Homelessness Gross Receipts Tax:

Economic Impact Report

CITY & COUNTY OF SAN FRANCISCO

Office of the Controller

Office of Economic Analysis

Proposition C, November 2018

09.26.2018

Introduction

- The proposed legislation would impose a new Gross Receipts Tax on the largest businesses in San Francisco. Like all local tax increases in California, the tax requires voter approval.
- Revenue from the tax would be dedicated to homelessness services in the city, including housing, mental health services, shelters, and rental assistance.
- The Controller's Office has estimated that the proposed tax would generate $250 - $300 million per year[1].
- Homelessness in the city has risen over the past 10 years, despite declines nationwide. In Fiscal Year 2017-18, the City spent approximately $380 million on services related to homelessness.
- The Office of Economic Analysis (OEA) has prepared this report because it has determined that the proposed tax would have a material impact on the city's economy. The tax comes after cuts to federal income taxes and a new tax on commercial rents in the city, but this report only assesses the impact of the proposed new tax.

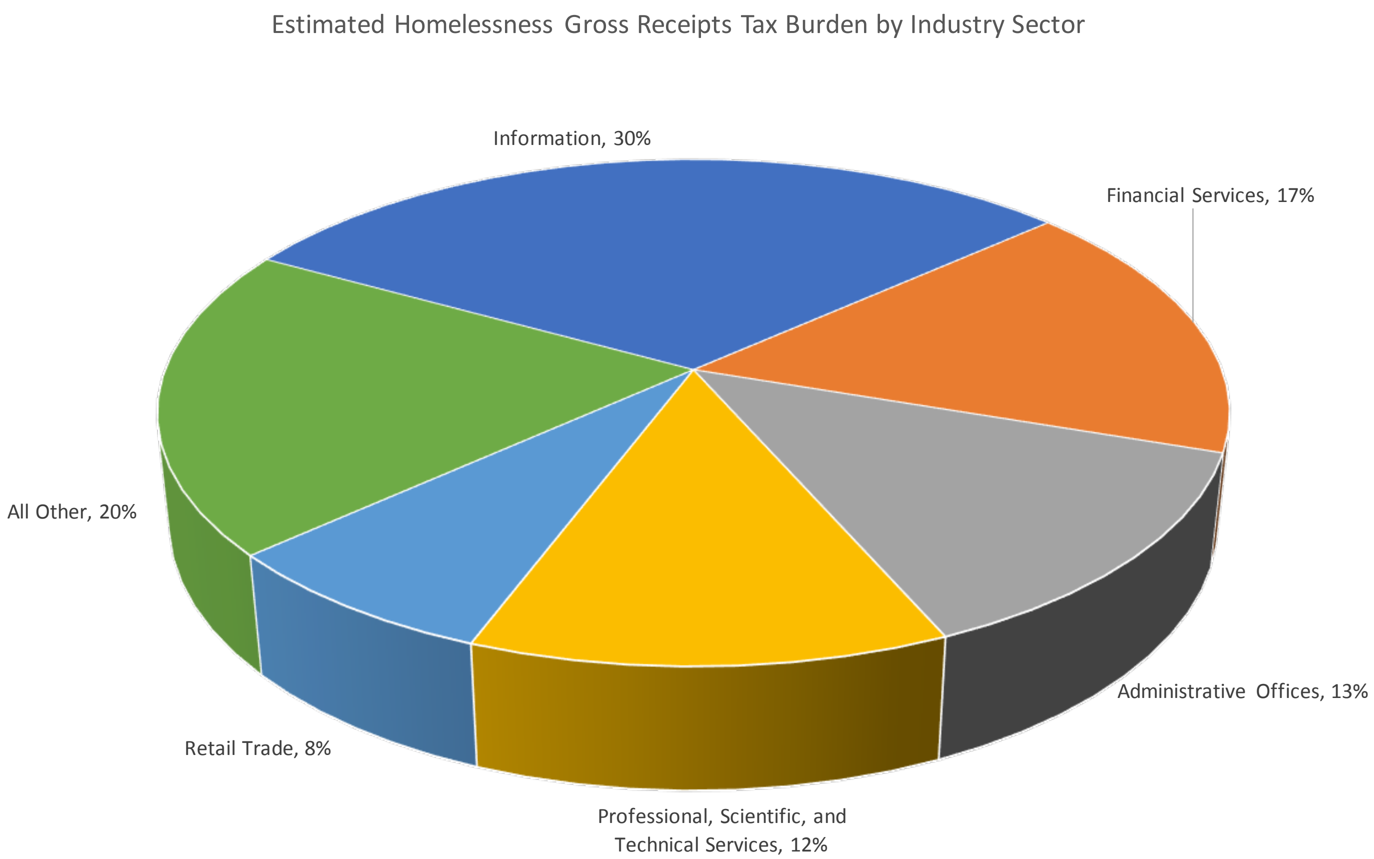
Details of the Tax

- The proposed tax would apply to businesses with more than $50 million in San Francisco gross receipts, and to corporate headquarters which currently pay the City's Administrative Office Tax.
- The Controller's Office has estimated that 300-400 local businesses would be affected by the tax, out of more than 13,000 current payers of the gross receipts tax.
- Overall, the City's business taxes generated approximately $900 million in revenue in fiscal year (FY) 2017-18[2]. The projected $250-$300 million in revenue from the new tax would thus represent a 28-33% increase in overall business tax revenues.
- In June, 2018, voters approved a tax on commercial rents in the city. Rents subject to that tax would be exempt this proposed tax.
- The proposed tax rates, which would be paid in addition to existing business taxes are shown on the next page, alongside the current top-tier Gross Receipts and Administrative Office Tax rates.

Current Gross Receipts Tax Rates, and Proposed

Industry Sectors	Current Top-Tier Gross Receipts Tax Rate	Additional Proposed Tax Rate
Wholesale & Retail Trade, Certain Services	.160%	.175%
Information, Manufacturing, Food Services, Biotechnology, Clean Technology, Transportation & Warehousing	.475%	.500%
Accommodations, Utilities, Arts, Entertainment, & Recreation	.400%	.425%
Administrative Services, Private Education & Health Services	.650%	.690%
Construction	.450%	.475%
Financial Services, Insurance, Professional, Scientific, and Technical Services	.560%	.600%
Real Estate, Rental and Leasing (except Commercial Real Estate)	.300%	.325%
Corporate Headquarters (Administrative Office Tax payers)	1.4% (of payroll)	1.5% (of payroll)

