File No. 250423 | Committee Item No. 6
Board Item No. ______

COMMITTEE/BOARD OF SUPERVISORS

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Completed by: Brent Jalipa **Date** May 15, 2025
Completed by: Brent Jalipa **Date** ______

[Resolution of Intention to Establish San Francisco Downtown Revitalization and Economic Recovery Financing District]

Resolution of Intention to establish San Francisco Downtown Revitalization and Economic Recovery Financing District ("District") to finance commercial-to-residential conversion projects and other authorized costs, determining the boundaries of the District, stating the need for the District and goals the District proposes to achieve, describing the use of property tax revenue that will be used to finance the District's activities, authorizing the Director of the Office of Public Finance to request the President of the Board of Supervisors to establish the time and date for a public hearing on the plan, and making related findings.

WHEREAS, The Board of Supervisors of the City and County of San Francisco ("City") adopted the Housing Element 2022 Update as the Housing Element of the San Francisco General Plan pursuant to Ordinance No. 10-23, which was finally passed by the Board of Supervisors on January 31, 2023, and signed by the Mayor on January 31, 2023, and the Regional Housing Needs Allocation in the Housing Element is 82,069 units over the eight-year period of 2023-2031; and

WHEREAS, The impacts of the COVID-19 pandemic, most notably the shift to hybrid and remote work with the consequent reduction in office workers and foot traffic, have adversely impacted the City's Downtown and other sectors of the City's economy, including retail, tourism and small business, and more broadly have impacted use and activation of public space, transportation, and public safety; and

WHEREAS, The City's office vacancy rate has increased more than six-fold between the third quarter of 2019 to the fourth quarter of 2024, from 5.2% to 34.3%, which equates to approximately 30 million square feet of vacant office space; and

WHEREAS, To address the twin problems of under-utilized office space and lack of housing in San Francisco, a recent report from the Board of Supervisors' Budget and Legislative Analyst, dated January 6, 2023, urged City policymakers to consider programs to incentivize the conversion of office space into residential units, and identified various policy options to incentivize the conversion of office buildings, including the following: reducing regulatory hurdles, such as protracted approval timeframes; exempting projects from or relaxing various standards in the Planning Code; and offering financial incentives to offset the costly architectural and engineering challenges of these conversions; and

WHEREAS, The Board of Supervisors is authorized to initiate the process to establish a downtown revitalization and economic recovery financing district pursuant to Division 8 of Title 6 of the California Government Code, commencing with Section 62450 ("Downtown Revitalization Law"); and

WHEREAS, The Board of Supervisors wishes to declare its intention to establish the San Francisco Downtown Revitalization and Economic Recovery Financing District ("Downtown Revitalization District") to finance commercial-to-residential conversion projects of communitywide significance that provide significant benefits to the Downtown Revitalization District and the City with incremental tax revenues generated by commercial-to-residential conversion projects within Downtown Revitalization District; and

WHEREAS, Preliminary analysis conducted by the Office of Economic and Workforce Development and third-party consultants has identified approximately 1,200 eligible properties within the allowable Downtown Revitalization District area and further estimates that approximately 50 non-residential properties, representing capacity for approximately 4,400 residential units, would be suitable candidates to participate over the lifetime of the program authorized under the Downtown Revitalization Law; and

WHEREAS, The Downtown Revitalization Law defines “communitywide significance” to mean benefits associated with the commercial-to-residential conversion project beyond the conversion of commercial space to residential dwelling units; and

WHEREAS, The Downtown Revitalization Law defines “commercial-to-residential conversion projects” as housing development projects that convert an existing qualifying commercial building to housing by either reuse of the existing commercial building or by replacing the commercial building with a new residential building; and

WHEREAS, Pursuant to Government Code, Section 62450(f)(1) of the Downtown Revitalization Law, the Downtown Revitalization District shall be a legally constituted governmental entity separate and distinct from the City for the sole purpose of financing commercial-to-residential conversion projects in Downtown San Francisco (as defined in Government Code, Section 62450(h)) that support downtown revitalization and economic recovery, and a local agency for purposes of Chapter 9 (commencing with Section 54950) of Part 1 of Division 2 of Title 5 of the California Government Code; and

WHEREAS, The California Legislature has determined that the Downtown Revitalization District shall be deemed a district within the meaning of Section 1 of Article XIIIA of the California Constitution (see Government Code, Section 62450(f)(2)); and

WHEREAS, The Downtown Revitalization District will be governed by a governing board to be known as the Board of Directors of the Downtown Revitalization District ("District Board"), and the District Board will be established by an ordinance of the Board of Supervisors to be considered for approval concurrently with this Resolution; and

WHEREAS, The District Board will be responsible for designating an appropriate government official to prepare a downtown revitalization financing plan for the Downtown Revitalization District ("Downtown Revitalization Financing Plan"); and

