Residential Vacancy Tax: Economic Impact Report

CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

Office of Economic Analysis

September 29, 2022

Introduction

- An upcoming ballot measure would impose an excise tax on owners of certain vacant residential units, for keeping those units vacant for more than 182 days in a calendar year.
- The proposed tax will appear on the November 2022 ballot in San Francisco, and will pass with a simple majority approval. Under California's Proposition 218, all local tax increases must be approved by the voters.
- The tax would apply to owners that keep units vacant in buildings with more than two residential units. Both condominiums and apartments kept vacant in those buildings would be subject to the tax.
- The measure would also establish a new fund known as the Housing Activation Fund. The Fund would provide rental subsidies and fund the acquisition, rehabilitation, and operation of multi-unit buildings for affordable housing.
- This report was prepared because the Office of Economic Analysis (OEA) determined that the proposed tax could have a material impact on the City's economy.

Details of the Tax: Definitions & Exemptions

- Residential units in buildings with two or fewer units are exempt from the tax.
- A unit is considered to be kept vacant if it is "unoccupied, uninhabited, or unused" for 182 days in a year. The days need not be consecutive. As described on the next page, there are several situations in which vacancy would not count against the 182-day limit.
- Units "occupied or intended for occupancy primarily by travelers, vacationers, or other transient occupants" are not subject to the tax. This excludes hotel rooms from the tax.
- Nursing homes, residential care facilities, or certain properties that are exempt from property tax under State law are not considered residential units. 501(c)3 non-profits and governments would be exempt from the tax, and units subject to the City's commercial vacancy tax would not be subject to this tax.