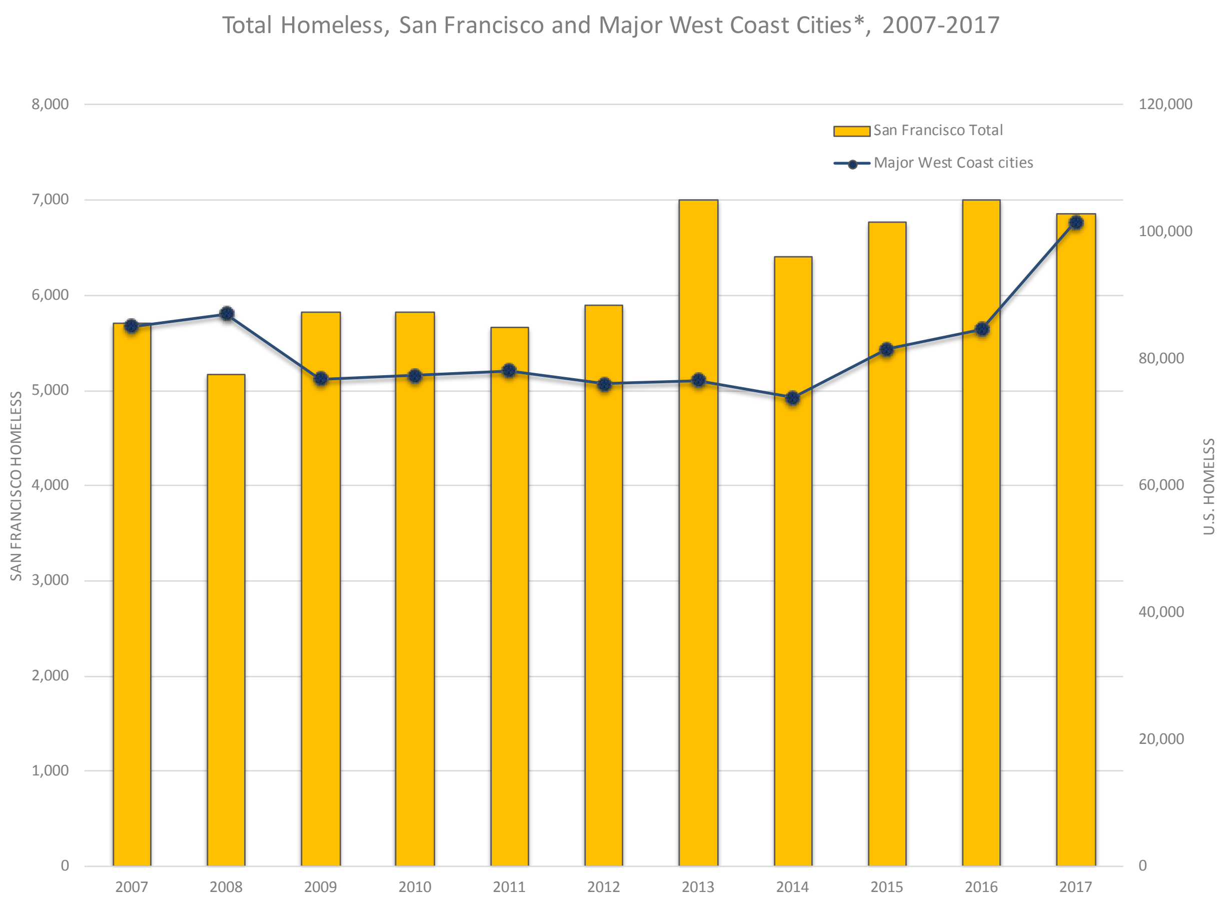
Impact of the Tax By Industry



The chart to the left indicates the expected breakdown of tax revenues, by industry.

It shows that two industry sectors—Information and Financial Services—would pay nearly half of the tax, as the largest businesses in the city are concentrated in those industries.

Local and Regional Homelessness Trends



Statistics on homeless in U.S. cities are available through the Department of Housing and Urban Development's Point in Time count, which is conducted annually on the same night across the country.

The data allows for the comparison of trends, locally and across the country. Along with other large cities on the West Coast, San Francisco's homeless count has generally risen from 2007-2017, in the face of national declines.

However, from 2014-17, the homeless population in the West Coast cities grew by 38%, and only by 7% in San Francisco.

"Major West Coast Cities" excludes San Francisco. For a list, see End Note 3.
Source: Department of Housing and Urban Development

Details of the Spending: Permanent Housing

- At least 50% of the proposed tax's revenues must be spent on permanent housing expenditures, including:
  - rental subsidies, of a period of 5 years or less, for homeless people being re-housed in the private housing market.
  - the construction, acquisition, rehabilitation, preservation, and operation of permanent supportive housing, along with on-site supportive services. Permanent supportive housing is generally for chronically homeless people.
  - the acquisition or master lease of single-room occupancy buildings in the city.
  - at least 45% of this spending on permanent housing would be dedicated to homeless youth and families

Details of the Spending: Shelters and Services

- The remainder of the tax revenue is dedicated as follows:
- At least 25% on mental health services for homeless people, including street-based intensive services and case management, assertive outreach services, mental health and substance abuse treatments, peer support, residential and drop-in services, and housing assistance.
- Up to 10% on homeless shelters, including Navigation Centers and bathrooms, showers, and handwashing stations for the homeless.
- Up to 15% on measures to prevent homelessness, including financial assistance to people who have recently become, or are at risk of becoming, homeless.

Potential Impact of the Tax on Homelessness

- Within the limits just described, decision-makers have discretion about how to allocate the tax revenue. Over the first 10 years, the Department of Homelessness and Supportive Housing (HSH) projected the funding could lead to the following approximate programmatic outcomes:
  - 5,000 openings for homeless people in newly-acquired housing, including both directly leased units and future vacancies in those units
  - 3,000 re-housed homeless people through rapid re-housing services
  - $60-$75 million in new funding, annually, for outreach and mental health treatment
  - 30,000 individuals assisted with eviction prevention, legal counsel, and short-term assistance intended to prevent homelessness
  - Temporary shelter for 25,000 homeless people at 1,000 new beds.
  - Approximately $250 million in funding, after 10 years, for capital expenditures for new housing, shelter and facilities for mental health programs.

