CITY AND COUNTY OF SAN FRANCISCO

BOARD OF SUPERVISORS

BUDGET AND LEGISLATIVE ANALYST

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TO: Budget and Finance Committee

FROM: Budget and Legislative Analyst

SUBJECT: October 31, 2012 Budget and Finance Committee Meeting

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Item 1 **File 12-1020**	**Department:** Public Utilities Commission (PUC), Real Estate Division

EXECUTIVE SUMMARY

Legislative Objectives

The proposed resolution would (a) approve and authorize an agreement for the purchase of a parcel of real estate, consisting of approximately 4.68 acre property with 50,593 square feet of office and industrial buildings and 200 exterior parking spaces at 1550 Evans Avenue and 330 Newhall Street for the San Francisco Public Utilities Commission (PUC), for a purchase price of $15,000,000; (b) adopt findings under the California Environmental Quality Act (CEQA); (c) adopt findings that the conveyance is consistent with the City's General Plan and Eight Priority Policies of City Planning Code Section 101.1; and (d) authorize the Director of Property to execute documents, make certain modifications and take certain actions regarding this resolution.

Key Points

- The subject property at 1550 Evans Avenue and 330 Newhall Street consists of two vacant buildings on a 4.68 acre site located in the Bayview district, near the PUC's Southeast Water Treatment Plant. The 1550 Evans Avenue building is an approximately 31,535 square foot, two-story office building and the 330 Newhall Street building is a 19,058 square foot warehouse. The site also includes surface parking for approximately 200 vehicles.
- If the proposed resolution is approved, the PUC would consolidate their Wastewater Enterprise Collection Division and other related SFPUC programs, including 134 staff, 92 vehicles and related equipment, to the 1550 Evans Avenue and 330 Newhall Street facility in order to more efficiently streamline operations related to the adjacent Southeast Water Pollution Control Plant.

Fiscal Impacts

- In March 2012, the subject property was appraised at $16,000,000 by a third-party appraiser. The cost of purchasing the subject 1550 Evans Avenue/330 Newhall Street property is $15,000,000 plus an estimated $18,179 in closing costs, for a total cost of approximately $15,018,179, which is $981,821 less than the recent appraisal value.
- The SFPUC's FY 2013–14 and FY 2014–15 budgets include $20,000,000 from the SFPUC Wastewater Enterprise's Commercial Paper program for the purchase of the subject property, or $4,981,821 more than the total estimated cost of $15,018,179. These additional budgeted funds would pay for staff and vehicle relocation costs, furniture expenditures, and potential costs to modify the site to consolidate multiple SFPUC enterprises and operations.
- The SFPUC will terminate three leases at (a) 3801 Third Street, (b) 1499 Evans Avenue and (c) 1301 Evans Avenue in San Francisco, for a savings of $424,776 per year. The net present value of these existing leases over 30 years is an estimated $8,175,367, which is $9,972,073 or 122% less than the net present value of the relocation and occupancy costs and Wastewater Revenue Bond principal and interest costs over 30 years of an estimated $18,147,349.

- If the PUC were to lease new properties at an estimated current annual cost of $1,246,222, the net present value of these new leases over 30 years is an estimated $23,095,561, which is $4,948,121 or 27% more than the net present value of the estimated relocation and occupancy costs and Wastewater Revenue Bonds principal and interest payments over 30 years of an estimated $18,147,349, under the proposed resolution.

Recommendation

- Approval of the proposed resolution is a policy decision for the Board of Supervisors.

MANDATE STATEMENT

In accordance with Administrative Code Section 23.1, all resolutions and ordinances involving sales, leases, acceptances, and other real estate transactions must be conducted through the Director of Real Estate and approved by the Board of Supervisors.

In accordance with Administrative Code Section 23.4, the Director of Real Estate cannot accept deeds or other instruments granting Real Property to the City without Board of Supervisors approval.

BACKGROUND

The subject property at 1550 Evans Avenue and 330 Newhall Street (Assessor's Block 5203, Lot 035) owned by 3rd & Evans Street, LLC, consists of two vacant buildings on a 4.68 acre site located on the northeast corner of Third Street and Evans Avenue in the India Basin Industrial Park in the Bayview district of the City. The 1550 Evans Avenue building is an approximately 31,535 square foot, two-story steel frame office building and the 330 Newhall Street building is a concrete tilt-up warehouse structure which totals approximately 19,058 square feet, for a total building area of approximately 50,593 square feet. The site also includes surface parking for approximately 200 vehicles. In 1977 and 1978, Morgan Equipment Company, a dealer in heavy equipment, purchased the site and constructed the two buildings as their headquarters. In November 2006, the Morgan Family of the Morgan Equipment Company formed the 3rd & Evans Street, LLC, which now owns the subject property. Several tenants have occupied one or both structures, including most recently Walden House, which vacated the site in March 2012.

According Mr. Josh Keene, Real Estate Services for the SFPUC, if the proposed resolution is approved, as shown in Table 1 below, the San Francisco Public Utilities Commission (SFPUC) would consolidate portions of the Wastewater Enterprise Collection Division and other related SFPUC programs, including staff and equipment, to the 1550 Evans Avenue and 330 Newhall Street facility in order to more efficiently streamline operations related to the adjacent Southeast Water Pollution Control Plant. The Southeast Water Pollution Control Plant is located at 750 Phelps Avenue, which is less than 0.3 miles from the 1550 Evans Avenue and 330 Newhall Street property. According Mr. Keene, the SFPUC Wastewater Enterprise Collection System Division is responsible for Pollution Prevention, Pretreatment and Sewer Cleaning and Inspection. Mr. Keene advises that the Wastewater Enterprise Collection Systems Division staff and equipment are presently located in numerous leased offices, leased lots and temporary City-owned locations across the City.

Additionally, Mr. Keene reports that select members of the SFPUC Sewer System Improvement Program (SSIP) Management Team will also occupy space at the proposed 1550 Evans Avenue and 330 Newhall Street facility. SSIP is a new multi-year capital program designed to improve and protect the City's aging wastewater system Currently 2.7 billion is approved by the SFPUC Commission will be included in the next update of the SFPUC 10 year capital program.

