize Businesses by Sector: Cupertino and the South Bay, 2012
(Businesses with Fewer than 250 Employees)



(a) Includes Information, Finance and Insurance, Real Estate, Rental, Leasing, Professional, Scientific, Technical Services, and Management of Companies and Enterprises

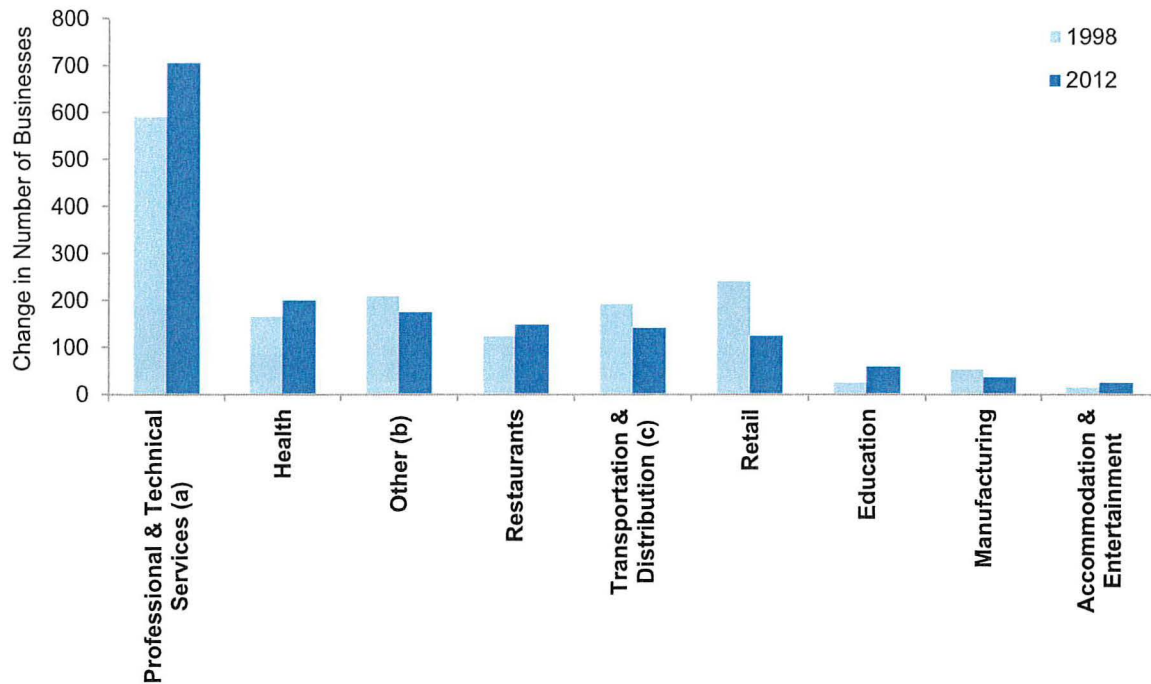
(b) Includes Construction, Wholesale Trade, and Transportation and Warehousing

(c) Includes Natural Resources, Utilities, Administrative and Support, Waste Management and Remediation, Other Services (except Public Administration) and Unclassified

Source: US Census ZIP Code and County Business Patterns, 2012; Strategic Economics, 2015.

Between 1998 and 2012, the number of small and midsize businesses in the professional and technical services, health, restaurant, accommodation, and education sectors grew, while the number of businesses in the industrial and retail sectors declined. As shown in Figure III-7, 115 new professional and technical businesses were added between 1998 and 2012, with smaller gains in education, health care, accommodation (hotels), and restaurants. During this same period, Cupertino lost nearly half of its retail businesses and one-quarter of its businesses in manufacturing, transportation, warehousing, and construction. Competition with technology and professional services firms for industrial space may be contributing to the decline in manufacturing, transportation distribution, and warehousing businesses. The decrease in retail establishments reflects the declining occupancy rates in Vallco mall over this time period.

Figure III-7: Change in Number of Small and Midsize Businesses by Sector: Cupertino, 1998 to 2012 (Establishments with 250 or Fewer Employees)



(a) Includes Information, Finance and Insurance, Real Estate, Rental, Leasing, Professional, Scientific, Technical Services, and Management of Companies and Enterprises

(b) Includes Natural Resources, Utilities, Administrative and Support, Waste Management and Remediation, Other Services (except Public Administration) and Unclassified

(c) Includes Construction, Wholesale Trade, and Transportation and Warehousing

Source: US Census ZIP Code and County Business Patterns, 2013; Strategic Economics, 2015.

Technology-based industries accounted for 21 percent of Cupertino's small to midsize businesses.

The technology industry includes businesses from several of the sectors discussed above, including professional and technical services, transportation and distribution, and manufacturing. In total, technology firms account for 21 percent of Cupertino's small to midsize businesses (Figure III-8). In comparison, only ten percent of small and midsize businesses in the South Bay as a whole are in technology. The majority of technology businesses are in software development, including custom computer programming services and computer systems design services.

According to local real estate brokers, many small and midsize companies locate in Cupertino to do business with Apple or the city's other large technology companies. The industries shown in Figure III-8 do not capture the full magnitude of Cupertino's technology economy, as many of the city's businesses in other industries – such as legal offices and consulting firms – provide services to Apple or other technology firms.

Figure III-8: Top Technology-Related Industries: Cupertino, 2012 (Businesses with Fewer than 250 Employees)

Industry	Firms	% of Total Firms	Estimated Jobs	% of Total Jobs
Custom Computer Programming Services	156	10%	1,606	9%
Computer Systems Design Services	76	5%	263	1%
Other Electronic Parts and Equipment Merchant Wholesalers	22	1%	164	1%
Computer, Computer Peripheral Equipment, Software Wholesalers	15	1%	282	2%
Other Computer Related Services	13	1%	217	1%
Software Publishers	13	1%	557	3%
Data Processing, Hosting, and Related Services	12	1%	124	1%
Electronic Shopping	10	1%	39	0%
All Others*	19	1%	537	3%
Total Technology-Related	336	21%	3,786	21%
Total Small and Midsize Firms	1,611	100%	17,724	100%

*Includes Computer Facilities Management Services, Internet Publishing and Broadcasting and Web Search Portals, Software and Other Prerecorded Compact Disc, Tape, and Record Reproducing, Bare Printed Circuit Board Manufacturing, Instruments and Related Products Manufacturing for Measuring, Displaying, and Controlling Industrial Process Variables, Semiconductor and Related Device Manufacturing, Printed Circuit Assembly (Electronic Assembly) Manufacturing, Semiconductor Machinery Manufacturing Computer Storage Device Manufacturing.

Source: US Census ZIP Code and County Business Patterns, 2013; Strategic Economics, 2015.

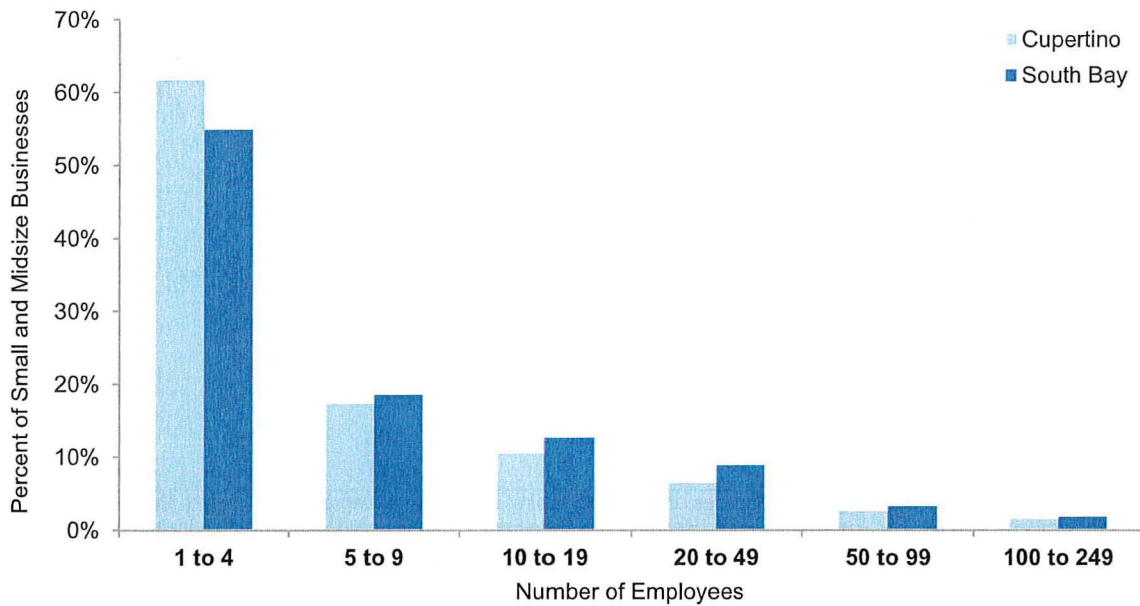
Business Size

Cupertino has a high concentration of very small businesses with between one and four employees. Businesses with one to four employees accounted for 62 percent of all businesses in Cupertino in 2012, compared to 55 percent of businesses in the South Bay as a whole (Figure III-9). These very small firms accounted for 14 percent of workers employed in small and midsize firms in Cupertino, compared to just over 10 percent of workers in the south Bay (Figure III-10). Very small businesses were also the only firm size category that experienced a net increase in number of businesses between 1998 and 2012 (Figure III-11).

Most of Cupertino's very small businesses are in the professional services sector. Figure III-12 shows businesses by size and industry. More than half of businesses with one to four employees are in the professional and technical services sector. According to local brokers and business leaders, Cupertino is attractive for small entrepreneurs and start-ups because of the highly-skilled workforce that lives in the city and in neighboring communities.

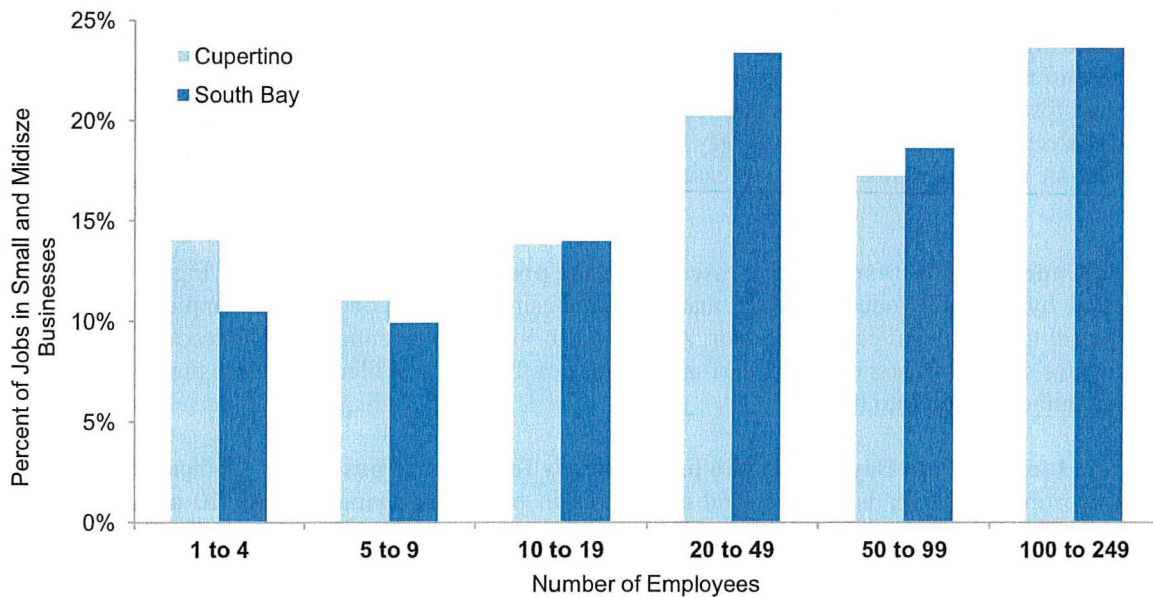
Compared to the South Bay, Cupertino has relatively few midsize businesses. Compared to the South Bay, Cupertino has fewer businesses and employees in firms employing between 10 and 250 workers (Figures III-9 and III-10). Between 1998 and 2012, the number of these midsize firms in the city declined (Figure III-11). Limited space availability may be one factor contributing in the weaker performance of midsize businesses as compared to very small establishments. Commercial real estate brokers in Cupertino report that many midsize businesses cannot find space in Cupertino, and that expanding businesses are often forced to leave the city because they cannot find suitably large offices for their growing businesses.

