File No. 230153

Committee Item No. ______________
Board Item No. 37

COMMITTEE/BOARD OF SUPERVISORS

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Prepared by: Arthur Khoo **Date:** February 9, 2023
Prepared by: ________________ **Date:** ________________

FILE NO. 230153 RESOLUTION NO.

[Urging City Departments to Develop Comprehensive Adaptive Reuse Strategy for Downtown]

Resolution urging the Planning Department to report on potential candidates for adaptive reuse in the Downtown core; urging the Planning Department and Department of Building Inspection to issue public facing criteria for members of the public and stakeholder property owners on potential office conversion to residential eligibility; and urging the Planning Department, City Controller and Treasurer Tax Collector to investigate private market restraints on adaptive reuse, including shareholder and REIT agreements that restrict conversion or the offering of commercial space for competitive rates, and local, state and federal tax policies that disincentivize the productive or adaptive reuse of properties that would otherwise be ripe for conversion.

WHEREAS, In December 2022, the vacancy rate of office space in Downtown San Francisco rose to between 23.7 and 27.6 percent, by some estimates nearly seven times the pre-pandemic 2019 vacancy rate of just 4 percent; and

WHEREAS, Though pre-pandemic office space vacancies had been impacted by a rise in remote work, a market trend embraced early on by San Francisco's high concentration of technology and finance companies, the pandemic emergency and related public health restrictions accelerated that trend; and

WHEREAS, While San Francisco's office space recession is not unique among cities across the country, it has nevertheless contributed to a decrease in foot traffic, less business patronage, and a hollowed out downtown; and

WHEREAS, The staggering increase in office space vacancies coincides with a generational housing crisis and state mandates for the construction of over 82,000 homes, of which 46,000 must be affordable to low- and moderate-income households; and

WHEREAS, In January 2023, the Budget and Legislative Analyst released a report (the BLA Report) on repurposing commercial real estate for residential use; and

WHEREAS, The BLA Report cites adaptive reuse programs in Los Angeles and New York that have facilitated the conversion of commercial office space to residential housing, whereas others have pointed to Calgary, Alberta as a model for transforming downtown commercial areas into diverse, thriving neighborhoods; and

WHEREAS, While the BLA Report calls for reduced regulatory hurdles, they fail to acknowledge that all residential uses are principally permitted throughout the downtown C-3 zoning districts, with no density limits or minimum parking requirements; and

WHEREAS, The development community has nevertheless signaled that conversion from office space to residential space is costly and unfeasible, despite some indication that viable candidates for conversion would cost less than bottom-up construction; and

WHEREAS, Another impediment to conversions is the comparatively lower market price for residential space as compared to commercial office space, with some estimates placing the asking price for commercial office space as high as $60 per square foot, a number which has reportedly declined in recent years but remains much higher than residential rental prices; and

WHEREAS, The commanding price for commercial office space presents additional challenges for shareholder- and REIT-financed properties, which can be bound by restrictive covenants that prevent adaptive reuse or the offering of space for more competitive rates; and

WHEREAS, A recent report by JK Dineen of the San Francisco Chronicle nevertheless inspires renewed interest in identifying prime candidates for office-to-residential conversion; now, therefore, be it

RESOLVED, That the Board of Supervisors of the City and County of San Francisco urges the Planning Department to report to the Board of Supervisors a comprehensive list of buildings in Downtown San Francisco that are potential candidates for commercial office to residential conversion; and, be it

FURTHER RESOLVED, That the Board of Supervisors further urges the Planning Department, in collaboration with the Department of Building Inspection, to issue public facing criteria for members of the public and stakeholder property owners to assess the viability of converting commercial office space to residential use; and, be it

FURTHER RESOLVED, That the Board of Supervisors urges the Planning Department, in collaboration with the Office of the City Controller, the Office of the Treasurer and Tax Collector, and other appropriate city partners, to investigate private market restraints on adaptive reuse, including shareholder and REIT agreements that restrict conversion or the offering of commercial space for competitive rates, and local, state and federal tax policies that disincentivize the productive or adaptive reuse of properties that would otherwise be ripe for conversion.

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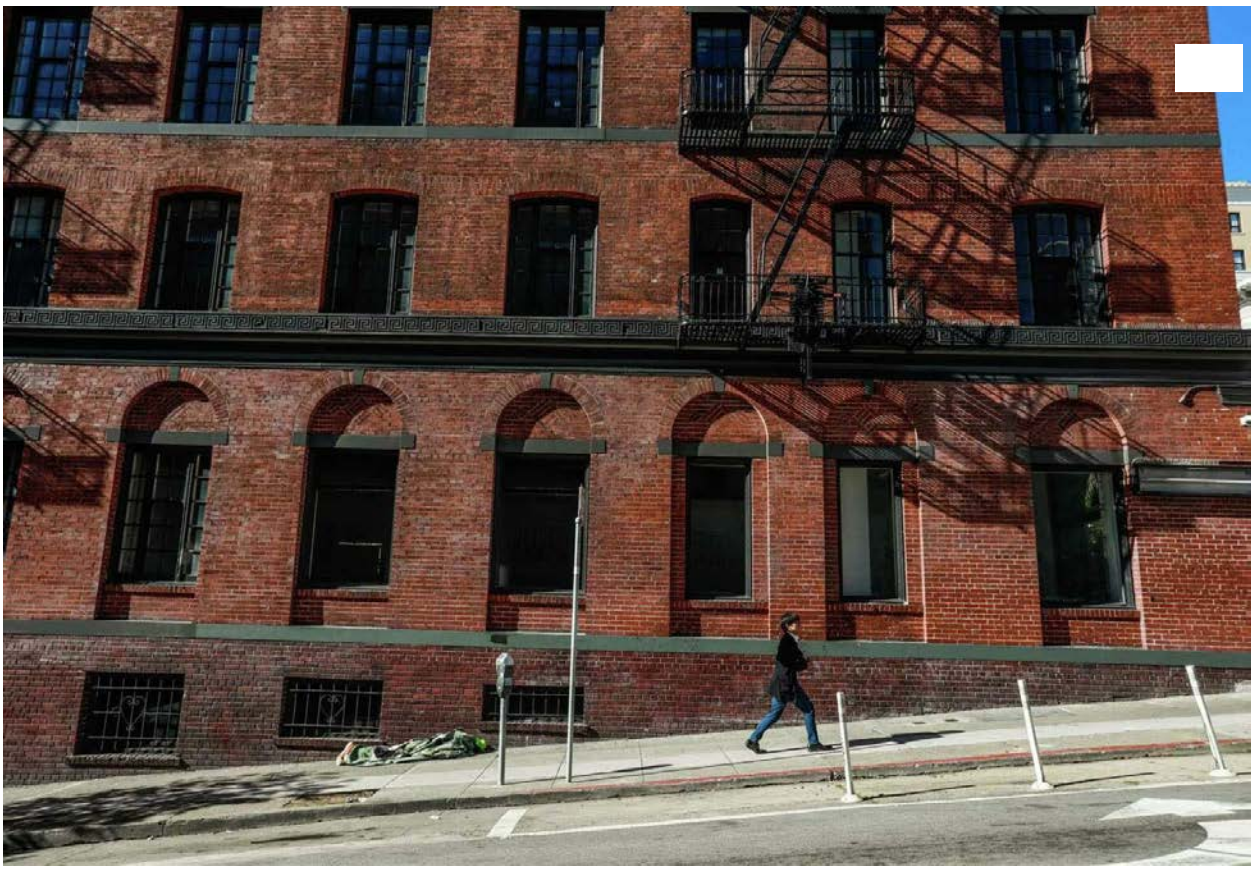
https://www.sfchronicle.com/sf/article/downtown-office-building-conversion-17758191.php

Bay Area // San Francisco

This historic building could hold the secret to saving downtown San Francisco

J.K. Dineen
Feb. 2, 2023Updated: Feb. 3, 2023 7:07 p.m.



A skinny, historic brick office building in Lower Nob Hill could be a poster child for the elusive trend that many see as the secret to saving downtown San Francisco: the office-to-residential conversion.

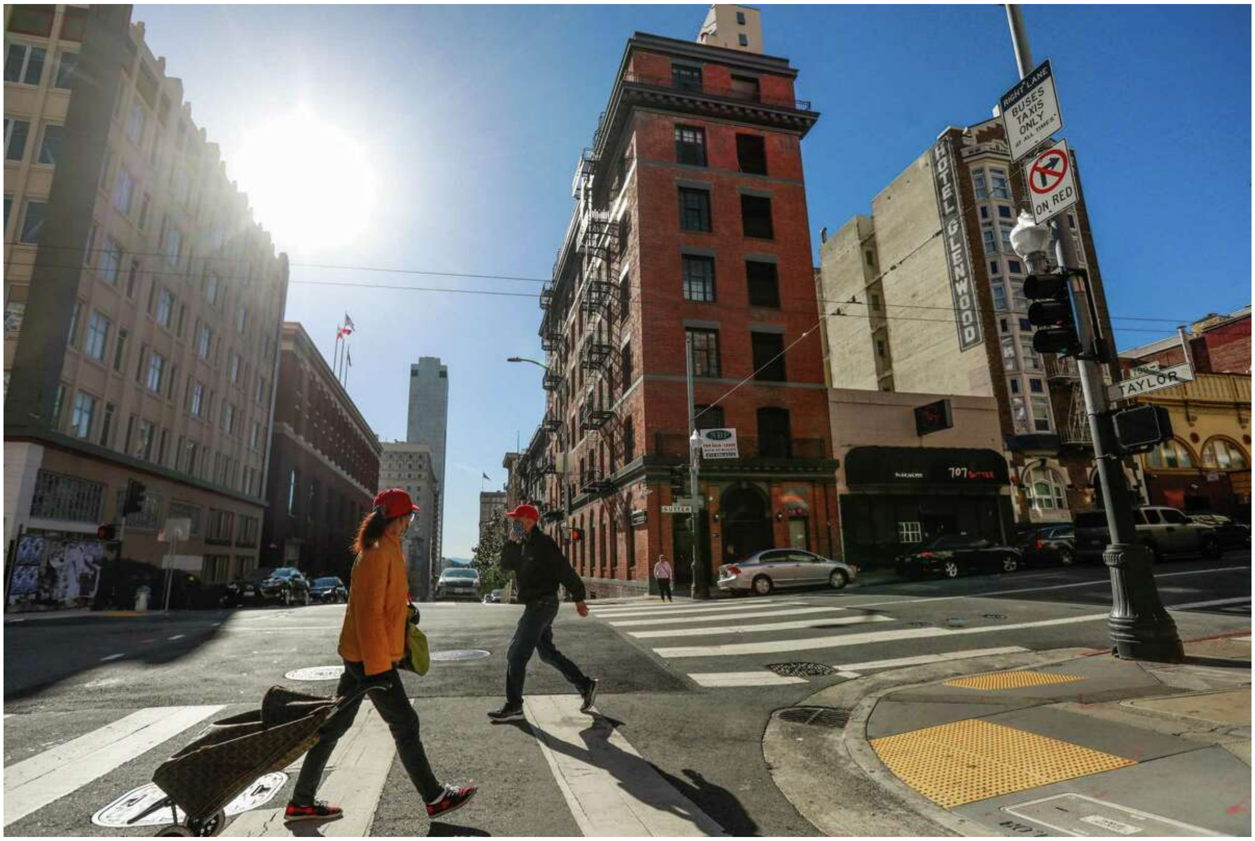
The nearly 20,000-square-foot building at 701 Sutter St., which was previously filled with tech tenants, has all the attributes that architects and investors say are needed for a conversion. The 1910 structure sits on a corner lot and is soaked in natural light. It has exposed beams, a mezzanine with arched windows and original wooden floors. It is on a mixed-use block replete with restaurants, close to several Academy of Art University buildings and a quick downhill walk to Union Square.

