CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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TO: Budget and Appropriations Committee

FROM: Budget and Legislative Analyst

SUBJECT: July 12, 2023 Budget and Appropriations Committee Meeting

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EXECUTIVE SUMMARY

Legislative Objectives

- The proposed ordinance provides up to three years of business tax credits for businesses in several office-based sectors that open (or opened) a physical location in San Francisco between Jan. 1, 2023 and Dec. 31, 2027, through no later than tax year 2028.
- It also postpones by two years Gross Receipts Tax rate increases for certain sectors that are scheduled to take effect for tax years 2023 and 2024.

Key Points

- The proposed ordinance would introduce a temporary Gross Receipts Tax credit for businesses in specific office-based sectors that open in, or relocate to, San Francisco during tax years 2023-2027.
- Qualifying businesses would be eligible for up to three years of credits, starting with the first tax year after the business opened a new San Francisco location, through no later than 2028. The maximum available credit per business is $1 million per year.
- The proposed ordinance would also delay for two years Gross Receipts Tax rate increases scheduled to take effect for 2023 and 2024 for the following sectors: retail trade, certain services, manufacturing, food services, accommodations, and arts, entertainment, and recreation. It would delay these increases until 2025 and 2026.

Fiscal Impact

- The Controller's Office estimates that the delay in the gross receipts tax increase will cost $27.8 million.
- The Mayor's proposed FY 2023-24 – FY 2024-25 budget assumed revenue losses of $4.4 million in FY 2023-24 and $11.2 million in FY 2024-25 resulting from the new location tax credit. Subsequent analysis by the Controller's Office and the limiting of the new location tax credit to certain zip codes have resulted in revised estimates of gross receipt tax revenue: no revenue loss in FY 2023-24, a $0.6 million revenue decrease in FY 2024-25, and a $5 million revenue decrease in FY 2025-26.

Policy Consideration

- The proposed changes are part of Mayor Breed's plan to stabilize Downtown and promote economic recovery amid the continuing impact of the Covid-19 pandemic and the increase in remote work.

Recommendation

- Approval of the proposed ordinance is a policy matter for the Board of Supervisors.

MANDATE STATEMENT

City Charter Section 2.105 states that all legislative acts shall be by ordinance, approved by a majority of the members of the Board of Supervisors.

BACKGROUND

In November of 2020, San Francisco voters approved Proposition F, which directed the City to complete its phaseout of the payroll tax and implementation of the Gross Receipts Tax, which is now the City's primary business tax. Under the schedule laid out in Proposition F, Gross Receipts Tax rates increased in 2021 for most industries, but to provide temporary relief for industries disproportionately affected by the Covid-19 pandemic, the Proposition F tax rate schedule included two-year tax rate decreases for specific sectors: retail trade; manufacturing; food services accommodations; arts, entertainment and recreation; and certain services (a classification that includes businesses such as nail salons).[1] Gross receipts tax rates for these sectors are scheduled to increase for both 2023 and 2024.

In the years since Proposition F, San Francisco's economy has continued to reflect challenges brought by Covid-19 and related decreases in commuting and travel. Declines in tourism, business travel and in-person office work have also contributed to an increase in commercial vacancies Downtown, which has traditionally been a core driver of the City's economy and tax revenue. The proposed ordinance would implement two types of tax relief as part of Mayor Breed's broader strategy for supporting Downtown's economic recovery.[2]

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance (1) postpones by two years Gross Receipts Tax rate increases for certain sectors that are scheduled to take effect for tax years 2023 and 2024, and (2) provides up to three years of business tax credits for businesses in several office-based sectors that open (or opened) a physical location in certain San Francisco zip codes[3] between Jan. 1, 2023 and Dec. 31, 2027, through no later than tax year 2028.

Extension of Targeted Gross Receipts Tax Relief

The proposed ordinance would delay for two years Gross Receipts Tax rate increases scheduled to take effect for 2023 and 2024 and keep them at the 2022 levels for the following sectors: retail trade, certain services, manufacturing, food services, accommodations, and arts, entertainment,

[1] The top tax bracket, for businesses reporting more than $25 million in annual gross receipts, received a 40 percent increase in their marginal tax rate between 2021 and 2022.

[2] Roadmap to Downtown San Francisco's Future.