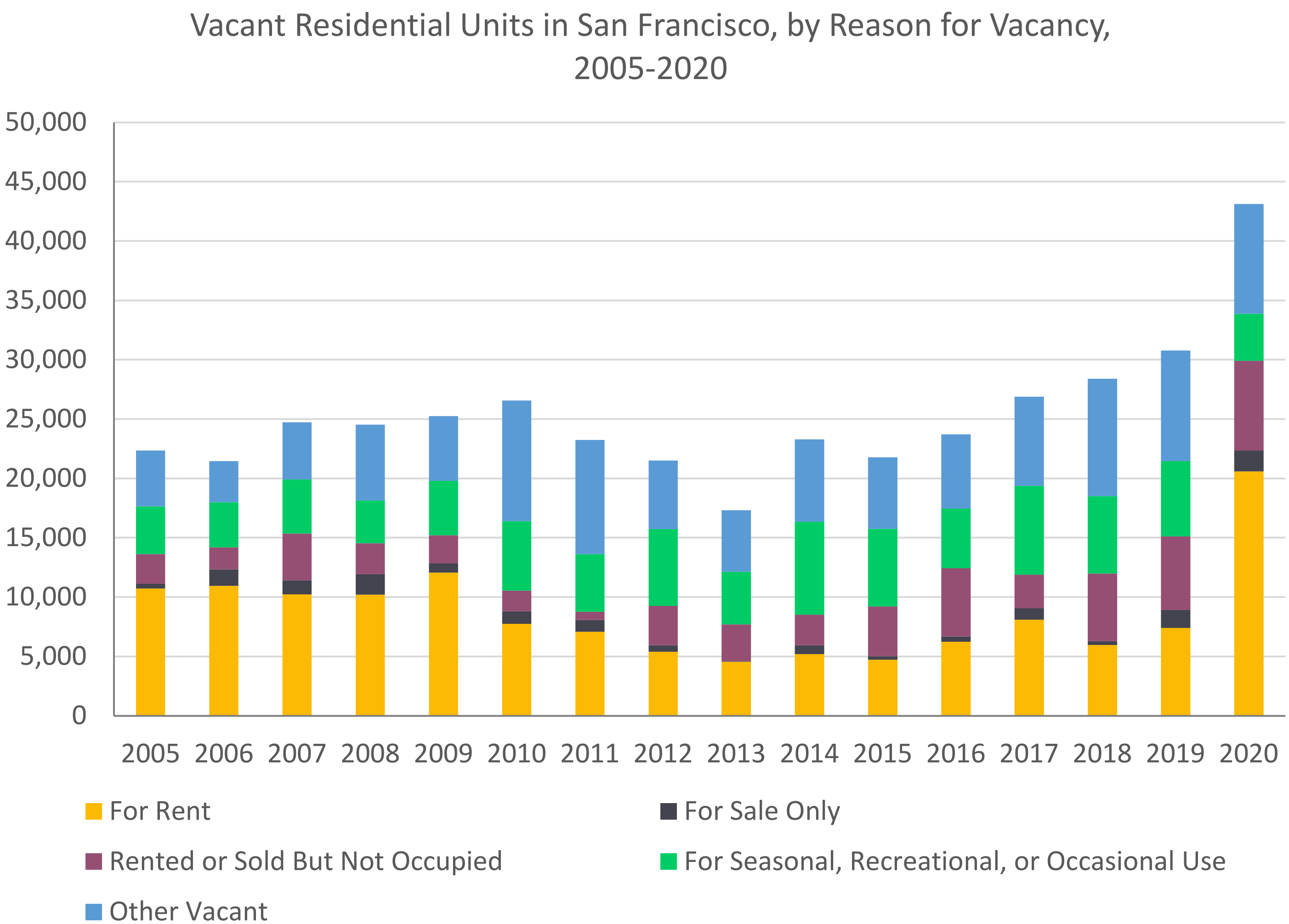
Additional Details: Excluded Periods

- The following time periods are excluded from the 182-day limit in any year, and effectively limit the situations where the tax might apply:
- Any period during which the owner uses the unit as a principal residence and has claimed the Homeowner's Exemption for property tax.
- Any period that the owner has leased the unit to unrelated, permanent tenants.
- A one-year period following the completion of construction of the unit.
- A period, up to one year, between an application for a building permit, and the issuance or denial of the application.
- A one-year period after the issuance of a building permit.
- A two-year period following any disaster which has made the unit uninhabitable.
- Any period in which the owner(s) is in long-term care, or a period after the death of a previous owner who was the unit's sole occupant.

Proposed Rates

Unit Size	First Year	Second Consecutive Year	Third and Subsequent Consecutive Years
Less than 1,000 square feet	$2,500	$5,000	$10,000
1,000-2,000 square feet	$3,500	$7,000	$14,000
More than 2,000 square feet	$5,000	$10,000	$20,000