Future Uses of the Tax Revenue

- The tax is legally dedicated to homelessness services, as previously outlined. Additionally, the measure includes language that appears to commit the City not to reduce current levels of spending on homelessness services. However, making such a commitment would require an amendment to the City Charter, which the proposed tax measure does not do.
- As a result, the Mayor and Board of Supervisors would retain the ability to reduce current levels of homelessness spending in the future.
- In order to model the economic impact of the tax, we must make assumptions regarding future spending of both the proposed tax's revenue, and the City's existing spending on homelessness services. If, for example, homelessness in San Francisco were to significantly decline in the future, the City could choose to divert spending to other needs.
- Given the persistence of local homelessness, in the face of national trends and despite significant investment by the City, this analysis assumes that the revenue generated by the tax would be spent exclusively to augment homelessness services for our twenty-year forecast period.

Progressivity and Stability

- The redesign of San Francisco's business tax system in 2012 changed what was once a flat business tax into a progressive rate structure. The post-2012 business tax structure has graduated rates which rise for larger companies, while the pre-2012 business tax was assessed at a flat percentage of payroll expense, regardless of business size.
- The proposed tax, which would effectively increase the gross receipts tax payments of the affected businesses, would make the business tax system significantly more progressive.
- At present, based on 2017 tax filings, the affected businesses, which account for 3% of Gross Receipts tax payers, pay 57% of all business tax revenue, including the Gross Receipts tax, Payroll Expense tax, and Administrative Office Tax. If the proposed tax was adopted, these businesses would pay 67% of total business tax revenue.
- The focus of the proposed tax on a small percentage of all businesses will likely lead to the new tax's revenue streams being more volatile than overall business tax revenues.