But what makes the brick-and-timber building particularly well positioned for a residential conversion is that it was cheap: The property recently sold for $8.3 million, 40% less than the $13.5 million it fetched in 2019.

It sold in November to the contractor SC Buildings and the residential investment group SCSH Development & Realty, which focuses largely on student housing. While the buyers did not respond to emails and phone calls seeking comment on their plans, the broker who represented the seller confirmed that the buyer plans to convert it to residential.

Broker Rick Durazzo of North Beach Properties said the property primarily attracted groups interested in converting it.

“It’s got great bones and is a rock star location for condos or apartments,” he said.



The deal comes as San Francisco’s office vacancy rate has hit 27%, and the availability rate, which includes sublease space, is 32.1%. Not surprisingly, none of the potential buyers who toured the property were looking to keep it as an office space.

“I have been in commercial real estate for 42 years, and thought I seen every damn downturn you could imagine,” said Durazzo. “This is the top of the heap.”

The concept of reviving the city’s downtown neighborhoods by filling empty buildings with residents has been the topic of panels, white papers, task forces and media reports. But all that attention has not resulted in projects coming into the planning department.

In addition to the 1910 Georgian structure at 701 Sutter, which has yet to apply for an application with the city, the one conversion proposal that has been filed with the city is for the Warfield office building at 988 Market St. That project aims to turn the 25,000 square feet in the building into 34 residential units, seven of them affordable.

With the city’s high construction costs, the key to making conversions work will be the ability to snag buildings at a bargain price, said Colin Yasukochi, research director for CBRE.

“A lot of people are scouring the market looking for office buildings that not only have the physical characteristics they are looking for but have a high vacancy and can potentially be bought at a discount," said Yasukochi. "The appropriate asset at the appropriate price. That is what will make conversion feasible."

Chris Haegglund, a principal at BAR Architects & Interiors, has met with a steady stream of building owners and investors interested in doing conversions, and even gave a presentation last week to the San Francisco Chamber of Commerce on the economics of turning office space into housing.

"There is a lot of momentum and a lot of interest," he said. "But I must say, at least so far, none of them are getting out of the due diligence phase."

He said construction costs have remained stubbornly high, and the residential market is uncertain. With 701 Sutter the price was right and the layout appears to be perfect for housing.

"The building has character," he said.

J.K. Dineen is a San Francisco Chronicle staff writer. Email: jdineen@sfchronicle.com Twitter: @sfjkdineen

CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST
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Policy Analysis Report

To:	Supervisor Gordon Mar
From:	Budget and Legislative Analyst's Office
Re:	Repurposing Commercial Real Estate for Residential Use
Date:	January 6, 2023

Summary of Requested Action

You requested that our office conduct an analysis of the extent to which repurposing commercial estate for residential use can address two problems: 1) the City's need to produce additional affordable and market-rate housing, and 2) commercial vacancies, particularly in (but not limited to) the Downtown office market. Your office also requested an analysis of policy options for encouraging such conversions.

For further information about this report, contact Fred Brousseau, Director of Policy Analysis, at the Budget and Legislative Analyst's Office.

Executive Summary

- San Francisco faces dual problems of a shortage of affordable housing production and high commercial property vacancy rates due to reduced demand, particularly for Downtown office space. Conversion of existing or planned commercial space to residential use offers a means of addressing both problems. However, as has been documented by housing and real estate experts, conversion of existing office buildings to residential use does not offer a full solution to these issues as such conversion is costly and complex. A combination of reforms in the City's development project planning and approval processes and financial incentives and subsidies could help facilitate such conversions for affordable and/or market rate housing, as demonstrated by the experience in some other cities.

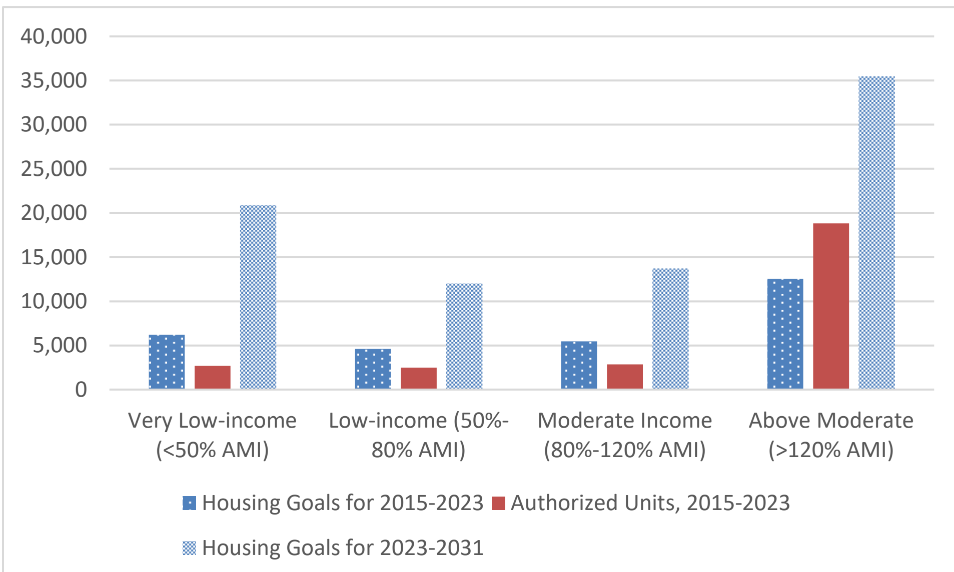
Affordable housing shortage in San Francisco

- San Francisco faces a shortage of affordable housing demonstrated by limited production relative to the City's State-required housing construction goals, known as the Regional Housing Needs Allocation (RHNA), for the eight-year period ending in 2023. The next set of State RHNA housing production goals for San Francisco generated by the State call for even more affordable and market-rate housing production between 2023 and 2031.

- The State's RHNA housing production goals for San Francisco were for 28,869 total units to be added to the City's housing inventory between 2015 and 2023, 16,333 of which were to be for Low, Very Low, and Moderate Income households. As shown in Exhibit A, through 2021 the City had not met the RHNA goals for lower-income households but had exceeded the housing production goals for market-rate housing.

- Exhibit A also presents the City's RHNA goals for the next eight-year period, which calls for the addition of 82,069 housing units, or 53,200 more units than for the eight-year period ending in 2023. The goal for affordable housing for households with moderate or lower incomes is 46,598 units, or 185 percent more than the so far unmet goal for the eight-year period ending in 2023.

Exhibit A: 2023-2031 San Francisco Housing Goals from Regional Housing Needs Allocation (RHNA) Compared to 2015-2023 Housing Goals and Units Authorized Through 2021



- San Francisco's plan for meeting its new RHNA goals, which is required to be embodied in the City's Housing Element of the General Plan, is due to the State in January of 2023. Failure to submit an approved plan by this deadline could cost the City its eligibility for various affordable housing funding programs and would subject the City and County to fines of up to $100,000 each month. Other penalties can be imposed if the City doesn't meet its goals during the eight year period.

Under-utilized office and commercial space

- The Covid-19 pandemic has had a significant impact on commercial building use and activity levels throughout the City, but particularly Downtown. Working from home or remotely for most of the 245,505 office workers that we estimate were working Downtown prior to the pandemic began in response to the Covid-19 threat but has continued through the present even as public health threats have waned.

- According to many experts, remote work will continue into the future, possibly in the form of hybrid work arrangements with reduced worker attendance at the office. This change in office work patterns has resulted in reduced demand for Downtown office space and large increases in commercial real estate vacancy rates as shown in Exhibit B. The reduced presence of office workers has also negatively affected many Downtown businesses that previously served those workers such as restaurants and retail outlets and left areas of Downtown much less active than it was pre-pandemic.

