Transfer Tax Increase on Properties Over $5 Million in Value: Economic Impact Report

Office of Economic Analysis

Item #160604

June 29, 2016

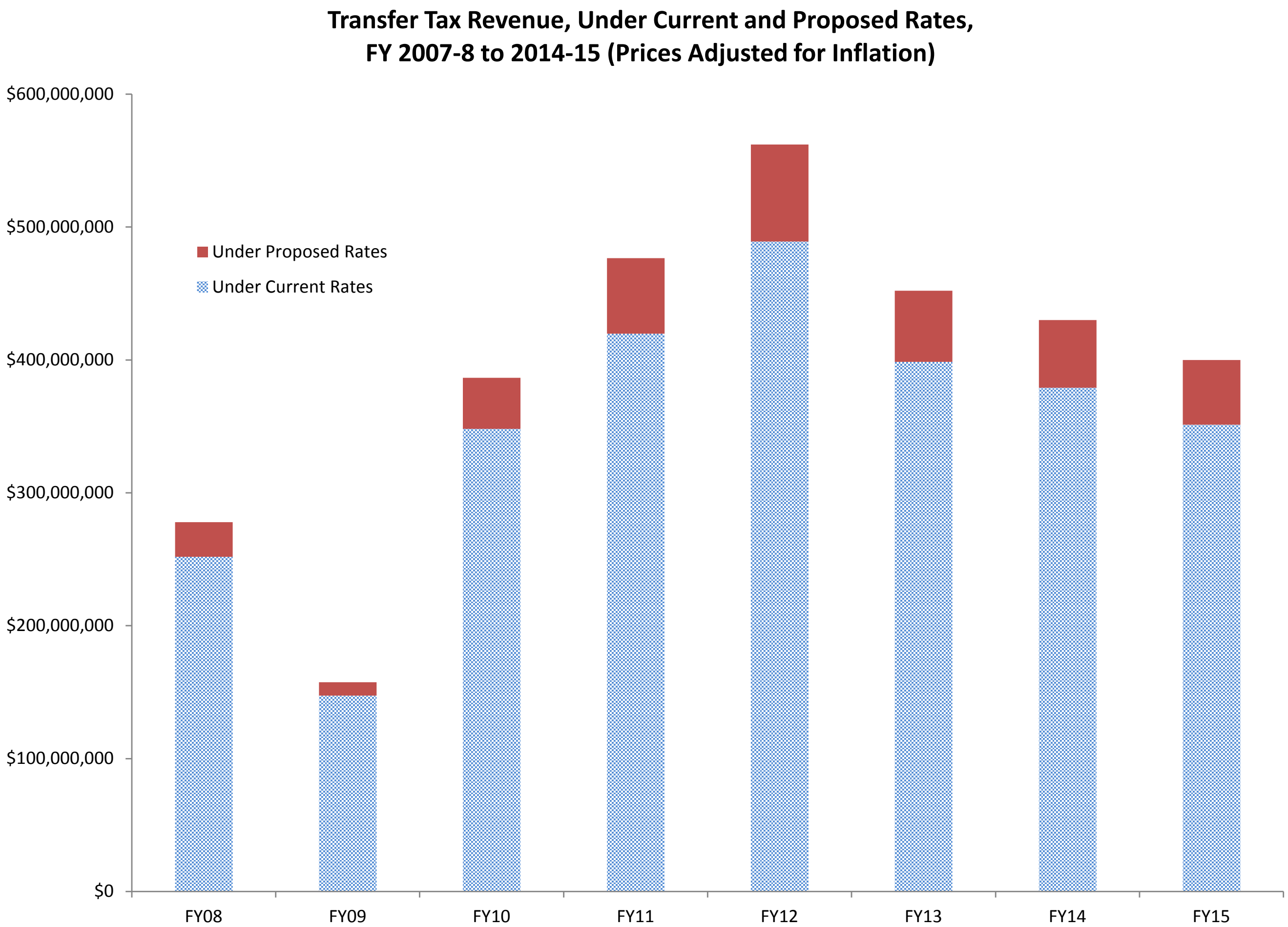
Introduction

- The proposed legislation would increase the Transfer Tax that is paid when real estate is sold in San Francisco. Only properties sold for over $5 million would face a higher tax.
- The City assesses a Transfer Tax on the sale of all real property. The tax rate ranges from 0.5% to 2.5%. The proposed increase would raise the highest rate to 3.0%.
- The tax is a general tax that may be used for any governmental purpose, and is not dedicated to a specific use.
- As any local tax increase requires voter approval, the proposed legislation is being considered for the November 2016 ballot. San Francisco voters previously approved increases to the City's Transfer Tax rates in 2008 and 2010.
