



Economics Research Associates

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RE: ERA Project No. 17450

Dear Ms. Olsen:

This letter represents the findings of Economics Research Associates' (ERA) peer review of CB Richard Ellis' Eureka Balloon Track Retail Development Economic Impact and Urban Decay Analysis of November 2006 (referred to in this review as the CBRE report). This document has been submitted to the City on behalf of Security National Properties as part of their application to develop a 586,000-square-foot mixed-use development on the site of a former Union Pacific railyard in the City of Eureka (Marina Center). The applicant is proposing that the project will be anchored by a 132,000-square-foot Home Depot store.

Recent findings by the State of California's Appellate Court (*Bakersfield Citizens for Local Control v. City of Bakersfield* (2004) 124 Cal.App.4th 1884) have interpreted the requirements of the California Environmental Quality Act (CEQA) as requiring disclosure of the possibility for "urban decay" when considering projects that include a large-format retailer, such as the proposed Home Depot store. It is important to recognize that, like most CEQA requirements, this standard is focused on impacts to the physical environment and as such it requires the consideration of conditions of disinvestment that could result in the decay of real property as a result of the defined project. These conditions are distinct from conditions of blight which are defined by the California Health and Safety Code (sections 33030-33039) which set the standards for the adoption of redevelopment project areas. The urban decay disclosure requirement is relatively new, and as a result the standards and practices related to compliance are still somewhat unsettled and evolving. In this peer review, ERA will comment, based on our previous experience and observations of conditions in Eureka, on the overall adequacy and completeness of the CBRE report. We will recommend issues for further exploration in the interest of increasing the comprehensiveness of the report.

As was presented in our initial correspondence with the City of Eureka, ERA is qualified to provide this review of the CBRE report having completed several high-profile urban decay studies for projects that have included large-format retailers: Key project examples include:

- Michael Brandman and Associates—Panama Road development in Bakersfield, CA
- Nasland Engineering—Brawley, CA retail center
- Imperial County —Proposed Wal-Mart super center in Calexico, CA
- Mooney and Associates—Proposed Wal-Mart super center in El Centro, CA
- City of Blythe, CA—East Blythe power center

ERA has approached this peer review by undertaking a site visit to Eureka, inspection of the subject property, along with general assessments of existing retail properties in the market area. We also received an updated briefing on the project by City of Eureka staff, as well as undertaking our own independent review of the CBRE report.

### ***General Comments***

In general, ERA finds the CBRE report to have been professionally prepared and adequate in its general approach, findings, and conclusions. There are, however, areas where the report could be strengthened and made to be more comprehensive. In this peer review, ERA will suggest some additional approaches and analysis which may be considered by CBRE, the City of Eureka, and the project applicant. These recommendations do not imply that they would result in materially different conclusions than those contained in the CBRE report. The comments are offered as approaches to confirm the overall findings of the CBRE report and to add additional dimensions to the study. ERA has not undertaken any analysis which would suggest that the conclusions of the CBRE report are incorrect in their general findings. In general, our comments are methodological in nature or focus on possible extensions to the research undertaken in the CBRE report. The comments will focus on three general areas:

- 1) Supply side conditions
- 2) Demand side conditions
- 3) Mitigation measures

In each of these areas, ERA sees the possibility for an extension of the CBRE analysis.

### ***Supply Side Conditions***

The CBRE report does not report the conditions in the area's commercial real estate market in any comprehensive or quantitative manner. While there is some information reported that was gained by interviews of local commercial real estate brokers, it would be very useful to have a more complete understanding of existing vacancy rates in the market. Based on the information in the CBRE report, it is not possible to identify if there are significant inventories of available retail space that would have to be absorbed in addition to the future presence of the Marina Center. Significant and persistent inventories may be seen as an indicator of a structural weakness in the region's commercial real estate market which would inhibit any future re-tenanting or slow the absorption of any displaced space vacated after the applicant's project is operational.

In a similar manner, additional information about land values and the redevelopment potential of competitive sites would also be useful in evaluating the urban decay potential of the Marina Center. Beyond the anticipated “churn” that is inherent in any retail market, it is possible to expect that the underlying land value at the comparable retailers described in Section VI of the CBRE report would be large enough to anticipate potential re-use or redevelopment. Information about the value of commercial development opportunities in the market area would assist in determining if any displacement that could potentially be caused by the Marina Center could be off set by future rounds of re-investment and redevelopment within the market area.