Figure III-9: Businesses by Size: Cupertino and the South Bay, 2012 (Businesses with 250 Employees or Fewer)



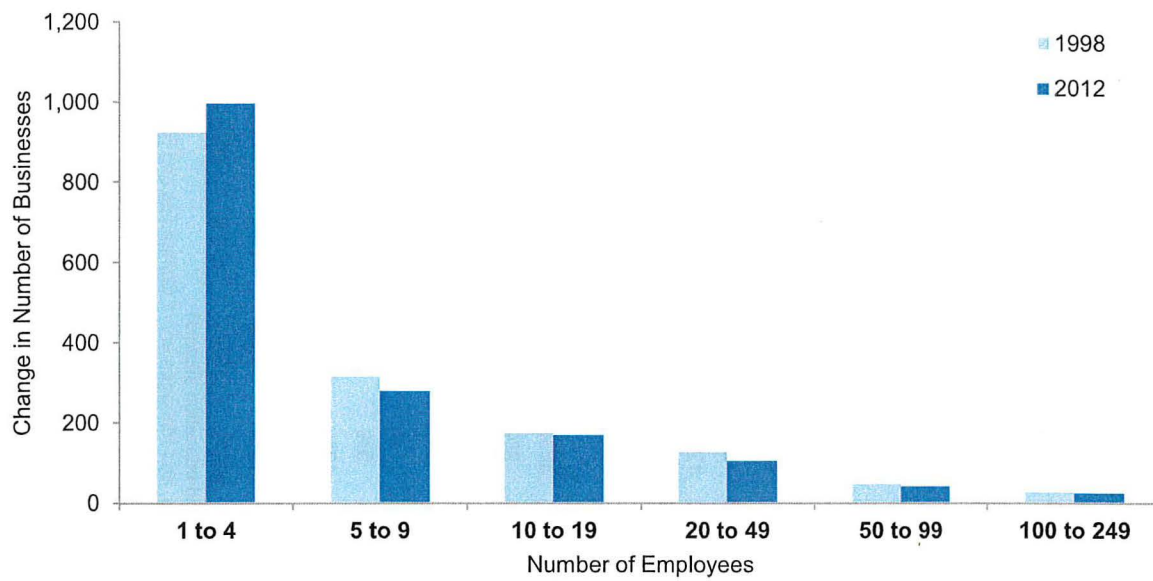
Source: US Census ZIP Code and County Business Patterns, 2012; Strategic Economics, 2015.

Figure III-10: Jobs by Business Size: Cupertino and the South Bay, 2012 (Businesses with 250 Employees or Fewer)



Source: US Census ZIP Code and County Business Patterns, 2012; Strategic Economics, 2015.

Figure III-11: Change in Number of Businesses by Size: Cupertino, 1998 to 2012 (Businesses with 250 Employees or Fewer)



Source: US Census ZIP Code Business Patterns, 1998, 2012; Strategic Economics, 2015.

Figure III-12: Businesses by Sector and Size: Cupertino and South Bay, 2012 (Businesses with Fewer than 250 Employees)

Sector	Business Size (Number of Employees)						Percent of Firms of Each Size					
	1 to 4	5 to 19	20 to 49	50 to 99	100 to 249	Total	1 to 4	5 to 19	20 to 49	50 to 99	100 to 249	Total
Cupertino												
Professional & Technical Services (a)	513	146	29	9	8	705	52%	33%	28%	22%	33%	44%
Manufacturing	20	10	0	5	1	36	2%	2%	0%	12%	4%	2%
Transportation & Distribution (b)	99	28	9	5	0	141	10%	6%	9%	12%	0%	9%
Retail	62	44	10	2	6	124	6%	10%	10%	5%	25%	8%
Accommodation & Entertainment	9	5	6	3	2	25	1%	1%	6%	7%	8%	2%
Restaurants	42	71	24	10	1	148	4%	16%	23%	24%	4%	9%
Health	104	77	12	2	5	200	10%	17%	12%	5%	21%	12%
Education	24	24	8	2	1	59	2%	5%	8%	5%	4%	4%
Other (c)	123	43	6	3	0	175	12%	10%	6%	7%	0%	11%
Total	996	448	104	41	24	1,613	100%	100%	100%	100%	100%	100%
South Bay												
Professional & Technical Services (a)	13,726	4,922	1,362	539	336	20,885	38%	24%	24%	25%	29%	32%
Manufacturing	1,157	1,070	432	171	110	2,940	3%	5%	7%	8%	10%	5%
Transportation & Distribution (b)	5,681	2,934	791	284	161	9,851	16%	14%	14%	13%	14%	15%
Retail	2,980	2,753	761	303	173	6,970	8%	14%	13%	14%	15%	11%
Accommodation & Entertainment	484	375	196	81	51	1,187	1%	2%	3%	4%	4%	2%
Restaurants	1,773	2,734	1,036	285	50	5,878	5%	13%	18%	13%	4%	9%
Health	4,163	2,756	479	170	108	7,676	12%	14%	8%	8%	9%	12%
Education	555	383	158	67	35	1,198	2%	2%	3%	3%	3%	2%
Other (c)	5,269	2,398	568	234	131	8,600	15%	12%	10%	11%	11%	13%
Total	35,788	20,325	5,783	2,134	1,155	65,185	100%	100%	100%	100%	100%	100%

Note: excludes businesses with more than 250 employees (which are primarily in the professional & technical services and education sectors).

a) Includes Information, Finance and Insurance, Real Estate, Rental, Leasing, Professional, Scientific, Technical Services, and Management of Companies and Enterprises

(b) Includes Construction, Wholesale Trade, and Transportation and Warehousing

(c) Includes Natural Resources, Utilities, Administrative and Support, Waste Management and Remediation, Other Services (except Public Administration) and Unclassified

Source: US ZIP Code and County Business Patterns, 2012; Strategic Economics, 2015.

CONCLUSION: CUPERTINO'S COMPETITIVE POSITION

The business and industry trends discussed in this section suggest many opportunities and several challenges for economic development in Cupertino.

Opportunities

Key opportunities for economic development include:

- **Growing job base:** The number of private jobs in Cupertino grew by nearly 20 percent over the last decade and a half, from 27,700 jobs in 1998 to 33,000 jobs in 2013. Cupertino's employment base also grew more quickly than employment in the South Bay as a whole during this time period.
- **Major employers:** Cupertino's economy is driven by a number of major technology employers, including Apple, Seagate, Pegasystems, and Trend Micro. Other firms seek to locate in Cupertino in order to do business with Apple and the city's other major employers as a vendor, partner, or consultant.
- **Concentration of small and midsize technology firms:** Cupertino's strength in technology is not limited to large employers. Approximately 20 percent of the city's small and midsize businesses (defined as those with fewer than 250 employees) are in technology firms. Moreover, many of the small and midsize businesses in other industries – such as legal offices and consulting firms – cater directly to Apple or other technology firms.
- **Attractive business climate for small entrepreneurs and start-ups:** Cupertino is attractive for small entrepreneurs and start-ups because of the highly skilled workforce that lives in the city and in neighboring communities. This is reflected in the city's strong concentration of professional and technical firms with one to four employees.

Potential Challenges

However, the industry trends also reveal several potential challenges for the city's long-term economic growth, including:

- **Few small and midsize manufacturing businesses:** While Cupertino's largest employer, Apple, is often categorized as a manufacturing business, the city has relatively few small and midsize businesses in manufacturing or other industrial industries such as transportation, distribution, or construction. This may reflect the challenges that small and midsize manufacturing firms face in competing with professional and technical firms for office and R&D space in Cupertino.
- **Challenging environment for midsize firms:** Compared to the South Bay, Cupertino has fewer businesses and employees in firms employing between 10 and 250 workers, and the number of businesses in this size range is declining. Limited space availability may be one contributing factor. Commercial real estate brokers in Cupertino report that many midsize businesses cannot find space in Cupertino, and that expanding businesses are often forced to leave the city because they cannot find sufficient space for their growing businesses.

IV. OFFICE SECTOR

The rapid job growth in Silicon Valley and Cupertino has fueled strong demand for existing office space. This section reviews recent office market trends in Silicon Valley and Cupertino, focusing on trends in the key employment locations within the City of Cupertino.¹⁸

OFFICE MARKET OVERVIEW

Figure IV-1 provides an overview of the office inventory, vacancies, and rents in Cupertino compared to other markets in Silicon Valley as of the first quarter of 2015. Figure IV-2 summarizes the office development that is entitled, proposed, or under construction in Cupertino and surrounding communities.

The Silicon Valley office market contains 85.6 million square feet of space, with an overall vacancy rate of 8.7 percent and an average monthly rental rate of \$3.67 per square foot. Overall, Class A office space accounts for slightly less than 60 percent of the region's office inventory (Figure IV-1).

Cupertino outperforms most nearby communities, with the exception of Mountain View, Menlo Park, and Palo Alto. As shown in Figure IV-1, the average rent for available office space in Cupertino was \$4.65 per square foot (\$4.94 for Class A) in the first quarter of 2015, with vacancy at a very low 2.3 percent (2.4 percent for Class A).

Three-fourths of Cupertino's office space is Class A. Class A office space represents a higher share of Cupertino's office inventory than in any other Santa Clara county market except Sunnyvale (Figure IV-1).

Cupertino's high rents and low vacancy rates reflect the city's many competitive advantages. As discussed in previous sections, Cupertino has excellent access to Highway 85 and I-280, enabling companies to draw from the highly educated labor force throughout Silicon Valley and providing easy access to venture capital. Moreover, many firms seek to locate in Cupertino to do business with Apple and the city's other major employers, and to take advantage of what is considered a prestigious business address second only to the North Valley cities of Palo Alto, Mountain View, and Menlo Park.

Low vacancy rates and limited turnover may constrain the city's ability to accommodate expanding companies. Brokers indicate that larger spaces, particularly in the range of 20,000 to 100,000 square feet, are in high demand for expanding companies seeking space in Silicon Valley. However, space of this size is extremely limited in Cupertino, and companies often compete with Apple – which typically offers to pay for significant tenant improvements – for available vacancies. According to market research by Newmark Cornish & Carey, Cupertino saw only three lease transactions of more than 10,000 square feet in 2014, while 14 deals were closed for spaces between 3,000 and 9,999 square feet, and 51 deals were closed for spaces of less than 3,000 square feet. As a result of the limited space availability, some companies that would prefer to locate in Cupertino instead sign leases elsewhere. Blue Coat and Amazon Lab 126 are two recent examples of Cupertino companies that moved to Sunnyvale in order to find sufficient space after expanding.

¹⁸ Cupertino also has a small light industrial and research and development (R&D) building stock, mostly in the Bubb Road area. However, most of the industrial/R&D buildings in Cupertino have been converted to office uses or a mix of office and R&D, and are therefore considered in this section as part of the overall office market.

Figure IV-1: Office Inventory, Vacancies, and Rents: Cupertino and Market Area Cities, Q1 2015

Market	Rentable Building Area (Sq. Ft.)			Vacancy Rate		Average Asking Monthly Rents (Per Sq. Ft., Full Service)	
	All Office	Class A	Class A as a % of Total	All Office	Class A	All Office	Class A
Cupertino	4,341,133	3,264,642	75%	2.3%	2.4%	\$4.65	\$4.94
Other West Valley	4,535,137	1,591,191	35%	6.2%	8.5%	\$3.46	\$4.09
Campbell	2,300,372	885,460	38%	8.9%	13.9%	\$3.48	\$4.03
Los Gatos	1,873,492	605,356	32%	4.0%	2.1%	\$3.46	\$4.64
Saratoga	361,273	100,375	28%	1.1%	0.0%	\$2.76	-
North Valley	34,850,862	21,876,263	63%	4.5%	4.5%	\$5.77	\$5.53
Menlo Park	5,659,752	1,872,466	33%	4.5%	7.6%	\$8.10	\$9.17
Mountain View	7,165,496	5,001,436	70%	2.1%	1.5%	\$5.53	\$5.55
Palo Alto	10,126,183	4,570,974	45%	4.3%	2.0%	\$6.85	\$7.63
Sunnyvale	11,899,431	10,431,387	88%	6.3%	6.5%	\$4.41	\$4.48
East Valley	41,953,983	23,723,874	57%	13.1%	12.6%	\$3.06	\$3.49
Santa Clara	13,031,174	8,523,307	65%	13.1%	13.9%	\$3.69	\$4.04
San Jose	27,789,874	14,807,910	53%	13.1%	11.7%	\$2.79	\$3.17
Milpitas	1,132,935	392,657	35%	11.1%	18.3%	\$2.15	\$2.07
Total Silicon Valley	85,681,115	50,455,970	59%	8.7%	8.3%	\$3.67	\$4.02

Source: Silicon Valley 1Q15 Office Market, Newmark Cornish & Carey, 2015; Colliers International, Q1 2015; Strategic Economics, 2015.