WHEREAS, The Downtown Revitalization Financing Plan will include, among other things, (i) a description of the potential commercial-to-residential conversion projects that are proposed in the area of the Downtown Revitalization District, which projects may include a mix of residential and commercial uses, but at least 60 percent of which must be designated for residential use, (ii) a requirement that if nonresidential use is included in the commercial-to-residential conversion project, at least 25 percent of the total planned units affordable to lower income households shall be made available for lease or sale and permitted for use and occupancy before or at the same time with every 25 percent of nonresidential development made available for lease or sale and permitted for use and occupancy, (iii) in accordance with the Downtown Revitalization Law, a requirement that certain percentages of total residential units must be restricted for affordable housing, (iv) an identification of each existing commercial building within the Downtown Revitalization District that is eligible for conversion to residential use and that may opt in to receive incremental tax revenue pursuant to the Downtown Revitalization Law, (v) a requirement that the incremental tax revenues generated by each individual opted-in commercial-to-residential conversion project within the Downtown Revitalization District that are allocated by the City to the Downtown Revitalization District be distributed by the Downtown Revitalization District back to that same project for the purpose of financing necessary development costs, with each individual commercial-to-residential conversion project receiving an annual distribution on a pay-go basis in an amount no greater than the amount of incremental tax revenues generated by that same commercial-to-residential conversion project for a maximum of 30 years or until the Downtown Revitalization District ceases to exist, whichever occurs first, (vi) a requirement that the first distribution of incremental tax revenue to a commercial-to-residential conversion project commence with the fiscal year that begins after the project is issued a certificate of occupancy, (vii) a specification of the maximum portion of the incremental tax revenue of the City proposed to be committed to the Downtown Revitalization District for each year during which the Downtown Revitalization District will receive incremental tax revenue, which portion may change over time, (viii) a limit on the total number of dollars of taxes that may be allocated by the City to the Downtown Revitalization District pursuant to the Downtown Revitalization Financing Plan, (ix) a date on which the Downtown Revitalization District will cease to exist, by which time all tax allocations to the Downtown Revitalization District will end, which date shall not be more than 45 years from the date on which the Downtown Revitalization District distributes funding to the first commercial-to-residential conversion project within the Downtown Revitalization District, (x) an analysis of the costs to the City of providing facilities and services to the area of the Downtown Revitalization District while the area is being developed and after the area is developed, (xi) an analysis of the tax, fee, charge, and other revenues expected to be received by the City as a result of expected development in the area of the Downtown Revitalization District and (xii) an analysis of the projected fiscal impact of the Downtown Revitalization District and the associated development upon the City; and

WHEREAS, Under Section 62457 of the Downtown Revitalization Law, the incremental tax revenues that may be allocated by the City to the Downtown Revitalization District include the following: (i) for each opted-in commercial-to-residential conversion project, the portion of the taxes produced by the levy of the 1% ad valorem tax rate upon the assessed value of such project that exceeds the assessed value for such property as shown on the assessment roll last equalized prior to the first building permit being issued as a part of the conversion of the commercial-to-residential conversion project; (ii) for each opted-in commercial-to-residential conversion project, the portion of any ad valorem property tax revenue annually allocated to the City pursuant to Section 97.70 of the Revenue and Taxation Code that corresponds to the increase in the assessed valuation of the opted-in commercial-to-residential conversion project; and (iii) for each opted-in commercial-to-residential conversion project, “net available revenue” (defined in the Downtown Revitalization Law to mean periodic distributions to the City from the Redevelopment Property Tax Trust Fund, created pursuant to Section 34170.5 of the California Health and Safety Code, that are available to the City after all preexisting legal commitments and statutory obligations funded from that revenue are made pursuant to Part 1.85 (commencing with Section 34170) of Division 24 of the Health and Safety Code) and that corresponds to the increase in the assessed valuation of the opted-in commercial-to-residential conversion project; and

WHEREAS, The Downtown Revitalization Financing Plan will be subject to adoption and implementation by the District Board following three public hearings; and

WHEREAS, The Board of Supervisors is obligated to hold a public hearing on the Downtown Revitalization Financing Plan before the District Board’s third public hearing, and shall thereafter approve or reject the Downtown Revitalization Plan; and

WHEREAS, The Downtown Revitalization Law provides that, after the adoption of the Downtown Revitalization Financing Plan, the Downtown Revitalization District shall establish a process for eligible commercial-to-residential conversion projects identified in the Downtown Revitalization Financing Plan to opt into receiving incremental tax revenue, and a process to reconsider the amount of incremental tax revenue to be distributed to a project if there is a change in use or the square footage of commercial space converted to housing planned to be built; and

WHEREAS, The Legislature has determined in the Downtown Revitalization Law that the creation of the Downtown Revitalization District and the adoption of the Downtown Revitalization Financing Plan shall not be deemed a “project” for purposes of the California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code; now, therefore, be it

RESOLVED, That the Board of Supervisors hereby finds that the recitals are true and correct; and, be it

FURTHER RESOLVED, That the Board of Supervisors hereby proposes and intends to cause the establishment of the Downtown Revitalization District, to be known as the "San Francisco Downtown Revitalization and Economic Recovery Financing District," under the provisions of the Downtown Revitalization Law; and, be it

FURTHER RESOLVED, That the Board of Supervisors hereby determines that the proposed boundaries of the Downtown Revitalization District shall be coterminous with Downtown San Francisco as defined in California Government Code, Section 62450 of the Downtown Revitalization Law, as shown on the map of the Downtown Revitalization District on file with the Clerk of the Board of Supervisors in File No. 250423, the boundaries of which are hereby preliminarily approved; and, be it

FURTHER RESOLVED, That the purpose of the Downtown Revitalization District is to finance commercial-to-residential conversion projects with incremental tax revenues generated by commercial-to-residential conversion projects within Downtown Revitalization District; and, be it

FURTHER RESOLVED, That the Board of Supervisors hereby determines and finds that the Downtown Revitalization District is needed to accomplish the following goals: to provide for the conversion of underutilized and vacant commercial buildings to residential buildings; increase the supply of housing in the City; increase foot traffic and activity in the Downtown area that will support small business, retail operators, transit ridership, and tourism visits to the City; generate jobs in the City's construction sector; and generally revitalize downtown San Francisco; and, be it

FURTHER RESOLVED, That the Board of Supervisors hereby determines and finds that by addressing such goals and needs, the commercial-to-residential conversion projects financed by the Downtown Revitalization District are of communitywide significance and will provide significant benefits to the Downtown Revitalization District and the City; and, be it

FURTHER RESOLVED, That the Board of Supervisors hereby declares that, pursuant to the Downtown Revitalization Law, if the Downtown Revitalization District is approved by the District Board in accordance with the Downtown Revitalization Law, and if the Downtown Revitalization Financing Plan is approved by Resolution of the Board of Supervisors pursuant to Government Code, Section 62451(d), in each case after any public hearings required by the Downtown Revitalization Law, the incremental property tax revenue that is generated by the investment in the commercial-to-residential conversion projects allocated by the City to the Downtown Revitalization District, which may include incremental property tax revenue described in Government Code, Sections 62457(a), (c) and (d), will be used to finance the commercial-to-residential conversion projects that generated the revenue; and, be it