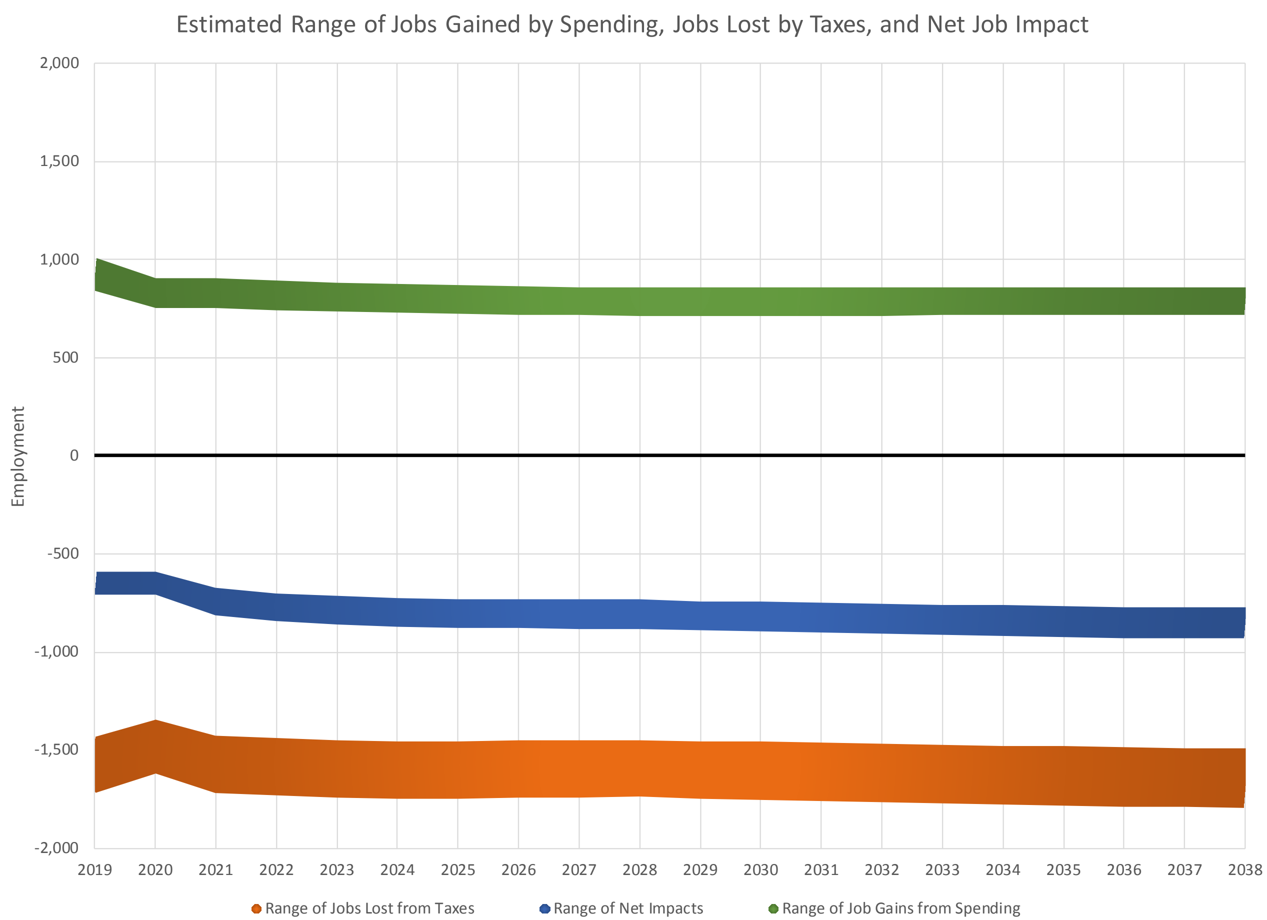
Economic Impact Factors

- The proposed tax would impact the local economy in a number of positive and negative ways. Some of these impacts are more quantifiable than others.
- On the positive side, the measure will likely reduce homelessness in San Francisco, improving health outcomes and reducing the use of acute and emergency services in the city.
- Furthermore, the increased spending on housing and related services will stimulate those sectors of the economy, leading to positive multiplier effects on other industries.
- Additionally, given the attention paid to street behavior and quality-of-life issues, a reduction in homelessness is likely to increase the attractiveness of the city to tourists, residents, and commuters.
- The primary negative impact is the increased tax burden on the affected businesses, which creates an incentive to move jobs out of San Francisco in the future. Any such movement would have negative multiplier effects on other industries.

Estimated Economic Impact

- The OEA uses its REMI model of the San Francisco economy to estimate the economic impact of policy changes.
- For this proposed tax, given our ability to estimate the factors discussed on the previous page, we estimated the impact of a $250-$300 million increase in production costs to industries affected by the tax, and the same amount of spending on housing and social services as detailed in the proposed legislation.
- This mix of costs and benefits yields a net average annual loss of of 725-875 jobs, over a twenty-year forecast period, and a city GDP loss of $200-240 million per year, in 2017 dollars. As illustrated on the next page, this estimate is net of the the jobs lost because of higher business taxes, as well as the jobs gained by increased spending on services and construction.
- These figures represent an average loss of 0.1% of all jobs in the city, and 0.1% of city GDP.

Gains and Losses Over Time



This chart indicates the job gains associated with the higher spending on social services and housing development in green, the jobs that would be lost from the taxes in orange, and the net impact of the two together, in blue.

This means that, on average over the next twenty years, there would be 725 to 875 fewer jobs in the city than there otherwise would be. It does *not* mean that the city would lose 725 to 875 jobs each year, cumulatively.

The range of job impacts stems from the revenue uncertainty – the low end of the range corresponds to $250 million in annual taxes and spending, and the high end of the range corresponds to $300 million annually.