There are approximately 36 million square feet of new office development planned, proposed, or under construction in Santa Clara County. As shown in Figure IV-2, cities with significant office development in the pipeline include Mountain View (10.2 million square feet), San Jose (9.2 million square feet), Santa Clara (5.8 million), Cupertino (up to 5.6 million), and Sunnyvale (4.8 million).

Major office projects planned or under construction in Cupertino include Apple Campus II, Main Street, and Vallco. If Vallco proceeds with its allocation of two million square feet of office space, the total amount of pipeline office construction totals 5.6 million square feet in Cupertino – or approximately 16 percent of the total new office development planned in Santa Clara County. It should be noted that in addition to the new Apple Campus, Apple will occupy the 260,000 square feet of office under construction at Main Street Cupertino.

Figure IV-2. Summary of Office Development Planned, Proposed, and Under Construction: Cupertino, West Valley, and Other Selected Santa Clara County Cities

Market	Square Feet	Percent of Total
Cupertino		
Apple Campus II	3,400,000	9%
Main Street	260,000	1%
Vallco*	2,000,000	5%
Total	5,660,000	16%
Other West Valley		
Campbell	170,000	0%
Los Gatos	433,000	1%
Saratoga	0	0%
Total	603,000	2%
Other Silicon Valley Cities		
Mountain View	10,230,000	28%
Sunnyvale	4,828,000	13%
Santa Clara**	5,870,000	16%
San Jose	9,264,000	25%
Total	30,192,000	83%
Total	36,455,000	100%

* The Cupertino General Plan allows for up to 2 million square feet of office to be built at Vallco; the amount of office area that included in the final development plan may change.

** Excludes the 3,000,000 square feet Yahoo campus proposal, which has stalled.

Source: City of Cupertino, 2015; New Development Report Q1 2015, Newmark Cornish & Carey, 2015; Strategic Economics 2015.

KEY EMPLOYMENT LOCATIONS WITHIN CUPERTINO

Within Cupertino, office uses are concentrated in several key locations. These are shown below in Figure IV-4 and include:

- **Stevens Creek:** Stevens Creek Boulevard between Highway 85 and the City of Cupertino's eastern boundary and South De Anza Boulevard between Stevens Creek Boulevard and the city's southern boundary
- **North De Anza:** North De Anza Boulevard between Stevens Creek Boulevard and Interstate 280.
- **Bubb Road:** Bubb Road west of Highway 85.

Figure IV-3 summarizes the total existing office inventory in each subarea. For the purposes of this analysis, the existing Apple Campus was excluded from the North De Anza subarea (although it is included in the total citywide inventory). Figure IV-3 also excludes projects that are planned or under construction, including Apple Campus 2, Main Street, and Vallco.

Accurate data on rents and vacancies in each subarea are not available. However, according to local real estate brokers, vacancies for each subarea are near zero, and rents tend to be very high throughout the city. Other key characteristics of the subareas are described below.

The Stevens Creek Boulevard subarea contains the most office space, including Cupertino City Center and a variety of smaller office buildings. As shown in Figure IV-3, 30 percent of Cupertino's office inventory is located in the Stevens Creek Boulevard subarea. This includes the approximately 300,000 square foot City Center, Class A office complex at the corner of Stevens Creek and North De Anza Boulevard. With the exception of City Center, the office spaces in the Stevens Creek subarea are a decentralized mixture of smaller Class B and C buildings with a variety of tenants. Much of this space has not been upgraded in recent years.

Currently, the premier location for office space in Cupertino is at the intersection of Stevens Creek and North De Anza Boulevards, and north along North De Anza. Cupertino City Center and the Apple Campus have historically anchored the prime North De Anza office corridor, which benefits from excellent access to Interstate 280.

Within the North De Anza subarea, there is a significant concentration of Class A space and most of the older space has been significantly upgraded. In particular, Bandle Road has seen upgrades of R&D spaces to conventional office spaces. While these upgrades were largely undertaken by Apple for its own use, these buildings would be very desirable for prospective tenants should they come on the market.

As a result of the Main Street and Apple Campus II projects, the most desirable location for office space is shifting eastward. Local brokers expect these developments to shift the premier location for office space in Cupertino to the east. Future redevelopment of Vallco could also contribute to this trend.

Bubb Road is a significant employment center, though smaller than Stevens Creek or North De Anza and characterized by a mix of R&D uses and older buildings. Bubb Road contains a number of older industrial buildings, some of which have been upgraded to office or R&D space by Apple. The western section of the subarea is developed with residential-style offices with smaller spaces and floor plates.

Figure IV-3: Existing Office* Inventory by Subarea

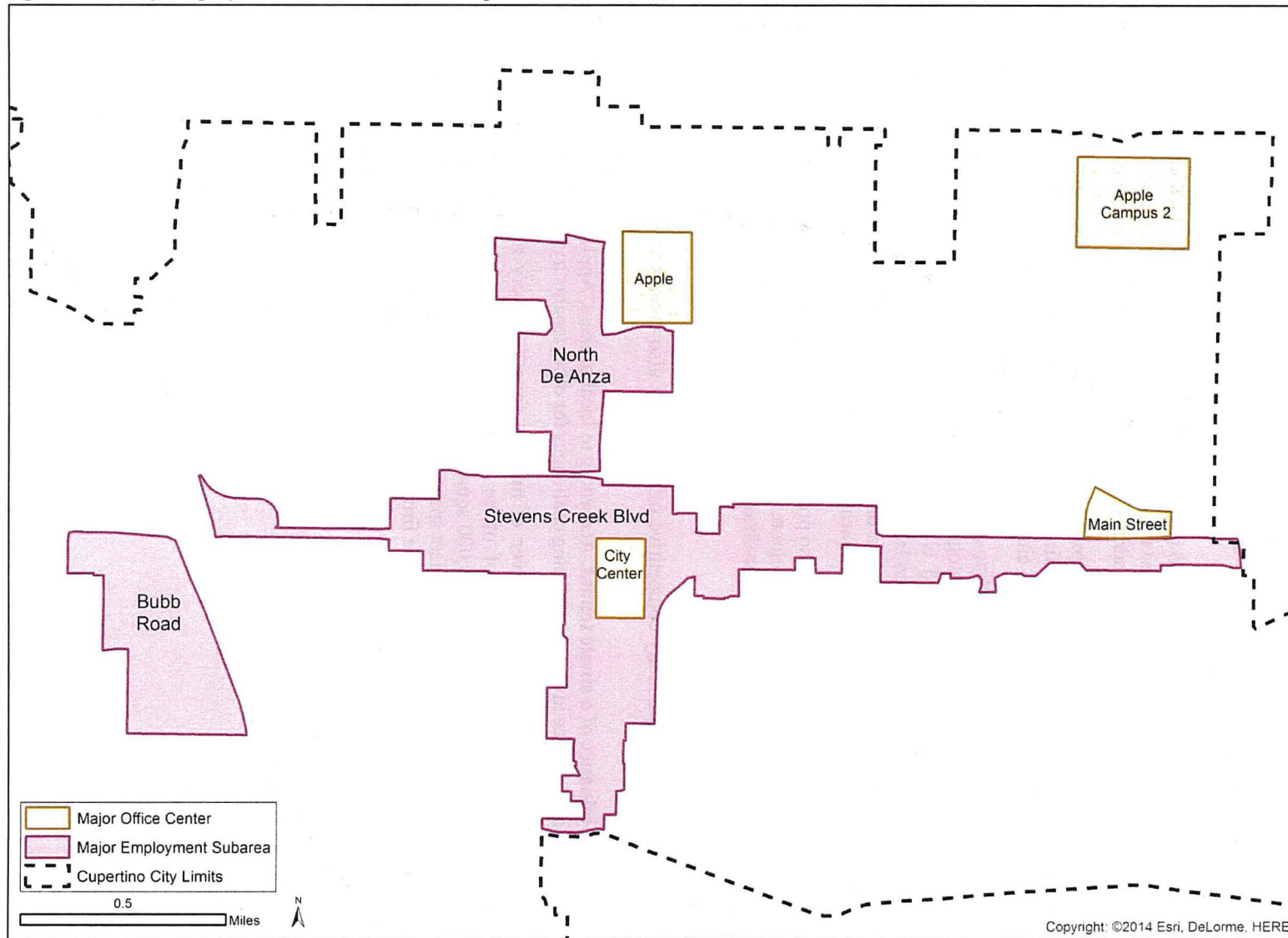
Subarea	Total Buildings	Total Rentable Building Area	
		Square Feet	% of Total
Stevens Creek Blvd	88	2,111,500	30%
North De Anza Blvd	25	1,261,400	18%
Bubb Road	54	848,600	12%
Other**	65	2,757,900	40%
Total Cupertino	232	6,979,400	100%

*Includes R&D and light industrial space as well as office inventory (as defined by CoStar); in Cupertino, R&D/light industrial space function similarly to traditional office space.

**Includes the 856,000 square foot existing Apple Campus

Source: CoStar, 2015; Strategic Economics, 2015.

Figure IV-4. Key Employment Locations within Cupertino



Sources: City of Cupertino, 2015; Strategic Economics, 2015.

CONCLUSION: CUPERTINO'S COMPETITIVE POSITION

Opportunities

Cupertino's price premium and low vacancy rates reflect several advantages that the city has in attracting and retaining office-based businesses:

- **Premier office location.** Cupertino is known as a premier location for businesses in high tech and other professional and technical services. Businesses and real estate brokers in the region recognize Cupertino as a highly prestigious address for corporations locating in the South Bay.
- **High-quality office stock.** Compared to other neighboring communities, Cupertino has an unusually high share of Class A office space. Moreover, much of the Class B and C stock has been upgraded over time by Apple, the city's largest employer.
- **Access to skilled labor.** Cupertino and surrounding communities in the West Valley, including Campbell, Los Gatos, and Saratoga, enjoy a particularly high concentration of high-income households and highly educated workers. Cupertino's location along Interstate 280 provides excellent access to a highly skilled labor pool in the Peninsula and the South Bay. Commute times on I-280 also tend to be shorter than on other, more congested highways such as Highway 101, making Cupertino a more attractive location for many employers.
- **Access to venture capital.** I-280 also provides excellent access to the Sand Hill Road area, the hub of venture capital activity in the region, as well as other venture capital firms and high-net-worth individuals funding new startup businesses around the Valley.

Potential Challenges

However, the city's exceptionally competitive office market also creates some challenges for economic development:

- **Predominance of a single tenant.** According to local brokers, Apple occupies 80 percent or more of the city's office inventory, creating challenges for other tenants trying to find space in Cupertino.
- **Limited availability and turnover of midsize spaces.** A very tight market for office space, combined with the high share of office space occupied by Apple, results in scarce leasing opportunities in the 20,000 to 100,000 square foot range. Although larger spaces are also in short supply, 20,000 to 100,000 square foot spaces are in high demand for growing, mid-size companies such as technology startups. As these firms mature and expand, they are often forced to find office space in other cities.

V. RETAIL AND HOTEL USES

Cupertino's high household incomes and strong employment base are driving significant demand for retail and hotel in the community. This section describes recent trends in the retail and hotel markets in Cupertino, in the context of national and regional trends.¹⁹

RETAIL

National and Regional Retail Trends

Due to a variety of factors, the national and regional retail environment is shifting, influencing the types of retailers that local communities can expect. Some of these wider industry trends are described below.

- **Online shopping has put pressure on conventional retail businesses.** As more retail sales shift online, demand for certain types of brick-and-mortar retail stores – for example, book, music, and video rental, and electronics stores – has declined significantly. In shopping centers and retail corridors across the region, demand for new retail space is increasingly driven by stores that face little or no competition from online sales, such as restaurants, groceries, hair and nail salons, and other personal services.
- **Preferences for retail space have evolved.** Some of the aging strip retail centers in the South Bay no longer meet the space needs of national and regional chains. These types of tenants tend to favor wide storefronts with high ceilings and highly visible signage, located in concentrated nodes with high traffic, good visibility, and easy vehicle and pedestrian access. Older retail buildings that do not meet those criteria may struggle to attract tenants, although in some instances they may also provide more affordable space for smaller, independent businesses.
- **In the Bay Area, new retail development is generally limited to expansions or redevelopment of existing malls and shopping centers, often as part of a mixed-use project.** The San Francisco Bay Area region has added very little new inventory in recent years, ranking 17th out of 19 primary markets for retail construction in 2015 despite having the lowest vacancy rate in the country.²⁰ There are many factors that have reduced the amount of new retail construction, including shrinking store sales, rising land costs, and rising construction costs. Generally, retail development projects generate lower financial returns than office or residential projects, making it difficult for retail development to compete for costly land unless it is part of a mixed-use project.
- **Mobile services are another source of competition for retailers.** Another small but growing retail trend affecting many cities is the rise of mobile services, including food trucks and convenience services such as dry cleaning or oil changes that travel to customers. National sales in food trucks alone are expected to rise from \$650 million in 2012 to \$2.7 billion in 2017.²¹ (Note that while several studies have attempted to quantify food trucks' market share, no data exist on the prevalence of other types of mobile services, such as dry cleaning, pet grooming, oil changing, etc.) The rising popularity of mobile services reflects the national and regional trend of increasing demand for specialty food, restaurants, and services. In the entrepreneurial South Bay in particular, more and more workers are accessing daily goods and services at work, and seeking temporary or event-like urban experiences after work and on the weekends. The spread of mobile services

¹⁹ Note that the retail portion of this section is primarily focused on the neighborhood-serving retail in Cupertino. Because Vallco is slated for redevelopment and the subject of its own Specific Plan, the shopping mall is not a focus in this analysis.