FURTHER RESOLVED, That the Board of Supervisors hereby authorizes the Director of the Office of Public Finance to request the President of the Board of Supervisors set a time and date for a public hearing of the Board of Supervisors on the proposed Downtown Revitalization Financing Plan and to cause the Clerk of the Board of Supervisors to provide notice of such public hearing by (i) causing a notice to be posted on the Downtown Revitalization District's internet website and (ii) publishing a notice at least 10 days before the public hearing in a newspaper of general circulation in the City; and, be it

FURTHER RESOLVED, Pursuant to Government Code, Section 62455, the Board of Supervisors hereby directs the Clerk of the Board of Supervisors to transmit a copy of this Resolution to the District Board; and, be it

FURTHER RESOLVED, That this Resolution in no way obligates the Board of Supervisors or the District Board to form the Downtown Revitalization District; the establishment of the Downtown Revitalization District is subject to all requirements of the

Downtown Revitalization Law, including (i) the Board of Supervisors' approval or rejection of a proposed Downtown Revitalization Financing Plan following a public hearing and (ii) the District Board's approval or rejection of the Downtown Revitalization Financing Plan following three public hearings conducted pursuant to Downtown Revitalization Law; and, be it

FURTHER RESOLVED, That the Board of Supervisors hereby finds and determines that the Legislature has determined in the Downtown Revitalization Law that the creation of the Downtown Revitalization District and the adoption of the Downtown Revitalization Financing Plan shall not be deemed a "project" for purposes of the California Environmental Quality Act (Division 13 (commencing with Section 21000) of the Public Resources Code; and, be it

FURTHER RESOLVED, That if any section, subsection, sentence, clause, phrase, or word of this Resolution, or any application thereof to any person or circumstance, is held to be invalid or unconstitutional by a decision of a court of competent jurisdiction, such decision shall not affect the validity of the remaining portions or applications of this Resolution, the Board of Supervisors hereby declaring that it would have passed this Resolution and each and every section, subsection, sentence, clause, phrase, and word not declared invalid or unconstitutional without regard to whether any other portion of this Resolution or application thereof would be subsequently declared invalid or unconstitutional; and, be it

FURTHER RESOLVED, That the Mayor, the Controller, the Director of the Office of Public Finance, the Clerk of the Board of Supervisors and any and all other officers of the City are hereby authorized, for and in the name of and on behalf of the City, to do any and all things and take any and all actions, including execution and delivery of any and all documents, assignments, certificates, requisitions, agreements, notices, consents, instruments of conveyance, warrants and documents, which they, or any of them, may deem necessary or advisable in order to effectuate the purposes of this Resolution; provided however that any such actions be solely intended to further the purposes of this Resolution, and are subject in all respects to the terms of the Resolution; and, be it

FURTHER RESOLVED, That all actions authorized and directed by this Resolution, consistent with any documents presented herein, and heretofore taken are hereby ratified, approved and confirmed by this Board of Supervisors.

APPROVED AS TO FORM:
DAVID CHIU, City Attorney

By: /s/ MARK D. BLAKE
MARK D. BLAKE
Deputy City Attorney

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Item 6 File 25-0423	Department: Office of Economic & Workforce Development (OEWD)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution states that the intention of the Board of Supervisors is to create a Downtown Revitalization and Economic Recovery Financing District to finance commercial-to-residential conversion projects.

Key Points

- The State has authorized San Francisco to establish the proposed District to provide tax increment funding to commercial-to-residential conversion projects. The proposed District will be legally distinct from the City and governed by a Board of Directors, appointed by the Board of Supervisors. The District's Financing Plan will also be subject to a Board of Supervisors approval, likely in Fall 2025. Projects must opt-in to receive tax increment by December 31, 2032. The proposed District includes Mid-Market, Civic Center, eastern SOMA, Union Square, and the Financial District.

Fiscal Impact

- Analysis commissioned by OEWD indicates that 49 properties are likely to participate in this program, generating $15.2 million in incremental property taxes. After deducting the allowable five percent for administrative costs, the property owners would receive approximately $98,500 per residential unit over thirty years.
- The City will incur costs to establish and support the District. We estimate one-time costs total $440,000 and ongoing costs total $330,000. Administrative costs could be reimbursed by the proposed Revitalization District, if there are sufficient incremental property tax revenues available. However, City Departments are currently not tracking their time related to this project and there is no funding allocated for these new General Fund costs.

Policy Consideration

- The forthcoming Financing Plan should identify which conversion projects and related costs will be eligible for funding, the fiscal impact to the City resulting from the new projects, and the amount of tax revenue diverted to the District.
- Because the District would allow divisions of property taxes outside of existing business processes, the proposed program is more complex and administratively burdensome than a grant program, which other cities have implemented to encourage conversion projects.

Recommendations

- Request the Controller's Office, Office of Economic & Workforce Development, Assessor, Tax Collector, Clerk of the Board, and any other City Department incurring costs to establish the proposed Downtown Revitalization District to track their time and expenses related to that work.
- Approval of the proposed resolution is a policy matter for the Board of Supervisors.

MANDATE STATEMENT

California Government Code Section 62451 allows the San Francisco Board of Supervisors to establish one downtown revitalization and economic recovery financing District. The initial legislative step is the adoption of a resolution of intention. This will be followed by the adoption of a resolution to approve a financing plan for the District.

BACKGROUND

Downtown Revitalization Law

In August 2024, the California Legislature approve a bill to amend the California Government Code to allow the City to establish one downtown revitalization and economic recovery financing district (AB 2488). The bill was approved by the Governor and became effective January 2025. The purpose of the district is to use property tax increment revenues to fund commercial-to-residential conversion projects in downtown San Francisco. The incremental property taxes resulting from the conversion projects would be returned to owners to offset their project costs.

