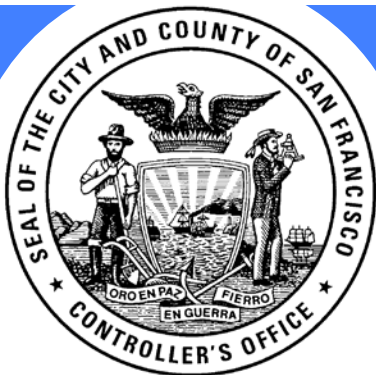


Tying Office Development to Affordable Housing Production: Economic Impact Report



CITY & COUNTY OF SAN FRANCISCO

Office of the Controller
Office of Economic Analysis

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- Since the 1980s, large office development in San Francisco has been subject to limitations imposed by Proposition M, which was approved by voters in 1986. Prop M applies a limit to the amount of additional new office space that the City can authorize in a year.
- The proposed ballot measure, known as the “San Francisco Balanced Development Act”, would reduce this annual limit if the city did not meet a certain target for affordable housing production that is set by State and Regional agencies. If the affordable housing target was ever exceeded, the limits established by Prop M would continue to apply.
- Given the level of affordable housing production in the city in past years, the proposal has the potential to significantly reduce future office development, and employment, in San Francisco. For this reason, the Office of Economic Analysis has prepared this economic impact report.

Details of the Measure

- Prop M established an annual *allocation* of 875,000 square feet of new office space in large development projects¹.
- The allocation is reduced by the square footage of each approved office building . Any allocation that is not used in a year is available in the next year, along with an additional 875,000 of new allocation.
- Thus, Prop M ensures that the city does not add more than 875,000 of square feet of large office space per year, on average over the long term.
- The proposed measure would reduce the 875,000 annual allocation by a percentage equal to the percentage by which the city missed its annual affordable housing target in the prior year.
- For example, if the annual affordable housing target was 2,042 units, and 75% of that target (1,532 affordable units) was produced in that year, then the city would have missed the target by 25%. The new allocation in the next year would be cut by 25%, from 875,000 square feet to 656,250.