²⁰ JLL, United States Retail Outlook, Q2 2015.

²¹ Intuit Network, "Food Trucks Motor into the Mainstream," December 2012, <http://network.intuit.com/wp-content/uploads/2012/12/Intuit-Food-Trucks-Report.pdf>.

presents a mixture of challenges and opportunities for municipal government that requires specific planning and regulatory responses, as discussed below.

Best Practices for Mobile Services Policies

Mobile services include food trucks, mobile auto care services, mobile dry cleaning, and any other goods and services offered from a vehicle. These services create an opportunity to fill existing gaps in services, stimulate economic activity, and activate underutilized spaces with events and programming. However, the increasing popularity of mobile services has also raised concerns in many communities about public safety, sanitation, traffic, and competition with existing brick-and-mortar businesses. Many California cities are revisiting their regulatory framework to ensure that mobile services can continue to provide needed goods and services without detracting from local businesses or the community's quality of life. While any city developing a mobile services program or policy will need to tailor local laws to respond to that community's particular circumstances, a set of best practices is emerging as cities in the Bay Area and elsewhere in the country gain increasing experience with food trucks and other mobile services. In general, best practice policies generally include some combination of the following components:

- **Efficient permitting processes that protect public safety and minimize congestion:** Many cities are adjusting the permitting process for mobile services to help address concerns about impacts on traffic, parking, health, and safety. For example, permits for mobile vendors are often particular to specific geographic areas within the city, times of day, or special events. Spatial regulation (minimum distance from schools, bus intersections, other vendors, etc.) and time regulations (maximum time of operation on a single site) also help limit the density of vendors on a single property or in a particular area. Creating a more transparent, efficient permitting system can also help streamline the process for mobile vendors. In cases where separate permits are required from separate jurisdictions, some municipalities have created educational materials to help vendors understand the steps in the process.
- **Stakeholder involvement and education:** Brick-and-mortar business owners may perceive mobile vendors as having an unfair advantage because they do not pay rent or property taxes, and in some instances may avoid paying sales tax as well. No rigorous studies have attempted to measure the competitive effects of mobile services on brick-and-mortar businesses. However, anecdotal evidence suggests that food trucks may actually enhance retail shopping districts by diversifying and complementing existing retail offerings, thus attracting more pedestrian traffic to the district. Involving and educating concerned business owners and residents throughout the process of enacting new regulations can help get all stakeholders on board with a new policy. Regulating the number of food trucks that can gather in a particular site or district can also help address retailers' concerns about impacts on local businesses, in addition to addressing traffic and safety issues. Economic development programs that seek to activate underutilized areas or attract more street activity (discussed below) can also help brick-and-mortar retailers recognize an advantage to allowing food trucks or other mobile services to locate nearby.
- **Space activation and programming:** In addition to addressing traffic and safety concerns, regulations on where mobile vendors can locate can also help achieve economic development goals by directing vendors to underutilized areas, or to areas that will benefit from additional street activity. Food trucks have been used successfully to activate underutilized areas in various locales around the Bay Area (see Fremont case study, below). Food trucks can also enhance downtown environments, for example by attracting more foot traffic or serving as a complement to drinking establishments.

Best Practices for Mobile Services Policies, Continued

Case Study: Mountain View's Permitting Process

In 2013, the City of Mountain View passed an ordinance to address concerns about traffic flow and public safety arising from the increased presence of mobile vendors in that community. The ordinance also streamlined street vendor permitting to account for mobile services operating on both public and private property, rather than on designated sites. Mountain View's rules address safety and congestion by requiring mobile vendors to maintain a minimum distance of 100 feet from schools, and by limiting vending on private property to a maximum of four hours on a particular site per day, with no more than three vendors on a property simultaneously. A separate Temporary Use permitting process was created to allow for longer hours and larger clusters of vendors at food truck rallies and other special events. In Mountain View's downtown area, vendors are prohibited from operating on the most centralized streets. This restriction is an additional safety measure that also mitigates some of the competitive concerns of brick-and-mortar stores in that area.

Case Study: Fremont Street Eats

Beginning in 2013, the City of Fremont began working with the Fremont Chamber of Commerce to establish a weekly food truck event in Downtown Fremont. Fremont Street Eats is now a weekly event in its third season, sponsored by the Chamber. Street Eats was intended as an economic development program intended to help activate the Downtown. Many existing businesses, including small retailers and restaurants, consider the program a successful economic development effort because it helps bring pedestrian traffic to an area that was historically underused.



Fremont Street Eats

Image: Fremont Chamber of Commerce

Key Sources: Interviews with Chris Costanzo, Code Enforcement, City of Mountain View and Jessica von Borck, Deputy City Manager, City of Fremont; Intuit Network, "Food Trucks Motor Into the Mainstream," December 2012, <http://network.intuit.com/wp-content/uploads/2012/12/Intuit-Food-Trucks-Report.pdf>; Silicon Valley Economic Development Alliance, Unpublished White Paper.

Cupertino Household Spending Patterns

The household spending patterns of Cupertino residents help shape the type of retailers that are attracted to the city, as well as the performance of the city's overall retail sector. This section describes some of the key characteristics of Cupertino consumers, drawing on data about average spending patterns and the city's socio-demographic composition.

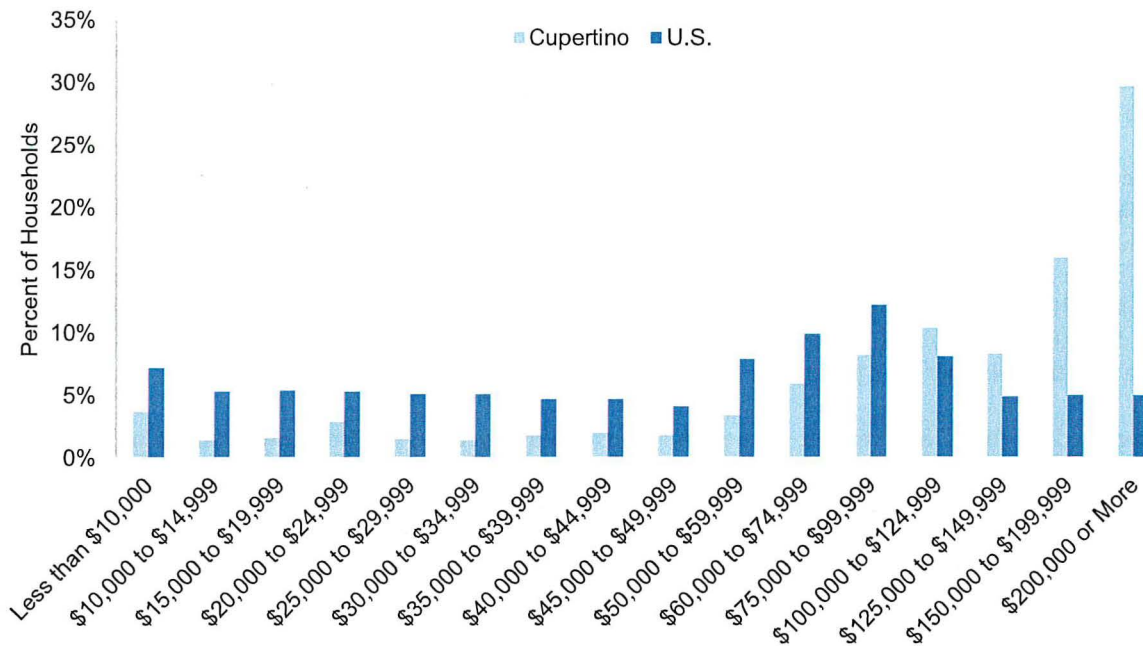
Reflecting the city's high income levels, Cupertino households spend significantly more than the average U.S. household. Cupertino households spent an average of \$85,999 in 2015 on all goods and services (including housing, transportation, food, etc.). In comparison, the average U.S. household spent \$56,056 in 2015. Cupertino households' spending reflects their high income levels. As shown in Figure V-1, nearly 30 percent of Cupertino households make \$200,000 or more a year; nearly two-thirds make at least \$100,000 a year. The median household income in Cupertino (\$134,870 in 2014) is more than two and a half times higher than the median U.S. household income (\$53,480).

Compared to the U.S. average, Cupertino households spend a slightly lower share of income on necessities such as housing, transportation, and food, and a relatively high share of income on day care and education, sports and entertainment, and apparel. Figure V-2 compares average Cupertino and U.S. household expenditures by category; Figure V-3 shows spending in each category as a percent of total expenditures. Cupertino household spending is higher than the U.S. average across all categories (Figures V-2). Similar to other U.S. households, Cupertino residents spend the most on transportation and auto expenses, housing and housing-related services and furnishings, and food and alcohol. However, these three categories account for just over half of total Cupertino household expenditures, compared to nearly 60 percent for the U.S. overall. At the same time, Cupertino residents devote a relatively high share of expenditures to day care and education, sports and entertainment, and apparel (Figure V-3).

Affluent families with children account for a high share of Cupertino households, but the city is also home to many singles and couples with distinct spending patterns. Figure V-4 shows the top ten PRIZM social groups in Cupertino.²² Most of the top social groups in Cupertino are characterized by married couples with children with high levels of education and income, and a preference for single-family homes. However, sizeable segments of the city's households – including the Young Digerati (accounting for 21 percent of Cupertino households), Movers and Shakers (6 percent), and Bohemian Mix (6 percent) – have few if any children, and prioritize living in close proximity to the office and/or to amenities such as movie theaters, nightclubs, fitness clubs, clothing boutiques, casual restaurants, microbreweries, and coffee shops.

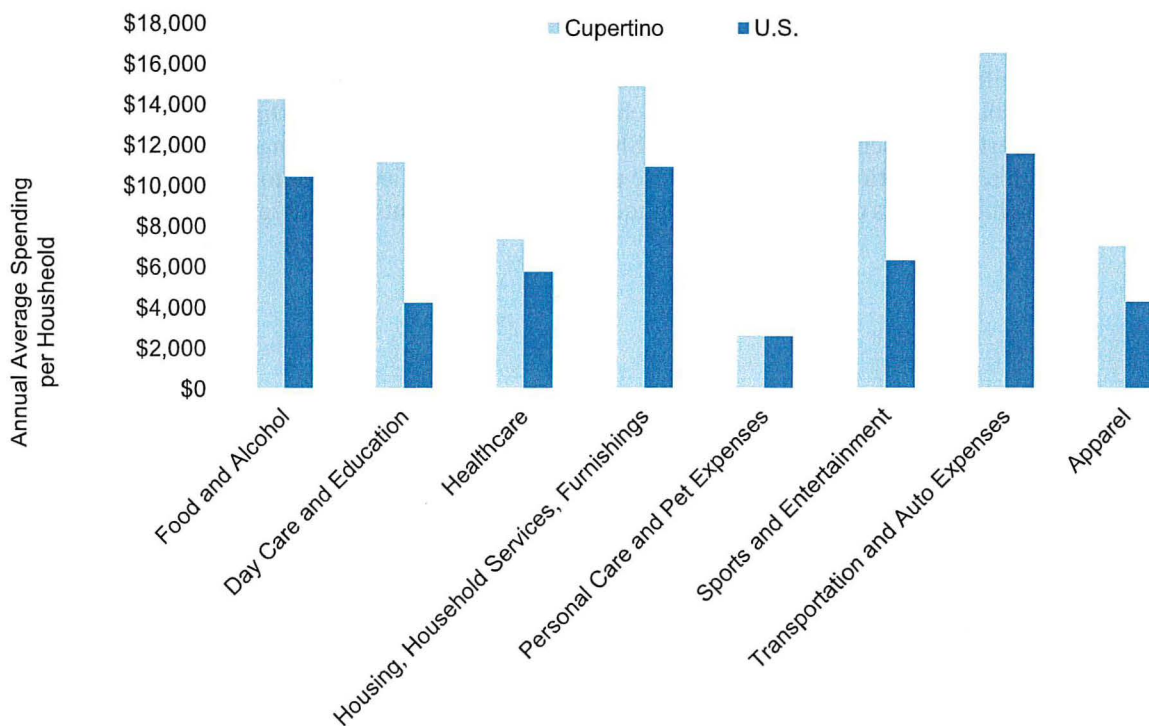
²² The Nielsen Company's PRIZM system defines every U.S. household in terms of 66 demographically and behaviorally distinct types, or "segments," to help marketers discern those consumers' likes, dislikes, lifestyles and purchase behaviors.