Table 1. SFPUC Consolidation at 1550 Evans Avenue and 330 Newhall Street

Property Address	Property is Leased or City-owned	Annual Cost of Property to the SFPUC	Number of Staff, Vehicles, or Storage	Square Feet	Current Lease Expiration Dates and Proposed Use of Property Following Consolidation
1301 Evans Avenue	Leased	$78,888	Staff (10) /Storage	3,287	Lease expires on December 31, 2012. Upon SFPUC's exit, the City's Human Services Agency (HSA) is targeting this office space, given HSA's displacement from Southeast Community Facility located at 1800 Oakdale in early 2013.
1499 Evans Avenue	Leased	10,800	Vehicles (17)	900	Lease expires on November 15, 2012. SFPUC Real Estate Services is working to negotiate a temporary holdover agreement for continued use until the 1550 Evans Avenue property is secured and available to occupy.
3801 3rd Street	Leased	335,088	Staff (32)	10,740	Lease expired on June 30, 2012 and is presently on month-to-month holdover status, revocable at any time by the landlord or SFPUC upon written notice.
2245 Jerrold Avenue	Fire Department	0	Storage of Equipment	Unknown	Revert to Fire Department
116 Napoleon Avenue	Department of Public Works	0	Staff (53)/ Vehicles	Unknown	Revert to Department of Public Works
750 Phelps Avenue	SFPUC	0	Staff (24)/ Vehicles	Unknown	Twenty-four employees are temporarily located at the SFPUC Southeast Water Pollution Control Plant.
111 Bay Street	SFPUC	0	Staff (15)	Unknown	Fifteen employees are temporarily located at the SFPUC North Point Facility.
Total		**$424,776**			

As shown in Table 1 above, the cost of the current SFPUC leases, which would be terminated when staff and equipment are relocated to the subject property of 1550 Evans Avenue and 330 Newhall Street, total $424,776 annually.

As shown in Table 1 above, in addition to these leased spaces, the SFPUC also currently uses the San Francisco Fire Department (SFFD) parking lot at 2245 Jerrold Avenue for storage of the Auxiliary Water Supply System's[1] equipment. In May 2010, the function of the Auxiliary Water Supply System (AWSS) was transferred from the SFFD to the SFPUC. As part of the function transfer of AWSS, SFPUC now owns this AWSS equipment that is currently stored at 2245 Jerrold Avenue and the SFFD is requesting that SFPUC remove this equipment.

SFPUC Wastewater Enterprise Collection System Division also currently has 53 staff in approximately six portable trailers and various vehicles at the Department of Public Works property at 116 Napoleon Avenue. According to Mr. Keene, the SFPUC Wastewater Enterprise Division's use of this DPW property is a holdover from prior to 1996, when the Wastewater Enterprise Division was part of DPW.

Table 2 below identifies the anticipated 134 SFPUC staff that would be relocated to the office building at 1550 Evans Avenue from expiring office leases at (a) 3801 3rd Street, (b) 1301 Evans Avenue, (c) the North Point Facility at 111 Bay Street and (d) DPW property at 116 Napoleon Avenue. The 134 SFPUC relocated staff includes (a) 110 Wastewater Enterprise Collection System Division staff and (b) 24 SSIP staff.

Table 2. Staff Relocation to 1550 Evans Avenue

Current Address	Description	Number of Staff
116 Napoleon Avenue	Sewer Cleaning & Inspection	53
111 Bay Street (North Point Facility)	Wastewater Source Control & Pretreatment	15
3801 3rd Street	Pretreatment, Field Monitoring Pollution Prevention, Technical Services & Hydraulic Modeling	32
1301 Evans Avenue	Pretreatment, Field Monitoring Pollution Prevention, Technical Services & Hydraulic Modeling	10
750 Phelps Avenue (Southeast Water Pollution Control Plant)	SSIP	24
	Total Staff	**134**

As shown in Table 1 above, 17 of the Wastewater Enterprise Collection System Division vehicles are presently stored in a leased parking lot at 1499 Evans Avenue. This 1499 Evans Avenue lease terminates on November 15, 2012, such that the SFPUC Real Estate Services is

[1] The Auxiliary Water Supply System provides additional fire protection from the domestic water system in the event of a major earthquake.

currently working to negotiate a temporary month-to-month holdover lease for continued use of 1499 Evans Avenue until the 1550 Evans Avenue property is secured and available to occupy.

DETAILS OF PROPOSED LEGISLATION

The proposed resolution would (a) approve and authorize an agreement between the Director of Property and 3rd & Evans Street, LLC for the purchase of an approximately 4.68 acre parcel, including 50,593 square feet of office and industrial buildings and approximately 200 exterior parking spaces at 1550 Evans Avenue and 330 Newhall Street (Assessor's Block 5203, Lot 035) in San Francisco, California for the San Francisco Public Utilities Commission (SFPUC), for a purchase price of $15,000,000; (b) adopt findings under the California Environmental Quality Act (CEQA); (c) adopt findings that the conveyance is consistent with the City's General Plan and Eight Priority Policies of City Planning Code Section 101.1; and (d) authorize the Director of Property to execute documents, make certain modifications and take certain actions in furtherance of this resolution.

According Mr. Keene, the subject property at 1550 Evans Avenue and 330 Newhall Street will enable the SFPUC Wastewater Enterprise to consolidate staff, vehicles, trucks and equipment of SFPUC programs including the Wastewater Enterprise Collection System Division and SSIP to one centralized location immediately adjacent to the Southeast Water Pollution Control Plant. Mr. Keene reports that if the proposed resolution is approved, the SFPUC would complete a phased occupancy of employees and vehicles, trucks and equipment, commencing in early 2013, which would result in a total of 134 SFPUC staff, 92 vehicles and various related equipment to be relocated to the subject facility.

The Planning Department determined (a) that the proposed purchase and sale agreement does not constitute a project under the California Environmental Quality Act (CEQA) on August 1, 2012 and (b) that the proposed purchase and sale agreement is consistent with the City's General Plan and Eight Priority Policies of City Planning Code Section 101.1 on September 7, 2012.

FISCAL IMPACTS

In March 2012, the subject property was appraised at $16,000,000 by a third-party appraiser, Mr. Ron Blum of Carneghi-Blum & Partners, Inc. on behalf of 3rd & Evans Street, LLC. The $16,000,000 appraisal was reviewed and approved by Mr. John Updike, the City's Acting Director of Property. According to Mr. Updike, although the appraiser was under contract with the seller, 3rd & Evans Street, LLC, Carneghi-Blum is a firm that the City contracts with frequently for complex appraisal analysis.

As shown in Table 3 below, the cost of purchasing the 1550 Evans/330 Newhall property is $15,000,000 plus an estimated $18,179 in closing costs[2], for a total cost of approximately $15,018,179, which is $981,821,000 less than the recent appraisal value.

[2] Closing costs include title charges, endorsement fees, and other third party costs.

Table 3: Estimated Cost of Purchasing 1550 Evans Avenue and 330 Newhall Street Property	
Purchase Price for 1550 Evans Avenue and 330 Newhall Street Property	$15,000,000
Estimated Closing Costs	$18,179
Total Estimated Cost of Purchasing 1550 Evans Avenue and 330 Newhall Street Property	**$15,018,179**

Currently, the SFPUC's FY 2013–14 and FY 2014–15 budgets appropriate $20,000,000 from the SFPUC Wastewater Enterprise's Commercial Paper program for the purchase of the subject property, or $4,981,821 more than the total estimated cost of $15,018,179. However, in addition to the acquisition costs, Mr. Keene reports that there would be additional staff and vehicle relocation costs, furniture expenditures, and potential costs to modify the site to consolidate multiple SFPUC enterprises and operations. Although the costs have not yet been determined, Mr. Keene advises that the SFPUC has budgeted the remaining $4,981,821 for such costs.