Vacant Units in San Francisco, 2005-2020

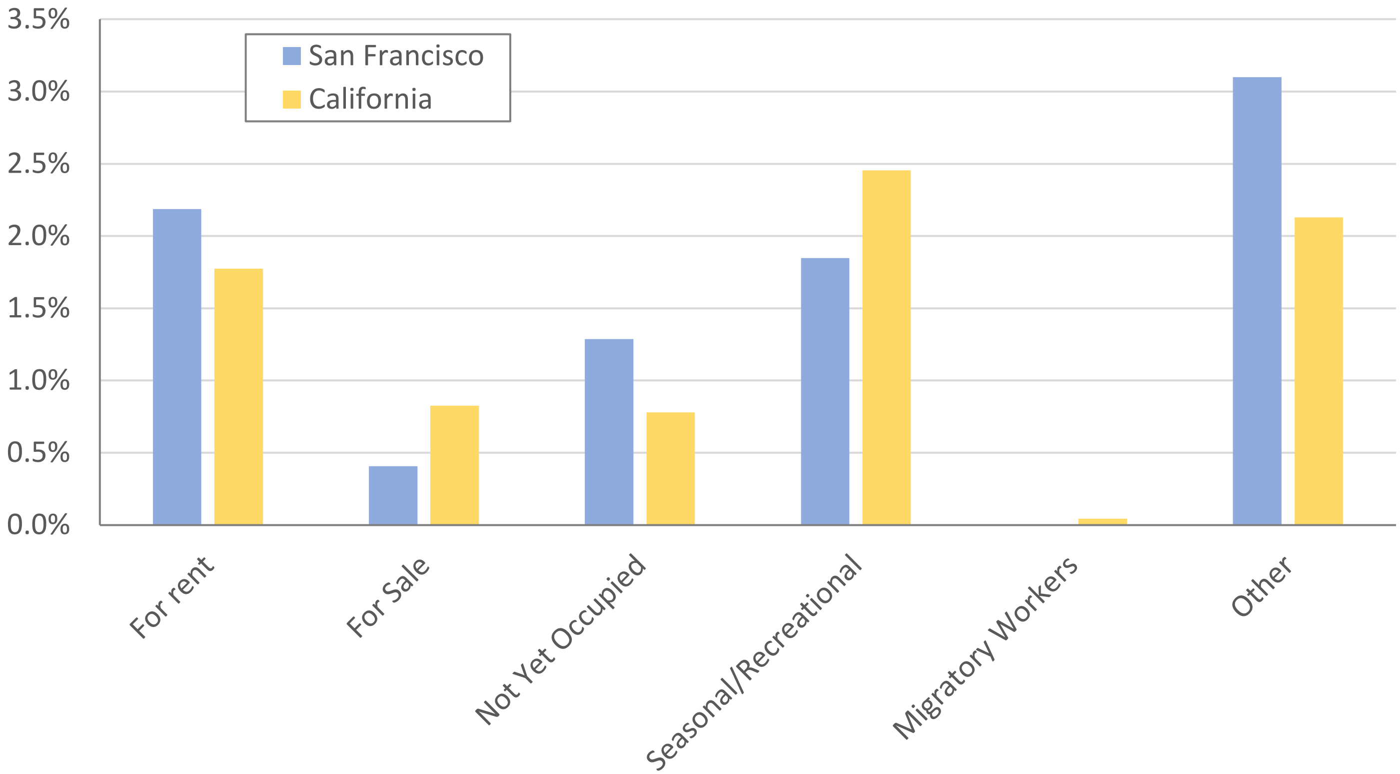


Annual Census data since 2005 indicate that generally between 20,000 – 30,000 residential units were vacant. This represents 5-10% of all residential units in the city. Prior to 2020, the Census provided no information on the duration of vacancy, or the annual numbers of days that units were kept vacant.

In 2020, the number of vacant units in the city increased by 40%. Almost all of this increase was due to an increase in the number of “For Rent” vacant units.