Figure V-1. Households by Income Level: Cupertino and the U.S., 2014\



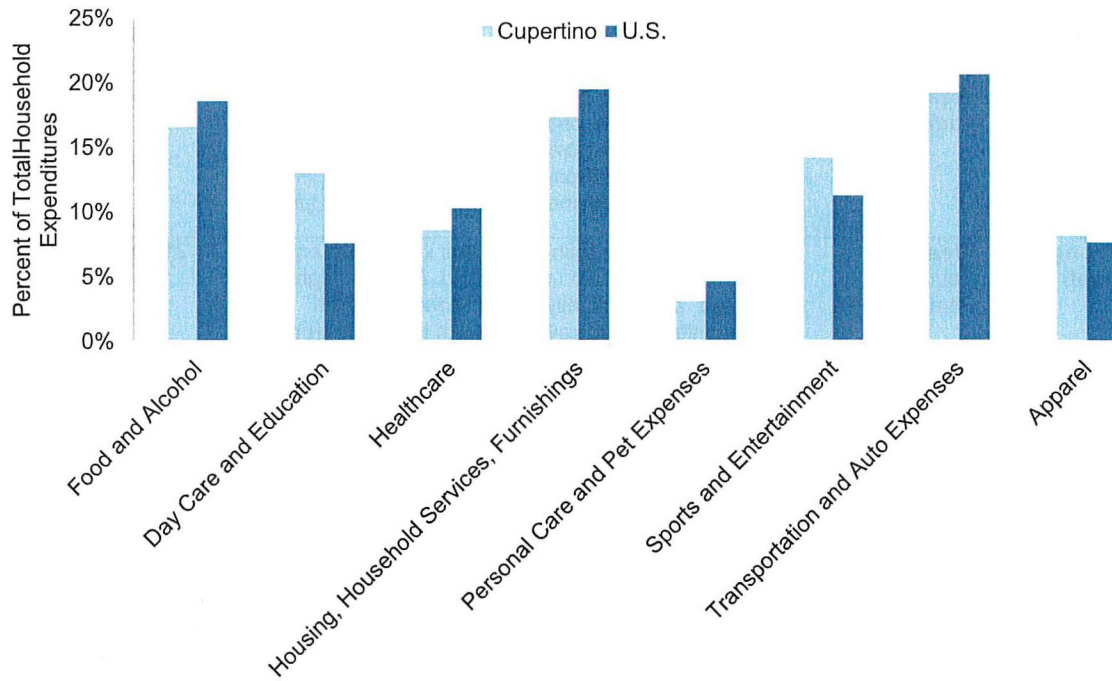
Sources: U.S. Census Bureau, American Community Survey 2010-2014 (5-Year Estimates), Social Explorer; Strategic Economics, 2015.

Figure V-2. Average Household Expenditures by Category: Cupertino and the U.S., 2015



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Figure V-3. Percent of Average Household Expenditures by Category: Cupertino and the U.S., 2015



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Figure V-4. Top 10 Social Groups* in Cupertino, 2015

Social Group*	Household Type	Description	% of Households	
			Cupertino	U.S.
1. Money & Brains	Wealthy Older Family Mix	The residents of Money & Brains seem to have it all: high incomes, advanced degrees, and sophisticated tastes to match their credentials. Many of these city dwellers are married couples with few children who live in fashionable homes on small, manicured lots.	40.3%	2.1%
2. Young Digerati	Wealthy Younger Family Mix	Young Digerati are tech-savvy and live in fashionable neighborhoods on the urban fringe. Affluent, highly educated, and ethnically mixed, Young Digerati communities are typically filled with trendy apartments and condos, fitness clubs and clothing boutiques, casual restaurants and all types of bars--from juice to coffee to microbrew.	21.1%	1.3%
3. Blue Blood Estates	Wealthy Older w/ Kids	Blue Blood Estates is a family portrait of suburban wealth, a place of million-dollar homes and manicured lawns, high-end cars and exclusive private clubs. The nation's second-wealthiest lifestyle is characterized by married couples with children, graduate degrees, a significant percentage of Asian Americans, and six-figure incomes earned by business executives, managers, and professionals.	8.5%	0.9%
4. Movers & Shakers	Wealthy Older w/o Kids	Movers & Shakers is home to America's up-and-coming business class: a wealthy suburban world of dual-income couples who are highly educated, typically between the ages of 45 and 64, and without children. Given its high percentage of executives and white-collar professionals, there's a decided business bent to this segment: members of Movers & Shakers rank near the top for owning a small business and having a home office.	6.2%	1.6%
5. Bohemian Mix	Upper Mid Middle Age Family Mix	A collection of mobile urbanites, Bohemian Mix represents the nation's most liberal lifestyles. Its residents are an ethnically diverse, progressive mix of young singles, couples, and families ranging from students to professionals. In their funky row houses and apartments, Bohemian Mixers are the early adopters who are quick to check out the latest movie, nightclub, laptop, and microbrew.	6.2%	1.9%
6. Upper Crust	Wealthy Older w/o Kids	The nation's most exclusive address, Upper Crust is the wealthiest lifestyle in America--a haven for empty-nesting couples over the age of 55. No segment has a higher concentration of residents earning over \$100,000 a year and possessing a postgraduate degree. And none has a more opulent standard of living.	5.8%	1.5%

Social Group*	Household Type	Description	% of Households	
			Cupertino	U.S.
7. Winner's Circle	Wealthy Middle Age w/ Kids	Among the wealthy suburban lifestyles, Winner's Circle is the youngest, a collection of mostly 35- to 54-year-old couples with large families in new-money subdivisions. Surrounding their homes are the signs of upscale living: recreational parks, golf courses, and upscale malls. With a median income over \$100,000, Winner's Circle residents are big spenders who like to travel, ski, go out to eat, shop at clothing boutiques, and take in a show.	4.8%	1.1%
8. Executive Suites	Upper Mid Middle Age w/o Kids	Executive Suites consists of upper-middle-class singles and couples typically living just beyond the nation's beltways. Filled with significant numbers of Asian-Americans and college graduates--both groups are represented at nearly twice the national average--this segment is a haven for white-collar professionals drawn to comfortable homes and apartments within a manageable commute to downtown jobs, restaurants, and entertainment.	1.2%	0.9%
9. Big Fish, Small Pond	Upscale Older w/o Kids	Older, upper-class, college-educated professionals, the members of Big Fish, Small Pond are often among the leading citizens of their small-town communities. These upscale, empty-nesting couples enjoy the trappings of success, including belonging to country clubs, maintaining large investment portfolios, and spending freely on computer technology.	0.8%	2.2%
10. Country Squires	Upscale Middle Age w/ Kids	The wealthiest residents in exurban America live in Country Squires, an oasis for affluent Baby Boomers who've fled the city for the charms of small-town living. In their bucolic communities noted for their recently built homes on sprawling properties, the families of executives live in six-figure comfort. Country Squires enjoy country club sports like golf, tennis, and swimming, as well as skiing, boating, and biking.	0.7%	1.8%

*PRIZM Social Groups, as defined by The Nielsen Company.
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Retail Performance

This section discusses retail sales and market trends in Santa Clara County and the City of Cupertino.

Silicon Valley's rapid employment growth and strong demographics are attracting significant interest from retailers. Reflecting this demand, Santa Clara County has some of the highest rents and lowest vacancies in the country. As shown in Figure V-5, the average monthly rent in Santa Clara County was \$2.32 per square foot in the first quarter of 2015, with an average vacancy of 5.0 percent. The Sunnyvale/Cupertino submarket had the highest average rent in the county (\$2.97 per square foot) and one of the lowest vacancy rates (3.6 percent). Most of the submarkets in the vicinity of Cupertino, including Palo Alto/Mountain View/Los Altos and Santa Clara, also had vacancies well below 5.0 percent.

Figure V-5. Retail Inventory, Rents, and Vacancies: Santa Clara County Markets, Q1 2015

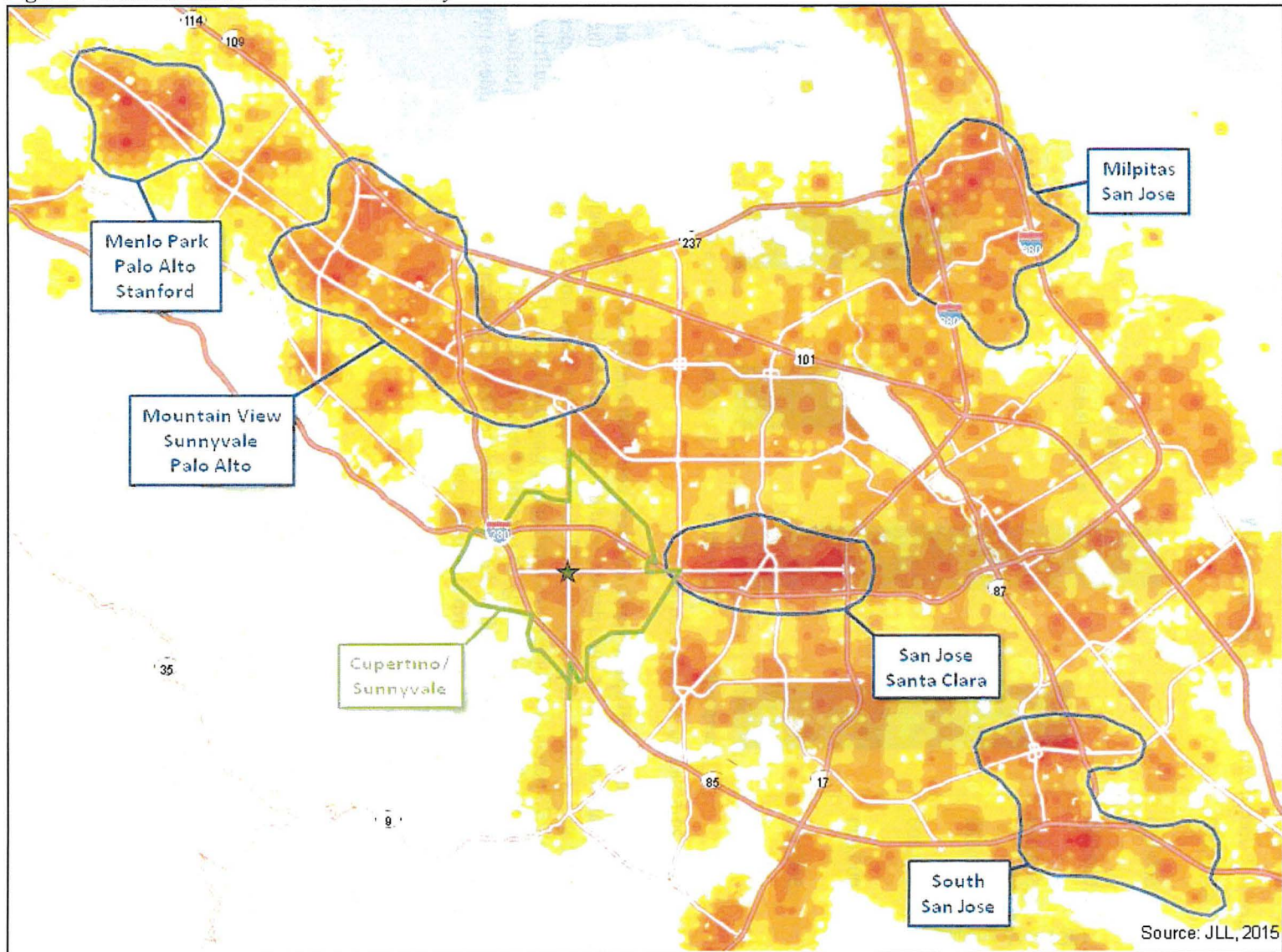
Market	Inventory	Vacancies		Average Monthly Rents (NNN)*
	Rentable Building Area (SF)	Rentable Building Area (SF)	% of Total	
Cupertino/Sunnyvale	4,612,272	164,318	3.6%	\$2.97
Santa Clara	2,530,509	110,900	4.4%	\$2.68
Palo Alto/Mountain View/Los Altos	2,713,079	89,255	3.3%	\$2.63
San Jose (DT/South)/Campbell/Los Gatos	18,527,673	908,405	4.9%	\$2.50
Milpitas/North San Jose	4,876,107	263,591	5.4%	\$2.30
Morgan Hill/Gilroy	4,718,147	375,370	8.0%	\$1.56
Total Santa Clara County	37,977,787	1,911,839	5.0%	\$2.32

* NNN: Triple net (tenants responsible for taxes, insurance, maintenance, and other costs).