Unlike most other tax increment financing districts, which normally fund affordable housing units, public open space, or some other type of public infrastructure improvement, this diversion of property tax revenues would be mostly for market rate housing.

Other Policy Changes Related to Downtown Revitalization

The proposed district is part of a suite of financial incentives the City is offering developers to support commercial-to-office conversions. In March 2024, voters approved Proposition C, which waives real estate transfer taxes for the first time a property, after having been converted to residential use, changes ownership (through 2029). In March 2025, the Board of Supervisors and Mayor approved an ordinance that amended the Planning Code to waive certain development impact and inclusionary housing fees for up seven million square feet of residential conversions in downtown San Francisco (File 24-0927). In addition, in July 2023, the Board and Mayor enacted an ordinance that amended the Planning Code to waive certain Planning Code requirements for downtown residential conversions (File 23-0371).

DETAILS OF PROPOSED LEGISLATION

The proposed resolution states that the intention of the Board of Supervisors is to create a Downtown Revitalization and Economic Recovery Financing District to finance commercial-to-residential conversion projects.

Downtown Revitalization and Economic Recovery Financing District

Once the District is formed and the associated Financing Plan is adopted, commercial-to-residential conversion projects would apply for incremental property tax revenue funding. The District and the Board of Directors would determine if the projects were eligible, based on criteria established by the Revitalization District. The District would allow such projects to opt in to receiving the City's portion of non-General Obligation bond incremental property tax revenue generated from the conversion to offset conversion costs. The amount of tax increment for each project would be capped at the project's "development costs," a term that is undefined in State law but should be defined in the Financing Plan. Projects could be 100 percent conversion from commercial-to-residential use or converting portions of buildings currently used for commercial purposes to residential uses.

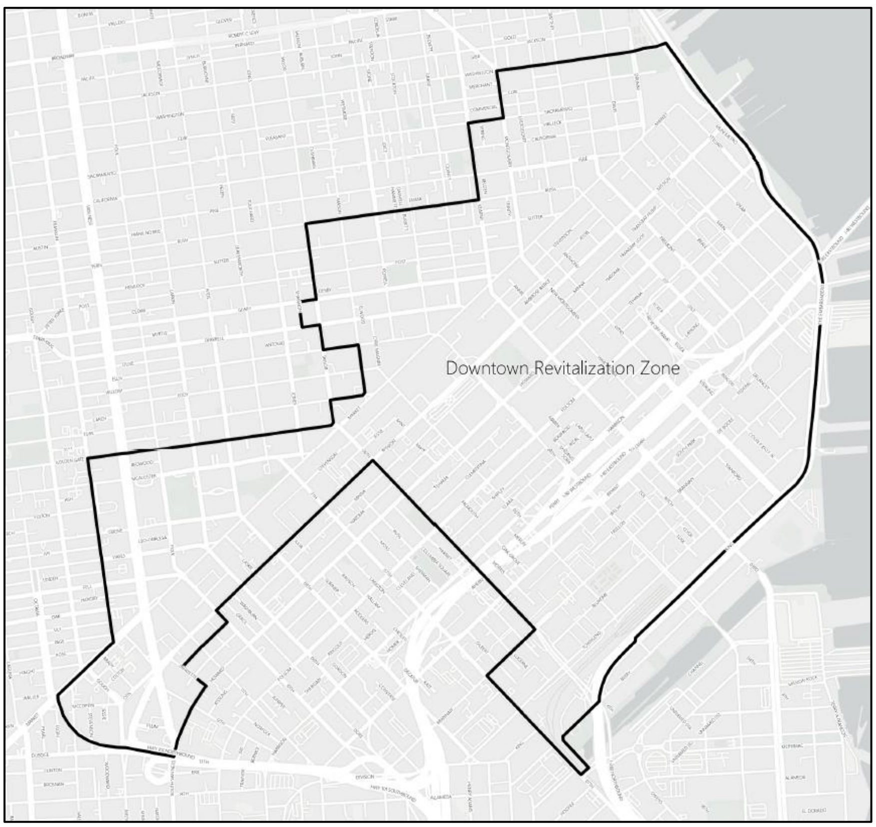
Projects must opt-in to receive tax increment by December 31, 2032.

The District would be dissolved once it no longer receives property tax revenues or 45 years after the first disbursement of tax increment funding, whichever comes first.

District administrative costs will be paid by the District using incremental property tax revenues generated from projects.

Projects seeking incremental property tax funding must pay prevailing wage and any other labor standards established by the Board of Supervisors.

Exhibit 1: Map of Proposed Downtown Revitalization District



Source: OEWD

As shown above, the proposed District includes Mid-Market, Civic Center, eastern SOMA, the East Cut, Union Square, and the Financial District. It does not include the Tenderloin. The District boundaries are defined in the State statute authorizing this legislation (California Government Code 62450).

Board of Directors

The proposed Downtown Revitalization and Economic Recovery Financing District will be legally distinct from the City and governed by a Board of Directors. File 25-0424 is an ordinance pending before the Board of Supervisors that would amend the Administrative Code to establish the District's Board of Directors (and must be considered concurrently with this resolution). The Board of Directors will have five seats: three of which would be members of the Board of Supervisors, appointed by the President of the Board of Supervisors, and two of which would be members of the public, nominated by the President of the Board of Supervisors and appointed by the Board of Supervisors. The President of the Board of Supervisors would also appoint a fourth member of the Board of Supervisors to serve as an alternate member. The Board of Directors will be subject to open meeting and public record requirements.

Administrative Support

The Clerk of the Board of Supervisors would provide administrative and clerical support to the Board of Directors. The Office of Economic and Workforce Development would provide analytical support to the Downtown Revitalization Financing District.

In addition, the Controller's Office, Assessor, and Tax Collector will support the District through the identification, collection, and distribution of tax increment revenues to eligible projects.