Pre-Pandemic Vacancies in the State Context

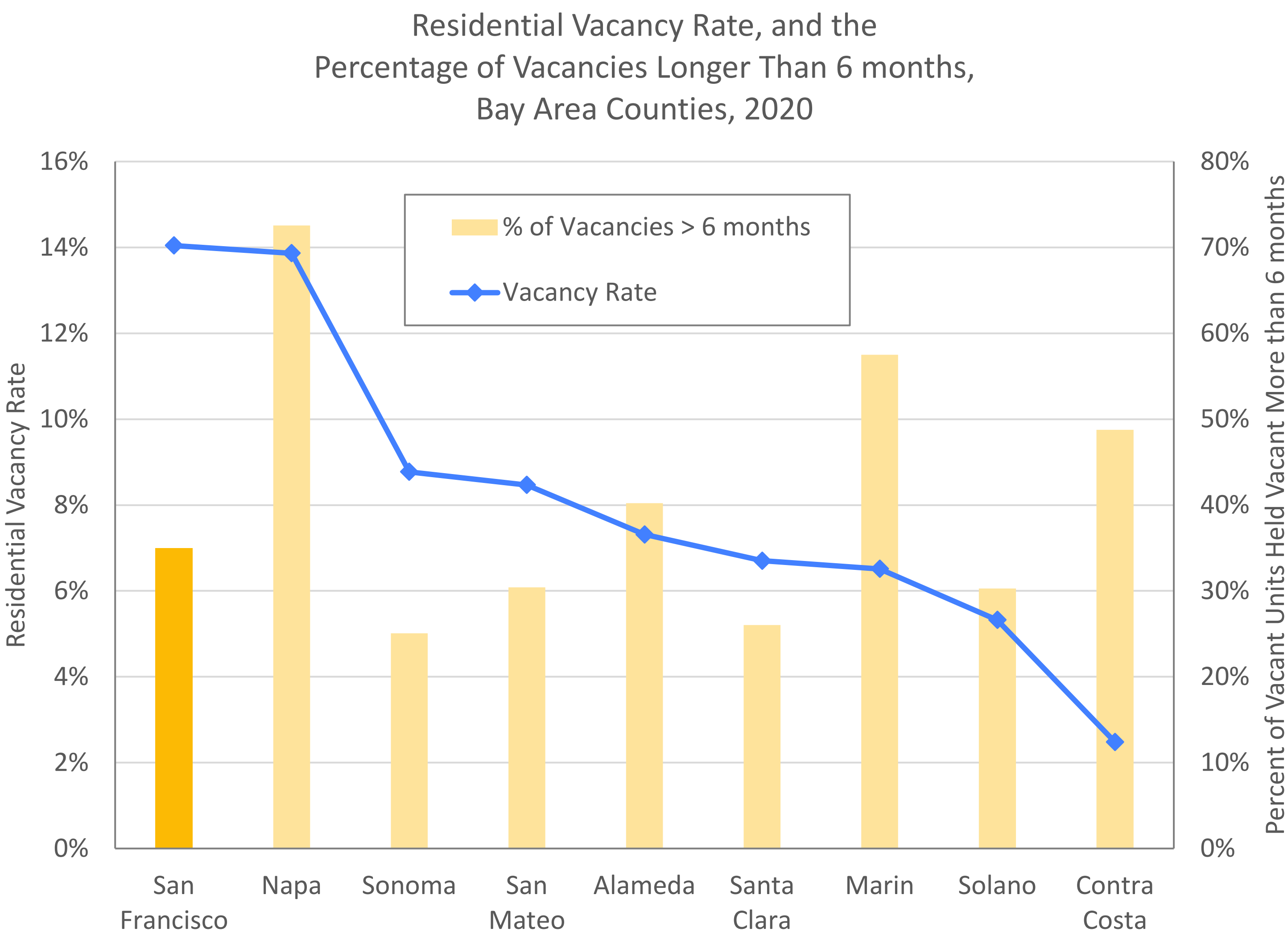
Average Residential Vacancy Rate, 2012-19:
San Francisco and California, by Reason for Vacancy



In the years before the spike in vacancies in 2020 during the pandemic, San Francisco had a somewhat higher residential vacancy rate than the State average. Overall, over the 2012-19 period, 8.8% of San Francisco residential units were considered vacant by the Census, versus 8.0% for the State as a whole.

San Francisco’s rate was higher for units “For Rent”, “Sold but Not Yet Occupied”, and those vacant for other reasons. Units vacant for sale and for seasonal, recreational, or occasional use were less prevalent in San Francisco than in California as a whole.

Longer-Term Vacancies in 2020



In 2020, the Census began to report data on the length of residential vacancies. In that year, San Francisco had the highest overall residential vacancy rate in the Bay Area in that year, along with Napa County.

However, only 35% of these units had been vacant for more than 6 months, which was average for the Bay Area.

Units with vacancies exceeding 6 months (approximately 182 days) would most likely be subject to the tax if not otherwise exempt. However, as stated earlier, the 182 days need not be consecutive, and several time periods do not count towards the 182-day limit.

Reasons for Long-Term Vacancy in San Francisco

Reported Reason for Vacancy	Shorter-Term (0-6 month) Vacancies	Longer-Term (6 month+) Vacancies
For seasonal/ recreational/ occasional use	5%	26%
Sold, not occupied	7%	25%
Personal/family reasons	4%	15%
For rent	53%	11%
All other reasons	6%	8%
Currently being repaired/renovated	14%	7%
For sale only	2%	5%
Rented, not occupied	7%	3%

The 2020 Census also provided additional detail about units that had been previously classified as vacant for "other" reasons. The table to the left shows a breakdown of the reported reasons for vacancy in San Francisco, for shorter-term (0-6 month) and the longer-term (6+ month) vacancy durations that could be subject to the tax.