Source: Retail Market Summary First Quarter 2015, DTZ Retail, 2015; Strategic Economics, 2015

Cupertino is located in a highly competitive trade area for retail, and experiences net sales leakage. Figure V-6 shows retail sales concentrations in and around Cupertino. In addition to Vallco, Cupertino's trade area contains several large retail shopping centers, including Westfield Valley Fair and Santana Row. The proximity of these competing centers, which feature many regional and national anchor tenants, restaurants, and entertainment options, limits the potential to locate the same types of tenants in Cupertino. Many Cupertino residents regularly shop and dine at these other retail centers, creating a significant amount of retail "sales leakage" – meaning that the city attracts fewer sales than would be expected based on local household and worker spending. The 2014 Market Report found that despite Cupertino's high household income and expenditure levels, retail sales within the city averaged \$10,480 per resident in 2013, compared to \$15,800 per capita for the surrounding regional trade area (defined as the zip codes located within a ten-minute drive time of Cupertino) and \$13,400 for Santa Clara County. Cupertino experienced net sales injections – meaning that the city attracted more sales than would be expected based on local household and worker spending alone – in only two categories: food and beverage stores and general merchandise stores.

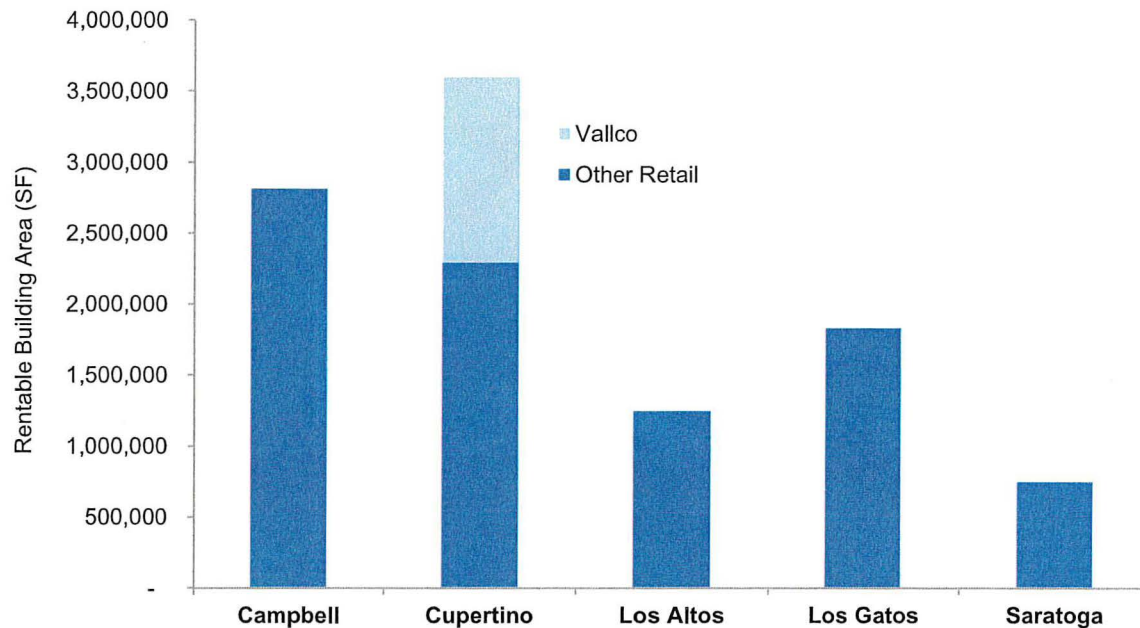
Figure V-6. Retail Sales in Santa Clara County



Used with permission from Christine Firstenberg, JLL.

Excluding Vallco, Cupertino has a similar amount of retail compared to other West Valley communities. Including the now largely vacant Vallco, there are about 3.6 million square feet of retail space in Cupertino, more than its neighboring communities (see Figure V-7). Vallco represents approximately one-third of this total.

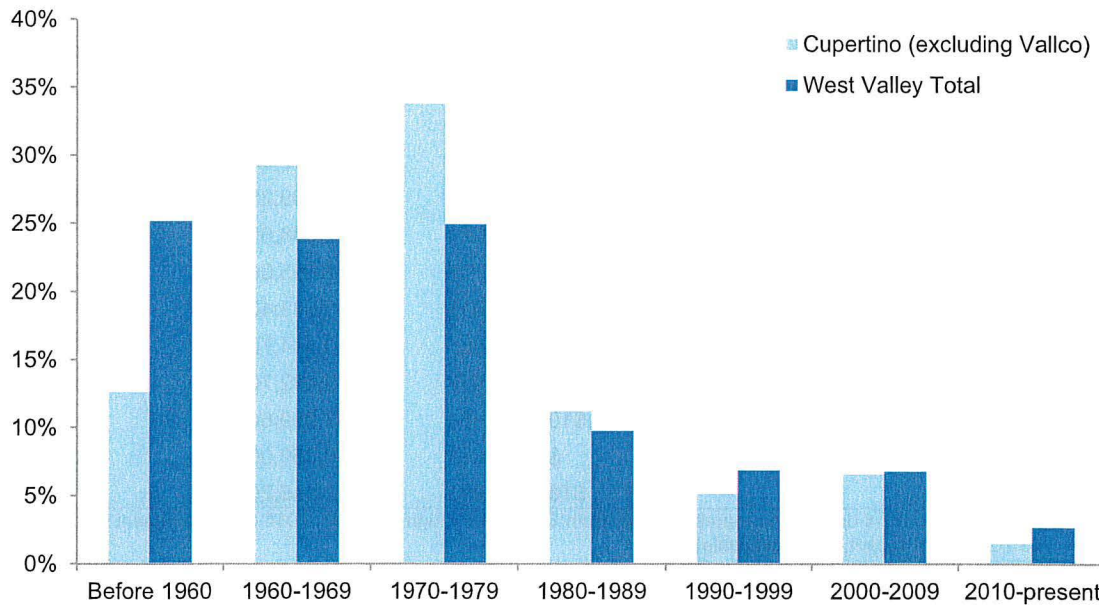
Figure V-7: Retail Inventory by City: West Valley, 2015



Source: CoStar, 2015; Strategic Economics, 2015.

Most of Cupertino's retail space was built between 1960 and 1980. Figure V-8 shows the percentage of Cupertino's retail stock built in each decade (excluding Vallco, built in the 1970s), compared with the West Valley sub region (which includes Campbell, Los Altos, Los Gatos, and Saratoga as well as Cupertino). Approximately 75 percent of Cupertino's retail space was built before 1980, with the majority built between 1960 and 1980. Similarly, approximately 75 percent of retail in the West Valley was also built before 1980, but more of the space in the West Valley dates from before 1960. Cupertino's retail stock includes a mixture of community, neighborhood, and strip shopping centers.

Figure V-8: Percentage of Retail Building Area, Cupertino* and West Valley**, by Year Built



* Excludes Vallco

** West Valley includes Cupertino, Campbell, Los Altos, Los Gatos, and Saratoga.

Source: CoStar, 2015; Strategic Economics, 2015.

Between 2005 and 2014, total retail sales in Cupertino declined by 17 percent after adjusting for inflation. As mentioned above, national and regional industry trends have weakened key categories of retail sales, especially general merchandise, electronics, and specialty retail, as consumers are buying many of these items online. Furthermore, many of the tenants that had formerly anchored Vallco have left Cupertino. As a result, sales in general merchandise stores dropped by 39 percent and sales in electronics and appliances decreased by 93 percent from 2005 to 2014 (Figure V-9).

Cupertino has many neighborhood- and business-serving retailers that serve residents' and workers' daily needs. The city is well-served by grocery stores, mid-priced restaurants, personal services, and other retailers that serve residents' daily needs. Cupertino's restaurants and personal services also serve the many commuters who flow into the city every day. The strongest retail categories include food and beverage stores and food services and drinking places. As shown on Figure V-9, food services and drinking places grew 28 percent between 2005 and 2014, while food and beverage stores grew by 27 percent. The large spike in sales of building materials may reflect temporary construction activity in Cupertino.

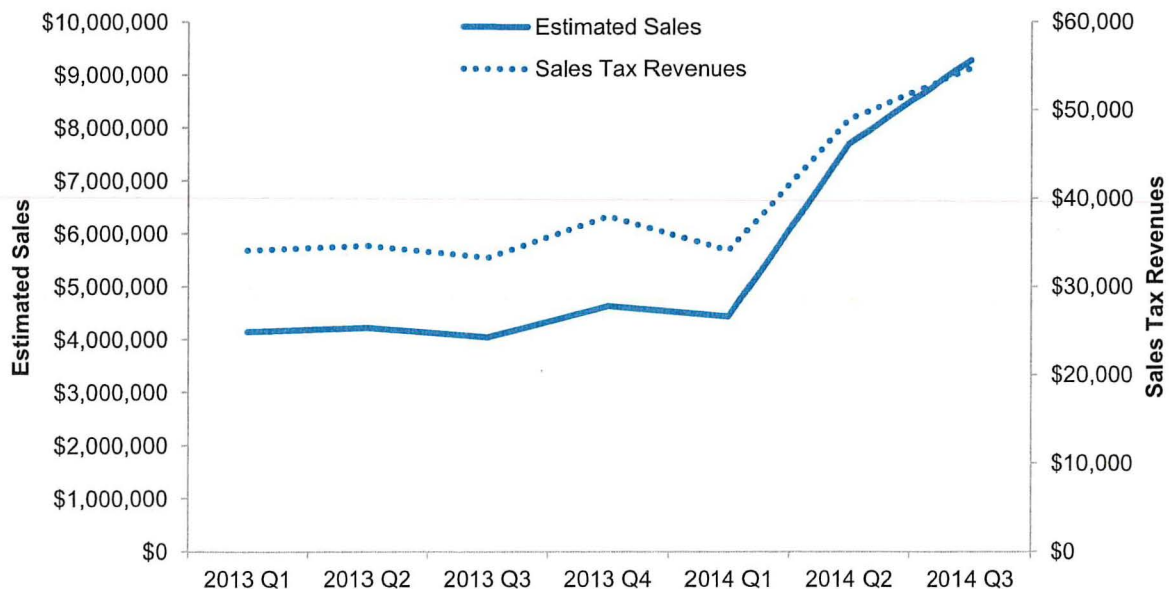
Figure V-9: Estimated Retail Sales in Cupertino by Category, 2005 and 2014 (in 2014 Dollars)

Category	2005 Sales	2014 Sales	Real % Change from 2005
Food Services and Drinking Places	\$119,080,940	\$152,650,400	28%
General Merchandise Stores	\$217,136,275	\$131,609,733	-39%
Miscellaneous Store Retailers	\$117,106,099	\$114,142,800	-3%
Food and Beverage Stores	\$86,496,850	\$110,189,250	27%
Clothing and Clothing Accessories Stores	\$44,903,584	\$47,538,600	6%
Health and Personal Care Services	\$30,359,707	\$22,095,067	-27%
Bldg. Matrl. and Garden Equip. and Supplies	\$2,779,612	\$20,583,400	641%
Furniture and Home Furnishing Stores	\$15,267,054	\$10,464,700	-31%
Motor Vehicle and Parts Dealers	\$13,011,977	\$9,432,700	-28%
Electronics and Appliances Stores	\$107,448,484	\$7,069,600	-93%
Sporting Goods, Hobby, Book, and Music Stores	\$9,664,512	\$6,359,000	-34%
Retail Sales Total	\$763,255,093	\$632,135,250	-17%

* 2005 Sales are adjusted to 2014 dollars and represent sales from Q4 2004 through Q3 2005. 2014 Sales represent sales from Q4 2013 through Q3 2014 (most recent period available).
Source: MuniServices, 2015; Strategic Economics, 2015.

Cupertino is attracting newer retail investments, including mixed-use development projects and renovation of existing centers, that have resulted in increased sales. The Main Street project is slated to add 130,500 additional square feet of retail in its lifestyle center. In addition, some existing retail centers, such as Homestead Square and Cupertino Village, have received recent renovations. As shown in Figure V-10, the renovations at Homestead Square resulted in a significant increase in sales and sales tax revenues after the first phase of the project opened in the second quarter of 2014.