[3] The Budget & Appropriations Committee amended the ordinance on June 28, 2023 to limit the new location tax credit to the following zip codes: 94102, 94103, 94104, 94105, 94107, 94108, 94109, 94111, 94133, and 94158.

and recreation. Under the current tax schedule, most tax brackets in these sectors received tax decreases in 2021 and 2022.[4] The gross receipts tax rate for these brackets are scheduled to increase by 50% and 33%, respectively, for tax years 2023 and 2024. The proposed ordinance would delay these increases until 2025 and 2026, maintaining 2022 gross receipts tax rates until then.

Exhibit 1 below compares the schedule of increases in the proposed ordinance with current schedule of increases as laid out in Proposition F.

Exhibit 1: Proposed Delays of Tax Rate Increases for Gross Receipts Up to $25 Million Annually

Business Activity	2023 Scheduled Increase	**2023 Proposed Increase**	2024 Scheduled Increase	**2024 Proposed Increase**	2025 Scheduled Increase	**2025 Proposed Increase**	2026 Scheduled Increase	**2026 Proposed Increase**
Certain Services	50%	**0**	33%	**0**	0	**50%**	0	**33%**
Retail Trade	50%	**0**	33%	**0**	0	**50%**	0	**33%**
Food Services	50%	**0**	33%	**0**	0	**50%**	0	**33%**
Manufacturing	50%	**0**	33%	**0**	0	**50%**	0	**33%**
Accommodations	50%	**0**	33%	**0**	0	**50%**	0	**33%**
Arts, Entertainment, and Recreation	50%	**0**	33%	**0**	0	**50%**	0	**33%**

Source: San Francisco Controller's Office

Note: Tax rates for gross receipts beyond $25 million are not scheduled to change and would not be affected by the proposed ordinance.

For the affected tax brackets, tax rates in these sectors ranged from 0.05% to 0.26% in 2022, depending on the sector and tax bracket. Following the increases described above, this range will increase from 0.11% to 0.52% in 2024 under the current schedule or in 2026 under the proposed ordinance.[5]

[4] The proposed ordinance would not affect top tax bracket, which applies to gross receipts over $25 million. Tax rates for this tax bracket did not receive the 2021 and 2022 decreases and instead received a 40% increase in 2021. Tax rates for gross receipts beyond $25 million are not scheduled to change and would not be affected by the proposed ordinance.

[5] In the top tax bracket, gross receipts tax rates were fully implemented in 2021 for these sectors and range from 0.22% (Certain Services) to 0.67% (Food Services and Manufacturing).

New Location Tax Credit

The proposed ordinance would also introduce a temporary Gross Receipts Tax credit for businesses in specific office-based sectors that open in, or relocate to, certain zip codes in San Francisco during tax years 2023-2027. (This includes eligible businesses that have already opened in 2023). Qualifying businesses would be eligible for up to three years of credits, starting with the first tax year after the business opened a new San Francisco location, through no later than 2028. The maximum available credit per business is $1 million per year. Businesses that reopen in San Francisco that previously had a City location within the past three years are not eligible for the credit.

Businesses in the following sectors that pay the Gross Receipts Tax are eligible for the tax credit: information; administrative and support services; financial services, insurance, and professional, scientific; and technical services. For these businesses, the proposed credit would be equal to 0.45% of San Francisco taxable gross receipts in the relevant year. The 2023 tax rates for these industries range from 0.57% to 0.94% of gross receipts.

Although most San Francisco businesses pay the Gross Receipts Tax, some businesses that have an administrative presence only in the City are instead required to pay an Administrative Office Tax. For these businesses, the proposed credit would be equal to 0.7% of taxable payroll.

Reporting to the Board of Supervisors

The proposed ordinance would require the Tax Collector to provide an annual report to the Board of Supervisors with the number of businesses taking the credit and the aggregate amount credited to these businesses. These reports would be due by October 31 of each year following the tax years that the credit is in effect.

FISCAL IMPACT

Extension of Targeted Gross Receipts Tax Relief

The Controller's Office estimates that the delay in the gross receipts tax increase will cost $27.8 million. To estimate the impact of the proposed delays in increasing the affected Gross Receipts Tax rates, the Controller's Office assumed 2021 levels of taxable business activity for tax years 2023-2026. It then subtracted the projected revenue under the proposed schedule of increases from the projected revenue under the current schedule of increases. Exhibit 2 below shows the results of this analysis, rounded to the nearest thousand.