Exhibit B: Vacancy Rates in San Francisco's Office and Retail Sectors, 2019 and 2022

Market	Total 2022 inventory (millions of square feet)	Total vacancy 2022	Total vacancy 2022	Vacant space 2022 (millions of square feet)
Retail Citywide	51.0	2.9%	5.8%	3.0
Office: Greater Downtown	85.9	5.6%	24.1%	20.7
Total	136.9			23.7

Sources: Office data from JLL Office Insight, Q3 of 2022; retail data from Cushman and Wakefield Retail MarketBeat, Q3 of 2022

Note: Greater Downtown includes the following office submarkets: North Financial District, South Financial District, Mid-Market, Union Square, Jackson Square, Mission Bay/China Basin, North Waterfront, Showplace Square, South of Market, and the Van Ness Corridor.

- To address the twin problems of under-utilized office and other commercial space and a lack of affordable housing in San Francisco, the conversion of commercial space to housing appears to be a proposal worth consideration by City policymakers. A review of three studies on the topic published by the Terner Center for Housing Innovation at U.C. Berkeley provides some key points on this idea:

    1. There is a substantial amount of land zoned for commercial use throughout California, including in San Francisco, that could potentially be converted to housing.

2. Despite available commercial land, its conversion to housing does not offer a panacea for solving the state's housing problems, as such projects are often costly and complex from an architectural and engineering standpoint. Such conversions accounted for only 9.7 percent of the 24,515 net new housing units added to San Francisco's housing stock between 2014 and 2019, the Terner Center reports.

3. Besides the cost and architectural/engineering challenges of converting office and other commercial buildings to residential use, such projects face other costs including the hurdles all development projects face in San Francisco: lengthy review and permitting timelines and City requirements such as development impact fees.

- At least two cities have obtained results in converting office buildings to residential uses through policy interventions. The City of Los Angeles adopted an Adaptive Reuse Ordinance in 1999 that created a ministerial path for approval of certain commercial to residential conversion projects in the downtown area. According to one study, approximately 12,000 of the 37,000 housing units added over the subsequent 20 years in downtown Los Angeles were created through adaptive reuse.

- In New York City, state financial incentives enacted pursuant to local policymakers' recommendations helped finance 12,865 residential units developed in the city through office conversions in recent decades.

- Another pool of commercial developments that could potentially be used to increase residential development are projects in the City's Development Pipeline that are slated for commercial development and could be converted to residential proposals before construction begins. Though the City cannot mandate changes in planned use for proposed development projects, some incentives such as streamlined approval processes could potentially encourage project sponsors to change their plans given current soft demand for office space and the need for more affordable housing. Planning Department records show there are 290 commercial projects in the Pipeline at this time, 157 entitled (approved by the Planning Department), and 133 not entitled.

Reducing regulatory hurdles

- Two propositions on the City ballot in November 2022, Propositions D and E, proposed changes that would have streamlined the City's development project approval process for certain affordable housing projects. State legislation adopted in 2022 and 2018 requires streamlining the approval process for certain types of affordable housing projects. The City's current draft Housing Element also includes proposals for streamlining the approval and permitting processes for certain types of projects.

- The two November 2022 affordable housing ballot initiatives were not approved by the voters, but the streamlining mechanisms proposed and those adopted in State legislation and proposed in the draft Housing Element for certain types of projects could be considered by the Board of Supervisors for commercial to residential conversion projects including conversion of Downtown office buildings that meet certain qualifications.

- The common theme to the current and proposed streamlining is to create a ministerial, or "by-right" approval process for residential projects that include at least some affordable housing, thus reducing discretionary approvals such as environmental review and related processing time that adds cost and uncertainty to development projects. These types of provisions could be adopted for certain commercial to residential conversion projects. These were the types of changes included in the City of Los Angeles's Adaptive Reuse Ordinance that resulted in increased reuse of commercial buildings and new housing in downtown Los Angeles.

Financial incentives: reducing project costs

- Tax incentives such as those established for New York City to encourage commercial conversions could be considered by the Board of Supervisors. As an alternative or an additional policy intervention, the Board of Supervisors could also consider directly offsetting costs for some types of commercial conversion projects such as those that include certain proportions of affordable housing. In Calgary, the City Council in 2021 provided grants for conversions from a new fund of approximately $77 million (U.S. Dollars) dedicated to adaptive reuse projects. The first three grants for approximately $23 million (U.S. Dollars) resulted in conversion of approximately 414,000 square feet of office space into housing.

- Chicago is also offering a tax incentive, and the Mayor of Washington, D.C. has proposed a tax break for converting downtown commercial space into housing if it includes affordable units.

Policy Options

Policy Options that Could Likely be Implemented Legislatively or Administratively:

1. The Board of Supervisors should: Solicit input from the Planning Department, Department of Building Inspection, Controller's Office, Mayor's Office of Housing and Community Development, and City Attorney's Office on taking the following steps to encourage conversion of under-utilized commercial uses to residential use, such as conversion of Downtown offices to residential use including affordable units:

    a. Reducing or removing Below Market Rate requirements for qualified projects,

    b. Exempting qualified projects from density and other development limitations, or relaxing existing limitations,

    c. Temporarily delaying the collection of impact fees, or reducing or eliminating impact fees for qualified projects,

    d. Updating sections of the Building Code to facilitate adaptive reuse in conjunction with the review underway headed by the Planning Department,

    e. Streamlining review of qualified projects where possible through legislative and administrative action, to include exemptions from Discretionary Review hearings by the Planning Commission and possible elimination or reduction of conditional use requirements, and

    f. Setting hard time limits on determining when applications are complete and processing applications for certain types of projects, including consideration of any additional staffing resources needed to achieve this change.

2. The Board of Supervisors could encourage Planning Department staff to study, commission an expert study, or collaborate with other organizations to determine how many commercial buildings in San Francisco might be candidates for adaptive reuse to help determine how to incentivize such conversions most efficiently.

3. The Board of Supervisors could consider funding alternatives to subsidize commercial to residential conversion projects that provide the greatest benefit to the City overall, possibly including conversion of underutilized office space Downtown, conversion of commercial properties in Neighborhood Commercial Districts and other areas of the City, and not yet constructed commercial projects in the Planning Department pipeline.

4. The Board of Supervisors could consider adoption of recommendations in the draft Housing Element Update related to expediting and reducing uncertainty about the entitlement process in San Francisco, directed at least toward projects proposing to convert commercial uses to residential.

Policy Option Likely Requiring Charter Amendments

5. The Board of Supervisors could sponsor amendments to the Charter, which require voter approval, and related City codes with the goal of creating a ministerial approval pathway for qualified projects, thus eliminating the need for CEQA review and/or specific discretionary approval processes and public hearings for qualified projects. This could include eliminating certain discretionary approval processes at the Planning Department, Board of Appeals, Historic Preservation Commission, Planning Commission, Recreation and Parks Commission, Arts Commission, and Board of Supervisors.

Project Staff: Fred Brousseau, Adam Sege

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Background

A Need for More Housing

San Francisco's high housing costs and the need for additional housing production, particularly affordable housing, have been well documented. Job and population growth have outpaced housing construction in recent years, contributing to rising rents and home prices. As of 2022, fewer than 40 percent of San Francisco households have the annual income (at least $137,000) needed to afford the City's median rent, according to the Planning Department.[1] Fewer than 25 percent of households have the annual income (at least $222,000) needed to afford buying a home at the median condominium price. In addition to straining residents' budgets, the City's high housing costs can also deter would-be residents from moving to San Francisco. As of 2018, some 200,000 workers commuted into the city from other jurisdictions, net of workers who commuted from San Francisco to other cities.[2]

Every eight years, every California city must submit to state officials a plan showing the city's strategy for meeting housing production targets in the upcoming eight-year period. These targets, part of the Regional Housing Needs Allocation (RHNA), are the result of goals set at both the state and regional level. The California Department of Housing and Community Development first assigns regional production targets, and then regional government bodies – in San Francisco's case, the Association of Bay Area Governments – determine targets for individual cities.[3] Targets include a goal for market-rate units and goals for three affordability categories: Very Low Income (below 50% of Area Median Income), Low Income (50-80% of AMI), and Moderate Income (80-120% of AMI).

For the current 2015-2023 period, San Francisco's RHNA target has been 28,869 housing units, including 16,333 units in the Very Low Income, Low Income and Moderate Income affordability categories, with the remaining 12,536 in the Above Moderate, or market rate, category. Market-rate housing production during this period has exceeded the City's RHNA goal by 50 percent, while production in affordable housing categories has fallen short of target levels. Through 2021, production in the Very Low-Income, Low Income and Moderate Income affordability categories stood at 43, 54, and 52 percent of target levels, respectively, with a combined deficit of 8,298 units.[4] Exhibit 1 shows the number of units authorized for construction vs. the goals for each income category as of the end of 2021.

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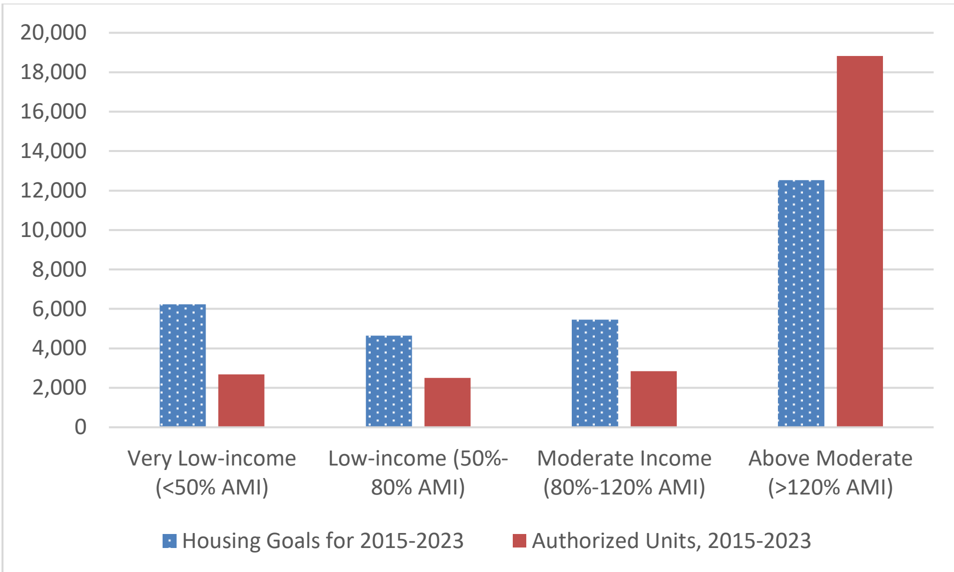
[1] "Housing Element: 2022 Update Final Draft," San Francisco Planning, December 7, 2022, page 44, Link