Longer-term vacancies were more likely to be: sold but not occupied, used occasionally, or kept vacant for personal/family reasons. Units for rent were a majority of the shorter-term vacancies, but only 11% of the longer-term ones.

The Census considers units under construction to be vacant as soon as exterior doors and windows are complete, which may be long before they are occupied. It's therefore likely that the Census estimates of "for sale" and "sold and not occupied" include units that are still under construction. Such units would be exempt from the tax for one year after construction.

Potentially-Affected Units by Size and Duration

	6 to 18 months	18 to 30 months	30 months or more	Total
< 1,000 square feet	2,059	878	273	3,209
1,000 - 2,000 square feet	1,756	1,383	559	3,699
> 2,000 square feet	45	45	-	90
Total	3,860	2,306	832	6,998

The table to the left details the Controller's Office estimate of the average number of units that would be affected, by duration of vacancy and size. It was obtained by using 2020 data on the distribution of vacant units by duration of vacancy and applying it to the average number of total units, in buildings with more than 2 units, that were vacant over the previous ten years.

These estimates take into account the tax's exemption for units in buildings with fewer than 3 units, but do not consider other exclusions and exemptions described on pages 2-3.

Applicability of the Tax, By Reason for Vacancy

Reported Reason for Vacancy	Number of 6+ month vacancies	Assumed Percentage Subject to Tax	Number of Units Assumed Subject to Tax
For seasonal/ recreational/ occasional use	1,819	35%	637
Sold, not occupied	1,750	50%	875
Personal/family reasons	1,050	90%	945
For rent	770	100%	770
All other reasons	560	90%	504
Currently being repaired/renovated	490	0%	0
For sale only	350	75%	262
Rented, not occupied	210	0%	0
Total	6,998		3,992

Applying the unit totals on the previous slide to the vacancy reasons on page 9 gives an estimate of the average number of units that have been vacant for each reason, over the 2010-20 period.

Only some of these units would be subject to the tax. Of the longer-term vacancies used for seasonal, recreational, or occasional use, some may be used up to 90 days per year as short-term rentals. That use alone would not shield them from the tax. Others may be used for intermediate-length occupancy; the City does not impose a maximum number of days per year for this use.

The exact numbers cannot be determined, but applying reasonable assumptions to each category suggests that, of the nearly 7,000 longer-term vacancies in buildings with more than two units, approximately 4,000 could be subject to the tax, on average.

Economic Impact Factors

- Economically, taxes have two main impacts: shifting spending from the taxed sector to the public sector, and creating incentives for people to change their behavior in ways that would minimize their tax burden. Both impacts can affect the broader economy in ways that foster or inhibit growth.
- For those who do not change their behavior and are required to pay the tax, the net impact involves the gain of City spending and the loss of spending in the private residential real estate sector.
- For those residential property owners that do change their behavior to avoid the tax, any broader impact would depend on which action they take.
- We lack the data to make an informed estimate of the extent to which behavior change will occur, or what actions affected property owners might take. Some possibilities are discussed on the next page.

Potential Responses to the Tax

- If the tax is adopted, owners of properties with longer-term vacancies would generally have three options:

1. Sell the vacant unit, or the building containing it. Given that the maximum rate of tax, achieved after three years of vacancy, is only 1% of the average value of a home in San Francisco, it's likely that very few property owners would take this option.

2. Reduce the number of days vacant to below the 182 limit: In practice this could take several forms:

    - Landlords could lower rents to attract full-time tenants to vacant apartments, though the opportunity cost of lost rental income far exceeds the tax. As noted earlier relatively few units are kept vacant for more than 6 months because they are listed for rent.

    - Some condominiums could use a combination of short- and intermediate-term renting to visitors to stay under the 182 limit, although short-term rentals have a 90-day limit, and only 1,000 ILOs may be registered city-wide.