On May 8, 2012, the Board of Supervisors approved the provision of up to $300,000,000 for the SFPUC Wastewater Enterprise's Commercial Paper program (File 12-0354). This allows the SFPUC to issue Commercial Paper from time to time to finance various Wastewater Enterprise capital projects pursuant to Proposition E (City Charter Section 8B.124) in anticipation of the issuance of its Wastewater Revenue Bonds projected to be issued in February 2013, as previously authorized by the Board of Supervisors in April 2010 (File 10-0340). These Wastewater Revenue Bonds are anticipated to have a 5.0% interest rate over a 30-year term, resulting in principal and interest payments over 30 years with a net present value of $18,147,349. These Wastewater Revenue Bonds will be repaid from sewer service fees charged to San Francisco residents and businesses.

As shown in Table 1 above, the SFPUC will terminate three leases at (a) 3801 Third Street, (b) 1499 Evans Avenue and (c) 1301 Evans Avenue in San Francisco, for a savings of $424,776 per year. The net present value of the existing leases over 30 years is an estimated $8,175,367, which is $9,972,073 or 122% less than the net present value of the estimated relocation and occupancy costs and Wastewater Revenue Bonds principal and interest payments over 30 years of an estimated $18,147,349.

Mr. Keene advises that there will be additional operational savings from the termination of the existing leases and relocation to the new property that cannot be quantified at this time. Operational savings include the proximity of the Southeast Water Pollution Control Plant and the consolidation of staff and resources at the proposed new location. Mr. Keene also notes that by purchasing the subject property, the SFPUC will also relocate personnel from temporary space, such as portable offices.

Additionally, Mr. Keene reports that purchase of the subject property at 1550 Evans Avenue and 330 Newhall Street is significantly less expensive alternative than a prior SFPUC proposal to construct a new office and vehicle storage facility for the Wastewater Enterprise Collection System Division at the Griffith Pump Station at 1601 Griffith Street, which was estimated by the PUC to cost approximately $48 million.

If SFPUC were to enter into new leases for comparable property rather than purchase the subject property, Mr. Keene estimates that the annual lease payments would be $1,246,222 based on rents for property currently available on the open market. Table 4 below shows SFPUC's estimated rent to lease office space (31,535 square feet), warehouse space (19,058 square feet), and corporate yard space (approximately 200 parking spaces) comparable to space available at 1550 Evans Avenue and 330 Newhall Street.[3]

Table 4. Estimate of Equivalent Expense of 1550 Evans Avenue and 330 Newhall Street (based on property available on the open market as of October 24, 2012)

	Space by Square Foot	Average Rent	Annual Lease Expense
Office Space	31,535	$24.25	$764,724
Warehouse Space	19,058	$15.82	$301,498
Corporate Yard Space	60,000	$3.00	$180,000
Total			$1,246,222

If the PUC were to lease new properties, as shown above in Table 4, the net present value of these leases over 30 years is an estimated $23,095,561, which is $4,948,121 or 27% more than the net present value of the estimated relocation and occupancy costs and Wastewater Revenue Bonds principal and interest payments over 30 years of an estimated $18,147,349.

Because purchase of the subject property incurs new costs to the PUC compared to the costs of leasing the existing properties, as noted above, the Budget and Legislative Analyst considers approval of the proposed resolution to be a policy matter for the Board of Supervisors.

RECOMMENDATION

Approval of the proposed resolution is a policy decision for the Board of Supervisors.

[3] Mr. Keene noted that when providing an estimate for comparison purposes, it is not possible to project actual costs without an actual deal and negotiations. As such, for the purposes of this analysis, current market rates for surrounding properties were surveyed to project what the market could bear. The estimate does not consider escalation of rents or volatility of the markets.

Item 2 File 12-1023	Department: Mayor's Office of Housing (MOH)

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed resolution authorizes the Mayor's Office of Housing (MOH) to enter into a 15-year agreement from December 1, 2012 through November 30, 2027 with 220 Golden Gate Master Tenant, LP (220 Golden Gate), a non-profit organization, for an amount not to exceed $18,475,118. Under the agreement MOH would pay operating subsidies to 220 Golden Gate to manage and operate at least 172 units of supportive housing for formerly homeless single adults at the Kelly Cullen Community under MOH's Local Operating Subsidy Program (LOSP).

Key Points

- The Mayor's Office of Housing in collaboration with the Department of Public Health (DPH) and the Human Services Agency (HSA), currently provides operating subsidies to owners and operators of 16 supportive housing facilities through its Local Operating Subsidy Program, which was created to bridge the gap between the cost of providing the housing and the amount that tenants can afford to pay (between 35% and 50% of their annual income). Tenants in supportive housing generally have very low incomes (10-15% of Area Median Income).
- Under the proposed agreement, MOH, through its subsidy program, would pay 220 Golden Gate $574,092 for seven months in FY 2012-13 and $999,114 for FY 2013-14 for operating 172 Kelly Cullen Community supportive housing units. The DPH FY 2012-13 and FY 2013-14 budgets contain General Fund monies previously appropriated by the Board of Supervisors for these Local Operating Subsidy Program subsidies. Over the 15 year term of the agreement, MOH would pay 220 Golden Gate not-to-exceed $18,475,118 in operating subsidies.
- 220 Golden Gate Master Tenant, LP is affiliated with the non-profit, Tenderloin Neighborhood Development Corporation (TNDC), through a limited partnership for which 220 Golden Gate Historic Corporation is the managing general partner. TNDC has constructed a two-year, $91,000,000 renovation of the site which is scheduled for completion in November 2012.
- On October 5, 2012, the Citywide Affordable Housing Loan Committee approved TNDC's request for Local Operating Subsidy Program funds for a 15-year term, which is consistent with the Committee's policy to provide funding to nonprofit housing developers who identify or purchase property for affordable housing development.
- Pursuant to the terms of a federal Social Innovation Fund (SIF) grant that will be used to fund support services, researchers from New York University will use data from the Kelly Cullen Community as part of a national study to test how housing impacts health outcomes and public costs for health care. Findings are intended to be used to create a supportive housing model that can be implemented in other cities.

Fiscal Impacts

- The estimated operating subsidy in FY 2012-13 of $477 per unit per month for 172 units is based on the difference between tenants' estimated rent payments of approximately $360 per housing unit per month, and 220 Golden Gate's estimated costs to operate the unit of approximately $837 per month. Operating costs include property management and office staff, utilities, taxes and licenses, insurance, maintenance, security, reserve deposits, and debt service on non-amortizing loans.

- Under the proposed agreement between MOH and 220 Golden Gate, after a full year of operations the MOH will re-examine actual operating expenditures and staffing patterns at the Kelly Cullen Community to determine whether the subsidy amount should be adjusted.

Recommendations

- Approve the proposed resolution.
- Request that the Department of Public Health report the findings of the New York University study findings on housing and health outcomes after the completion of the study to the Board of Supervisors.

MANDATE STATEMENT AND BACKGROUND

Mandate Statement

Pursuant to San Francisco Charter Section 9.118, agreements of $10,000,000 or more, or for a term of more than ten years, are subject to Board of Supervisors approval.