Figure V-10. Homestead Square Shopping Center: Estimated Quarterly Sales and Sales Tax Revenues, 2013-2014



Note: Not adjusted for inflation.

Source: MuniServices, 2015; Strategic Economics, 2015.

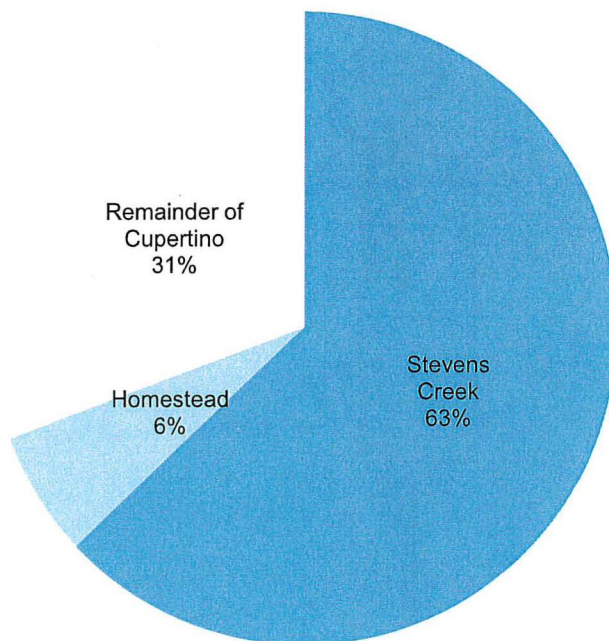
Preservation of smaller, independent retail may become increasingly challenging as rents continue to rise and construction of new spaces remains limited. Cupertino has a significant inventory of lower cost retail spaces in older shopping centers. Residents have expressed concerns that as some of these centers redevelop over time, it may become more difficult for these tenants to remain in the city. Stakeholders have also identified the need for additional technical assistance and outreach to small businesses in Cupertino.

Key Retail Locations within Cupertino

Cupertino's retail is concentrated along two major corridors within the city: Stevens Creek Boulevard and Homestead Road (shown below in Figure V-12). This section discusses the performance and other key characteristics of these two corridors. (Note that while Vallco Mall is contiguous with the Stevens Creek Boulevard Subarea, it will be addressed in a separate process and is not included as part of this subarea analysis.)

Stevens Creek Boulevard serves as Cupertino's main commercial corridor, accounting for 63 percent of total retail sales in 2014. The Stevens Creek subarea – including most of Stevens Creek and South De Anza Boulevards – is Cupertino's longest commercial corridor and accounts for the majority of retail sales in the city (Figure V-11). Although there is significant variation in the performance, trade area, and overall condition of the retail spaces in Stevens Creek, local brokers report that some of the highest rents in the city are found along Stevens Creek Boulevard.

Figure V-11. Estimated Retail Sales by Subarea: Cupertino, 2014*



* Total estimated retail sales for the City of Cupertino is \$610 million. This figure includes the estimated non-taxable retail sales but does not include business-to-business, professional services, or other non-retail sales.

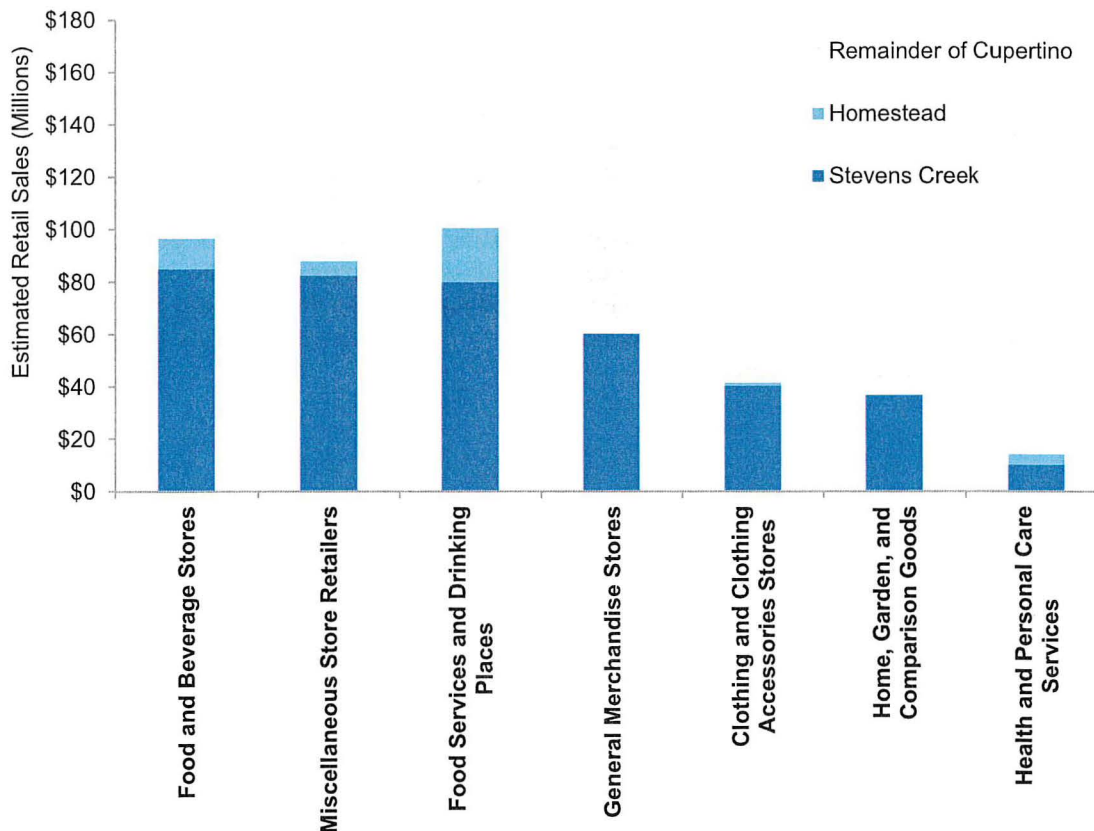
Source: MuniServices, 2015; Strategic Economics, 2015.

Figure V-12: Stevens Creek Boulevard and Homestead Road Subareas



Sources: City of Cupertino, 2015; US Census TIGER Line Data, 2013; Strategic Economics, 2015.

Figure V-13. Estimated Retail Sales by Category and Subarea: Cupertino, 2014



Source: MuniServices, 2015; Strategic Economics, 2015.

The retail mix in the Stevens Creek subarea serves day-time employees and local residents. Like Cupertino as a whole, retail in the Stevens Creek subarea is largely composed of food and beverage stores (22 percent of retail sales in the subarea), miscellaneous store retailers (21 percent) and food services and drinking places (21 percent). A significant portion of the sales in miscellaneous store retailers is from auto service stations. These categories of retail are generally both resident- and employee-serving. For example, many of the restaurants and some of the retailers (e.g., Staples) are oriented towards serving business customers. At the same time the corridor has many grocery stores (including Whole Foods, 99 Ranch, Marina Food) and other resident-serving businesses such as Target, TJ Maxx, and Pier One.

In contrast to Stevens Creek Boulevard, the Homestead Road corridor is primarily neighborhood-serving. Homestead Road runs along Cupertino's northern border with Sunnyvale, and the shopping centers on this corridor serve residents in both cities. The corridor accounted for 6 percent of Cupertino's retail sales in 2014. Homestead Road is diversified than the Stevens Creek corridor, containing mostly restaurants, grocery stores, and other food and food service establishments. Within the Homestead Road subarea, food services and drinking places accounted for an estimated 53 percent of sales, followed by food and beverage stores (30 percent).

Cupertino's highest-performing retail nodes are on Stevens Creek Boulevard, between North Stelling Road and North De Anza Boulevard. Figure V-14 shows sales performance per square foot in 2014 for shopping centers within the Stevens Creek Boulevard. The highest sales (\$250-\$350 per square foot) were in centers anchored by the national retailers Whole Foods and Target. The Oaks Shopping Center, along

with centers along North and South De Anza Boulevard had sales in the range of \$100-\$200 per square foot, while the collection of mostly older properties along the eastern section of Stevens Creek Boulevard typically achieve less than \$100 a square foot.

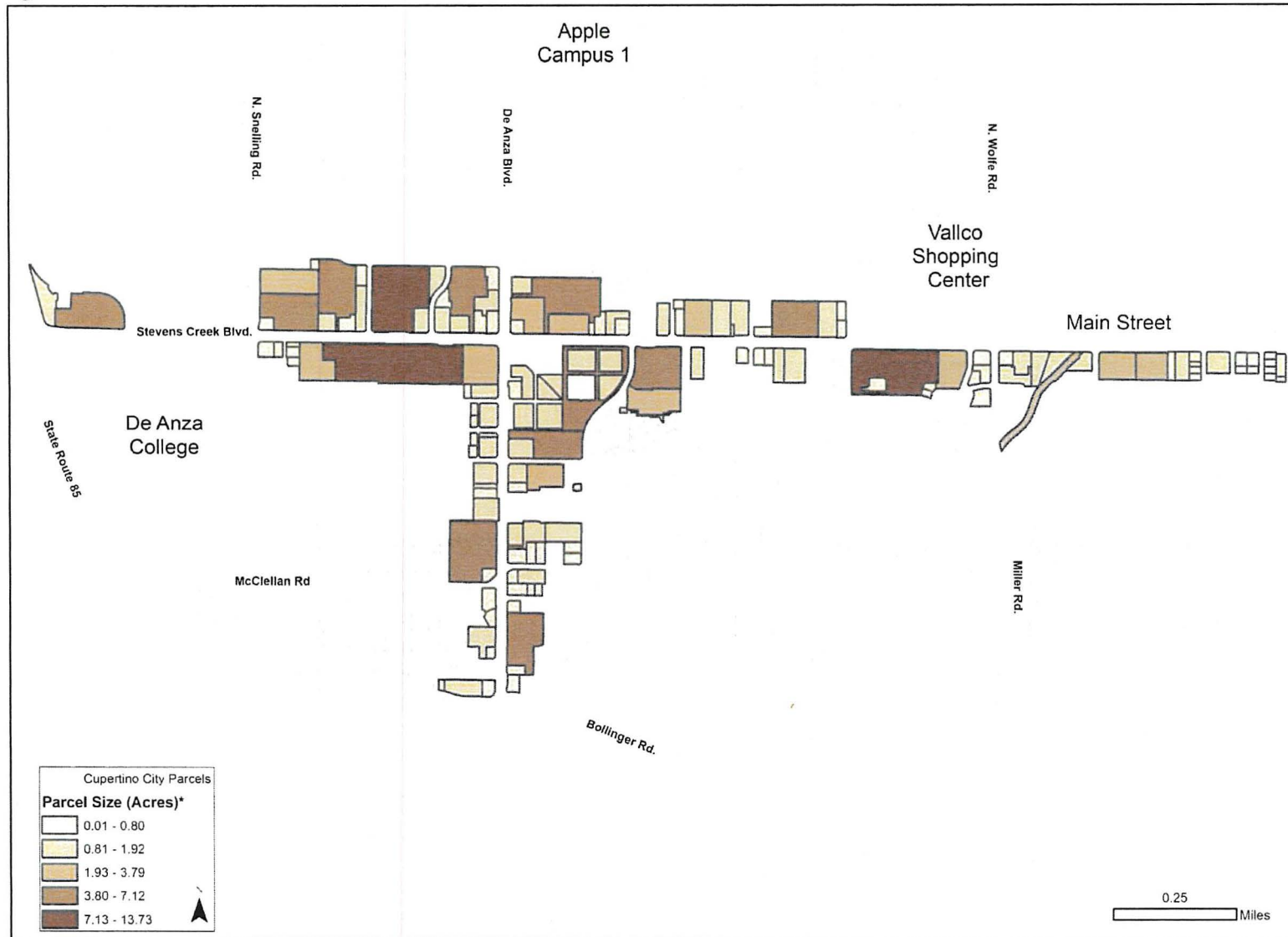
While the smaller, strip shopping centers on Stevens Creek Boulevard have generally been successful at attracting new tenants, many have not been upgraded in years. Figure V-15 shows the parcel sizes and ownership patterns in the study area. The older, lower performing properties located along the eastern section of Stevens Creek are located on relatively small, shallow lots. This type of lot configurations can pose an impediment both for attracting new users to existing buildings, and for the development of new buildings. Small shallow parcels often do not meet the needs of modern retailers, who are often looking for greater storefront width, ceiling height, street visibility, and parking than these lots can provide. Moreover, in order to build new retail space, developers may have to coordinate with multiple property owners to assemble an appropriately sized parcel.