***Demand Side Conditions***

The CBRE report estimates retail demand in Eureka by defining the market as Humboldt County and uses a “Retail Sales Leakage Analysis” to determine the market demand. In terms of market definition, ERA has successfully used a gravity potential model to determine the likely geographic extent of a new project’s effects on existing retail markets when evaluating the impacts of new market entrants. A gravity and potential model has the advantage of specifying the trade area as a continuous statistical surface and can avoid possible errors in market definition that may come from using an interval order level of data such as a County.

A gravity model, which is based on Riley’s law of “retail gravitation.”<sup>1</sup> is a widely used technique in determining market trade areas for retail stores. The basic formulation of a gravity and potential model is expressed in the following mathematical terms:

$$S_{ij} = K_i P_i W_j D_{ij}$$

Subject to the constraints of:

$$\sum_{i=1}^n S_{ij} = S_j; \sum_{i=1}^n S_{ij} = P_i$$

Where:

$S_{ij}$  = Sales at store  $j$  by the population in location  $i$

$P_i$  = Population in location  $i$

$W_j$  = Weight or attractiveness of store  $j$ .

This measure includes an empirically determined qualitative measure of attractiveness for relevant retail outlets called the “weight.” If all outlets were equally attractive, they would

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<sup>1</sup> Isard, Walter et al., *Methods of Interregional and Regional Analysis*, Ashgate 1998, ch.6 (“Gravity and Spatial Interaction Models”)

carry a weight of 1. Weights are determined empirically by balancing the model to find observed supportable square feet.

$$S_j = \text{Total annual sales at store } j$$

$$D_{ij} = \text{Distance from the center of tract } i \text{ to store } j$$

and

$$K_i = \frac{1}{\sum_{j=1}^n W_j} D_{ij}$$

which represents a market specific balancing factor accounting for rates of sales by area residents.

The model implies that population closer to a retail center is more likely to patronize those stores than ones that are farther way. At the same time, the size of the center, measured either in square feet, total sales, or the diversity of goods available, can offset the disadvantages of distance from any given consumer. The model uses that analogy of physical gravity in which objects in physical space influence one another subject to the constraints of mass and distance. Gravity models have a distinguished and respected track record in retailing and can be considered as a supplement to the information presented in the CBRE report

As a related issue, CBRE deploys a retail sales leakage analysis which is introduced in Section IV of the report. While the report describes some of the variables that are included, no information is given about the structure of the model, the relationship between the variables, or the strength of those relationships in terms of either confidence intervals or goodness of fit statistics (such as  $R^2$  values). More detailed documentation of the structure of this model and the data which informs it would be very helpful in establishing its robustness for the purposes of the urban decay determination.

As a minor consideration CBRE bases population forecasts for the market on California Department of Finance data and correctly notes that they do not provide subcounty forecasts<sup>2</sup>. In other studies, ERA has used data from regional councils of governments (such as the Humboldt County Association of Governments) who often develop population forecasts at the TAZ (transportation analysis zone—often co-terminus with census tracts) level as part of their long range transportation planning. ERA has not determined if this data is available in Humboldt County.

### ***Mitigation Measures***

Home Depot is a category killer. These types of stores are designed to offer a complete range of goods that, due to the stores' scale, independent retailers can not match. This does

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<sup>2</sup> See page 17 and exhibit 5 of the CBRE report

not mean that no competitors will survive with the introduction of a category killer into the market, but frequently they are forced to move away from price competition and focus on quality and personalized customer service. In many markets independent competitors have found success by focusing on specialized niches. While CBRE indicates that the development of the Marina Center is unlikely to cause urban decay, the possibility exists for dislocation in the local retail market. As a result, it may be helpful to suggest some mitigation measures that the applicant could provide related to displacement rather than urban decay. Ideas for this could include:

- Fund a retail consulting workshop through the local Chamber of Commerce with retail merchandising and or strategy experts
- Fund for a period of one year a shuttle between the Marina Center, Bayshore, and the old town/downtown districts
- Contribute to a regional retail marketing and branding effort

These are just suggestions. Other mitigation measures might also be considered.

### *General Conclusions*

ERA has presented these peer review comments in the spirit of improving a good quality submission by CBRE. We have not found any fatal flaws that would invalidate the findings of the report. It is our hope that these comments can be seen as constructive in nature as the City moves forward with its review process for this project

Please let me know if you have any questions or comments on any of the issues in this letter and I will be happy to address them for you.

Sincerely

A handwritten signature in black ink that reads 'DAVID BERGMAN' with a stylized flourish at the end.

David E. Bergman, AICP  
Principal

DEB/jla