- The Office of Economic Analysis has prepared this report because it has determined that the proposed tax increase could have a material impact on the city's economy.

Current and Proposed Rates

Property Sales Price	Current Transfer Tax	Proposed Transfer Tax
$100 - $250,000	$2.50 per $500 (0.5%)	$2.50 per $500 (0.5%)
$250,001 - $1,000,000	$3.40 per $500 (0.68%)	$3.40 per $500 (0.68%)
$1,000,001 - $5,000,000	$3.75 per $500 (0.75%)	$3.75 per $500 (0.75%)
$5,000,001 - $10,000,000	$10.00 per $500 (2.00%)	$11.25 per $500 (2.25%)
$10,000,001 - $25,000,000	$12.50 per $500 (2.50%)	$13.75 per $500 (2.75%)
$25,000,001 and above	$12.50 per $500 (2.50%)	$15.00 per $500 (3.00%)

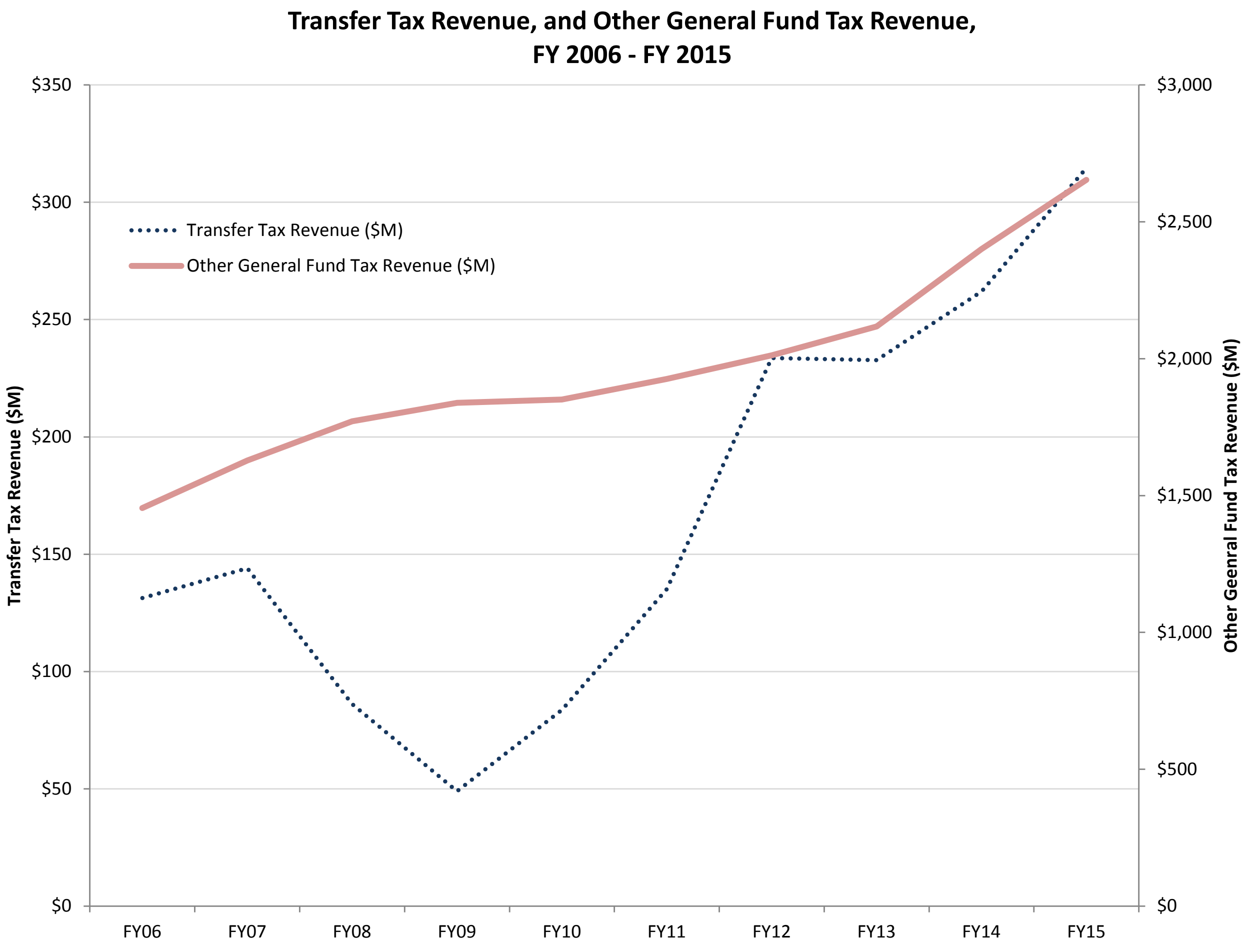
The Proposed Increase Would Generate an Average $44 Million in Additional Transfer Tax Revenue Each Year