Financing Plan

If the proposed resolution of intention is approved, the Board of Directors will designate an official to propose a Financing Plan, subject to approval by the District's Board of Directors after three public meetings. The Financing Plan will also be subject to Board of Supervisors approval after the District's Board of Directors has held two of the three public meetings related to the Financing Plan. Under state law, the Financing Plan must be consistent with the City's General Plan and include:

1. A map and legal description of the proposed District.
2. A description of the potential commercial-to-residential conversion projects
3. Affordability requirements (described below)
4. Identification of each existing commercial building within the District that is eligible for conversion
5. Limiting tax increment disbursements to the amounts generated by each project, paid on a pay-go basis for up to 30 years, and capped at the amount of "development costs" incurred by the individual project.
6. Specifying the maximum portion of the incremental tax revenue the District may take from the City and a projection of the tax revenues that will be received by the District.
7. Allowing tax increment revenues to pay for the District's administrative costs (up to five percent of tax increment revenues, not including reimbursements to the City for establishing the District).

8. A fiscal impact analysis that includes new services that must be provided by the City as a result of the new development

The state law also requires that if any existing residential units are demolished as part of a commercial-to-residential conversion, that they must be replaced as specified in state law.

Affordability Requirements

The first 1.5 million square feet of new residential space resulting from conversion projects will be subject only to local affordability requirements (which have been waived for the first seven million square feet of conversions). Thereafter, residential projects receiving tax increment must include affordable housing per one of the methods below, in particular:

1. At least 5 percent of total units for rent are affordable to very low income households or the local inclusionary requirement, whichever is higher, for a minimum of 55 years. (30 – 50 percent AMI), or
2. At least 10 percent of total units for rent are affordable to lower income households or the local inclusionary requirement, whichever is higher, for a minimum of 55 years. (50 – 80 percent AMI), or

A. At least 10 percent of total units for sale are affordable to households of moderate income or the local inclusionary requirement, whichever is higher, for a minimum of 45 years. (80 – 120 percent AMI)

Annual Report

The District must publish an annual report that details the projects receiving tax increment financing.

FISCAL IMPACT

Property Tax Diversion

Within the proposed district, projects would receive the City share of the incremental increase in property tax revenue. According to an analysis by BAE Urban Economics, a consulting firm hired by OEWD, there are approximately 1,205 eligible properties within the proposed District. Of those, 49 would likely be suitable for commercial-to-residential conversion, based on their age, size, vacancy, and quality – resulting in approximately 4,400 new residential units. BAE estimated that if all of these likely 49 sites were converted to residential uses, the incremental increase in property taxes would total $15.2 million per year. This figure only includes the City share of property taxes and is an estimate of the maximum incremental property tax revenue resulting from a preliminary analysis of properties that may be likely to participate in the program; the analysis did not assess the feasibility of each potential project. After deducting five percent ($0.7 million) for administrative costs, the total likely incremental property tax diverted across the District is approximately $280,000 per building or $3,300 per dwelling unit per year; roughly, the equivalent of one month of rent for each dwelling unit. If this amount were disbursed to the projects for the maximum 30 years allowed under the state law, this would amount to a lifetime total disbursement of roughly $98,500 per unit in today's dollars.

These new net revenues would otherwise be General Fund revenues, though without the District, the projects may not move forward, and the revenues would not be generated.

Under State law, unused property tax increment could be used for "downtown revitalization programs," a term that is undefined in the State statute authorizing this legislation.

In-Lieu Vehicle License Fee Revenue

The State legislation authorizing the proposed District allows for the diversion of incremental in-lieu vehicle license fee revenue to conversion projects.[1] The value of the in-lieu vehicle license fee is determined on a citywide basis and increases every year based on the growth in the jurisdiction's assessed value. BAE estimated that the value of the in-lieu vehicle license fee for the 52 properties that are likely suitable for conversion would be $2.2 million per year.

However, because the value of the in-lieu vehicle license fee revenue is not tied to specific properties, but determined on a citywide basis, it may be difficult to determine a reasonable amount to divert to individual property owners, as there is no VLF component on a property tax bill paid by a property owner. The District Board would determine whether or not to disburse a portion of this additional amount to conversion projects as part of the Financing Plan.

Administrative Costs

As noted above, if the proposed Resolution of Intention and ordinance establishing the District Board of Directors are approved, the Board of Supervisors would then consider the District's Financing Plan, which is expected to be final in Fall 2025. The Board of Supervisors must approve the Financing Plan in order for the District for be formed. The Financing Plan is required to contain provisions for reimbursing the City for costs to establish the District and for ongoing administrative costs. The administrative costs include:

- Resources spent by the Controller's Office, Economic & Workforce Development, Clerk of the Board, Assessor, Tax Collector, and City Attorney's Office on establishing the proposed Revitalization District. This includes: devising a method to divide the property tax revenues for the City and the Revitalization District, information technology project to upgrade systems of record related to property taxes, preparing this resolution, preparing the Financing Plan, among other tasks.
- Resources spent by the Assessor, Tax Collector, and Controller to determine and allocate the incremental property tax revenue of each property that opts-in to this program.
- Resources spent by the Clerk of the Board to carry out public meetings for the Revitalization District's Boad of Directors.

[1] In 2004, the State reduced vehicle license fees and backfilled revenues to local governments in the form of higher State revenues based on each local government's property tax revenues.

- Resources spent by the District preparing its annual report and financial statements.

Exhibit 1 below estimates the one-time and ongoing costs for each department to support the proposed Revitalization District.

Exhibit 1: One-time and Ongoing Costs

Department	One-Time	Ongoing
Controller	300,000	150,000
Board of Supervisors	-	130,000
Economic & Workforce Dev.	140,000	25,000
Assessor	-	25,000
Tax Collector	-	-
Total	440,000	330,000

Source: BLA, based on discussions with OEWD, CON, ASR, TTX, BOS

The figures above are estimates of staff time to undertake work to establish and support the Revitalization District. None of the costs are included in department submissions to the Mayor's Budget Office for the FY 2025-26 budget, so they represent the opportunity cost of this work, which may delay other projects.