The Affordable Housing Requirement

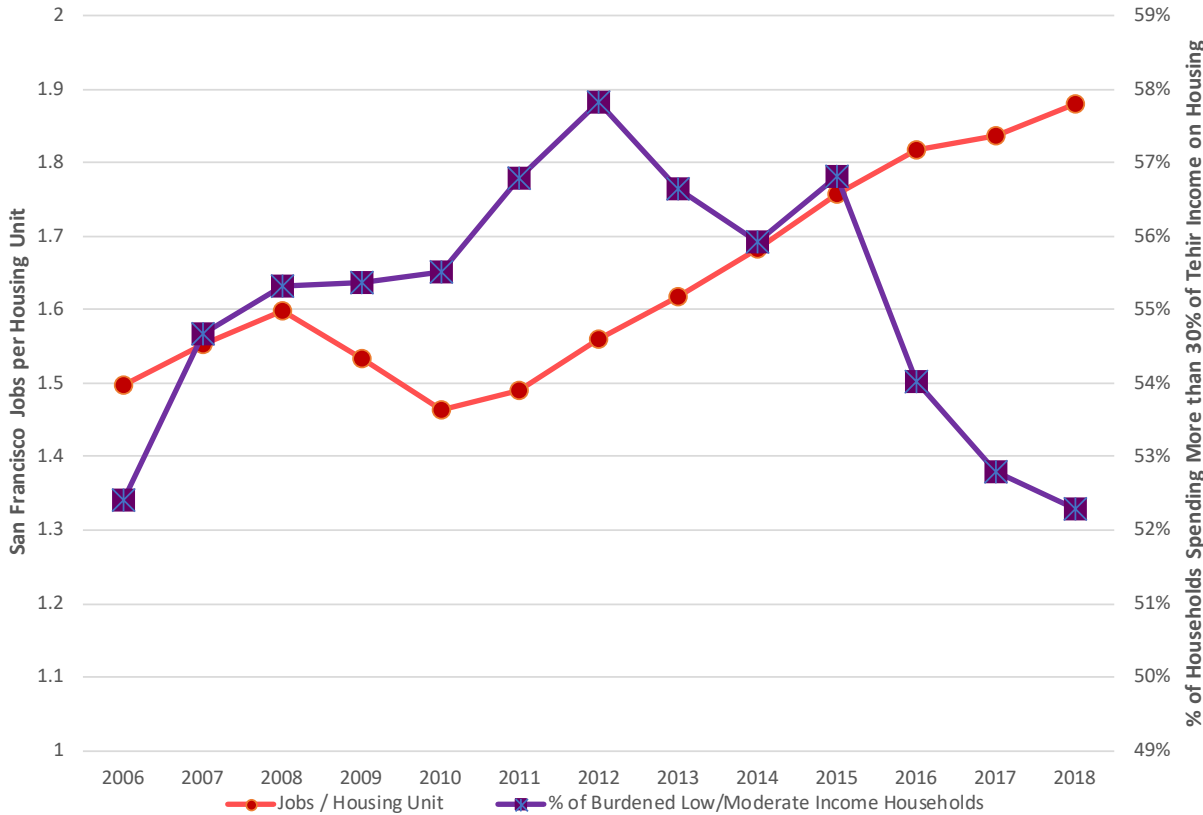
- The affordable housing target referred to in the measure comes from the Regional Housing Needs Allocation (RHNA), a state program implemented by regional agencies.
- The RHNA process establishes housing production targets for California cities every eight years. The targets are broken down by the income levels of their intended residents.
- Under the proposed measure, office allocation would be reduced unless the city produced 2,042 affordable housing units per year for low- and moderate-income households, or 1/8 of the city's 8-year RHNA target, whichever is greater, each year.
- The measure would not relax any of the City's planning restrictions on housing development, and would not generate any new funding for affordable housing.
- Because new office development funds affordable housing through the City's Jobs-Housing Linkage Fee, restrictions of office development will reduce funding sources for new affordable housing.

Further Provisions and Exemptions

- The restrictions associated with reduced allocations would not apply to new office projects which began before September 11, 2019. Much of the office development which was planned as part of the Central SoMa redevelopment would therefore not be affected by this legislation.
- This provision will likely greatly limit the impact of the proposed measure in the near term, though the measure will continue to apply indefinitely into the future.
- Later projects within Central SoMa may only be approved after 15,000 housing units have been completed within the neighborhood.
- Additionally, future projects may be completed, irrespective of the new limits on allocation, under several provisions. However, any office development project that moves forward under these provisions will reduce the allocation available in future years. Over the long term, therefore, they will not change the measure's impact on future office development, or the city's economy.

Employment Growth and Housing Affordability

Jobs-Housing Ratio and Low- & Moderate-Income Housing Burden in San Francisco, 2006-2018



The proposed measure raises the issue of the relationship between employment growth and housing affordability in the city.

Employment growth clearly grew faster than housing supply in San Francisco during the 2010s. The chart to the left shows that the city's jobs/housing ratio has risen by more than 25% since 2010.

However, while the housing burden facing low- and moderate-income San Franciscans remains very high, housing appears to have become more, rather than less, affordable as the jobs-housing ratio has increased during the 2010s.