The Controller's Office has modeled the effect of the tax increase by determining what each property that sold in the city since 2007 would have paid in Transfer Tax, under the current and proposed tax rates.

The results, adjusted for inflation. average to an additional $44 million per year, although new revenue from the proposal is expected to vary greatly from one year to the next.

The Transfer Tax Accounts for Approximately 10% of General Fund Tax Revenue. It is Much More Volatile than Other Tax Revenue Streams



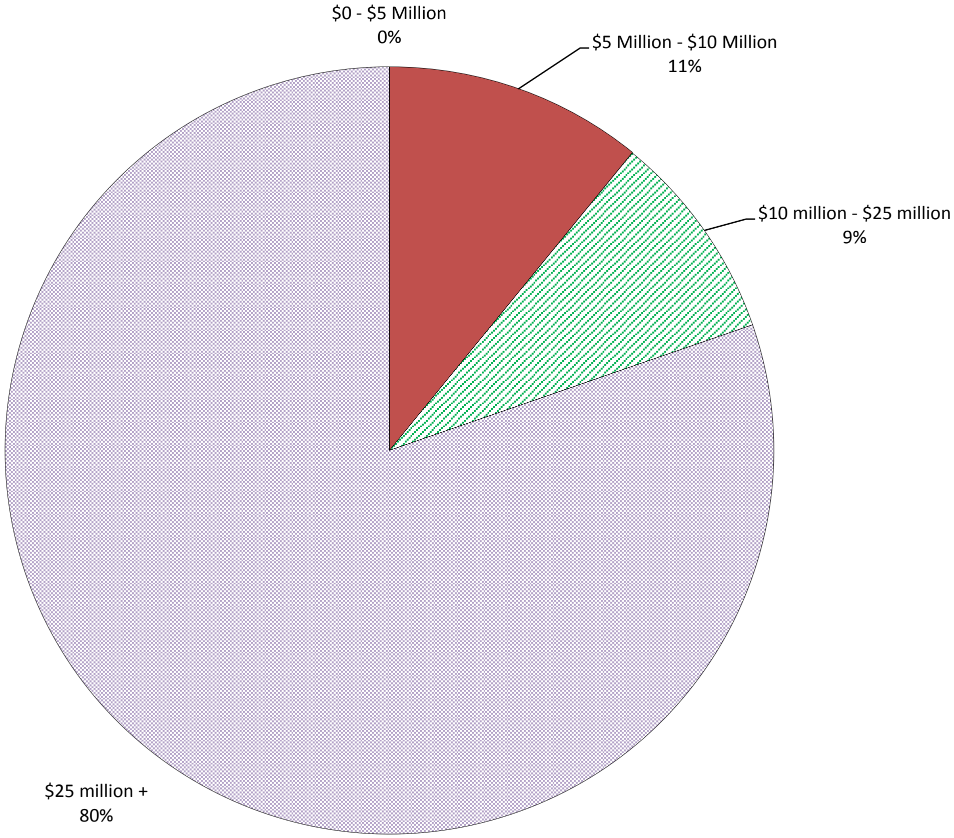
Transfer Tax revenue is highly cyclical, and significantly more volatile than any of the other tax revenue streams that support the City's General Fund.