Administrative costs could be reimbursed by the proposed Revitalization District, if there are sufficient incremental property tax revenues available. Because the incremental property tax revenue would not be available until a certificate of occupancy for a conversion project is issued, OEWD estimates that such revenues would not be available for approximately five years. In the interim, the City's administrative costs would be funded by the General Fund.

As noted above, OEWD estimates that the maximum property tax increment that District would generate annually is $15.2 million, with up to five percent or $760,000 available for ongoing administrative costs. Depending on the number of properties that opt-in to the program, the administrative costs may or may not be fully covered by the incremental property tax revenues.

There is no cap on reimbursing the City for costs related to establishing the Revitalization District, however, except for the City Attorney's Office, the Departments incurring such costs have so far not been tracking their time and expenses. They should do so retroactively and going forward in order to obtain reimbursement.

POLICY CONSIDERATION

Unresolved Policy Issues

The state statue authorizing the proposed Revitalization District does not address what conversion projects within the District should be eligible for tax increment funding, which project costs would be eligible for such funding, or whether and what other downtown revitalization programs should receive funding from the District if there are any unused tax increment revenues after project costs are paid. These should be defined in the forthcoming Financing Plan.

The Financing Plan should also establish a cap on the amount of tax increment that could be diverted to a single project (beyond the existing limit of the project's eligible costs). For example, the City's Capital Plan includes a policy that limits the amount of property taxes diverted to enhanced infrastructure financing districts (EIFD) to 50 percent of incremental property tax revenues within a given district and limits aggregate EIFD debt payments to five percent of citywide property tax revenues. Limiting the tax increment for individual projects would provide new General Fund revenues to support increases in City services for the new residents, which may be especially important given the previously approved waiver of development impact fees. The Financing Plan will include an assessment of the District's impact on City revenues and spending, which is unknown at this time, but could be positive or negative. Additional residents will generate new non-property tax revenues (such as sale tax revenues) but also require additional services (e.g. public safety, transportation).

Implementation Challenges

The proposed Revitalization District allows for tax increment funding for projects that partially convert from commercial-to-residential use and also for projects that are within existing redevelopment areas, increasing the complexity of administration.[2] Because assessed values and property taxes are measured, recorded, and billed at the parcel level, property tax systems are built to house data and make calculations at that level of detail. According to the Controller's Office, should any data, calculations, or payments be contemplated at sub-parcel level, this would have to occur manually outside of existing systems, increasing administrative complexity, cost, and risk. As it is not possible to allocate tax increment for a single parcel to more than one entity, the Controller has requested properties within the boundaries of existing redevelopment areas be excluded from the District.

In addition, as noted above, determining the amount of in-lieu vehicle license fee revenue for each property is difficult, since the revenue is not associated with a particular property. The VLF revenue is also subject to State legislative change. For these reasons, the Controller's Office recommends not diverting VLF revenue to property owners, consistent with other tax increment financing districts in the City.

Alternative Program

Given the unresolved policy issues and administrative complexity of the proposed Revitalization District, the Board should consider alternative adaptive reuse programs. As we discussed in our January 2023 report to the Board of Supervisors, "Repurposing Commercial Real Estate for Residential Use," Calgary, Canada implemented a grant program to fund adaptive reuse. Chicago

[2] According to OEWD's preliminary analysis, only 49,800 of the 3,764,246 square feet of potential projects within the proposed District are within existing redevelopment areas, accounting for $0.2 million of the estimate $15.2 million in estimated incremental property tax revenue. However, any one of the estimated 1,200 buildings within the proposed District could be eligible for this program, depending on the eligibility parameters in the forthcoming Financing Plan. Property tax increment within an existing redevelopment area would first go to previously adopted redevelopment obligations.