Jobs Impact by Industry

Industry	Average Employment Change (low/high)		Average Annual Percent Change
Construction	-79	-95	-0.3%
Manufacturing	-27	-33	-0.2%
Wholesale trade	-26	-32	-0.1%
Retail trade	-152	-183	-0.3%
Transportation and warehousing	-24	-29	-0.1%
Information	-71	-86	-0.1%
Finance and insurance	-111	-133	-0.2%
Real estate and rental and leasing	-40	-49	-0.1%
Professional, scientific, and technical services	-109	-131	-0.1%
Management of companies and enterprises	-97	-117	-0.4%
Administrative, support, waste management, and remediation services	-58	-70	-0.1%
Educational services; private	-27	-32	-0.1%
Health care and social assistance	258	309	0.3%
Arts, entertainment, and recreation	-33	-39	-0.1%
Accommodation and food services	-121	-146	-0.1%
Other services (except public administration)	-70	-84	-0.1%
State and Local Government	105	126	0.1%

Impact on Homelessness and Health Outcomes

- The modeling above does not include other factors which we could not readily quantify. Chief among these are the future size of the homeless population in the city, their health outcomes, and the City's future cost of serving them.
- While we have identified no research that found that expanded homelessness services or facilities increases homelessness, quantifying the reduction in homeless population, and the attendant health benefits, is challenging. The measure should reduce the City's acute services costs, though it is not clear if these savings would exceed the City's additional expenditures on homelessness services.
- A recent review by the National Academies[4] noted studies that found net savings from programs that focused on persistently-high users of emergency medical systems, although it did not find conclusive evidence that permanent supportive housing is cost-effective in general.
- San Francisco's coordinated entry program is designed to prioritize high-need individuals, and reduce the burden on City services to the greatest extent possible.