[2] San Francisco Housing Needs and Trends Report," San Francisco Planning, July 2018, Link

[3] "RHNA - Regional Housing Needs Allocation," Association of Bay Area Governments, accessed December 11 2022, Link

[4] "Appendix F: Evaluation of the 2014 Housing Element," San Francisco Planning, November 2022, Link

Exhibit 1: Actual Housing Units Authorized Compared to Housing Goals from San Francisco's Regional Housing Needs Allocation, by Household Affordability Level, 2015-2023 (as of end of 2021)

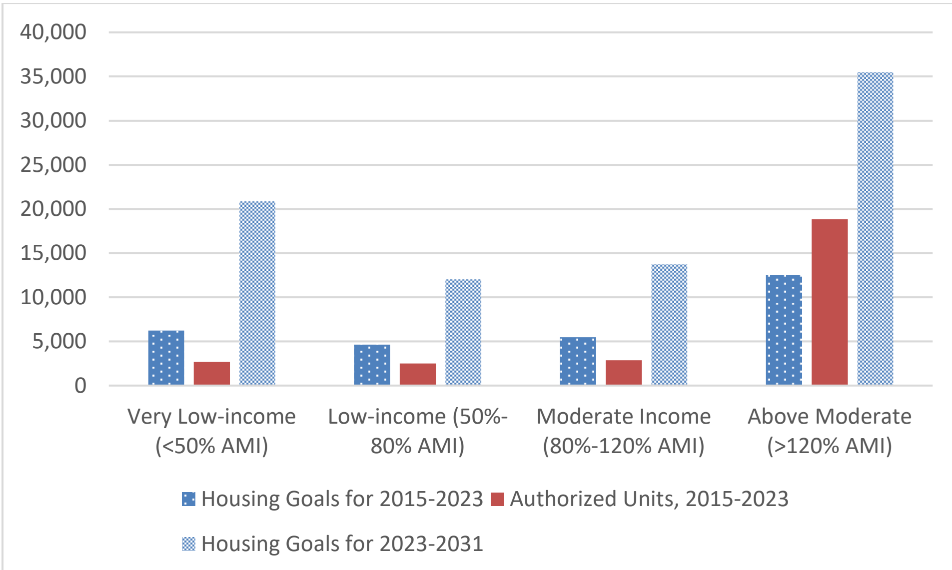


Source: "Housing Element: 2022 Update Final Draft," San Francisco Planning Department

For the upcoming 2023 – 2031 period, San Francisco's RHNA target is 82,069 units, including 46,598 affordable units.[5] This represents a 185 percent increase over the current RHNA target for affordable housing of 16,333 which, as mentioned above, has not been met. San Francisco's plan for meeting this target, embodied in the City's Housing Element of the General Plan, is due to the State in January of 2023. Failure to submit an approved plan by this deadline would cost the City its eligibility for many affordable housing funding programs and would subject the City and County to fines of up to $100,000 each month.

[5] "What is the Housing Element?" San Francisco Planning, accessed December 11, 2022, Link

Exhibit 2: 2023-2031 San Francisco Housing Goals from Regional Housing Needs Allocation Compared to 2015-2023 Housing Goals and Units Authorized Through 2021



Source: "Housing Element: 2022 Update Final Draft," San Francisco Planning
Note: The 2023-2031 housing goals include a fifth income category of Extremely Low-Income; the target for this category is included here in the Very Low-Income category.

Commercial Vacancies

The changes brought by the Covid-19 pandemic and its ripple effects brought profound change to San Francisco's commercial real estate market, including an office vacancy rate several times higher than it was prior to 2020. In the greater Downtown area[6], the office sector has exhibited a fourfold increase in its total vacancy rate between the third quarter of 2019 and the third quarter of 2022, driven largely by reduced space needs among employers due to the rise of remote work. Exhibit 3 below shows increases in total office vacancy rates Citywide and in select neighborhoods.

[6] The greater Downtown area is composed of the City's primary office submarkets as designated by JLL in their regular reports on San Francisco's commercial real estate: North Financial District, South Financial District, Mid-Market, Union Square, Jackson Square, Mission Bay/China Basin, North Waterfront, Showplace Square, South of Market, and the Van Ness Corridor.

Exhibit 3: Total San Francisco Office Vacancy Rates: Greater Downtown and Select Submarkets, 2019 and 2022

	2019 Q3	2022 Q3
Financial District (north)	5.1%	23.4%
Financial District (south)	6.1%	20.1%
Mid-Market	5.2%	32.7%
Union Square	6.4%	20.4%
Total: Greater Downtown[a]	5.6%	24.1%

Source: JLL San Francisco Office Insight, Q3 2019 and Q3 2022

[a] North Financial District, South Financial District, Mid-Market, Union Square, Jackson Square, Mission Bay/China Basin, North Waterfront, Showplace Square, South of Market, and the Van Ness Corridor.

The retail sector has also seen a significant increase in vacancies, albeit a smaller one. By one real estate services firm's measure, the City's retail market had an overall vacancy rate of 5.8 percent for the third quarter of 2022, double the rate for the same quarter of 2019 (2.9 percent).[7] Exhibit 4 shows total inventory, total vacancy, and vacant space for office space in the greater Downtown area and retail Citywide, as of Quarter 3 of 2022.

Exhibit 4: Approximate Vacant Space in Office and Retail Sectors, Q3 of 2022

Market	Total inventory (millions of square feet)	Total vacancy	Vacant space (millions of square feet)
Retail	51.0	5.8%	3.0
Office	85.9	24.1%	20.7
Total	136.9		23.7

Sources: Office data from JLL Office Insight, Q3 of 2022 for greater Downtown, defined above; retail data from Cushman and Wakefield Retail MarketBeat, Q3 of 2022.

Commercial vacancies hurt the City's revenue and economy in multiple ways. Vacant retail spaces do not generate sales revenue, representing a lost opportunity to generate sales tax revenue. Widespread vacancies can also reduce property values, assessed valuations, and, ultimately, property tax revenue. Unlike the drop in sales revenue, property tax effects are not immediate for reasons related to the process of assessing properties pursuant to California's property tax

[7] Cushman and Wakefield Retail MarketBeat reports, Q3 of 2019 and Q3 of 2022.

laws.[8] However, they can be sizable: For the downtown area only, the City's Chief Economist has projected that changes in the area's commercial real estate market could cause a reduction of $100 million to $200 million in annual property tax revenue by 2028.[9] An independent study conducted by the Institute on Taxation and Economic Policy, a nonprofit, nonpartisan tax policy organization, projects a 27 to 43 percent decrease in San Francisco's commercial real estate prices related to the increase in remote work.[10] In addition, vacancies reduce street vibrancy, which can discourage would-be commuters and visitors from spending time in commercial corridors.

Repurposing Commercial Space for Residential Use: Two Models

The housing shortage and elevated office vacancy rates described above each pose significant challenges for the City. Together, however, they also present potential opportunity: vacant commercial real estate could provide space for residential repurposing and construction, and the demand for housing could drive revitalization of vacant commercial space and the neighborhoods in which it is located.

Looking at this potential, the Terner Center for Housing Innovation at the University of California at Berkeley has prepared three reports addressing repurposing commercial space. The reports conclude that a significant amount of land is zoned for commercial purposes throughout California, including in San Francisco, and that conversion of some of these properties to residential use could be one way to address the housing challenge throughout the state given reduced demand for retail and office use in recent years.[11]

The Terner Center studies reviewed for this report make clear that converting commercial properties to residential use is not a panacea for solving California's housing shortages. They identify challenges to such conversions including architectural and building design limitations,

[8] Apart from annual increases of up to 2 percent, state law allows changes to a property's assessed value only in the case of a sale of the property, an appeal from the property owner that is approved by the City's Assessment Appeals Board, or a reduction of assessed values by the Assessor under the terms of Proposition 8.

[9] "Hearing - Economic Impact Review of Vacancies and Reduced Daytime Population in the Economic Core," and "Hearing - Future of Commercial Real Estate and the Impact on the Local Economy and Tax Revenue," Presentation by San Francisco Chief Economist Ted Egan to the San Francisco Board of Supervisors' Budget and Finance Committee, November 16, 2022, Link

[10] Chernick, Howard, David Copeland and David Merriman, 2021. "The Impact of Work from Home on Commercial Property Values and the Property Tax in U.S. Cities," Institute on Taxation and Economic Policy. Link

[11] Romem, Issa and David Garcia, 2020. "Residential Redevelopment of Commercially Zoned Land in California," Terner Center for Housing Innovation, University of California, Berkeley. Link

municipal development approval processes that add time, cost, and uncertainty to conversions, and differences in the economic return for a residential use compared to commercial.[12] One of the studies finds that commercial to residential conversions have taken place throughout the state, including in San Francisco, between 2014 and 2019, but that they have generally comprised a small percentage of total new housing units and, even with estimated conversions in the future, cannot be expected to alone address the state's, or San Francisco's, housing shortages.[13]

According to the Terner Center, an estimated 2,369, or 9.7 percent of 24,515 net new housing units added to San Francisco's housing stock between 2014 and 2019 were from conversions of commercial property (i.e., parcels with an office or retail land use designation).[14] Many California counties' conversion rates were similar or lower than San Francisco's, but notably higher was Los Angeles County, where conversions of commercial land to residential use accounted for 30.6 percent of net new housing units between 2014 and 2019. The authors of this Terner Center report note that the parcel conversion rate within five miles of Downtown Los Angeles was approximately three times higher than the rest of the region. The City of Los Angeles adopted an Adaptive Reuse Ordinance in 1999 to encourage reuse of commercial buildings. A reported 12,000 of the 37,000 housing units added over the subsequent 20 years in downtown Los Angeles were created through adaptive reuse.[15]

This section discusses two possible models for conversion of commercial space for residential use: conversion of existing commercial buildings, particularly offices, and conversion of planned commercial projects during the development project review process.