3. Pay the tax

Assumptions About Behavior Change

- Given the lack of hard data about how owners of 4,000 impacted properties might react to this new tax, this analysis makes the assumptions that:
  - The tax would result in an ongoing loss of property value for some owners of longer-term vacant units, and 80 of the 4,000 owners (2%) sell their unit to a new owner who occupies the unit full-time. The impact of this on citywide housing prices would be less than 0.1%.
  - 175 of the owners (25% of those indicating that the units were vacant more than 6 months because they were For Rent) lower their asking rent. This absorption of demand would reduce citywide rents and housing prices by less than 0.1%, and increase consumer spending by $8 million.
  - 800 of the remaining owners utilize a combination of short-term and intermediate-length renting to stay under the 182-day limit. This is projected to add $18 million in consumer spending.
  - Owners of the remaining 2,945 units pay the tax. The estimated tax revenue that would result is detailed on the next page.

Potential Tax Revenue, Under Those Assumptions

Year	Revenue by Unit Size ($M) <1,000 sf	1,000 - 2,000 sf	> 2,000 sf	Total Revenue
2024	$3.4	$5.4	$0.2	$9.0
2025	$4.6	$8.3	$0.3	$13.2
2026 and beyond	$5.2	$10.0	$0.3	$15.4

Based on the estimate of 2,945 tax-paying units from the previous page, the tax rates on page 5, and the distribution of units by size and duration of vacancy on page 11, the table to the left estimates the tax revenue.

By 2026, and in subsequent years, tax will be owed because of units kept vacant for one, two, and three years. An estimated $15 million could be collected, if past patterns of residential vacancy hold in the future, and the tax results in behavior change in accordance with these assumptions.

This estimate is lower than the Controller's revenue estimate contained in the Voter Information Pamphlet. It reflects the further assumptions made in this report about behavior change, and how many units would fall below the 182 limit because of the excluded periods described on page 3.

Economic Impact Assessment

- The OEA uses the REMI model to estimate the citywide economic impact of significant new legislation.
- Based on the assumptions described earlier, we used REMI to model the overall impact of the following changes to the city's economy:
- $15 million increase in costs for the residential real estate industry, reflecting the tax paid.
- $7.5 million increase in spending on affordable housing, and $7.5 million in rent subsidies, based on a 50:50 split specified in the legislation.
- $26 million in additional consumer spending, associated with the increased occupancy of units who do not pay the tax.
- The result is a small positive impact on the city's economy, with the city's growing by an average of $15 million, and the number of jobs growing by 100, as a result of the legislation.

Administrative Issues

- Currently, most residential property owners are not required to register as a business or file an annual tax return with the City.
- Under the current proposal, all non-exempt residential property owners would be required to file a tax return annually. Failure to do so would lead to the rebuttable presumption that the unit was kept vacant, and the tax was owed.
- San Francisco currently has more than 200,000 owner-occupied homes and condominiums, and thousands more apartment buildings. The City has no consistent information on the vacancy status of these buildings. Although the tax does provide that funds may be used by the Tax Collector to aid in implementing the tax, it is unlikely the the City will ever have complete information on the vacancy status of every unit.
- Accordingly, compliance challenges may be another reason why revenue collections could fall below expectations, with accompanying behavior change by property owners.

Conclusions

- The Census data indicates that San Francisco has had a somewhat higher residential vacancy rates than the California and Bay Area averages.
- However, the one year of data we have for vacancies exceeding six months – the target of the proposed tax – suggests San Francisco's longer-term vacancy rate is average by Bay Area standards.
- We estimate approximately 4,000 vacant units would be subject to the tax in an average year, and of those, approximately 3,000 would pay the tax. The remainder would become occupied to the point that the tax was no longer owed.
- Economically, the tax would shift spending from property owners to affordable housing development and rent subsidies. It would also lead to an increase in consumer spending in units that were no longer vacant more than 182 days a year.
- We estimate the overall economic impact to be positive but very small: an $15 million increase to GDP and 100 more jobs.

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