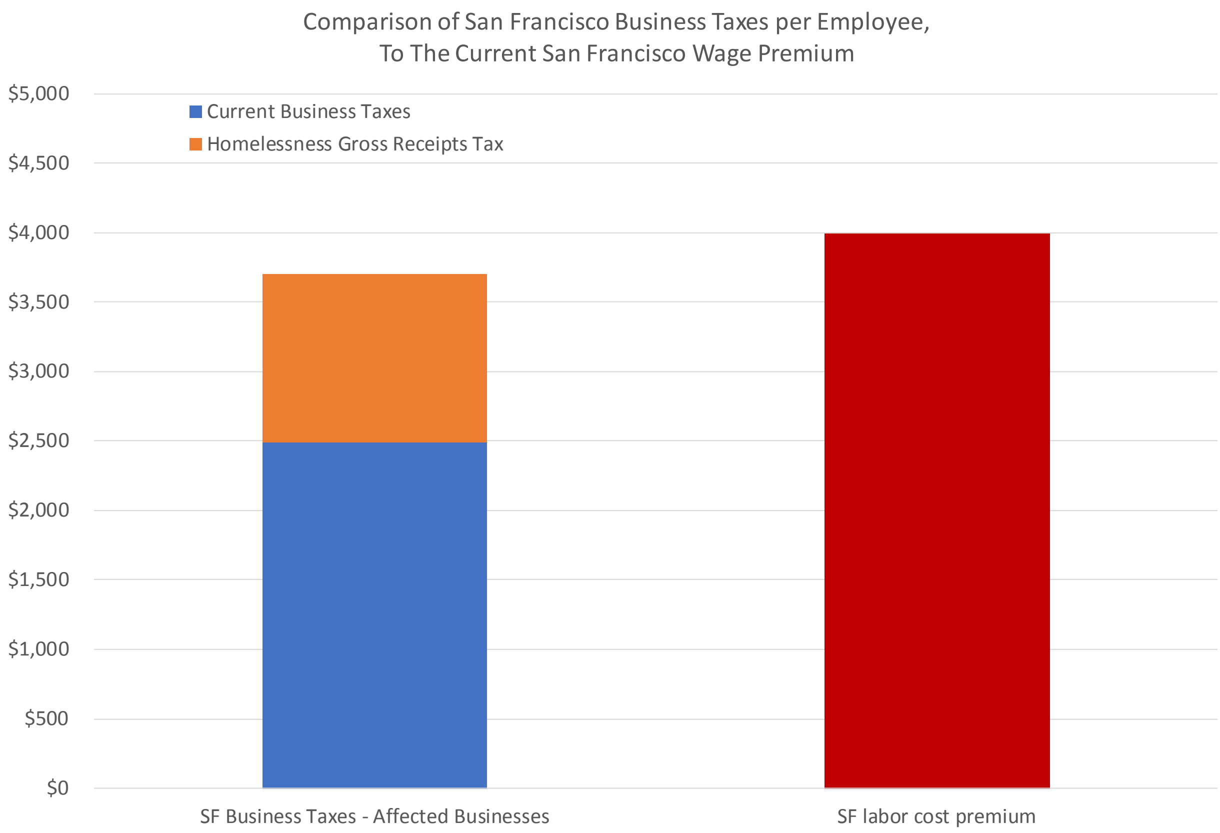
Impact on Quality of Life

- The expected reduction in the number of homeless people in San Francisco can be expected to improve physical and social conditions on the city's streets.
- Anecdotally, these "quality of life" issues have an impact on the perception of the city held by tourists, commuters, and residents.
- While these issues have not led to citywide increases in residential or hotel vacancy rates, both of which remain at or near all-time highs, it is reasonable to assume that an increase in perceived attractiveness of the city would lead to higher hotel rates, residential property values, and perhaps commercial activities in retail areas currently impacted by homelessness.
- However, we are unable to quantify the fiscal or economic benefits of these expected improvements.

Impact of Federal Tax Reductions

- The proposed tax comes one year after the U.S. Federal Government reduced corporate income taxes on businesses. Among other changes, the top-line rate of corporate income tax was cut from 35% to 21%.