Background

Local Operating Subsidy Program

The Mayor's Office of Housing (MOH), in collaboration with the Department of Public Health (DPH) and the Human Services Agency (HSA), currently provides operating subsidies to owners and operators of 16 supportive housing facilities, through its Local Operating Subsidy Program The program was started in 2004 as a part of the Mayor's ten year "San Francisco Plan to End Chronic Homelessness," which has a goal of providing 3,000 new supportive housing units between 2006 and 2017 to low income persons who were formerly homeless. Supportive housing provides social and other related services as well as housing to formerly homeless persons in order to improve their social outcomes and in an attempt to reduce the City's associated health, mental health, social services, criminal justice, and other related costs.

According to Ms. Lydia Ely, MOH Project Manager, tenants in supportive housing have very low incomes (10-15% of Area Median Income, or $7,210 to $10,815 annually in 2012)[1]. Under the agreements between the City and housing operators, rent in supportive housing units is capped to a fixed percentage of a tenant's income (50% in DPH subsidized units, 35% in HSA subsidized units). The Local Operating Subsidy Program was created to bridge the gap between the cost of operating the housing and the amount the tenants can afford to pay, thereby providing long-term financial incentives to owners and operators to create permanent supportive housing units and keep their units affordable for the long term.

General Fund monies for the 16 existing operating subsidy agreements are funded in the DPH and HSA budgets, depending on whether the housing units are sponsored by DPH or HSA, and

[1] The Area Median Income for a single-person household in the San Francisco region, as defined by the federal Department of Housing and Urban Development is $72,100 in 2012.

are subject to Board of Supervisors appropriations approval. The funds for the operating subsidies are then work-ordered to MOH, which manages the Local Operating Subsidy Program.

In FY 2011-12, MOH paid $5,063,967 in Local Operating Subsidy Program operating subsidies to 15 supportive housing operators for approximately 788 units throughout the City. According to Ms. Ely, the Local Operating Subsidy Program is projected to subsidize approximately 1,456 units of supportive housing by the end FY 2016-17.

As shown on Table 1 below, in FY 2011-12 the Local Operating Subsidy Program provided subsidies under 15 housing agreements covering 788 units of supportive housing, at an average cost per unit per month of $536.

Table 1
Actual Local Operating Subsidy Program Agreements, Subsidized Units, Budget, and Subsidy per Unit
FY 2007-08 through FY 2011-12

Fiscal Year	Number of Local Operating Subsidy Program agreements	Number of subsidized units	Total annual budgeted amount ($)	Average subsidy per unit per month ($)
FY 2007-08	5	192	$370,093	$161
FY 2008-09	6	277	1,586,757	477
FY 2009-10	10	557	3,588,812	537
FY 2010-11	14	668	4,937,351	616
FY 2011-12	15	788	5,063,967	536

As shown in Table 2 below, MOH estimates that by FY 2016-17, the Local Operating Subsidy Program will provide subsidies to 29 housing projects covering 1,456 units of supportive housing under the Local Operating Subsidy Program, at an average cost per unit per month of $658.

Table 2
Estimated Local Operating Subsidy Program Agreements, Subsidized Units, Budget, and Subsidy per Unit
FY 2012-13 through FY 2016-17

Fiscal Year	Number of Local Operating Subsidy Program agreements	Number of subsidized units	Total annual budgeted amount ($)	Average subsidy per unit per month ($)
FY 2012-13	21	1,260	$6,635,497	$439
FY 2013-14	28	1,423	10,024,006	587
FY 2014-15	28	1,427	10,767,674	629
FY 2015-16	29	1,451	11,259,355	647
FY 2016-17	29	1,456	11,494,942	658

DETAILS OF PROPOSED LEGISLATION

The proposed resolution authorizes the Mayor's Office of Housing to enter into a 15- year agreement with 220 Golden Gate Master Tenant, LP (220 Golden Gate) for an amount not to exceed $18,475,118 (see Table 5 below). MOH, through the Local Operating Subsidy Program, will pay subsidies to 220 Golden Gate to manage and operate 172 units of supportive housing at the Kelly Cullen Community. The proposed agreement would be effective from December 1, 2012 to November 30, 2027. Funding for the proposed agreement is General Fund monies appropriated annually in the DPH budget and is subject to Board of Supervisors appropriation approval. The proposed agreement is administered by MOH, under a work order agreement between DPH and MOH.

Tenderloin Neighborhood Development Corporation

The Tenderloin Neighborhood Development Corporation is a non-profit public benefit corporation that develops, owns and operates affordable housing units and provides supportive services for low-income people in the Tenderloin District. TNDC is affiliated with the 220 Golden Gate Historic Corporation, which is a managing general partner with the subsidy recipient, 220 Golden Gate Master Tenants, LP.[2] To date, the TNDC owns and operates 30 affordable housing buildings with 3,000 tenants in the Tenderloin and adjacent communities.

[2] 220 Golden Gate Master Tenants, LP leases the project from the developer and owner, 220 Golden Gate Associates, LP.

The Kelly Cullen Community

The Kelly Cullen Community is located in the Tenderloin District at 220 Golden Gate Avenue. Kelly Cullen Community is a 138,023 square foot; 9-story historic mixed-used building built in 1909 and was formerly used as the Central YMCA. Tenderloin Neighborhood Development Corporation has spent two years and $91,000,000 on property renovations to the Kelly Cullen Community with funding from a mix of federal, state and local sources.[3] Included in the renovations are 172 affordable housing units that will be available for formerly homeless single adults and average 235 square feet, two managers units, and restored historic community areas. According to Ms. Ely, this development is the largest affordable housing project to receive MOH Local Operating Subsidy Program subsidies. Construction is anticipated to be completed in November 2012 and the tenant move-in date is scheduled for December 1, 2012 at a rate of 30 tenants per month until full capacity is reached on May 31, 2013.

Local Operating Subsidy Program funding for the Kelly Cullen Community will be provided by DPH and each unit, less the manager's units, will be occupied by a DPH referred tenant. Furthermore, all tenants in the Kelly Cullen Community are required to be at or below 40% of the area median income (AMI) for San Francisco, which translates to $22,200 maximum yearly income for a 1-person household. There will be 111 units available to tenants at or below the 40% AMI level and 61 units available to tenants at or below 25% AMI, which translates to $19,425 maximum yearly income for a 1-person household.

DPH Integrated Health and Wellness Center

On the ground floor of the Kelly Cullen Community, DPH has developed and is leasing 11,000 square feet for its new Integrated Housing and Behavioral Health Clinic that will provide medical, psychiatric, and substance abuse services and will serve both tenants and residents of San Francisco. DPH staff will provide services and will be funded by a mix of federal Social Innovation Fund (SIF), MHSA, and DPH program dollars, appropriated annually in the DPH budget. Through the SIF grant, researchers from New York University will use data from the Kelly Cullen Community as part of a national study to test how housing impacts health outcomes and public costs for health care in order to create a supportive housing model that can be implemented in other cities.

