

CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS
BUDGET AND LEGISLATIVE ANALYST
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Policy Analysis Report

To: Board of Supervisors
From: Budget and Legislative Analyst's Office
Re: First Year Free Program
Date: June 28, 2024



Summary of Requested Action

In response to the 2023 Civil Grand Jury Report “Taking Care of Business: San Francisco’s Plan to Save its Small Businesses,” the Board of Supervisors requested that the Budget and Legislative Analyst conduct an analysis on the financial impacts of making First Year Free a permanent program.

For further information about this report, contact Nicolas Menard at the Budget and Legislative Analyst’s Office.

Executive Summary

- The First Year Free program waives first-year permit, license, and business registration fees for non-residential small businesses with up to \$5 million in gross receipts. The Board of Supervisors approved the program started 2021 and has extended it through June 2025.
- In FY 2023-24, the First Year Free program has waived approximately \$1,564,250 in fees through April 2024. Using a straight-line projection, this would amount to approximately \$1,877,101 for the full fiscal year. The program also funds two off-budget full-time equivalent (FTE) positions and is anticipated to incur approximately \$100,000 in information technology costs for the two-year period of FY 2023-24 and FY 2024-25.
- The value of fee waivers is impacted by the number of new business locations opening in San Francisco each year. New business location openings dropped in 2020 due to the COVID-19 pandemic. After a slight recovery in 2021, business openings further decreased in 2022 and 2023. The number of new business location openings, regardless of size, has decreased from 19,556 in 2018 to 13,220 in 2023.
- Using a baseline amount of \$1,877,101 in FY 2023-24 fee waivers, we assume that new business enrollment and fees will escalate by three percent annually, and that labor costs will escalate by four percent annually. In this scenario, we estimate that

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the total cost to operate the program for 10 years would be approximately \$30.3 million. Costs would be below this estimate if business enrollment does not increase each year or if there are staffing vacancies for any period.

- A ballot initiative proposed for the November 2024 ballot would change the City's business tax and fee structure. The ballot initiative would reduce business registration fees on businesses with under \$2 million in gross receipts but would increase fees for businesses with between \$2 million and \$5 million in gross receipts. Overall, we do not anticipate a significant change to the cost of the First Year Free program if the proposed initiative is approved.
- The Treasurer-Tax Collector's office is planning to introduce legislation that would waive approximately \$10 million in license fees if the proposed business tax initiative is approved. If the proposed legislation were to eliminate Unified License fees, the cost of the First Year Free program would be reduced by approximately \$338,521 in FY 2024-25, and by approximately \$4.5 million over 10 years compared to our projections.
- According to the March 2024 Budget Outlook Update, the City is projected to have a General Fund budget deficit of approximately \$236 million in FY 2024-25, which is projected to increase to approximately \$1.36 billion in FY 2027-28. While there is sufficient balance to fund the First Year Free program without an appropriation in FY 2024-25, funding the program in future years would have to be balanced against other General Fund priorities in light of the projected deficit.

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Background

Civil Grand Jury Report

The 2023 Civil Grand Jury Report “Taking Care of Business: San Francisco’s Plan to Save its Small Businesses” recommended that the Mayor and Board of Supervisors “should take the legislative and budgetary steps necessary to make First Year Free a permanent program.” The Board of Supervisors responded by stating that the recommendation requires further analysis and directed the Budget and Legislative Analyst to study the financial impacts and provide a report by June 30, 2024.

First Year Free Program Background

In July 2021, the Board of Supervisors approved an ordinance waiving first-year permit, license, and business registration fees for certain small businesses (File 21-0741). The goal of the waiver program, referred to as the “First Year Free” program, was to provide relief to small businesses during the City’s recovery from the COVID-19 pandemic. In November 2022, the fee waivers were expanded to all non-residential business types and extended through June 2023 (File 22-0970). In July 2023, the Board of Supervisors retroactively approved an ordinance to codify the First Year Free program and extend it through June 2024 (File 23-0664). In April 2024, the Board of Supervisors approved an ordinance to extend the program through June 2025 (File 24-0126).¹ The Treasurer-Tax Collector administers the First Year Free program, which has enrolled 7,467 businesses as of June 17, 2024, although not all enrolled businesses have received a monetary benefit.