Exhibit 2: Estimated General Fund Revenue Loss of Extending Targeted Gross Receipts Tax Relief (Millions)

Business Activity	FY 2022-23*	FY 2023-24	FY 2024-25	FY 2025-26	Total
Accommodations	$0.4	$1.2	$1.2	$0.4	**$3.3**
Arts, Entertainment, and Recreation	$0.2	$0.7	$0.7	$0.2	**$1.8**
Certain Services	$0.1	$0.3	$0.3	$0.1	**$0.7**
Food Services	$0.8	$2.3	$2.3	$0.8	**$6.3**
Manufacturing	$0.6	$1.7	$1.7	$0.6	**$4.5**
Retail Trade	$1.4	$4.2	$4.2	$1.4	**$11.3**
Total	**$3.5**	**$10.4**	**$10.4**	**$3.5**	**$27.8**

Source: San Francisco Controller's Office

FY 2022-23 values are for half the fiscal year. The proposed ordinance would decrease revenues in the 2023 calendar and going forward.

New Location Tax Credit

The Mayor's proposed FY 2023-24 – FY 2024-25 budget assumed revenue losses of $4.4 million in FY 2023-24 and $11.2 million in FY 2024-25 resulting from the new location tax credit. Subsequent analysis by the Controller's Office and the limiting of the new location tax credit to certain zip codes have resulted in revised estimates of gross receipt tax revenue: no revenue loss in FY 2023-24, a $0.6 million revenue decrease in FY 2024-25, and a $5 million revenue decrease in FY 2025-26.

POLICY CONSIDERATION

Limitations of Cost Estimates

The cost estimates above use 2021 as a baseline year and assume business activity will remain at the same level in the coming years. Notably, 2021 was the second year of the Covid-19 pandemic; should the City's economic recovery continue in the coming years, relevant business activity may exceed 2021 activity levels, resulting in the actual costs of the proposed changes exceeding estimated costs. Alternatively, should economic activity fall below 2021 levels in certain years, actual costs would likely be lower than projected.

The projected cost for the new location tax credit also does not account for businesses that relocate to San Francisco, having previously had a location in the City more than three years prior. Because these relocations do not require a new business license, they do not show up in the data the Controller's Office used to project costs of the new location tax credit. Businesses in this category that relocate to San Francisco and receive the tax credit would increase both the tax credit's cost and the number of jobs associated with its implementation.

Job Losses and Downtown Vacancies

The proposed changes are part of Mayor Breed's plan to stabilize Downtown and promote economic recovery amid the continuing impact of the Covid-19 pandemic and the increase in remote work. As we reported in February,[6] the City lost nearly 22,837 total private sector jobs between the second quarter of 2019 and the second quarter of 2022, with the Accommodation and Food Services (-24,977 jobs) and Retail Trade (-7,711 jobs) sectors experiencing the greatest reductions.[7] From Q4 of 2019 to the Q4 of 2022, office vacancy rates in the Greater Downtown area increased from 5.2% to 25.1%.[8]

Lower Projections of Overall Business Tax Revenue

The March 2023 five-year revenue projections issued jointly by the Controller, Mayor's Office, and our office project average business tax revenue of $934.4 million per year between FY 2022-23 and FY 2025-26. However, these projections are $104.8 million lower per year, on average, than the average revenue of $1,039.18 million that had been projected for the same years in the January 2022 five-year forecast. Factors contributing to this decrease in projected revenue include an increased estimate of long-term telecommuting rates among office workers and reductions in the City's population.

RECOMMENDATION

Approval of the proposed ordinance is a policy matter for the Board of Supervisors.

[6] *Options for Addressing Economic and Tax Revenue Trends in Downtown San Francisco*

[7] Quarterly Census of Employment and Wages, U.S. Bureau of Labor Statistics

[8] JLL San Francisco Office Insight, Q4 2019 and Q4 2022

Item 2 **File 23-0657** *(Continued from 6/28/23 meeting)*	**Department:** Homelessness & Supportive Housing (HSH)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed ordinance would modify the Homelessness Gross Receipt Tax funding allocation requirements by $5,983,000 in FY 2023-24 and $10,376,000 FY 2024-25.

Key Points

- Under current law, Proposition C Homeless Gross Receipts Tax revenues must be spent in the following manner: at least 50 percent on permanent housing (including 20 percent on transitional aged youth, 25 percent on families, and the remaining portion on all populations), up to 10 percent on shelter and hygiene, up to 15 percent on prevention, and at least 25 percent on mental health.