Approval of Local Operating Subsidy Program Providers

According to Ms. Ely, DPH, HSA and MOH selected the 16 existing Local Operating Subsidy Program providers during review, by the Citywide Affordable Housing Loan Committee[4], of applications responding to various Notices of Funding Availability (NOFA) for capital funding for acquisition and predevelopment financing for supportive housing for homeless persons, or Requests for Proposals (RFP) for specific development sites.

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[3] Federal, state and local funding sources include the federal tax credits allocated by the California Tax Credit Allocation Committee, American Reinvestment and Recovery Act, Affordable Housing Fees, Historic Preservation Tax Credits, Affordable Housing Program Loans, and Medical Health Services Act (MHSA) program funds tax credits.

[4] The Citywide Affordable Housing Committee is composed of the Director' s of the Mayor's Office of Housing, the Department of Public Health, and the Human Services Agency and their designee.

The Citywide Affordable Housing Loan Committee approved the subsidies under the Local Operating Subsidy Program, in accordance with the Committee's policy to consider and potentially offer funding to nonprofit housing developers who are able to identify or purchase residential facilities for affordable housing development. The Committee approved the TNDC's request for LOSP funds for a 9-year term on December 16, 2011. Ms. Ely noted that pursuant to the recommendations provided by the Budget and Legislative Analyst's office in the 2012 Performance Audit on San Francisco Affordable Housing Policies and Programs, MOH has altered their practices and is now executing 15-year LOSP agreements which require the Board of Supervisors' approval. Consequently, TNDC returned to the Committee with an updated 15-year proposed budget which was approved October 5, 2012.

Operating Expenditures Subsidized by the Local Operating Subsidy Program

Under the proposed agreement for the Kelly Cullen Community the rent charged to tenants in subsidized units under the Local Operating Subsidy Program (LOSP) is capped at a maximum of 50% of a tenant's gross monthly income. Ms. Ely estimates that the average tenant's rent will be approximately $360 per unit, per month. To cover all operating expenses, each unit would need to generate $837 in tenant rent, per month. The $477 shortfall per unit, per month will be bridged with the LOSP funding.[5]

The operating subsidies from the Local Operating Subsidy Program will be used to subsidize operating expenses which include rent, management fees, salaries and benefits, administration, utilities, taxes and licenses, insurance, maintenance, debt service and reserves. Pursuant to 220 Golden Gate's capital funds loan agreement with the MOH, 220 Golden Gate must maintain a Replacement Reserve Account which requires monthly deposits and can only be used for capital improvements as well as an Operating Reserve Account which also requires monthly deposits based on a defined formula for unexpected operational expenses.

Table 3 shows Kelly Cullen Community's income including the requested Local Operating Subsidy Program funding, and expenditures for FY 2012-2013, which is a seven month period due to the effective date of the agreement (December 1, 2012), and for FY 2013-14. The operating expenses for Kelly Cullen Community for FY 2012-13 are $1,052,835 and the income is $478,743 not including the operating subsidy. The requested $574,092 in Local Operating Subsidy Program funding will bridge the Kelly Cullen Community operating budget's shortfall.

[5] According to Ms. Ely, LOSP funding is an operations subsidy used to operate the building as a whole and not a per-unit subsidy. The per unit calculations are used for informational and comparison purposes only.

Table 3
Kelly Cullen Community Income and Operating Expenses with LOSP Operating Subsidy

FY 2012-13 Budget (7 mos.)

Income	Items	Amount
	Tenant Rents	$438,480.00
	Misc. Income	40,263.00
	Subtotal, Rents and Income	478,743.00
	LOSP Funding	574,092.00
	Total	**$1,052,835.00**
Expenses	**Items**	
	Salaries/Benefits	$276,817.50
	Management Fees	97,083.00
	Utilities	137,471.50
	Maintenance & Repair	257,858.00
	Administration	89,665.00
	Taxes & Insurance	120,814.50
	Debt Service, Reserves and Misc. Fees	73,128.50
	Total	**$1,052,835.00**

FY 2013-14 Budget (12 mos.)

Income	Items	Amount
	Tenants Rents	$761,076.00
	Misc. Income	69,820.00
	Subtotal, Rents and Income	830,896.00
	LOSP Funding	999,114.00
	Total	**$1,830,010.00**
Expenses	**Items**	
	Salaries/Benefits	$479,572.50
	Management Fees	168,307.00
	Utilities	239,787.00
	Maintenance & Repair	449,777.50
	Administration	156,253.00
	Taxes & Insurance	210,733.50
	Debt Service, Reserves and Misc. Fees	125,579.50
	Total	**$1,830,010.00**

According to Ms. Ely, Kelly Cullen Community will have 14.6 full time operating staff, which MOH and TNDC have determined is the necessary staffing level due to the size of the facility, and needs of potential tenants[6] as well as the uncertainty in operational needs that is commonly experienced in the first year of an affordable housing project. Moreover, this facility will have 24-hour front desk coverage which will be provided by Desk Clerks (see Table 4) with additional coverage by the Night Managers. Proposed operating staff are shown in Table 4 below. Staffing patterns will be re-examined by MOH and TNDC after the first year of operation to determine whether cost savings can be achieved.

Table 4
Proposed Property Management Staffing for FY 2012-13 through FY 2013-14 for Kelly Cullen Community

Position	FTE
General Manager	1
Night Manager	1.5
Assistant Manager	2
Desk Clerks	4.6
Janitorial and Cleaning	3.0
Maintenance	2.5
TOTAL	**14.6**
Ratio of staff to resident	**1:11.78**

[6] 50 tenants will be selected for the San Francisco Health Plan's list of high cost users of Medicaid services and 122 tenants will come from DPH's Direct Access to Housing (DAH) waiting pool which prioritizes homeless individuals with severe behavioral health or medical problems.

According to Ms. Ely, the project costs for the Kelly Cullen Community are higher relative to recent LOSP projects due to the staffing requirements, and the costs of managing large community spaces such as the gymnasium and auditorium that needed to be restored as part of the historic rehabilitation process. To offset operating expenditures, TNDC plans to charge usage fees for several of its community spaces and has developed a marketing plan and fee schedule that was approved by the MOH to advertise these facilities.

FISCAL IMPACTS

As shown in Table 5 below, the Kelly Cullen Community will receive subsidies under the Local Operating Subsidy Program for 172 units in FY 2012-13 at an average estimated subsidy of $477 per unit per month (based on 7 months from December 1, 2012 through June 30, 2013).

