Commercial Rent Taxes for Child Care, Homeless Services, and Transportation

Economic Impact Report

CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

Office of Economic Analysis

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Purpose of this Report

Since December, 2017, three proposed taxes have been introduced that would raise the gross receipts tax on lessors, and sub-lessors, of commercial real estate in San Francisco. Effectively, the proposals are **taxes on commercial rent**, paid by the landlord, not the tenant.

- Supervisor Peskin introduced a tax to fund City transportation operations and infrastructure.
- Supervisors Kim, Yee, Ronen, Fewer, and Peskin sponsored a tax to fund early childhood education.
- Supervisors Safai, Sheehy, Tang, Cohen, and Farrell sponsored a tax to fund affordable housing and homeless services.
- The Office of Economic Analysis has prepared this report after determining that each proposal would materially affect the city's economy.

Common Features of All Three Proposals

All three tax proposals are considered **dedicated taxes** – meaning the revenues raised from the taxes must be spent on programs that are specified in the legislation. New dedicated taxes require voter approval, by a two-thirds majority. Each of the proposals sets aside 2% of the revenue to administer the tax, and to refund any over-payments.

All three proposals exempt commercial landlords with less than $1 million in gross receipts from taxation.

In addition, all three proposals necessarily exclude certain financial corporations (such as banks), insurance companies, and transportation companies, as these businesses are exempted from all local taxation under State law.

Finally, all three allow commercial landlords to exempt gross receipts from non-profit tenants.

Safai et. al. Proposal

The Safai et. al. proposal is the narrowest of the three proposals. Gross receipts from all retail trade, accommodations, arts/entertainment/recreation, and production/distribution/repair tenants are exempt from the tax.

Nevertheless, we estimate that 71% of all commercial gross receipts in the city would be subject to the tax, as a majority is received by large office buildings. These non-exempt gross receipts would be taxed at a rate of 2%.

The tax revenues would be dedicated to the following programs. The proposal does not prohibit the Mayor and Board of Supervisors from reducing these programs' General Fund support in the future.

- Acquisition/rehabilitation of permanent supportive housing, single-room occupancy buildings, and rent-controlled buildings to make them permanently affordable to low- and middle-income households.
- Rental subsidies to low-income households.
- A $1.5M - $3M contribution to the General Fund in fiscal years 2018-19 and 2019-20.

Kim et. al. Proposal

The Kim et. al. proposal features the highest rate of the three, 3.5%, but would exclude from the tax any receipts from government, arts, industrial, and non-formula retail* uses, in addition to the common exemptions discussed on page 3. In addition, Warehouse uses would be taxed at a rate of 1%.

We estimate that all of the above exemptions represent about 20% of the tax base, so 80% of the commercial gross receipts in the city would be subject to the tax.

The tax revenues would be dedicated to the following programs. **The proposal prohibits the Mayor and Board of Supervisors from reducing these programs' General Fund support in the future.**

- Early childhood care and education.
- Increasing the compensation of child care of professionals and staff.
- 15% of the revenue would be contributed to the General Fund, for any government purpose.

**Formula retail* is a term in the City's Planning Code which essentially refers to chain stores.

Peskin Proposal

The Peskin proposal is the broadest of the three, with exemptions only for commercial landlords (receiving less than $1 million in rent), and receipts received from non-profit tenants.

Otherwise, commercial rents would be taxed at a rate of 2%.

The tax revenues are dedicated to the following uses. However, the legislation does not prohibit reducing current levels of General Fund support to transportation.

- Transportation operations
- Transportation infrastructure

This report assesses the impact of increasing spending on transit operations. Depending on the specific programs funded, the spending may also raise productivity by reducing average commuting. Without further detail on the spending, these productivity effects cannot be estimated for this report.

Tax Rate Summary

In each proposal, different tax rates would apply, depending on the type of occupant of the commercial real estate.

Type of Tenant		Peskin	Kim et. al.	Safai et. al.
Production, Distribution, Repair (PDR)	Industrial	2%	3.5%	0%
	Warehouse (except Self-Storage)	2%	1%	0%
	Other PDR	2%	3.5%	0%
Retail	Non-Formula Retail	2%	0%	0%
	Formula Retail	2%	3.5%	0%
Entertainment, Arts, Recreation	Arts Activities	2%	0%	0%
	Other Entertainment / Recreation	2%	3.5%	0%
Visitors (Accommodations)		2%	3.5%	0%
Non-Profits		0%	0%	0%
State/Federal/Local Government		2%	0%	1.7%
All Others		2%	3.5%	1.7%

Revenue Estimates

The table below details our estimates of the tax base, the percent exempted under each proposal, the tax rate, and the projected annual tax revenue.