During economic downturns, the number of sales – particularly of large properties – tends to drop, yielding dramatic declines in tax revenue.

Between the 2007 and 2009 fiscal years, Transfer Tax revenue declined by 66%. It grew 133% since the recession's end in FY 2011 to FY 2015.

The Proposed Legislation Would Increase the Share of the Tax's Revenue Derived from the Largest Properties, Which are Mainly Office Buildings

Projected New Revenue from Proposed Tax Increase, by Property Sales Price



Based on the last 8 years of property sales in the city, if the proposed rates had been in effect, approximately 80% of the new revenue would have come from properties selling for more than $25 million.

While there are single-family residential properties in San Francisco that sell for more than $25 million, they are relatively rare.

Most of the transactions in this category are from downtown office buildings. This means that the economic impact of the tax is partly shared with the purchasers of these buildings, and their tenants, office-using businesses.

Economic Impact Factors

- An increase to the transfer tax rate would reduce any capital gain that sellers receive from their sale of an affected property.
- For this reason, it will likely slow down the rate of commercial and high-end residential sales, which would negatively affect the real estate industry.
- It would also reduce the amount that a buyer would be willing to offer for a property, because he or or she will face the higher tax liability when selling the property in the future.
- Because of this, and because the office-using tenants of buyers are somewhat sensitive to costs, it is unlikely that sellers will be able to pass through the full amount of the tax to buyers.
- Conversely, large property owners wishing to avoid the tax have few alternatives. It is likely that sellers, therefore, will bear the brunt of the higher tax.
- The proposed legislation would also increase the City revenues, and thus the City's direct and indirect contribution to the local economy.

Economic Impact Assessment

- As stated earlier, based on property sales from 2007 until 2015, the Controller's Office has estimated that the proposed legislation can be expected to generate approximately $44 million a year, given today's real estate prices.
- Using our REMI model of the San Francisco economy, the Office of Economic Analysis modeled the net impact of the following factors, under a range of assumptions about the price-sensitivity of sellers and buyers of large properties, and thus where the ultimate burden of the tax will fall:
  - Reduced sales in the real estate industry.
  - Higher tax revenues for the City.
  - Higher rents for office-using tenants, phased-in over time as newly-purchased office buildings secure new leases from tenants.
  - Reduced supply of office space, through conversions or deferred construction, also phased-in over time.

Conclusions

- Under a range of reasonable assumptions about where the ultimate tax burden will fall, the impact of the proposed tax increase on the City's GDP will be small—approximately -0.01% of the City's economy.
- Over 20 years, the average impact on overall private sector employment in the city will be a loss of between 20 and 70 jobs, or about 0.01% of current private sector employment. The loss of employment in real estate and office-using sectors is projected to slightly outweigh the gain in employment at private and non-profit contractors with the City, who stand to grow as a result of higher City tax revenue.
- When the expected growth of public sector jobs is considered, the net employment effect becomes positive, with City and City-contractor job gain outweighing the loss of other private sector employment, by 100 to 200 jobs.
- The overall effect on the size of the City's economy is slightly negative, despite the small net job gain, because the lost private sector jobs that would be lost have higher productivity than the City and contractor jobs that would be gained.

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