Adaptive Reuse

Adaptive reuse refers to renovating a building to facilitate a different purpose than that for which it was initially built. Commercial buildings can be repurposed for a different commercial use, such

[12] Garcia, David and Elliott Kwan, 2021. "Adaptive Reuse Challenges and Opportunities in California," Terner Center for Housing Innovation, University of California, Berkeley. Link

[13] Romem, Issa, David Garcia, and Dr. Ida Johnsson, 2021. "Strip Malls to Homes: An Analysis of Commercial to Residential Conversions in California," Terner Center for Housing Innovation, University of California, Berkeley. Link

[14] To focus on conversions, the authors excluded undeveloped land, as well as properties with both commercial and residential land use. The number of units was taken from county assessor data when available. If not available, the number of units was estimated by the authors using the average number of units per acre of the ten nearest conversions. Therefore, the number of units may not match some City records.

[15] Lall, Jessica, Marie Rumsey, Michael Shilstone, Clara Karger, and Lily Rosenberg, "Adaptive Reuse: Reimagining Our City's Buildings to Address Our Housing, Economic and Climate Crises," Central City Association of Los Angeles, April 2021. Link

as laboratory space. However, this section focuses on adaptive reuse of commercial space for the purpose of creating housing.

One type of adaptive reuse involves renovating office space for residential use. Class B and C office buildings[16] in particular are considered by some real estate analysts to be more financially suitable for conversion because they command lower rents than Class A buildings and because they generally have fewer features intended for commercial use not suitable for residential purposes that would need to be removed. As of Quarter 3 of 2022, JLL reports a total of 15.8 million square feet of Class B and C office space in the North and South Financial Districts, Mid-Market, and Union Square areas of San Francisco and 24.8 million square feet in the more extended Downtown stretching from the Embarcadero to the Van Ness Avenue corridor.[17] Conversions of Class B and C office space in Lower Manhattan have produced more than 25,000 units of housing in recent decades.[18]

Adaptive reuse can also cover repurposing of other commercial space, such as retail real estate. As noted in the first section of this report, as of Quarter 3 of 2022 there were an estimated 3 million square feet of vacant retail space throughout the City. Some of these spaces, too, could be candidates for conversion.

Compared to demolishing and replacing buildings, adaptive reuse has the potential to result in shorter development timelines for various reasons including a reduced likelihood of community opposition.[19] It also carries significant environmental benefits: according to one study, it can take up to 80 years for the operational energy savings associated with a new, energy efficient building to outweigh the impact on climate change associated with the building's construction.[20]

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[16] Class A, Class B, and Class C are terms used in the real estate industry to describe categories of property, based on factors that include building age, features and location. According to the real estate firm JLL, Class B properties are usually older than Class A properties, have average interior finishes and materials, and are usually (though not always) located outside central business districts, and Class C properties are usually older than both Class A and Class B properties and located in areas of lower demand. Link

[17] JLL San Francisco Office Insight, Q3 2022.

[18] The Real Estate Board of New York. Testimony to New York State Assembly Standing Committee on Housing Regarding Repurposing Vacant and Underutilized Real Estate for Affordable Housing Development. December 2020.

[19] Garcia, David and Elliott Kwan, 2021. "Adaptive Reuse Challenges and Opportunities in California," Terner Center for Housing Innovation, University of California, Berkeley. Link

[20] "The Greenest Building: Quantifying the Environmental Value of Building Reuse," Preservation Green Lab of the National Trust for Historic Preservation, Updated March 10, 2016, Link

However, adaptive reuse of office space can often cost as much or more as demolition and new construction while bringing added technical complexity due to the different needs for residential and office spaces. For example, building codes and consumer preferences generally require more windows when space is being used for residential units instead of office space, creating logistical complexities when considering the possible conversion of large-footprint office buildings. In addition, many office buildings have communal bathrooms in the middle of a large floor, rather than smaller bathrooms distributed throughout the floor; converting such floors into multiple residential units would require constructing new bathrooms and kitchens and would require significant plumbing work. Such considerations make certain categories of buildings more generally feasible to convert than others. For example, buildings with a smaller footprint make it easier to satisfy light and air requirements than buildings with a larger footprint.

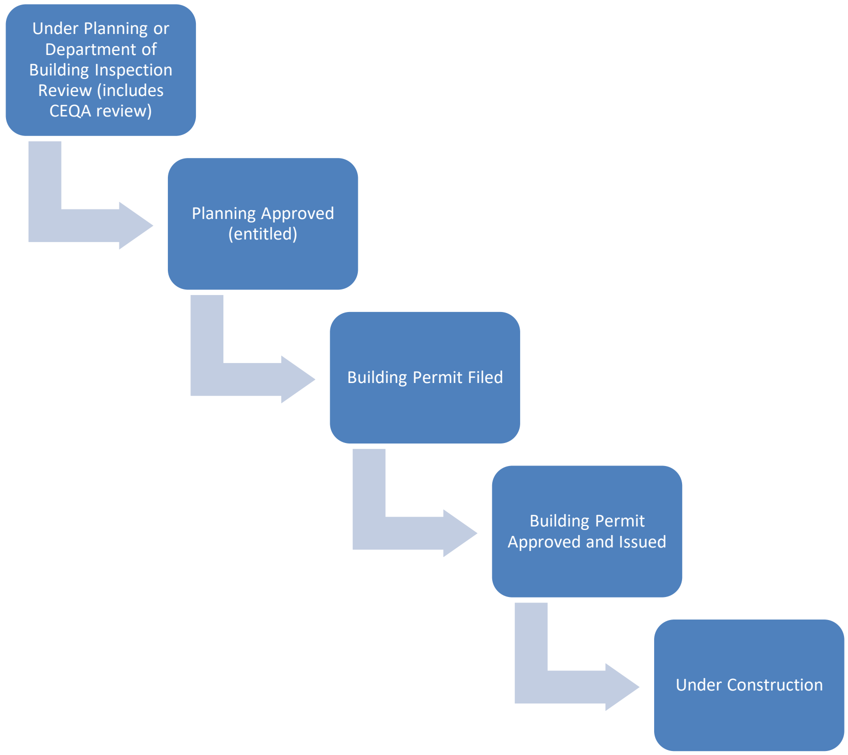
Conversions of Projects in the Planning Department Pipeline

A separate model entails the conversion of planned commercial buildings to residential use before construction has begun. This can happen anywhere in the development project application review process, from filing for a building permit through the Planning Department entitlement process and up to the issuance of a building permit. In contrast to adaptive reuse, this method of conversion avoids the technical complexities of converting an existing building from one use to another.

Changing a planned commercial project to a planned residential project adds cost and uncertainty. Depending on when such a change occurs during development project planning and application processing, the project sponsor will likely need to restart architectural and engineering planning; the sponsor might also need to select new architecture and engineering firms and restart the environmental review process, which is described below. To make such a conversion more feasible in the interest of encouraging more housing production, including affordable housing, policymakers could provide a range of incentives, such as those explored in the next section.

Exhibit 5 shows the stages of development project application review for a new commercial or residential project. Projects in each of these stages are referred to by the Planning Department as being in the City's Development Pipeline. As of Quarter 3 of 2022, at least 28 retail projects, 27 office projects, and 42 projects with multiple commercial uses without residential units were in the City's Pipeline, with most of these projects not yet entitled. Exhibit 6 provides a snapshot of the Development Pipeline as of Quarter 3 of 2022.

Exhibit 5: Stages of Development for Pipeline Projects



Source: "Pipeline Report," S.F. Planning Department, accessed December 14, 2022, Link

Exhibit 6: San Francisco Commercial Development Pipeline, Quarter 3 of 2022[21]

Row Labels	Not Entitled	Entitled	Grand Total
Multiple Commercial Uses, With Residential Units	50	104	154
Multiple Commercial Uses, Without Residential Units	25	17	42
Retail	22	6	28
Office	16	11	27
Cultural, Institutional, Educational	11	10	21
Industrial	6	7	13
Hotels and Other Visitor Services	3	1	4
Medical	0	1	1
Grand Total	**133**	**157**	**290**

Source: SF Development Pipeline 2022 Q3 data provided by S.F. Planning Department staff

Drawbacks to Conversion

Although this report focuses on options for incentivizing the conversion of commercial space into housing, it is worth noting that tradeoffs accompany such conversions. For instance, the classes of office real estate seen as most feasible to convert – Class B and Class C buildings – are also the most affordable for office tenants. Reducing the availability of such space could increase the challenges that smaller businesses face in accessing the Downtown market, particularly for categories of businesses that have historically faced barriers to accessing credit, including woman-owned businesses and businesses owned by people of color.

More broadly, eliminating commercial space comes at the opportunity cost of the tax revenue and economic activity that such space provides. Unlike residential buildings, occupied commercial space generates business tax revenue for the City, and property tax revenue from office buildings can be higher than from residential uses, as office and other commercial buildings often have higher value per square foot. The indirect spending associated with occupied offices is also significant. Though residents spend in their neighborhoods too, a 2021 study found that workers in San Francisco spent an average of $168 per week when working from their offices prior to the pandemic.[22] The Downtown commercial district also contributes to the City's economy through the wages of those who work there. Consideration of opportunity costs should also include the likelihood that the commercial vacancy rate will eventually decrease due to market forces, as the City Chief Economist has predicted,[23] though the duration of time until that occurs is unknown and could be protracted, leaving certain areas under-utilized.