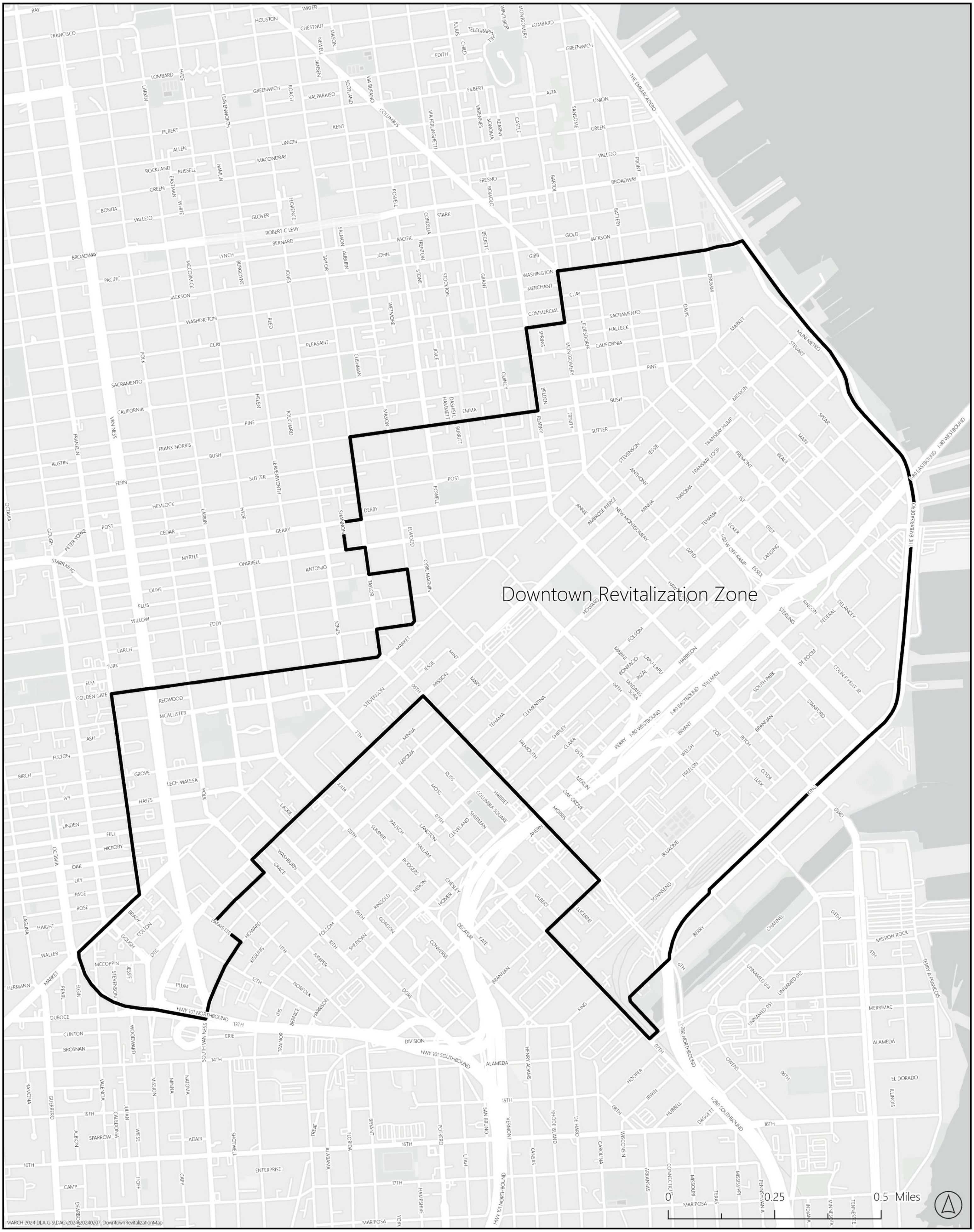
established a tax increment funding program for adaptive reuse, similar to this proposal, and Washington DC has established a tax rebate program that has an annual cap of $8 million.

The City could establish its own, locally controlled program, and provide grants to eligible projects using the General Fund. Unlike this proposed tax increment funding program, which diverts revenues, a grant program would encumber existing financial resources that could be used for other purposes. A tax district may provide developers with more funding certainty than a grant program, which would be subject to annual appropriation. We estimate the ongoing administrative cost of a grant program would be $250,000 per year (approximately 1.0 FTE).

RECOMMENDATIONS

1. Request the Controller's Office, Office of Economic & Workforce Development, Assessor, Tax Collector, Clerk of the Board, and any other City Department incurring costs to establish the proposed Downtown Revitalization District to track their time and expenses related to that work.
2. Approval of the proposed resolution is a policy matter for the Board of Supervisors.

Downtown Revitalization Zone



CITY AND COUNTY OF SAN FRANCISCO
BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST
1390 Market Street, Suite 1150, San Francisco, CA 94102
PHONE (415) 552-9292 FAX (415) 252-0461

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.

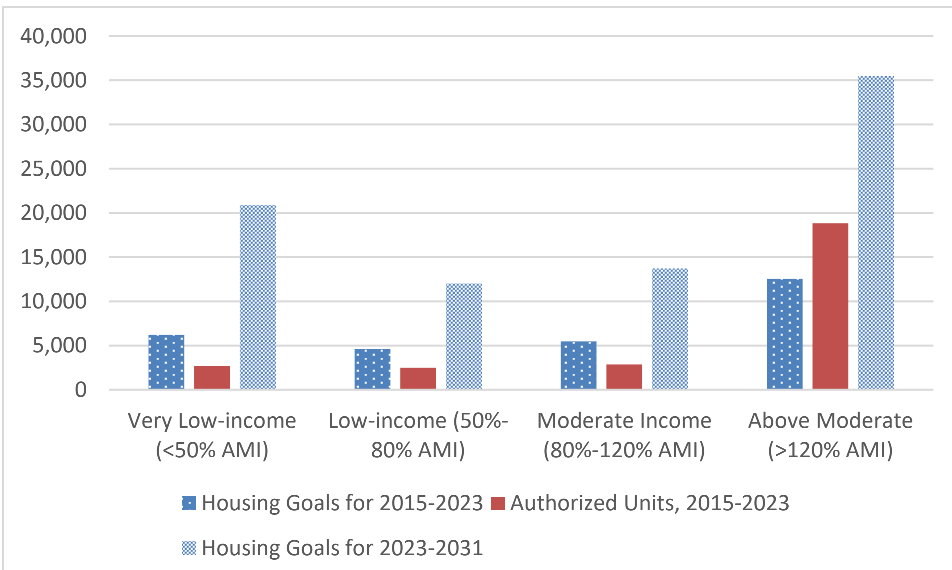
Affordable housing shortage in San Francisco

- 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.

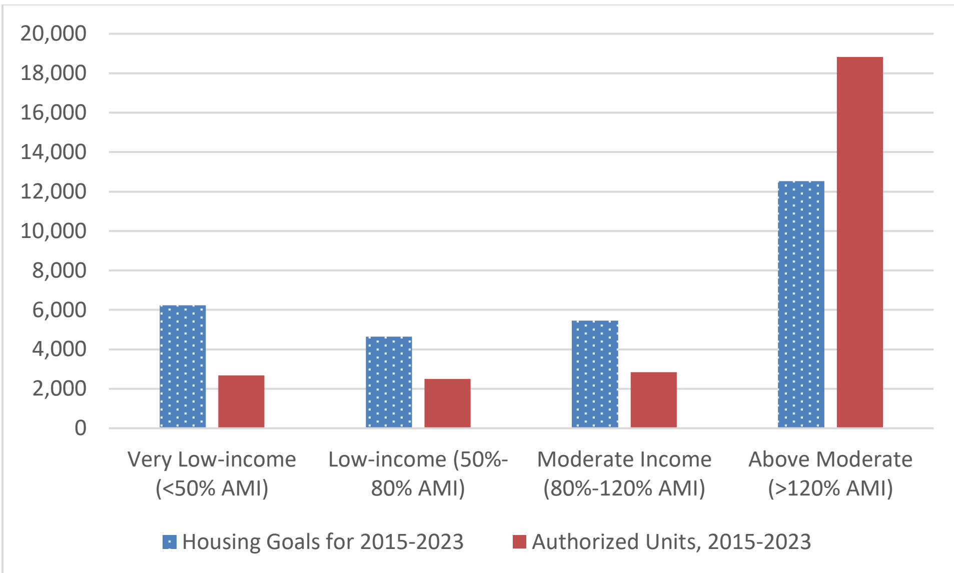
[1] "Housing Element: 2022 Update Final Draft," San Francisco Planning, December 7, 2022, page 44, Link