Both new small businesses and existing small businesses with new locations that have up to \$5 million or less in gross receipts in San Francisco are eligible for fee waivers. However, fee waivers may be revoked if a business that originally qualified for a fee waiver had more than \$15 million in gross receipts in San Francisco in the calendar year of or in any of the three calendar years following the date the business commenced or opened a new location.

First Year Free Program Costs and Projections

Program Costs

According to the Treasurer-Tax Collector’s Office, in FY 2023-24, the First-Year Free program has waived approximately \$1,564,250 in fees through April 30, 2024. Using a straight-line projection, this would amount to approximately \$1,877,101 for the full fiscal year. This would be a 14

¹ In 2020 and 2021, the Board of Supervisors and the Mayor approved ordinances that temporarily waived certain license fees, business registration fees, and payroll expense taxes and extended deadlines for paying certain business fees and taxes due to the COVID-19 pandemic (Files 20-1260 and 20-1415).

percent increase in fees waived from FY 2022-23, during which the program waived a total of \$1,649,977 in fees. As discussed below, new business formation decreased by ten percent between CY 2022 and 2023.

In addition to fee waivers, the First Year Free program funds two off-budget full-time equivalent (FTE) positions, a 1634 Principal Account Clerk, which is currently filled, and a 4310 Commercial Division Assistant Supervisor, which are both currently filled. The total cost to fund both positions in FY 2024-25, if filled, is approximately \$330,000. The Treasurer-Tax Collector's office also anticipates information technology costs to support the program will cost approximately \$100,000 for the two-year period of FY 2023-24 and FY 2024-25. The Treasurer-Tax Collector's Office likely has sufficient program balance in unspent funds from prior years to fund the program through FY 2024-25. The proposed Citywide FY 2024-25 – FY 2025-26 budget does not provide additional appropriations for the program.

Business Openings

The value of fee waivers is impacted by the number of new business locations opening in San Francisco each year. New business location openings dropped in 2020 due to the COVID-19 pandemic. After a slight recovery in 2021, business openings further decreased in 2022 and 2023. The number of new business location openings from 2018 through 2023, regardless of business size and eligibility for the program, is shown in Exhibit 1 below.²

Exhibit 1: New Business Openings, 2018 through 2023

Year	Business Location Openings	Percent Change
2018	19,556	
2019	19,132	-2%
2020	14,286	-25%
2021	15,365	+8%
2022	14,660	-5%
2023	13,220	-10%

Source: Open Data SF

If new business location openings recover towards pre-pandemic levels, the cost to operate the First Year Free program would likely increase as well.

Cost Projections

Assuming that no changes are made to the First Year Free program, the cost to operate the program in future years depends on the number of qualifying businesses that register and the fee amounts that are waived. For example, some new businesses will undertake tenant

² The Treasurer-Tax Collector's Office was unable to provide business location data segmented by gross receipts.

improvements to commercial spaces and therefore may qualify DBI fee waivers, while other new businesses do not require permits or licenses.

Using a baseline amount of \$1,877,101 in FY 2023-24 fee waivers, we conservatively assume that new business enrollment and fees will escalate by three percent annually, and that labor costs will escalate by four percent annually. If new business enrollment and fees each increase by three percent, the total annual increase to fee waivers would be 6.09 percent, due to compounding. In this scenario, the total cost to operate the program for 10 years would be approximately \$30.3 million, as shown in Exhibit 2 below.

Exhibit 2: Estimated First Year Free Program 10-Year Costs

Year	Fee Waivers	Staffing Costs	Total Cost
Year 1 (FY 2024-25)	\$1,991,416	\$329,824	\$2,321,240
Year 2 (FY 2025-26)	2,112,693	343,017	2,455,710
Year 3 (FY 2026-27)	2,241,356	356,738	2,598,094
Year 4 (FY 2027-28)	2,377,855	371,007	2,748,862
Year 5 (FY 2028-29)	2,522,666	385,848	2,908,514
Year 6 (FY 2029-30)	2,676,297	401,281	3,077,578
Year 7 (FY 2030-31)	2,839,283	417,333	3,256,616
Year 8 (FY 2031-32)	3,012,195	434,026	3,446,221
Year 9 (FY 2032-33)	3,195,638	451,387	3,647,025
Year 10 (FY 2033-34)	3,390,252	469,443	3,859,695
Total	\$26,359,652	\$3,959,904	\$30,319,556

Source: BLA estimates using Treasurer-Tax Collector data

This estimate assumes that new business growth is currently at a low point due to the downtown’s relatively slow recovery from the COVID-19 pandemic and will gradually increase over the next decade. Costs would come in below this estimate if business enrollment does not increase each year or if there are staffing vacancies for any period. City fees generally escalate each year based on the Consumer Price Index (CPI), which could be below three percent in future years. Additionally, it is possible that some information technology costs may be needed in future years, although we cannot estimate that at this time.