Table 5
Projected Subsidy Expenditures for Kelly Cullen Community under the Proposed Agreement

Fiscal Year	Months of Contract	Projected Local Operating Subsidy Program Expenditure	Local Operating Subsidy Program Units at the KCC (estimated)	Average Local Operating Subsidy Program Subsidy Per Unit Per Month
FY 2012-13	7	$574,092	172	$477
FY 2013-14	12	999,114	172	484
FY 2014-15	12	1,029,628	172	498
FY 2015-16	12	1,061,370	172	514
FY 2016-17	12	1,094,387	172	530
FY 2017-18	12	1,128,727	172	547
FY 2018-19	12	1,158,567	172	561
FY 2019-20	12	1,188,525	172	576
FY 2020-21	12	1,225,768	172	594
FY 2021-22	12	1,265,786	172	613
FY 2022-23	12	1,307,398	172	633
FY 2023-24	12	1,350,667	172	654
FY 2024-25	12	1,395,656	172	676
FY 2025-26	12	1,446,291	172	700
FY 2026-27	12	1,561,800	172	757
FY 2027-28	5	687,336	172	799
TOTAL:	180	**$18, 475,118**	**15 Year Average:**	**$**601

According to Ms. Ely, the MOH's underwriting guidelines require that expenses are escalated by 3.5% each year which is why the program expenditures and subsequently the subsidy per unit, per month increase each year.

FY 2012-13 and FY 2013-14 Kelly Cullen Community operating subsidies were appropriated by the Board of Supervisors in the DPH budget in the amount of $574,092 and $999,114, respectively. Each unit is expected to be occupied by May 31, 2013 with DPH referred, formerly homeless single adults who will pay approximately $360 a month, per unit. The difference between the annual operating expenses per unit, or $837, and tenant rent payment is $477, which is the amount of the subsidy that will be provided by the Local Operating Subsidy Program. Under the proposed agreement, the amount of the subsidy will be adjusted annually by MOH, based on a review of the Kelly Cullen Community's actual operating expenditures, staffing needs, and revenues collected from fees for public use of the KCC's community spaces.

RECOMMENDATIONS

1. Approve the proposed resolution.
2. Request that the Department of Public Health report the findings of the New York University study findings on housing and health outcomes after the completion of the study to the Board of Supervisors.

Item 4 File 12-0965	Department(s): Treasurer/Tax Collector

EXECUTIVE SUMMARY

Legislative Objectives

- The proposed ordinance would amend Section 906.5 of the City's Business and Tax Regulations Code to prevent the Payroll Expense Tax Exclusion for Small Business Net New Payroll from terminating in the event the voters of the City and County of San Francisco approve a Gross Receipts Tax. The existing Small Business Net New Payroll Exclusion would terminate if the voters approve a Gross Receipts Tax. The intent of the proposed ordinance is to encourage small businesses to create new jobs in San Francisco or relocate existing jobs to San Francisco.

Key Points

- Businesses that have annual payroll expenses of more than $250,000 currently pay Payroll Expense Taxes to the City of 1.5 percent of total annual payroll expenses. On July 10, 2012, the Board of Supervisors approved an ordinance establishing the Payroll Expense Tax Exclusion for Small Business Net New Payroll, an Exclusion for net new payroll expenses up to $250,000 incurred by small businesses.
- Under the existing ordinance, the Small Business Net New Payroll Exclusion is available to eligible businesses in Tax Years 2012 through 2015[1] and the Exclusion will terminate if the voters approve a Gross Receipts Tax within 30 days after the passage of the Gross Receipts Tax. The proposed ordinance would amend the Small Business Net New Payroll Exclusion such that the Exclusion would no longer terminate if the voters approve a Gross Receipts Tax. Instead, the Exclusion would remain in effect for Tax Years 2012 through 2015 so long as the Payroll Expense Tax is in effect during that time.
- If the voters approve the Gross Receipts Tax under Proposition E, the City's Payroll Expense Tax would phase out from Tax Years 2014 to 2018. Therefore, the Small Business Net New Payroll Exclusion, if the proposed ordinance is approved, would be in effect during the phase-out of the Payroll Expense Tax in Tax Years 2014 and 2015.

Fiscal Impact

- Based on the current Payroll Expense Tax rate of 1.5 percent, the Controller's Office previously estimated reduced Payroll Expense Tax revenues of $2,000,000 annually resulting from the Net New Payroll Exclusion, or a total reduction in City revenues of approximately $8,000,000 over the four-year term of the Net New Payroll Exclusion. According to Mr. Ted Egan of the Controller's Office of Economic Analysis, if the voters approve Proposition E, which would phase out the Payroll Expense Tax from Tax Years 2014 to 2018, the estimated annual reduction in City revenues in Tax Years 2014 and 2015 would be less than the previously estimated $2,000,000 due to reductions in the Payroll Expense Tax rates in Tax Years 2014 and 2015, resulting in $1,800,000 in foregone revenues to the City in Tax Year 2014 based on a scheduled Payroll Expense Tax rate of 1.35 percent, and $1,500,000 in foregone revenues to the City in Tax Year 2015, based on an expected Payroll Expense Tax rate of 1.125 percent. Under the proposed ordinance, Payroll Expense Tax revenues to the City would be reduced by an estimated $7,300,000

[1] A "Tax Year" is a calendar year.

over the four-year term of the Net New Payroll Exclusion if the voters approve Proposition E, rather than the Controller's previous estimate of $8,000,000 over the four-year term of the Net New Payroll Exclusion.

Policy Considerations

- In defining "Base Year Payroll Expense," Article 12-A Section 906.5(b)(2) states: "*If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the first year that the person incurs Payroll Expense, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion.*" According to City Attorney's Office, the intent of this provision is to establish a minimum Base Year Payroll Expense of $150,000 for the purposes of calculating the Exclusion for businesses that have payroll expenses of less than $150,000 and therefore do not file Payroll Expense Tax returns.

  In order to clarify the intent of Section 906.5(b)(2), the proposed ordinance should be amended to state: "*If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion.*"

- Given the estimated reduced Payroll Expense Tax revenues to the City of $7,300,000 over the four-year term of the Net New Payroll Exclusion, and given the City's interest in promoting job creation in San Francisco, the Budget and Legislative Analyst recommends that the proposed ordinance be amended to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.

Recommendations

- Amend the proposed ordinance to state: "*If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion.*"
- Amend the proposed ordinance to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.
- Approval of the proposed ordinance, as amended, is a policy matter for the Board of Supervisors.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

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

Background

In accordance with the City's Business and Tax Regulations Code Section 902, every business entity, including sole proprietors with no employees, that conducts business in San Francisco must obtain a valid annual business registration certificate and pay business registration fees to the Office of the Treasurer and Tax Collector. In addition, the City's Business and Tax Regulations Code provides that (a) businesses that have annual payroll expenses of $150,000 or more are required to file annual Payroll Expense Tax statements with the Office of the Treasurer and Tax Collector, and (b) businesses that have over $250,000 in annual payroll expenses are subject to the City's Payroll Expense Tax, which is currently 1.5 percent of total annual payroll expenses. Under Business and Tax Regulations Code Section 905-A, San Francisco businesses with annual payroll expenses of $250,000 or less are exempt from paying the City's Payroll Expense Tax.

Business and Tax Regulations Code Section 902.1(a) specifically defines Payroll Expense as compensation paid to individuals including shareholders of a professional corporation or a Limited Liability Company (LLC), for salaries, wages, bonuses, commissions, property issued or transferred in exchange for the performance of services (including but not limited to stock options), compensation for services to owners of pass-through entities, and any other form of compensation, who during any Tax Year, perform work or render services, in whole or in part in the City. The City's FY 2012-13 Budget includes $454,305,800 in Business Registration and Payroll Expense Tax revenues.