[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)

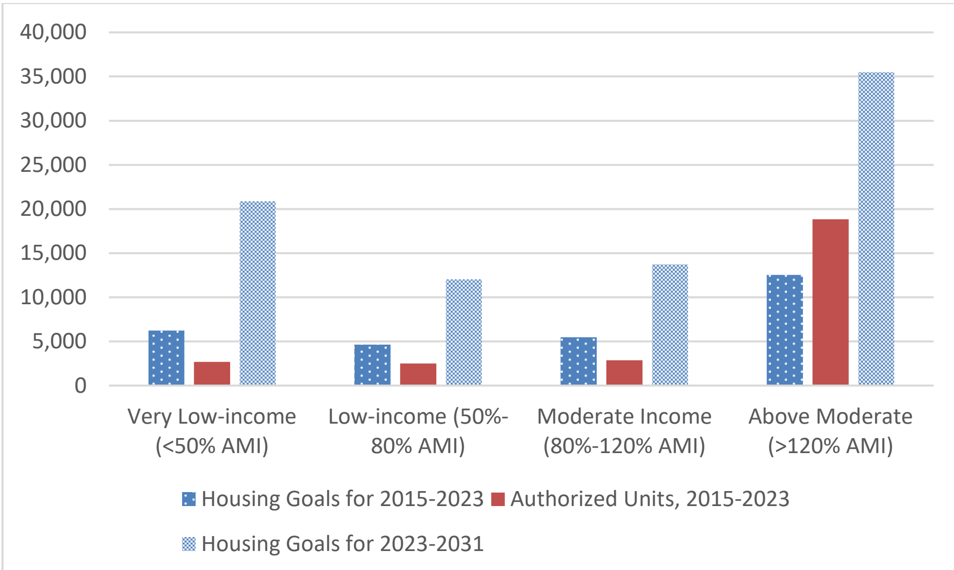


Source: "Housing Element: 2022 Update Final Draft," San Francisco Planning Department

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.

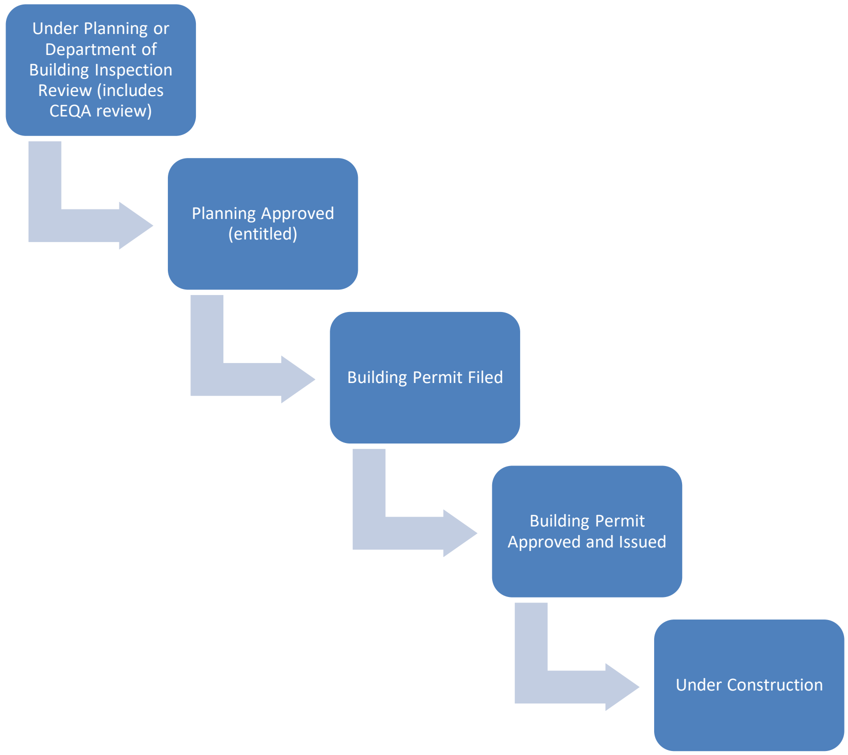
Conversions of Projects in the Planning Department Pipeline

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.

[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.

[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

[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

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[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.

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[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

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[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.

OFFICE OF THE MAYOR
SAN FRANCISCO

DANIEL LURIE
MAYOR

TO: Angela Calvillo, Clerk of the Board of Supervisors
FROM: Adam Thongsavat, Liaison to the Board of Supervisors
RE: [Resolution of Intention to Establish San Francisco Downtown Revitalization and Economic Recovery Financing District]
DATE: April 22, 2025

Resolution of Intention to establish San Francisco Downtown Revitalization and Economic Recovery Financing District ("District") to finance commercial-to-residential conversion projects and other authorized costs, determining the boundaries of the District, stating the need for the District and goals the District proposes to achieve, describing the use of property tax revenue that will be used to finance the District's activities, authorizing the Director of the Office of Public Finance to establish the time and date for a public hearing on the plan, and making related findings.

Should you have any questions, please contact Adam Thongsavat at adam.thongsavat@sfgov.org