Office building ownership in Downtown San Francisco has historically been very lucrative, and many owners may be averse to converting their currently under-utilized buildings to potentially less lucrative residential use. Some may believe that office demand will return at some point to its pre-pandemic levels and may not want to give up that potential market. Without sufficient

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[21] Publicly available Development Pipeline data does not include project totals broken down by proposed use(s). At the advice of Planning Department staff, we obtained the totals above by tallying all projects with a positive net square footage change in these use categories and separating out projects with positive net square footage change in multiple commercial use categories. For hotels, we tallied projects with a positive net room total, as there was not a square footage category for this usage. Residential-only projects were excluded.

[22] Barrero, Jose Maria, Nicholas Bloom, and Steven J. Davis, 2021. "Why Working from Home will Stick", Hoover Institution. Link

[23] "Hearing - Economic Impact Review of Vacancies and Reduced Daytime Population in the Economic Core," and "Hearing - Future of Commercial Real Estate and the Impact on the Local Economy and Tax Revenue," Presentation by San Francisco Chief Economist Ted Egan to the San Francisco Board of Supervisors' Budget and Finance Committee, November 16, 2022, Link

financial and regulatory incentives, conversions may not be desirable to most office building owners.

Mechanisms for Incentivizing Conversions

Generally, repurposing commercial properties for residential use is allowed under current City regulations, particularly for Downtown properties, provided that projects complete the regulatory approval process and comply with relevant building codes. The barriers to residential conversions of commercial properties are therefore primarily financial feasibility and the multiple impediments that all development projects face in San Francisco face including local regulations and processes for project approvals, planning and building code requirements, and various development impact fees and inclusionary housing requirements. At least two other cities' approaches to overcoming similar barriers included financial and regulatory incentives. In New York City, a tax incentive focused on Lower Manhattan helped finance more than 12,000 of the residential units developed in the city through office conversions in recent decades[24]; although approved at the state level, the incentive package resulted from the recommendations of a city task force co-chaired by two New York City deputy mayors.[25] In Los Angeles, the Adaptive Reuse Ordinance created several regulatory incentives for residential conversion projects, some of which are described below.

This section explores several avenues for reducing the costs and regulatory hurdles associated with conversion projects, grouped into two categories: 1) modifying regulations, and 2) providing direct subsidies. City policymakers can consider these options for various types of commercial conversions to residential use depending on their policy objectives: market rate housing, housing with some Below Market Rate units, 100 percent affordable housing projects, and others.

Modifying Regulations

Two San Francisco ballot propositions in the November 2022 election proposed Charter amendments that would have streamlined the approval of projects meeting certain affordability requirements with more expedient project permitting processes, and likely lowered project costs. These propositions failed at the ballot, but their streamlining provisions could potentially be used in the context of encouraging conversion of structures from commercial to residential use by reducing project costs and the elapsed time required to obtain project approvals from the City.

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[24] Campion, Sean, 2022. "The Potential for Office-to-Residential Conversions: Lessons from 421-g," Citizens Budget Commission. Link

[25] Lodge, John E. "An Analysis of the Lower Manhattan Revitalization Plan," 1996. Massachusetts Institute of Technology. Link

For qualified projects meeting certain affordable housing requirements, provisions of the two ballot measures included: a) eliminating discretionary approvals by the Planning Commission, Board of Appeals, Historical Preservation Commission, Board of Supervisors, and Arts Commission; and b) eliminating Discretionary Review hearings; and c) imposing time limits on various stages of the approval process.

Two pieces of State legislation adopted in 2022 (AB 2011 and SB 6) mandate streamlining provisions for residential projects in certain areas zoned for commercial use. Applied to 100 percent affordable and certain mixed income projects, the provisions of AB 2011 include time limits on determining a proposed project's consistency with qualifying criteria and on design review, and removal of rezoning requirements. AB 2011 also eliminates the need for environmental review for certain housing projects.

Building on the provisions in the ballot initiatives, the new State legislation and other ideas, the City could potentially make changes to its development processes and requirements that would encourage conversion of underutilized commercial properties to residential uses for more types of housing and in more areas. Some of these actions may require changes to the City Charter and some may be possible to implement by action of the Board of Supervisors without waiting for the next election in 2024. The City Attorney can advise the Board of Supervisors on possible paths to adopt the changes identified.

Some of the areas the Board of Supervisors could consider modifying in the interest of encouraging more housing in underutilized commercial space are as follows. Some may involve a tradeoff in terms of the City incurring new costs or forgoing some existing processes.

Inclusionary Requirements

San Francisco requires residential projects of 10 or more units to contribute to the City's affordable housing production in one of three ways: projects must either offer a set percentage of the project's units at specified levels of affordability for a specified number of years, create a number of affordable units at a separate site (set as a percentage of the new project's units), or pay a fee that the City will use to support affordable housing.[26] [27] Percentages and fees vary based on the size, tenure and location of the project, and they increase annually on a set schedule.[28] 100 percent affordable housing projects are not subject to this requirement.

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[26] San Francisco Planning Code, Sec. 415

[27] More information about current percentages can be found here.

[28] "Inclusionary Affordable Housing Program," San Francisco Planning, Informational Summary of Legislative Amendments effective August 26, 2017 (BF No. 161351) and effective November 26, 2017 (BF No. 170834), Revised October 25, 2017, Link

Market conditions affect the degree to which these requirements decrease the production of housing units or increase the supply of affordable housing.[29] Specifically, the effects of these requirements depend on the degree to which compliance costs are borne by the property owners who sell to the project developers (i.e., lower sale prices than what would otherwise be expected) versus by the developers and ultimately consumers who will live in the new units.

With the goal of setting these requirements at optimal rates for production of affordable and market-rate housing, the Planning Code requires the Controller's Office to prepare an Economic Feasibility Analysis of the requirement every three years, or in response to major economic changes. The Controller's office prepares this report in consultation with an Inclusionary Housing Technical Advisory Committee, which consists of four members chosen by the Mayor and four members chosen by the Board of Supervisors. The report can recommend changes to the inclusionary requirements, as it did in 2017.

The Inclusionary Housing Technical Advisory Committee is in the process of preparing a new report, having reconvened in October 2022. In consultation with this Committee and the Controller's Office, the City could amend current regulations to reduce or eliminate inclusionary requirements for certain types of projects, such as some conversions of commercial properties to residential use in areas such as Downtown.

Density Limitations

Lot-based density limitations apply to most of the City's residentially zoned land and cap the number of units on the lot.[30] When these limitations are set below what other rules (such as height and bulk restrictions) will allow, they produce larger and more expensive units and potentially reduce revenue available to developers considering a residential project such as through a commercial conversion. Between 2005 and 2018, only 7 percent of San Francisco's housing production occurred in zoning districts that allow three units or fewer per lot,[31] despite these districts covering 70 percent of the City's residentially zoned land.[32] To address this barrier and help incentivize converting commercial property to residential use, the City could allow for greater density for residential conversion projects, particularly in Neighborhood Commercial Districts where one unit per 600 square feet of parcel size is a common allowed density. Under

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[29] "Inclusionary Housing Working Group: Final Report," Inclusionary Housing Working Group, Office of the Controller, February 13, 2017, pages 3-4, [Link]

[30] "Appendix C: Analysis of Governmental and Non-Governmental Constraints," *San Francisco Housing Element (Final Draft for Adoption),* San Francisco Planning, December 6, 2022, page 24, [Link]

[31] This does not include Accessory Dwelling Units. These zoning districts – RH-1, RH-2, and RH-3, allow one, two and three units per lot, respectively, and an additional ADU is allowed citywide. Property owners can also seek Conditional Use Authorizations to exceed these limits.

[32] "Appendix C: Analysis of Governmental and Non-Governmental Constraints," *San Francisco Housing Element (Final Draft for Adoption),* San Francisco Planning, December 6, 2022, page 24, [Link]

state legislation that took effect in January of 2022, this upzoning may be exempt from environmental review.[33]

Impact Fees

Like many jurisdictions, San Francisco assesses impact fees on development projects that the City uses to offset the cost of infrastructure, providing public services, or other social costs associated with the new development.[34] The size of these fees varies, based on the project location and scale. While generally carrying a smaller cost than the inclusionary housing requirement, these fees add to project costs and can therefore affect project feasibility, particularly in the Downtown area and in other neighborhoods in the eastern portion of the City, where impact fees are generally higher.[35] According to a 2018 analysis by the Terner Center of a range of development fees, including impact fees, the cumulative effect of development fees is to "substantially increase the cost of building housing."[36]

The first development impact fee payment is typically due when a project sponsor obtains the first construction permit for their project. During the most recent economic downturn, the City provided the option to delay the first impact fee payment, so that it was due when the developer received its first Certificate of Occupancy. To reduce the effect of fees on the feasibility of conversion, the City could similarly delay the collection of development impact fees for certain types of projects, as called for in the draft Housing Element Update.[37] Alternatively, the City could reduce or completely waive development impact fees for projects meeting certain qualifications. Such an action would entail a decision by City policymakers to incur some infrastructure or public service costs in exchange for certain kinds of development and/or would reduce funds available for affordable housing projects in the case of deferring or waiving the Jobs-Housing Impact Fee. The loss of fees would need to be weighed against the potential gain in other revenue, such as property or sales taxes.

Building Code

San Francisco's Building Code contains numerous provisions relating to residential buildings, such as air, light, life safety, and plumbing requirements. For potential adaptive reuse projects, the architecture of buildings directly affects the feasibility of creating residential units that comply with building codes and are financially viable. For example, buildings with a smaller floor plate

[33] "SB 9 Fact Sheet," *California Department of Housing and Community Development*, 2022. Link

[34] "Development Impact Fee Register," San Francisco Planning, updated December 1, 2022, Link

[35] Correspondence with San Francisco Planning Department staff.

[36] Mawhorter, Sarah, David Garcia, Hayley Raetz, 2018. "It All Adds Up: The Cost of Housing Development Fees in Seven California Cities," Terner Center for Housing Innovation, University of California, Berkeley. Link

[37] "Housing Element: 2022 Update Final Draft," San Francisco Planning, December 7, 2022, page 131, Link

have a higher ratio of exterior wall space per floor, making it easier to retrofit units to comply with air and light requirements.