Fiscal Impact

- The source of funding in FY 2023-24 and FY 2024-25 is interest earnings on Proposition C Homelessness Gross Receipts fund balance that would otherwise be allocated to housing for TAY and families and to mental health programming.
- The proposed re-allocation of Proposition C revenues is part of a larger spending plan that was part of the Mayor's proposed budget for FY 2023-24 and FY 2024-25. This revised proposal for Proposition C funding differs from the original version of this ordinance programmatically by reducing the number of rapid re-housing and permanent supportive housing slots and shifting funding for the Mission cabin program and the vehicular assistance program to other funding sources.

Recommendation

- Approval of the proposed ordinance is a policy matter for the Board of Supervisors.

MANDATE STATEMENT

Charter Section 2.105 requires that legislative acts in San Francisco be by ordinance, subject to approval by a majority of the Board of Supervisors.

Business and Tax Regulations Code Section 2811 states that amendments to the Homeless Gross Receipts Tax are subject to Board of Supervisors approval by a two-thirds vote. Such amendments may only be to further the purpose of the tax.

BACKGROUND

The Homelessness Gross Receipts Tax was authorized by voters in November 2018 with the passage of Proposition C and became effective in January 2019. The tax added between 0.175% to 0.69%, depending on the businesses type, to the gross receipts tax on businesses earning over $50 million in a given year.

Under current law, expenditures of Homelessness Gross Receipts Tax revenues must be spent in the following manner:

- At least of 50 percent on permanent housing
  - Of which, at least 20 percent must be spent on transitional aged youth (TAY), defined as underage 30
  - Of which, at least 25 percent must be spent on family housing
  - Of which, the remaining portion must be spent on general housing, serving all populations
  - Of which, no more than 12 percent can be spent on short-term (less than five-year) rental subsidies
- Up to 10 percent on shelter and hygiene programs
- Up to 15 percent on prevention programs
- At least 25 percent on mental health services

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would modify the Homelessness Gross Receipt Tax funding allocation requirements by $5,983,000 in FY 2023-24 and $10,376,000 FY 2024-25. The side caption of ordinance reports a total of reallocation of “approximately” $16,360,000 across both years, the underlying re-allocations actually total $16,359,000.

FISCAL IMPACT

Exhibit 1 shows the proposed change in use of Homeless Gross Receipt Tax revenues.

Exhibit 1: Proposed Uses

	FY 2023-24	FY 2024-25	Total
Shelter	1,340,000	6,482,000	7,822,000
Prevention	4,643,000	3,894,000	8,537,000
Total	**5,983,000**	**10,376,000**	**16,359,000**

The source of funding in FY 2023-24 and FY 2024-25 is interest earnings on Proposition C Homelessness Gross Receipts fund balance that would otherwise be allocated to housing for TAY and families and to mental health programming.

Program Impact

The proposed re-allocation of Proposition C revenues is part of a larger spending plan that was part of the Mayor's proposed budget for FY 2023-24 and FY 2024-25. This revised proposal for Proposition C funding differs from the original version of this ordinance programmatically in the following ways:

- reduces spending by not expanding hours at Hospitality House and not increasing funding for a vehicular assistance program in FY 2023-24 and in FY 2024-25
- reduces the number of new rapid re-housing slots from 350 to 235 in FY 2024-25
- reduces 75 new permanent supportive housing slots in FY 2024-25
- reduces funding for prevention in FY 2024-25 by $1.96 million
- shifts funding from the cabin program in the Mission to a State grant
- shifts $100,000 of the originally proposed $200,000 for the vehicular assistance program to a work order and delete $100,000 in funding

Exhibit 2 below shows the revised spending plan, which includes Proposition C revenues and other sources, described above.

Exhibit 2: Updated Spending Plan

	FY 2023-24	FY 2024-25	Total
General Housing			
235 Slots of Adult Rapid Rehousing	3,464,000	6,007,000	9,471,000
Prevention			
750 Slots Homelessness Prevention	8,122,000	8,161,000	16,283,000
75 Problem Solving Slots for Latin Youth	960,000	960,000	1,920,000
Shelter			
D10 60 Cabin Site	3,000,000	7,066,000	10,066,000
Vehicular Assistance Program Pilot	100,000	0	100,000
Expand Hours at Buena Vista Horace Mann Family Shelter	600,000	600,000	1,200,000
60 Mission Cabins (21 Months)	5,200,000	0	5,200,000
Total	**21,446,000**	**22,794,000**	**44,240,000**

Source: HSH

RECOMMENDATION

Approval of the proposed ordinance is a policy matter for the Board of Supervisors.