If new business openings were to immediately return to pre-pandemic levels in FY 2024-25, or approximately 20,000 new business openings per year, we estimate that the one-year cost would be approximately \$3.3 million. This amount includes three percent fee escalation and staffing costs.

Possible Business Tax and Fee Changes

In February 2024, the Offices of the Treasurer-Tax Collector and Controller issued a report outlining a series of recommendations to potentially change the City’s business tax structure. Among the changes, the report recommended reducing or eliminating certain fees that

disproportionally impact small businesses while increasing the more progressive gross receipts tax. Any recommended changes to taxes would require voter approval, however fee reductions may be approved by the Board of Supervisors. In May 2024, a citizens' group submitted a petition for a ballot initiative that would implement business tax and business registration fee changes that are based on these recommendations. As of the writing of this report, the Department of Elections is reviewing the petition signatures.

Assuming that the initiative is qualified for the November 2024 ballot and approved by voters, we do not anticipate significant changes to the cost of the First Year Free program. In FY 2023-24 to date, approximately 29 percent of fees waived by the program are for fees collected by the Treasurer-Tax Collector's office. The remaining 71 percent are for fees collected by other departments, such as the Department of Building Inspection (DBI) and Department of Public Health (DPH), which would not be affected by the proposed ballot initiative. For the Business Registration Fee, which is collected by the Treasurer-Tax Collector's office, the proposed initiative would reduce fees for businesses with under \$2 million in gross receipts by approximately 17 to 21 percent, but it would increase fees for business with between \$2 million and \$5 million in gross receipts by approximately 146 percent.

In 2021, the Treasurer-Tax Collector's office provided the Budget and Legislative Analyst with total business registration fees paid in 2018 by gross receipts tier. The total fee amount collected by businesses with under \$5 million in gross receipts was approximately \$24 million. If the proposed fee changes to each tier were applied to the 2018 fee collection amounts, the total amount collected would be approximately \$22.3 million, or a reduction of seven percent.³ Because business registration fee waivers account for 14 percent of First Year Free fee waivers, we do not anticipate a significant change to the cost of the program if the proposed initiative is approved.

Additionally, the Treasurer-Tax Collector's office is planning to introduce legislation that would waive approximately \$10 million in license fees. The legislation would only go into effect if the business tax initiative is approved, as the fee waivers would be offset by certain tax revenue increases. Although the details of the legislation have not been finalized, the Treasurer-Tax Collector's office intends that the legislation would eliminate Unified License fees, which are fees collected by the Treasurer-Tax Collector's office on behalf of other departments. In FY 2023-24 to date, Unified License fees account for approximately 17 percent of fees waived by the First

³ The gross receipt tiers from 2018 do not fully align with the current tiers. For example, 2018 used a tier of \$1 million to \$2.5 million, rather than tiers of \$1 to \$1.5 million, \$1.5 to \$2 million, and \$2 to \$2.5 million, and a tier of \$2.5 to \$7.5 million, which exceeds the \$5 million limit of the First Year Free program. For this analysis, we evenly divided the \$1 million to \$2.5 million tier fees among the three current tiers, and we assumed that half of the \$2.5 to \$7.5 million tier fees were for businesses under \$5 million in gross receipts.

Year Free program. If the Unified License fees were eliminated, the cost of the First Year Free program would be reduced by approximately \$338,521 in FY 2024-25, and by approximately \$4.5 million over 10 years compared to the projections shown in Exhibit 2 above.

Projected General Fund Deficit

According to the March 2024 Budget Outlook Update, issued by the Controller, Mayor's Budget Office, and Budget and Legislative Analyst, the City is projected to have a General Fund budget deficit of approximately \$236 million in FY 2024-25, which is projected to increase to approximately \$1.36 billion in FY 2027-28. While there is sufficient balance to fund the program without an appropriation in FY 2024-25, funding the program in future years would have to be balanced against other General Fund priorities in light of the projected deficit.