According to Mr. Greg Kato, Policy and Legislative Manager in the Office of the Treasurer and Tax Collector, there are approximately 80,000 business entities with current business registration certificates in San Francisco, including sole proprietors and businesses that have no payroll expenses. Of the approximately 80,000 businesses currently registered with the City, 11,864 or 14.8 percent of all registered businesses submitted Payroll Expense Tax statements for Tax Year 2011 indicating annual payroll expenses of $150,000 or more, as shown in Table 1 below.

Table 1
Payroll Expense Tax Statement Filings for Tax Year 2011

Annual Payroll Expenses	Number of Businesses
$150,000 to $250,000	4,570
$250,001 to $500,000	2,314
Subtotal, Small Businesses	6,884
Greater than $500,000	4,980
Total	**11,864**

Source: Treasurer and Tax Collector

The Small Business Net New Payroll Exclusion

On July 10, 2012, the Board of Supervisors approved Ordinance No. 160-12 adding Section 906.5 to Article 12-A of the City's Business and Tax Regulations Code to establish a four-year Payroll Expense Tax Exclusion for net new payroll expenses up to $250,000 incurred by small businesses doing business in San Francisco. Section 906.5(b)(1) defines a "small business" as a business with annual payroll expenses between $1 and $500,000 in the Base Year. The Base Year is 2011 for those businesses that had payroll expenses in 2011. For those businesses that did not have payroll expenses in 2011, the Base Year is the first year a business incurs payroll expenses. If the business is exempt from filing a Payroll Expense Tax return in the first year that the business incurs payroll expenses, the business' Base Year payroll expense is considered to be $150,000 for the purposes of calculating the Exclusion.

The Small Business Net New Payroll Exclusion provides that a small business may exclude (a) annual payroll expenses that are greater than the business' Base Year Payroll Expense, or (b) $250,000, whichever is less. Effectively, the maximum annual Exclusion is $250,000, and the Exclusion for each Tax Year is calculated using the Base Year Payroll Expense rather than the previous year's Payroll Expense. Based on the City's current Payroll Expense Tax rate of 1.5 percent of annual payroll expenses, the maximum annual savings to an eligible business is $3,750 (.015 x $250,000).

Under Section 906.5(l), the Small Business Net New Payroll Exclusion is available to eligible businesses in Tax Years 2012 through 2015 and the Exclusion will terminate if the voters approve a Gross Receipts Tax, on the effective date of the Gross Receipts Tax. Proposition E, which is on the City and County of San Francisco's ballot for the November 6, 2012 election, proposes to phase in a Gross Receipts Tax from Tax Years 2014 to 2018 and phase out the City's Payroll Expense Tax over the same period. Although the Gross Receipts Tax would begin to phase in in Tax Year 2014, it will be considered effective when the Board of Supervisors certifies the election, or within 30 days after the election. Therefore, under current law, if the voters approve Proposition E, the Small Business Net New Payroll Exclusion would terminate before it takes effect. The proposed ordinance would amend the Net New Payroll Exclusion to remain in effect through Tax Year 2015 so long as the City's Payroll Expense Tax is in effect.[2]

According to Section 906.5(a), the purpose of the Small Business Net New Payroll Exclusion is to provide small businesses with an incentive to create new jobs in San Francisco or relocate existing jobs to San Francisco.

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would amend the City's Business and Tax Regulations Code Article 12-A Section 906.5 to prevent the Small Business Net New Payroll Exclusion from terminating in the event the voters of the City and County of San Francisco approve a Gross Receipts Tax. Under the proposed ordinance, the Small Business Net New Payroll Exclusion would remain in effect for the full four-year term from Tax Year 2012 to Tax Year 2015 in the event that voters approve a Gross Receipts Tax. If the Board of Supervisors does not approve the proposed ordinance, the Net New Payroll Exclusion would terminate in the event that the voters approve a Gross Receipts Tax.

[2] As noted below, under Proposition E the Payroll Expense Tax would be phased out over a four-year period as the gross receipts tax is phased in.

The proposed ordinance specifies that the Small Business Net New Payroll Exclusion may be used only in calculating a business' Payroll Expense Tax liability and no other tax liability. Therefore, the Small Business Net New Payroll Exclusion would remain in effect for the full four-year term only so long as the Payroll Expense Tax is in effect. Under Proposition E, the Payroll Expense Tax is scheduled to phase out from Tax Years 2014 to 2018.

Proposition E, which is on the City and County of San Francisco's ballot for the November 6, 2012 election, proposes to phase in a Gross Receipts Tax and phase out the City's Payroll Expense Tax from Tax Years 2014 to 2018. Therefore, if the proposed ordinance is approved, the Small Business Net New Payroll Exclusion would be in effect during the phase-out of the Payroll Expense Tax in Tax Years 2014 and 2015, if the voters approve Proposition E. Under Proposition E, the Payroll Expense Tax rate in Tax Year 2014 would be 1.35 percent (a 10 percent decrease from 1.5 percent), and the Payroll Expense Tax rate in Tax Year 2015 is expected to be 1.125 percent (a 25 percent decrease from 1.5 percent), although the Controller may adjust the rate using a pre-established formula to ensure a revenue-neutral transition from the existing Payroll Expense Tax to the proposed Gross Receipts Tax.

The maximum annual savings to eligible businesses from the Small Business Net New Payroll Exclusion is $3,750 (.015 x $250,000), based on the maximum exclusion of $250,000 in net new payroll expenses and the City's current Payroll Expense Tax rate of 1.5 percent. If the voters approve Proposition E and the Payroll Expense Tax rate decreases to 1.35 percent in Tax Year 2014 and to 1.125 percent in Tax Year 2015, under the proposed ordinance, the maximum annual savings to eligible businesses would be $3,375 in Tax Year 2014 (.0135 x $250,000) and $2,813 in Tax Year 2015 (.01125 x $250,000).

The Likely Number of Eligible Businesses

Under the existing Small Business Net New Payroll Exclusion, an estimated 29,589 San Francisco business entities with payroll expenses between $1 and $500,000 in Tax Year 2011 may be eligible to claim the Small Business Net New Payroll Exclusion if their payroll expenses in Tax Years 2012 through 2015 increase beyond their 2011 Payroll Expense. This includes an estimated 22,705 registered businesses with annual payroll expenses between $1 and $149,999 that were not required to file Payroll Expense Tax returns in Tax Year 2011; and 6,884 businesses with annual payroll expenses between $150,000 and $500,000 that filed Payroll Expense Tax returns in Tax Year 2011, as shown in Table 1 above.[3]

In addition, up to an estimated 45,431 businesses that have current business registration certificates in San Francisco, but had no payroll expenses in Tax Year 2011, will potentially be eligible for the Net New Payroll Exclusion starting the year after these businesses incur payroll expenses for the first time and establish a Base Year Payroll Expense.[4] Businesses that did not

[3] Mr. Ted Egan, Chief Economist in the Controller's Office of Economic Analysis, estimates that 29,589 registered businesses had payroll expenses between $1 and $500,000 in Tax Year 2010. If the number of businesses with payroll expenses between $1 and $500,000 in Tax Year 2011 is comparable to Tax Year 2010, then approximately 22,705 registered businesses (29,589 minus 6,884) with payroll expenses between $1 and $149,999 in Tax Year 2011 will be eligible for the Net New Payroll Exclusion starting in Tax Year 2012.