As part of a cross-department initiative led by the Planning Department, City staff are currently analyzing possible opportunities to revise the Building Code to remove unnecessary barriers to residential construction (including commercial conversion projects).[38] Though the City has limited control over the Building Code, in consultation with the findings of the staff involved in this effort, the City could potentially relax certain Building Code requirements for certain types of projects or add language to clarify Building Code requirements for adaptive reuse projects, as Los Angeles's Adaptive Reuse Ordinance did.[39]

Approval Process

The City's approval process for residential projects has been documented as particularly time-consuming and longer than other jurisdictions. A March 2022 study prepared for the State of California's Air Resources Board and Environmental Protection Agency presented the results of a review of entitlement timeframes for development project applications processed between 2014 and 2017 in 20 of the largest local government jurisdictions in California. The results showed that the City and County of San Francisco took the longest time, at nearly 26.6 months on average.[40] The next closest jurisdiction was the City of Palo Alto at 18.6 months.

Numerous factors contribute to the length of time that approvals take, including the time it takes to process applications and to receive discretionary approvals such as conditional use permits from the Planning Commission. For prospective developers, a lengthy approval process increases risk and cost, including for possible commercial conversion projects. To shorten the approval timeline, the City could set hard time limits on determining when applications are complete and processing applications for certain types of projects. Before initiating such a change, the City should solicit Planning Department input about whether this would delay the processing of non-fast-tracked projects and whether this could be accommodated with reallocations of existing staff resources or whether additional resources would be necessary to prevent such delays.

Other changes for qualified commercial conversion to residential projects could include – at a minimum – actions proposed in the two housing initiatives on the San Francisco ballot in November 2022: removing General Plan consistency reviews; eliminating discretionary approvals by the Planning Commission, Board of Appeals, Historical Preservation Commission, Arts

[38] The initiative also involves analyzing whether such opportunities exist in the Planning Code.

[39] Ward, Jason M. and Daniel Schwam. "Can Adaptive Reuse of Commercial Real Estate Address the Housing Crisis in Los Angeles?" RAND Corporation. 2022. Link

[40] Moira O'Neill-Hutson, Eric Biber, et al., Examining Entitlement in California to Inform Policy and Process: Advancing Social Equity in Housing Development Patterns, University of California, Berkeley and University of California, Irvine, prepared for the California Air Resources Board and the California Environmental Protection Agency. March 2022. Link.

Commission, and Board of Supervisors; reducing conditional use requirements; and eliminating Discretionary Review hearing provisions. If replicating proposals in the November 2022 ballot initiatives, some of these actions would require amending the Charter.

Conditional Use Permits

When a project sponsor intends to create housing on sites that currently have certain types of businesses, such as a laundromat, grocery store larger than 5,000 square feet, gas station, movie theater, or residential care facility, the sponsor needs to obtain a conditional use permit to remove those existing uses.[41] Conditional use approval is a discretionary action by the Planning Commission, generally awarded at a hearing. Conditional use authorization can add delays and uncertainty to new construction residential projects, adding another disincentive to converting an existing commercial property or project in the pipeline into a residential use. To incentivize such conversions, the City could waive the conditional use permit requirement for pipeline projects converting from commercial to residential use, similar to what is recommended in Action 9.4.2 of the draft Housing Element Update.[42] Depending on the provisions, this could require a Charter amendment or code amendments.

Discretionary Review Hearings

A Discretionary Review Hearing refers to the review of building permit applications by the Planning Commission at a public hearing. Although the Planning Commission has authority to review every building permit application, it delegates this review for the overwhelming majority of projects to Planning Department staff, who approve applications that comply with the Planning Code, design guidelines, and other applicable policies.[43] However, any member of the public has the option of requesting review of a proposed project by the Planning Commission itself, even if the proposal complies with all pertinent Planning Code requirements, through the Discretionary Review process. If someone requests such a review, Department staff will not approve an otherwise-approvable application at the end of the standard review process. Instead, the Planning Commission will review the application at a public hearing, typically within 12 weeks, and it has the option to request changes from the applicant or to disapprove the project. This process is intended to address extraordinary or unusual circumstances, although many requests for Discretionary Review fall outside of those parameters.[44]

Discretionary Review hearings are rare for Downtown projects, which typically require Planning Commission approval anyway, offering the public the opportunity to provide input. However,

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[41] "Appendix C: Analysis of Governmental and Non-Governmental Constraints," *San Francisco Housing Element (Final Draft for Adoption),* San Francisco Planning, December 6, 2022, page 35, Link

[42] "Housing Element: 2022 Update Final Draft," San Francisco Planning, December 7, 2022, page 158, Link

[43] "Discretionary Review," San Francisco Planning, updated November 19, 2021, Link

[44] "Discretionary Review," San Francisco Planning, updated November 19, 2021, Link

removing the option of Discretionary Review hearings for projects that comply with the Planning Code may help expedite the approval process for commercial to residential conversion projects in neighborhoods outside of Downtown. This would likely require amending the City's Business and Tax Regulation code that provides the authority for Discretionary Review hearings.

CEQA / Environmental Review

Under the California Environmental Quality Act, state and local governments must review the environmental impact of proposed development projects, share their findings with the public, and take steps to reduce environmental harms. In San Francisco, the Planning Department is responsible for leading the environmental review process under CEQA. This process includes determining whether a proposed project requires an Environmental Impact Report; if it determines a proposal does not, the Department must generally produce either a) a negative declaration, b) a mitigated negative declaration, in instances where developers have made changes to address potential environmental impact, c) a Community Plan Evaluation, or d) a Categorical Exemption.[45]

The environmental review process can add time and uncertainty to the development review process, particularly if a proposed project is found to have environmental impacts that trigger imposition of additional conditions on the project or a full environmental impact report. The two affordable housing initiatives on the November 2022 ballot both would have established a ministerial pathway for certain affordable housing projects that should have eliminated the need for environmental review as they would no longer be subject to discretionary review. Similarly, SB 35, enacted in 2017, is currently used to exempt 100% affordable developments from environmental review[46] and AB 2011, adopted in 2022, provides CEQA exemptions to certain categories of housing projects on commercially zoned land.

State law governs the terms of CEQA, including which types of projects are statutorily exempt from CEQA and thus are not subject to environmental review. Ministerial projects are identified in State law as not being subject to CEQA, but determination of which projects are ministerial projects can be made at the local level. The two November 2022 San Francisco affordable housing ballot initiatives were intended to provide fixed standards for certain types of affordable housing projects that would have resulted in them being ministerial and not subject to CEQA. The Board of Supervisors could propose similar changes to the City Charter and codes identified in this report so that approval of proposed conversions of underutilized commercial space to residential use would qualify as ministerial and not be subject to CEQA. Any changes to the Charter would be subject to a vote of the people.

[45] San Francisco Administrative Code, Sec. 31.06

[46] "SB-35 Planning and zoning: affordable housing: streamlined approval process," California Legislative Information, September 29, 2017, [Link]

As part of the City of Los Angeles's adaptive reuse ordinance adopted in 1999, the City created a by-right or ministerial approval process for eligible projects in certain areas of downtown Los Angeles, meaning that CEQA did not apply. The ordinance, which also includes exemptions from rezoning and parking requirements for qualified projects, is reported to have reduced average permitting time from 30 to six months.[47] The City of Los Angeles is currently working on updates to its 1999 Adaptive Reuse Ordinance as part of the process of updating the city's Downtown Community Plan, known as DTLA 2040.

Determining General Plan Consistency

For most projects, determining General Plan consistency does not add additional steps to the development approval process. However, because of the public funding, land, or other resources involved in 100% affordable housing projects, these projects are typically subject to a review of whether the project is consistent with the General Plan, referred to as a General Plan Referral. This can add an additional step to the process of receiving Board of Supervisors funding approval, and across all General Plan Referrals (including for projects unrelated to affordable housing) from 2017 to 2021, the average GPR review time was 98 days.[48] To maximize the benefits of the streamlined approval processes, the City could propose amending the Charter through a vote of the people and/or relevant codes to state that funding for Below Market Rate projects or conversion of commercial properties to residential use is consistent with the General Plan, avoiding the need for project-specific findings. The draft Housing Element Update makes a recommendation along these lines.

Housing Element Update: CEQA related recommended actions

The City's draft Housing Element Update includes an implementation plan. One of the nine implementing programs, Reducing Constraints on Housing Development, Maintenance, and Improvement, presents actions the City could take to improve the housing development process and regulations. This program is identified in the document as an acknowledgement that the City's regulatory codes and permitting processes could be simplified and made more accessible, that community-led strategies support systematic approaches rather than project-by-project decision-making, and that the cumulative effect of complex entitlement and post-entitlement permitting is making the process uncertain and even more costly.

Within the Reducing Constraints on Housing Development, Maintenance, and Improvement program are a group of recommendations addressing Compliance with State Programs and Laws

[47] William Riggs and Forrest Chamberlain, "The TOD and smart growth implications of the LA adaptive reuse ordinance," *Sustainable Cities and Society,* January 31, 2018, Link
[48] "Appendix C: Analysis of Governmental and Non-Governmental Constraints," San Francisco Housing Element (Final Draft for Adoption), San Francisco Planning, December 6, 2022, Link

(Action Group 8.5), several of which address the CEQA process. The CEQA-relevant recommendations in this group include:

- Evaluating the local CEQA review process to identify what goes beyond the CEQA statute and state guidelines in San Francisco-specific initial study checklist topics and requirements pertaining to notification, posting, public hearings, and appeals. (8.5.6),
- Completing legislative and/or procedural changes to enable the CEQA and code review process to begin earlier in the application process to expedite permit processing. (8.5.7),
- Examining and changing necessary legislation to allow project applications that only require building permits to not meet the definition of a "project" under CEQA (locally and/or at state level). (8.5.8),
- Developing a streamlined process for implementing use of the Housing Element Environmental Impact Report for future housing projects and future Planning Code amendments related to housing consistent with the Housing Element Update, and
- Complying with all state laws including CEQA timelines (8.5.12)

While these recommended actions are not directed to proposed projects to convert commercial uses to residential, they are aimed at expediting the environmental review process in general and could be considered by the Board of Supervisors either as changes for all projects or for certain projects only such as commercial conversions and/or affordable housing.

