File 100865

SMALL BUSINESS COMMISSION
OFFICE OF SMALL BUSINESS

CITY AND COUNTY OF SAN FRANCISCO
GAVIN NEWSOM, MAYOR

August 30, 2010

Ms. Angela Calvillo, Clerk of the Board
Board of Supervisors
City Hall Room 244
1 Carlton B. Goodlett Place
San Francisco, CA 94102-4694

Re: Board of Supervisors File No. 100865 [Establishing an Alcohol Mitigation Fee]

Small Business Commission Recommendation: **Do not approve**

Dear Ms. Calvillo:

On August 9, 2010, the Small Business Commission held a hearing on Board of Supervisors File No. 100865 and recommended that the Board of Supervisors not approve this ordinance.

The intent of this ordinance, according to the legislations chief proponent, the Marin Institute, is to "ensure alcohol wholesalers and importers- not bars, restaurants, or retailers- will pay their fair share to mitigate the tremendous economic costs of alcohol harm in San Francisco."[1] The Marin Institute also claimed that it was "ludicrous" to think that consumers will be less likely to purchase alcohol if the fee is implemented.[2] These premises were used in part to justify the introduction of this ordinance and both were subsequently discredited by the Controller's Office in the ordinance's Economic Impact Report. The impact of this fee will in fact be shifted directly to small businesses and their customers, and the effect of reduced consumer spending will be significant. Rather than acknowledging these real implications to small businesses, proponents have pitted San Francisco small businesses against important social programs.

Nexus Study and Equitability

While this ordinance proposes cost recovery for unreimbursed alcohol related costs that the City incurs, the fee does not take steps to mitigate alcohol related costs to the City. Furthermore, the collection of this fee will provide dedicated funding to programs which largely serve the City's well known chronic inebriant population, which may disincentivize the City from finding real solutions to address the significant costs incurred by these approximately 300 or less persons. The report failed to work with service providers to identify the types of alcohol consumed by persons in targeted programs and services, prohibiting the City from targeting the alcohol most responsible for these costs. Therefore, if passed, this fee will not equitably "charge for harm" and will instead target a broad range of responsible consumers, including visitors from other cities who contribute to our vibrant and economically significant nightlife and restaurant industries. Additionally, this fee disproportionately impacts working class and low income responsible drinkers.

1. Marin Institute (July 12, 2010). "Charge for Harm' Alcohol Mitigation Fee Deserves San Francisco Small Business Support. Press release.
2. Townsend, Tess (August 5, 2010). "Raise a Glass, Raise Tax Revenue," *The Bay Citizen*

Loss of Business and Controller Projections

Since this fee is only being charged for alcohol sold in San Francisco, it further increases the competitive disadvantage that San Francisco small businesses already face. The Controller's Office confirms this by stating in the updated Economic Impact Report that since local consumers can more easily shop at non-San Francisco establishments that are not subject to the fee, the reduction in consumption in San Francisco may be greater than projected. Not taking the above into consideration, the projected average loss in spending per alcohol retailer is already significant.

832 Off Sale Licenses[1]
$9.3 Million loss of spending[2]
=$11,177 average per business
(Since spirits are majority of loss of sales, liquor stores will be disproportionately affected.)

2,744 On Sale Licenses[1]
$4.3 Million loss of spending[2]
=$1,567 average per business
(Since spirits are a majority of loss of sales, bars and restaurants with type 47 and 48 licenses will be disproportionally affected.)

These numbers do not include any markup and additional factors that the SBC has identified, detailed below.

While the SBC believes that the projections used by the Controller's Office are structurally sound, those projections, including loss of sales and job losses, assume that the fee will be passed on to consumers at the same rate collected by the City. Wholesalers and distributers have confirmed that a markup will be added to the fee, which increase the fee by an additional 10 to 20%. In addition, various business sectors that resell or produce and/ or distribute alcoholic beverages face additional factors that will affect the end consumer cost and economic impact. These factors may skew a number of the Controller's projections, including the severity of business losses resulting from drops in consumer spending and the loss of private sector jobs, which will no longer be offset by the increase or retention of public sector employment.

<u>On Sale Retailers</u>

- The Economic Impact Report assumes that beers sold are 12 ounce servings. A significant amount of beer sold in bars and restaurants are in 16 ounce pint glasses. The calculation for the on-sale portion of the Economic Analysis may not be an accurate representation of the fee price and related calculations as it relates to consumer cost and elasticity.

1. California ABC license query August 9, 2010.
2. San Francisco Controllers Office. *Economic Impact Report for BOS File No. 100865,* Ted Egan. August 9, 2010. Page 7.

- The California Board of Equalization has established guidelines to account for spillage and spoilage of beer, wine and spirits when reviewing sales tax revenue calculations. The recovery fee for spilled and spoiled product will need to be spread among the revenue generating alcoholic beverages sold to consumers. This amount is approximately 10%.