[4] Of the approximately 80,000 registered businesses in San Francisco, an estimated 34,569 have payroll expenses of at least $1, resulting in an estimated 45,431 registered small businesses with no payroll expense.

exist in Tax Year 2011 can also become eligible for the Net New Payroll Exclusion starting the year after these new businesses incur payroll expenses and establish a Base Year Payroll Expense.

Although an estimated 29,589 businesses will potentially be eligible for the Net New Payroll Exclusion based on having a Base Year Payroll Expense of $500,000 or less, to apply for the Net New Payroll Exclusion, a business must have payroll expenses greater than $250,000 in the current Tax Year and must have annual payroll expenses greater than their Base Year Payroll Expense. Based on the number of businesses that had payroll expenses between $250,000 and $500,000 in Tax Year 2011, as shown in Table 1 above, the number of businesses that apply for the Net New Payroll Exclusion during the proposed four-year effective term of the Exclusion is unlikely to exceed 2,000 in a given year.

FISCAL IMPACT

Payroll Expense Tax Revenue Impact

Based on the current Payroll Expense Tax rate of 1.5 percent, the Controller's Office previously estimated reduced Payroll Expense Tax revenues of $2,000,000 annually resulting from the Net New Payroll Exclusion, or a total reduction in City revenues of approximately $8,000,000 over the four-year term of the Net New Payroll Exclusion. The reduction in Payroll Expense Tax revenues for the first two years of the Net New Payroll Exclusion was incorporated into the City's Budget through the Budget and Finance Committee's Budget Adjustments, allocating $1,500,000 in FY 2012-13 and $2,500,000 in FY 2013-14.

Mr. Ted Egan, Chief Economist in the Controller's Office of Economic Analysis, advises that the estimated annual reduction in City revenues in Tax Years 2014 and 2015 would be less than the previously estimated $2,000,000 if the Payroll Expense Tax rate decreases in Tax Years 2014 and 2015 as proposed under Proposition E, which is on the City and County of San Francisco's ballot for the November 6, 2012 election. According to Mr. Egan, the estimated amount of the annual reduction in City revenues in Tax Years 2014 and 2015 would decrease proportionately to the scheduled decrease in the Payroll Expense Tax rate. Therefore, assuming a Payroll Expense Tax rate of 1.35 percent in Tax Year 2014 (which is 10 percent less than the current Payroll Expense Tax rate of 1.5 percent), the estimated reduction in City revenues would be $1,800,000 (10 percent less than the previously estimated $2,000,000). Assuming a Payroll Expense Tax rate of 1.125 in Tax Year 2015 (which is 25 percent less than the Payroll Expense Tax rate of 1.5 percent), the estimated reduction in City revenues would be $1,500,000 (25 percent less than the previously estimated $2,000,000). Under the proposed ordinance, the estimated reduction in City revenues would total $7,300,000 over the four-year term of the Exclusion if the voters approve the Gross Receipts Tax proposed under Proposition E.

Administrative Costs

According to Mr. Kato, the Office of the Treasurer and Tax Collector is in the process of revising the Treasurer/Tax Collector's existing Payroll Expense Tax documents and programming the Treasurer/Tax Collector's computer system to be ready when businesses start filing Tax Year 2012 Payroll Expense Tax returns in January 2013. The cost of professional services needed to make these revisions represents a one-time General Fund cost of approximately $55,000. This one-time General Fund cost of $55,000 was not included in the City's FY 2012-13 Budget because the Board of Supervisors approved the Net New Payroll Exclusion after approving the City's FY 2012-13 Budget. Therefore, the Office of the Treasurer and Tax Collector is working with the Mayor and the Controller to identify funds to pay for these costs.

POLICY CONSIDERATIONS

"Base Year Payroll Expense" is Open to Misinterpretation

In defining "Base Year Payroll Expense," Article 12-A Section 906.5(b)(2) states:

"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the first year that the person incurs Payroll Expense, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."

According to the City Attorney's Office, the intent of this provision is to establish a minimum Base Year Payroll Expense of $150,000 for the purposes of calculating the Exclusion for businesses that have payroll expenses of less than $150,000 and therefore do not file Payroll Expense Tax returns. This provision is intended to apply to business that (a) had payroll expenses of less than $150,000 in Tax Year 2011 and previous years; (b) incurred payroll expenses of less than $150,000 for the first time in Tax Year 2011; or (c) incur payroll expenses of less than $150,000 for the first time in Tax Years 2012 through 2014.

In order to clarify that that the intent of Section 906.5(b)(2) is to establish a minimum Base Year Payroll Expense of $150,000 to be used in calculating the Exclusion for all business with payroll expenses of less than $150,000 in the Base Year, the proposed ordinance should be amended to state:

"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the <u>Base Year</u>, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."

Report on the Effects of the Net New Payroll Exclusion

Business and Tax Regulations Code Section 906.5 states that the purpose of the Small Business Net New Payroll Exclusion is to "increase the number of jobs within the City… by providing an incentive for small businesses to create new jobs or to relocate existing jobs to the City…" Because the Net New Payroll Exclusion is based on net increases in payroll expenses rather than new jobs, it may also incentivize (a) increasing hours for existing employees, and (b) increasing wages for existing employees.

However, because businesses routinely increase and decrease their payrolls from year to year, the net increase in payroll expenses that businesses exclude from their Payroll Expense under the Net New Payroll Exclusion will not serve as a clear indicator of the increase in business payrolls that occurred as a result of the Net New Payroll Exclusion. An unknown portion of the increase in business payrolls would have occurred without the Net New Payroll Exclusion, thus making it difficult to determine what portion of the increase in business payrolls was caused by the incentivizing effects of the Net New Payroll Exclusion.

Given the estimated reduced Payroll Expense Tax revenues to the City of $7,300,000 over the four-year term of the Net New Payroll Exclusion, and given the City's interest in promoting job creation in San Francisco, the Budget and Legislative Analyst recommends that the proposed ordinance be amended to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.

RECOMMENDATIONS

- Amend the proposed ordinance to state: *"If a person is exempt from filing a Payroll Expense Tax return pursuant to Business and Tax Regulations Code 6.9-2 in the Base Year, the person's Base Year Payroll Expense shall be $150,000 for the purposes of calculating this exclusion."*

- Amend the proposed ordinance to require the Controller's Office of Economic Analysis to issue a report to the Budget and Finance Committee of the Board of Supervisors at the end of four-year term of the Net New Payroll Exclusion, assessing the effects of the Exclusion on incentivizing job creation and payroll growth among small businesses that applied for the Net New Payroll Exclusion.

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