Housing Element Update: Development project approval process provisions

The City's draft Housing Element Update includes numerous programs to implement its goals of increasing housing production in San Francisco. A number of them could be applied specifically to commercial to residential conversion projects or to all projects Citywide. The recommended actions cover areas such as collecting development impact fees later in the development process (such as when a Certificate of Final Completion is issued instead of when the building permit is issued), expanding development impact fee exemptions to a broader range of affordable housing (e.g., housing for middle income households), removing General Plan referral requirements for 100 percent affordable housing projects, permanent supportive housing, and shelters, and removing public art requirements for 100 percent affordable housing requirements. These ideas and others are incorporated in our policy options for actions the Board of Supervisors could take directed to projects to convert commercial uses to residential uses.

Direct Subsidies

Ultimately, the City regulations discussed above add to project costs for developers. Relaxing regulations for certain types of projects – such as adaptive reuse conversions that include affordable housing– can therefore incentivize such projects by lowering their costs. For example, the City of Los Angeles's Adaptive Reuse Ordinance provided incentives for conversions by removing environmental review requirements, clarifying building code regulations, and relaxing regulations related to parking and rooftop additions.[49]

As an alternative or additional policy intervention, the City and County of San Francisco could also directly offset costs for at least some types of commercial conversion projects. Several cities have implemented incentive programs. In Calgary, the City Council in 2021 invited applicants to apply for grants from a new fund of $100 million (approximately $73 million in U.S. dollars) dedicated to adaptive reuse projects, with projects eligible for $75 (approximately $55 U.S. dollars) in funding for each square foot of space to be converted. Grants of up to $10 million (approximately $7.3 million U.S. dollars) did not require Calgary City Council approval, and applicants could seek Council approval for larger grants.[50] The first three successful applicants sought a combined $31 million (approximately $23 million in U.S. dollars) in subsidies, for projects converting a combined 414,000 square feet of office space into housing.[51] As of October 2022, five office-to-housing conversion projects had been approved since the program's launch.[52]

Other cities are using tax incentives to encourage conversions. Chicago is offering tax incentives for adaptive reuse of buildings within a specific downtown corridor.[53] In a presentation describing the program, the City of Chicago cited as precedent an office-to-residential conversion project approved by the City Council in 2010 that created 310 units, 20% of them affordable.[54] Tax increment financing from the city subsidized $34 million, or more than 23 percent of the total project costs. Washington D.C. Mayor Muriel Bowser has also proposed a tax break as an incentive for converting downtown commercial space into housing that includes affordable units.[55]

As a preliminary step to inform the design of a subsidy program, the City and County of San Francisco could conduct an in-depth analysis to estimate how many buildings might be good

[49] Garcia, David and Elliott Kwan, 2021. "Adaptive Reuse Challenges and Opportunities in California," Terner Center for Housing Innovation, University of California, Berkeley. Link
[50] "Downtown Calgary Development Incentive Program," The City of Calgary, accessed December 12, 2022, Link
[51] Bell, David. "Empty Calgary office towers flipped to residential with $31M taxpayer subsidy," CBC News, April 27, 2022, Link
[52] Noah Arroyo, "Yes, S.F. could turn empty downtown offices into housing. Here's what it would take," San Francisco Chronicle, October 17, 2022, Link
[53] "LaSalle Street Reimagined," City of Chicago, accessed November 18, 2022, Link
[54] "LaSalle Street Reimagined: 10/18/2022 Pre-Submission Conference," City of Chicago, October 18, 2022, Link
[55] Kashino, Marisa M. "Should DC's Empty Office Buildings Get Turned Into Apartments?," *Washingtonian*, July 28, 2022, Link

candidates for conversion. Calgary commissioned a report that looked at 28 buildings in the city and determined that adaptive reuse could be feasible for half of them.[56] A 2022 RAND Corporation report estimated approximately 2,300 commercial properties in Los Angeles could be feasible candidates for conversion into housing.[57] As of early October 2022, Denver was also considering allocating $75,000 in federal funding toward a study of the feasibility of converting office buildings to housing in its downtown.[58] Estimating the number of San Francisco buildings that could seek subsidies for conversion – and analyzing what subsidies would be likely make conversions feasible – could assist policymakers in projecting program cost and impact.

Already in San Francisco, the San Francisco Bay Area Planning and Urban Research Association (SPUR) and the Urban Land Institute (ULI) San Francisco are conducting a joint analysis of opportunities for office-to-residential conversions, with technical assistance from the architecture firm Gensler and the real estate and economic development advisory firm HR&A Advisors. The study is analyzing conversion opportunities for three building prototypes – high-rise, mid-rise, and urban infill – and SPUR expects to have a draft complete around late February of 2023. While the study is not designed to produce a precise estimate of the number of buildings where conversion is most feasible, it will provide new insight into conversion potential Downtown and could help inform the City's next steps in studying possible subsidy programs.

Policy Options

Policy Options that Could Likely be Implemented Legislatively or Administratively:

1. The Board of Supervisors should: Solicit input from the Planning Department, Department of Building Inspection, Controller's Office, Mayor's Office of Housing and Community Development, and City Attorney's Office on taking the following steps to encourage conversion of under-utilized commercial uses to residential use, such as conversion of Downtown offices to residential use including affordable units:

    a. Reducing or removing Below Market Rate requirements for qualified projects,

    b. Exempting qualified projects from density and other development limitations, or relaxing existing limitations,

[56] "Switching vacant Calgary offices to housing is 'viable'," Western Investor, June 8, 2021, Link

[57] Ward, Jason M. and Daniel Schwam. "Can Adaptive Reuse of Commercial Real Estate Address the Housing Crisis in Los Angeles?" RAND Corporation. 2022. Link

[58] Olivia Young, "Denver considers converting vacant office space into housing: 'there will be affordable housing that comes out of this,'" October 3, 2022, Link

c. Temporarily delaying the collection of impact fees, or reducing or eliminating impact fees for qualified projects,

d. Updating sections of the Building Code to facilitate adaptive reuse in conjunction with the review underway headed by the Planning Department,

e. Streamlining review of qualified projects where possible through legislative and administrative action, to include exemptions from Discretionary Review hearings by the Planning Commission and possible elimination or reduction of conditional use requirements, and

f. Setting hard time limits on determining when applications are complete and processing applications for certain types of projects, including consideration of any additional staffing resources needed to achieve this change.

2. The Board of Supervisors could encourage Planning Department staff to study, commission an expert study, or collaborate with other organizations to determine how many commercial buildings in San Francisco might be candidates for adaptive reuse to help determine how to incentivize such conversions most efficiently.

3. The Board of Supervisors could consider funding alternatives to subsidize commercial to residential conversion projects that provide the greatest benefit to the City overall, possibly including conversion of underutilized office space Downtown, conversion of commercial properties in Neighborhood Commercial Districts and other areas of the City, and not yet constructed commercial projects in the Planning Department pipeline.

4. The Board of Supervisors could consider adoption of recommendations in the draft Housing Element Update related to expediting and reducing uncertainty about the entitlement process in San Francisco, directed at least toward projects proposing to convert commercial uses to residential.

Policy Option Likely Requiring Charter Amendments

5. The Board of Supervisors could sponsor amendments to the Charter, which requires voter approval, and related City codes with the goal of creating a ministerial approval pathway for qualified projects, thus eliminating the need for CEQA review and/or specific discretionary approval processes and public hearings for qualified projects. This could include eliminating certain discretionary approval processes at the Planning Department, Board of Appeals, Historic Preservation Commission, Planning Commission, Recreation and Parks Commission, Arts Commission, and Board of Supervisors.

Introduction Form

(by a Member of the Board of Supervisors or the Mayor)

I hereby submit the following item for introduction (select only one):

- ☐ 1. For reference to Committee (Ordinance, Resolution, Motion or Charter Amendment)
- ☒ 2. Request for next printed agenda (For Adoption Without Committee Reference)
  (Routine, non-controversial and/or commendatory matters only)
- ☐ 3. Request for Hearing on a subject matter at Committee
- ☐ 4. Request for Letter beginning with "Supervisor ______ inquires…"
- ☐ 5. City Attorney Request
- ☐ 6. Call File No. ______ from Committee.
- ☐ 7. Budget and Legislative Analyst Request (attached written Motion)
- ☐ 8. Substitute Legislation File No. ______
- ☐ 9. Reactivate File No. ______
- ☐ 10. Topic submitted for Mayoral Appearance before the Board on ______

The proposed legislation should be forwarded to the following (please check all appropriate boxes):

☐ Small Business Commission ☐ Youth Commission ☐ Ethics Commission

☐ Planning Commission ☐ Building Inspection Commission ☐ Human Resources Department

General Plan Referral sent to the Planning Department (proposed legislation subject to Charter 4.105 & Admin 2A.53):

☐ Yes ☐ No

(Note: For Imperative Agenda items (a Resolution not on the printed agenda), use the Imperative Agenda Form.)

Sponsor(s):

Supervisor Peskin

Subject:

[Urging City Departments to Develop Comprehensive Adaptive Reuse Strategy for Downtown]

Long Title or text listed:

Resolution urging the Planning Department to report on potential candidates for adaptive reuse in the Downtown core; and the Planning Department and Department of Building Inspection issue public facing criteria for members of the public and stakeholder property owners on potential office conversion to residential eligibility; and the Planning Department, City Controller and Treasurer Tax Collector investigate private market restraints on adaptive reuse, including shareholder and REIT agreements that restrict conversion or the offering of commercial space for competitive rates, and local, state and federal tax policies that disincentivize the productive or adaptive reuse of properties that would otherwise be ripe for conversion.

Signature of Sponsoring Supervisor: ______