- While retail off-sale outlets can increase their prices incrementally to reflect the actual increase in cost of goods, a significant majority of on-sale and bars restaurants use $.25 and $1.00 price points. Resellers will either absorb the price increase or raise their prices in excess of the increase and risk a higher reduction in demand and elasticity.

- Sales tax adds 9.5% to the price of this fee. Bars include the sales tax price in the price they advertise to customers. Also, credit card fees add approximately 3% to the fee, when applicable.

San Francisco restaurants are operating at very slim profit margins. According to the Golden Gate Restaurant Association, the average pre-tax profit margin in San Francisco restaurants is 2.8%.

<u>Off Sale Retailers</u>

- Formula retailers will have a significant advantage over local small businesses. These large vendors will be able to spread the increase in alcohol over thousands of products and among dozens of stores in the bay area to keep San Francisco alcohol prices down. Consumers will recognize this price difference and shift spending towards these chain retailers.

<u>Microbreweries and Small Wineries</u>

- Consumers will typically shift their beer spending towards lower price products, confirmed in the elasticity models in the Economic Impact Report. This has the potential to disproportionately hurt the local, small business craft breweries. It may also put San Francisco and other craft brews out of reach of low and moderate income consumers.

- Small wineries and breweries outside of San Francisco, who self distribute, may choose to no longer distribute in San Francisco. Costs of distributing inside San Francisco are already greater due to tolls, parking and other factors. Winemakers and craft breweries seeking to break into the San Francisco market may instead concentrate their efforts elsewhere.

- San Francisco and Bay Area craft brewers and wineries rely on sales of their product in San Francisco to establish and build their brand. This fee will discourage and hinder their growth in this important market and encourage homogenisation as large multi-national alcohol companies leverage their scale and marketing resources to push their own "craft brews" to consumers. This contrasts the direction that the City is moving to in areas such as shop local, farmers markets, and the slow food movement.

- The Small Business Assistance Center has worked with several clients who are proposing to open wineries in the City of San Francisco, partly due to the recent Eastern Neighborhoods zoning changes. Increased costs of doing businesses in their proposed home City may result in these job producing businesses opening in other nearby cities.

Cost Containment

The Nexus Study states that there are a number of additional unreimbursed expenses that are not included in this ordinance. The SBC is concerned that in five years, the services that this fee provides cost recovery for, including existing and new programs, may result in the fee being significantly increased by the Board of Supervisors. Medical and programmatic cost increases for these programs may outpace inflation and further burden small businesses, should the Board increase the fee following the next Nexus Study in five years. Lastly, the fee itself has the potential to increase significantly should alcohol consumption projections fall short or consumer spending habits in San Francisco change. This would not require approval by the Board of Supervisors, as the Controller's Office will bi-annually adjust the current fee amount to meet the revenue goals of the ordinance.

Ordinance Time Frame

This proposed ordinance has been studied at the local level since June of 2009. Regrettably, the Small Business Commission only became involved in reviewing the ordinance upon referral at the end of June 2010. While the SBC respects that Supervisor Avalos is under a strict time frame to pass this ordinance due to the November election, had the SBC been brought in as a stakeholder from the beginning, the opportunity for collaboration may have allowed for many of our concerns to be addressed in the Nexus Study and for a more equitable ordinance to be before the Board of Supervisors. The small business community shares concerns over both the social and individual impacts of chronic inebriation and we are willing to work with the City to identify solutions that address this important issue in a manner that does not target the broad population of responsible drinkers to address an issue largely limited to a small subset of the population and will not have a significant negative impact to a large number of small businesses.

The Commission thanks Supervisor Avalos and his staff for their informational presentations and work to keep the Commission informed over the past two months. The Commission also thanks Ted Egan of the Controllers Office for his continued support to keep the SBC informed on the economic impact of this and other ordinances. Lastly, the Commission thanks the hundreds of businesses as well as the Marin Institute and other organizations that have provided commissioners with important feedback on this ordinance.

Sincerely,

RM Dick-Endrizzi

Regina Dick-Endrizzi
Director, Office of Small Business

cc. Members of the Board of Supervisors
Starr Terrell, Mayors Office

File No. 100865 [Establishing an Alcohol Cost Recovery Fee] SBC Response
Chris Schulman to: Angela Calvillo 09/01/2010 03:37 PM
Cc: Eric L Mar, Michela Alioto-Pier, David Chiu, Carmen Chu, Ross Mirkarimi, Chris Daly, Sean Elsbernd, Bevan Dufty, David Campos, Sophie Maxwell, John Avalos, Starr Terrell, Regina Dick-Endrizzi
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History: This message has been replied to.

Angela,

Attached is the revised SBC response to BOS File No. 100865 [Establishing an Alcohol Cost Recovery Fee].

The Commission is recommending that the Board of Supervisors not approve this ordinance.

Regards,

Chris Schulman
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