	Peskin	Kim et. al.	Safai et. al.
Total Commercial Gross Receipts (2016, $B)	$5.3	$5.3	$5.3
% of the Tax Base Exempted Under Each Proposal	5%	20%	29%
Tax Rate	2%	3.5% / 1%	1.7%
Annual Tax Revenue ($M)	$103	$146	$64

Cost of Higher Taxes, Benefits of Higher Spending

Imposing a new gross receipts tax on commercial real estate would reduce revenues to that industry. Some of the cost of the tax would be passed through to tenants, in the form of higher base rents. On the margin, a small amount of commercial space would be left vacant or put to other uses.

Additionally, tenants whose rent would be exempt, or taxed at a lower rate, in a proposal could be advantaged in the rental market. A second impact of the proposal would be to marginally shift employment among these advantaged and disadvantaged groups of tenants.

Thirdly, the spending associated with the new tax revenue would create benefits for the city's economy. Higher transportation, child care, or housing would benefit residents and businesses, and tend to expand the local economy through positive multiplier effects.

The overall economic impact depends upon the relative magnitude of these costs and benefits.

Estimating the Pass-Through

In order to estimate how much of the tax on commercial landlords will be ultimately passed through to tenants in other industries, we needed to statistically estimate:

- the sensitivity of commercial tenants to changes in rents – to what extent do tenants release commercial space when rents rise, or only choose to occupy space when rents fall?
- the sensitivity of commercial real estate owners to changes in rents– to what extent do developers add new space, or owners of existing buildings withdraw space from the commercial market, when rents fluctuate?

Our modeling indicates that, in the short run, commercial tenants are fairly insensitive to changes in rent, but commercial property owners are extremely insensitive to changes in rent.

In economic theory, the party with the least sensitivity to price changes bears the brunt of the pass-through. Consequently, we project that, at least in the short run, **commercial real estate will ultimately bear 88% of the tax burden, and tenants pay only 12%.**

Benefits of Higher Spending

While the multiplier effects of higher government spending can readily be modelled, the three proposals would likely also generate broader economic benefits that cannot be estimated for this report, given the level of detail in the legislation.

- Greater support for childcare can lead to higher levels of labor force participation, particularly for women, which grows the economy.
- Investment in transportation infrastructure can improve its efficiency and raise productivity.
- Investments in supportive and permanently-affordable housing reduce the long-term costs of housing and social services.

Instead, as shown on the next page, we have assumed that the spending expands other sectors of the economy – the child care sector, maintenance services, real estate, etc.

Economic Impact Assessment

The table below indicates the estimated first-year distribution of the economic costs and benefits to different sectors of the economy, for each proposal.

	Peskin	Kim et. al.	Safai et. al.
Annual Tax Revenue ($M)	$103	$146	$64
Economic Costs ($M):			
Revenues of Commercial Real Estate	-$92	-$132	-$57
Rent Increase to Tenants	$13	$18	$8
Economic Benefits ($M):			
Investment in Childcare/Compensation		$121	
Investment in Housing / Rental Subsidies			$61
Investment in Transportation	$101		
Local Government (General Fund, Tax Administration)	$2	$25	$3

Economic Impact Assessment

This table indicates how each of the three proposals would affect the overall economy, as indicated by employment GDP, and per capita income. The figures below are average impacts over the next 20 years.

	Peskin	Kim et. al.	Safai et. al.
Citywide Employment Change	-184	-746	-358
Employed San Francisco Residents	-161	-540	-251
GDP Change (2017$, million)	-$98	-$76	-$80
Disposable Income Per Capita (real 2017 $)	-$14	-$54	-$24

Conclusions

The model results suggest that the economic costs modestly outweigh the spending benefits of the three proposals.

On average over the next twenty years, the impacts on real GDP, and total employment range from -0.04% to -0.08%.

By way of context, real GDP has grown by an average of 3.2% per year, and total employment has grown by an average of 2.6%, in San Francisco from 2007 to 2017.

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