Figure V-14. Performance of Shopping Centers in the Stevens Creek Boulevard Corridor, 2014



Source: MuniServices, 2015; Strategic Economics, 2015.

Figure V-15. Parcel Sizes in the Stevens Creek Boulevard Corridor



*Parcels under common ownership have been aggregated based on owner name.
Sources: City of Cupertino, 2015; Strategic Economics, 2015.

HOTEL

This section reviews hotel market trends in Silicon Valley and Cupertino. For a more detailed hotel market analysis, see the 2014 Market Study.

Regional Hotel Trends

Silicon Valley's expanding technology sector, and especially major tech companies such as Apple, Google, and Facebook, are generating significant weekday demand for hotel rooms. Hotel occupancy rates and room rates have increased sharply as a result of the region's growing economy. In Santa Clara County, occupancy rates climbed 32 percent between 2009 and 2014, and most hotels in the county are now at or near full capacity on weeknights. Average daily room rates rose 50 percent over the same period.²³

As a result of this rising demand, the South Bay has become a national hot spot for new hotel development. In 2014 alone, 11 new hotels accounting for 1,370 new hotel rooms opened in Santa Clara County. An additional 408 rooms were under construction as of July 2015, while nearly 6,000 hotel rooms have been proposed throughout the county.²⁴ In addition to building new rooms, hotel operators are increasingly looking to enter the market by acquiring and rebranding existing properties. In Cupertino, for example, Hilton recently purchased Kimpton's Cypress Hotel and converted it to a Juniper Hotel Curio Collection by Hilton.

Cupertino's Hotel Market

As in other South Bay communities, demand for hotels in Cupertino is driven by business travel. Cupertino currently has 785 hotel rooms across five properties. The 2014 Market Study, based on data from 2012 and 2013, found that mid-week occupancy rates approached 90 percent for Cupertino hotels but were significantly lower on weekends. That study estimated that between 70 and 75 percent of demand was generated by business travelers. The strong office market, along with Apple's expansion, suggests that business traveler demand for hotel rooms in Cupertino will remain strong for the foreseeable future.

To help meet this demand, Cupertino currently has two hotels under construction and two more proposed. The Marriott Residence Inn at Main Street and the Hyatt House Hotel, north of Vallco, are currently under construction and together will add 328 rooms to Cupertino's hotel inventory. Two mixed-use development proposals, at Marina Plaza and The Oaks shopping centers, both contain hotel components together comprising an additional 322 rooms. Together, these four hotel developments would nearly double Cupertino's current hotel inventory (Figure V-16).

Figure V-16. Hotel Rooms Proposed and Under Construction, Cupertino

	Rooms	Status
Marriot Residence Inn (Main Street)	180	Under Construction
Hyatt House Hotel at VallCo Park	148	Under Construction
Marina Plaza	122	Proposed
The Oaks Redevelopment	200	Proposed

Source: BAE, 2014; City of Cupertino, 2015; Strategic Economics, 2015

²³ Nathan Donato-Weinstein, "Record room prices tempt developers into hotel construction," Silicon Valley Business Journal, March 27, 2015,

<http://www.bizjournals.com/sanjose/print-edition/2015/03/27/record-room-prices-tempt-developers-into-hotel.html>.

²⁴ Hari Jun, "In Focus: Silicon Valley Hotel Market Update," HVS San Francisco, July 2015.

CONCLUSION: CUPERTINO'S COMPETITIVE POSITION

Based on the retail and hotel analysis described above, this section summarizes Cupertino's competitive position.

Opportunities

- **Strong local buying power:** Reflecting their incomes, Cupertino residents spend more on all types of retail than the average U.S. household. Combined with the inflow of daily commuters, this creates significant local demand for retail. Cupertino's many tech companies also generate strong demand for hotel uses.
- **Many neighborhood- and business-serving retailers:** The city is well-served by grocery stores, mid-priced restaurants, personal services, and other retailers that serve residents' and workers' daily needs.
- **New investment:** Cupertino is attracting newer retail and hotel investments, including mixed-use development projects and renovation of existing shopping centers. New retail investments can result in increased sales and higher sales tax revenues, while new hotels can generate increased transient occupancy (hotel) tax revenues.

Potential Challenges

- **Declining sales and stagnating sales tax revenues:** Between 2005 and 2014, total retail sales in Cupertino declined by 17 percent after adjusting for inflation. This reflects the gradual decline of the Vallco shopping mall, as well as national and regional industry trends that have weakened key categories of retail sales. At the same time, Cupertino experienced a loss in business-to-business sales tax producers (including Hewlett-Packard, which relocated when Apple acquired its campus in 2010), resulting in declining overall sales tax revenues. The City has partially offset this decline by renegotiating an existing sales tax rebate agreement with Apple. In the long run, however, these trends have decreased the diversity of revenue sources for the City's General Fund.
- **Highly competitive retail trade area and significant sales leakage:** While the city supports many neighborhood-serving establishments, specialty retailers must compete with a number of very successful shopping centers a short distance away, including Westfield Valley Fair and Santana Row. Cupertino is experiencing sales leakage in most retail categories, indicating that many residents and workers are traveling outside the city to shop.
- **Older strip retail centers:** Some of the city's older strip retail shopping centers, including many located on Stevens Creek Boulevard east of De Anza Boulevard, do not provide the wide storefronts, visibility, and parking that modern retailers typically require. These strip centers also tend to be located on relatively small, shallow parcels that also create challenges for redevelopment. At the same time, however, older shopping centers provide lower cost retail spaces that may work well for smaller, independent retailers.

APPENDIX: FORUM AND ROUND TABLE ON LOCAL BUSINESSES

FORUM OVERVIEW

On August 19, 2015, the City of Cupertino hosted a forum to engage community members about the City's Economic Development Strategic Plan. Approximately 20 community members attended. The purpose of the workshop was to: (1) educate the community about the Economic Development Strategic Plan process and why the City is doing the project, (2) solicit community input on initial ideas and options, and (3) provide an opportunity for the community to ask questions regarding the project.

INTRODUCTION AND PRESENTATION

To kick off the meeting, City Manager David Brandt welcomed the workshop participants and thanked them for being a part of the project. He introduced the elected officials in attendance as well as City staff and MIG staff. Next, Angela Tsui, Cupertino Economic Development Manager, told participants that this effort is focused on supporting and growing businesses in Cupertino. Ms. Tsui emphasized that community input will help guide the strategies and programs the City pursues. She also reminded participants the evening's discussions will focus on local businesses issues, not land use issues.

Sujata Srivastava, Principal of Strategic Economics, gave a brief presentation about the Economic Development Strategic Plan project and schedule, highlighting why the City is developing the project, why it is important to the community, and what the opportunities are for public input. The presentation also included pertinent facts about employment and industry trends, fiscal health, and the retail sector in the City of Cupertino.

Christine Firstenberg of JLL Retail gave a presentation on retail activity in Cupertino and throughout the region. She identified challenges and opportunities for retailers in the current market, reviewed site selection factors and described the regional retail market.



Sujata Srivastava, Principal of Strategic Economics, presents the Economic Development Strategic Plan schedule

The full presentation can be viewed on the City's Economic Development webpage, as well as in HD on YouTube: <http://youtu.be/5ZirQ6U8Kz4>

SMALL GROUP DISCUSSIONS

Noé Noyola, a facilitator with MIG, provided an overview of the workshop structure and initiated the small group discussions. Mr. Noyola introduced the question cards on each table inviting participants to fill out

if they had specific questions during the discussions. These cards were then reviewed and collected by City staff for follow-up.

During the small group discussion, City staff facilitated small group discussions guided by five questions. The exercise questions were as follows:

1. What do you think are Cupertino's top strengths and community assets? How do those strengths and assets benefit businesses?
2. What do you think are the major challenges for retaining and recruiting businesses?
3. What types of businesses should the City focus on recruiting and/or expanding?
4. What can the City and community partners do to better support businesses in Cupertino?
5. Are there particular locations in Cupertino that require upgrades or revitalization?



Community members engage in conversation around the five questions

At the end of the group discussions, the facilitators asked for one of the table members to volunteer to be the reporter. Each group had ten minutes to summarize the main points that were discussed at their table.

COMMUNITY INPUT

Each table of participants engaged in a robust conversation guided by the five discussion questions. Community members identified the following ideas, suggestions, questions and concerns in response to the guided facilitation. These responses are organized by theme below.

Top Strengths and Community Assets

- Cupertino is centrally located within Silicon Valley.
- City residents are active, engaged, and tech-savvy.
- Cupertino is home to one of the best school systems in the world.
- Those that work in Cupertino often support Cupertino's small businesses by shopping locally.
- Cupertino has a strong City Hall and Civic Center Area.
- The City has good infrastructure with new bike lanes, accessible highways, and many employee ride share programs.

Constraints and Recommendations for Retaining Existing Businesses

- Cupertino should look to adjust their permitting process to support existing businesses.
- Small independent retailers have been closing in Cupertino because they cannot compete with chain retailers.
- The City should cultivate a stronger relationship with the Cupertino Chamber of Commerce.
- The current cost of living, rent, and mortgage rates within Cupertino are prohibitive for retaining existing businesses.
- It is possible that the proximity of Cupertino stores to neighboring cities creates a hyper-competitive environment.

- Under current market conditions, small businesses are competing with large companies.
- Many locally-owned “mom and pop” businesses are closing. There are a limited variety of uses in one place

Constraints and Recommendations for Recruiting New Businesses

- Cupertino should increase “supply” by providing more spaces for new businesses.
- The City should follow market trends for allowed business uses (e.g., entertainment uses for teens).
- Afterschool services should be located close to food/retail services.
- The City could support businesses that create late night uses.
- The City should identify office space available for small businesses.
- Cupertino should consider strategies to develop or protect spaces with affordable rent.

Types of Businesses City should focus on recruiting

- Services for youth and seniors.
- Businesses that cater to kids and young adults.
- Five star hotels and full service hotels.
- Large event spaces.
- Small, locally-owned and independent businesses.
- Alcohol serving and higher end restaurants.
- Small restaurants that have a small-town feel.
- “Driveby” dining opportunities, such as pre-order and pickup.
- Stores with home goods, pottery, arts and crafts.
- An independent movie theater.
- Programmed public spaces.
- “Mainstream” grocery stores and grocery store at Vallco.
- A centralized pharmacy.
- Policies to keep variety of stores instead of just restaurants (e.g, Main Street is 30% restaurants).



A workshop participant summarizes her group's discussion to all participants and staff present.

City and community partners to better support businesses

- They should encourage the “silent majority” to attend hearings.
- They should encourage youth to work with school district.
- City should support projects that serve and provide benefit to the community.
- City and community partners should create innovative programs and economic incentives that can aid smaller businesses (e.g., below market rate rent).

Locations in Cupertino that would benefit from upgrades or revitalization

- Vallco
- Oaks

- Cupertino Inn
- Loree Center
- Homestead Lanes
- Downtown
- Apple store
- Murphy Street

Additional Comments

- With Smart Growth principles in mind, accept change and be prepared for it (such as increased traffic and a larger aging population).
- Youth are attracted to: Campbell, Mt. View/Castro, Los Gatos
- Fostering economic diversity is important.
- Mountain views are an asset that should not be blocked by new development.
- Cupertino does not have a real downtown, could benefit from more of an “authentic” downtown or city center such as in the cities of Campbell and Sunnyvale.
- Development could reflect local history and culture, such as Mariani Cannery.
- Creating programmed public spaces would attract families and young people and support nearby businesses
- City should promote open space (San Antonio Park).
- City should improve City Services (Blackberry Farms).
- Work with developers to provide below market rate space for high-priority businesses (as a community benefit).

Questions and Comments on Comment Cards

- What is the percent of people who reside and work in the City of Cupertino?
- Local groceries have online ordering and delivery system to deliver groceries to employees before they head home.
- Child daycare services for employees who work in Cupertino.
- How many of the 1-4 [person] businesses in Cupertino occupy buildings other than ‘home offices’?
- What resources are available to non-Nordstrom retailers/small retailers?
- Do they have a way for businesses to get a low interest loan for expensive rent area?
- Definition of retail: not just restaurants and “boutique” shops.
- We deserve Real Goods retail; tired of going outside of Cupertino and it’s going to be worse when Sears and Penny’s will be gone. Keep our money in Cupertino.
- Took all history of Cupertino and didn’t leave any old buildings (Cali Bros).

NEXT STEPS

To close the community forum, MIG staff thanked attendees’ participation and reiterated how this community input will be used in the process. For attendees that were interested in keeping abreast of the project, staff showed participants where they can download the summary of the results on the website and submit additional comments to Economic Development staff.