- While the tax savings to San Francisco businesses are difficult to estimate and apportion to the city, it is likely that the 14% income tax cut would outweigh the proposed 0.5% gross receipts tax increase for the majority of the 300-400 affected businesses.
- As stated earlier, this report estimates the economic impact of the proposed tax alone; it does not consider the impact of the Federal tax cut, as this decision is not before San Francisco voters.
- While the Federal tax cut increased the profitability of most local businesses, it provided the same benefit to businesses in other U.S. locations. Accordingly, notwithstanding the Federal tax cut, the proposed tax would widen the difference in tax burden that businesses face by being in San Francisco, compared to other nearby locations.

Business Tax and the Cost of Doing Business



Source: Treasurer's Office; IPUMS-USA, University of Minnesota, www.ipums.org.

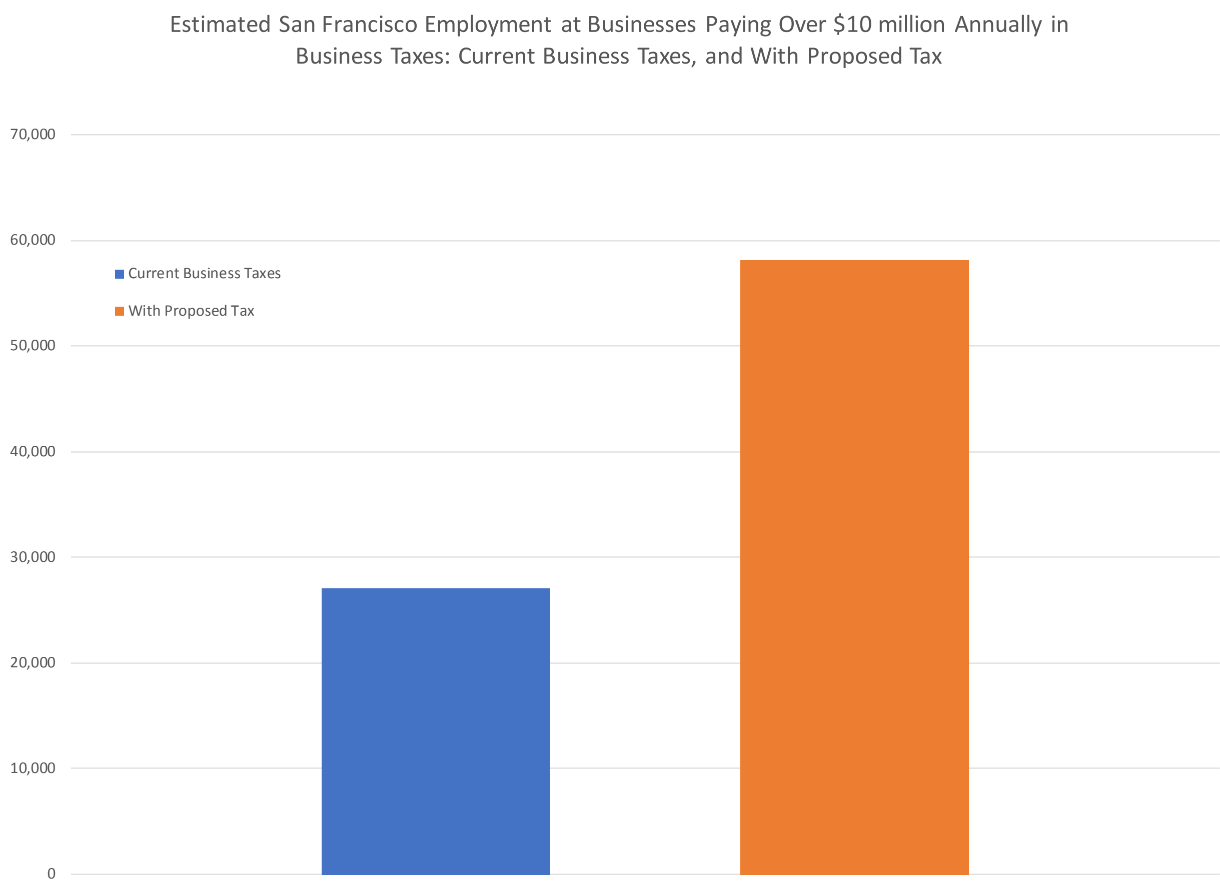
At present, San Francisco businesses that would be affected by the proposed tax spend an average of close to $2,500 per employee per year in business taxes to the city, including the Payroll Expense Tax, Gross Receipts Tax, and Administrative Office Tax.

If the proposed tax was adopted, this per-employee figure would rise to over $3,700 per year.

To put these figures into context, average annual wages are $4,000 higher in San Francisco compared to the rest of the Bay Area, after adjusting for the occupational, educational, and demographic differences that affect pay. This is largely due to the city's high cost of housing and transporting workers to jobs in San Francisco.

In other words, for the 300-400 affected businesses, the proposed tax would make business taxes nearly as big an impediment to growth as housing and transportation already are.

Relocation Risk of Large Employers



The risk of affected businesses moving out of San Francisco in response to the tax is difficult to quantify. One way to illustrate the risk is by looking at the number of people who work for companies that pay a large amount of local tax, such as over $10 million per year.

There is no reason to believe businesses necessarily view $10 million per year as any kind of threshold. Nevertheless, at present, only a few businesses in the city pay above that amount. With the proposed tax, that would rise to approximately 15.

These few large businesses have a disproportionate impact on the city's job market. Under the current business tax system, the few businesses paying over $10 million in tax employ close to 30,000 people; if the proposed tax was adopted, the approximately 15 would employ close to 60,000.

Conclusions

- Our direct assessment of the overall economic impact of the proposed tax is negative, resulting in average annual employment and economic losses of approximately 725-875 jobs, and $200-$240 million in GDP, as a result of the measure.
- These impacts are small in the context of the city's job market and economy, equal to a 0.1% difference, on average, over 20 years.
- Additional positive factors, not quantified in this analysis, include an expected improvement in health outcomes, a reduction in acute service costs, and an attractiveness of the City, because of the likely decline in the homeless population. To the extent that these policy objectives are achieved, the economic impact could be better than we project.
- A significant negative economic risk not included in our direct analysis is that larger businesses may relocate or expand in other cities as a result of the tax, which will raise the cost of doing business in San Francisco. To the extent that this relocation occurs, economic impacts could be more negative than we project.

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End Notes

1: https://sfelections.sfgov.org/sites/default/files/Documents/candidates/Nov%202018/PropC_ControllerAnalysis.pdf
2: Including the gross receipts tax, administrative office tax, payroll expense tax, and business registration fee.
3: West Coast cities include the following Continua of Care: Seattle/King County, Portland/Gresham/Multnomah County, Sacramento City and County, Oakland/Alameda County, San Jose/Santa Clara City and County, Los Angeles City and County, Santa Ana/Anaheim/Orange County, San Diego City and County.
4: National Academies of Sciences, Engineering, and Medicine. 2018. *Permanent Supportive Housing: Evaluating the Evidence for Improving Health Outcomes Among People Experiencing Chronic Homelessness.* Washington, DC: The National Academies Press. doi: https://doi.org/10.17226/25133.