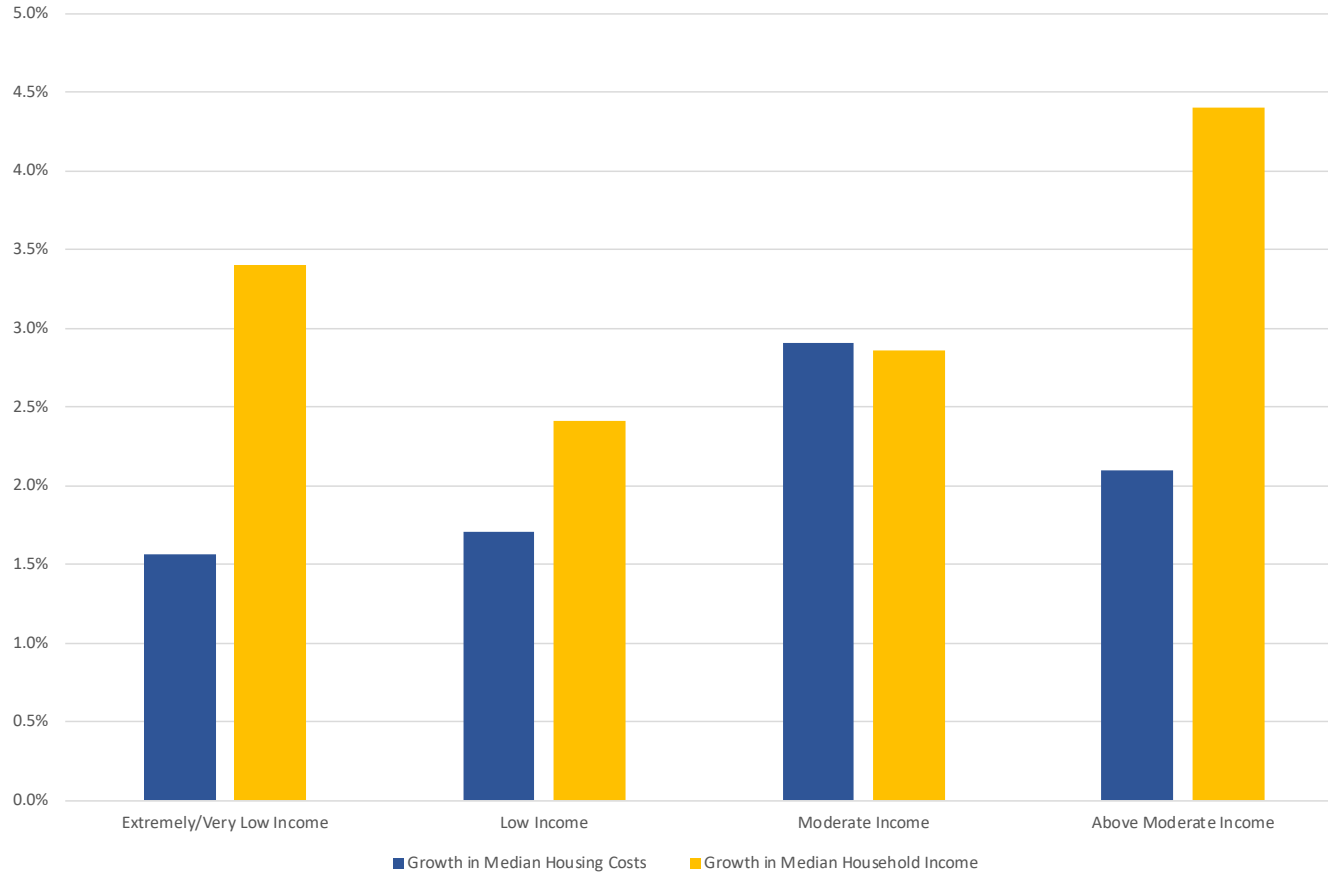
According to Census data, the percentage of low/ moderate income households in the city spending more than 30% of their income on housing has tended to decline since the end of the recession².

As shown on the next page, one reasons for this seems to be that job growth has fueled growth in household income, which has been faster than growth in housing costs, for most households in the city.

Source: Bureau of Labor Statistics; Census Bureau, *American Communities Survey*, ipums.org; Mayor's Office of Housing and Community Development.

Growth in Incomes and Housing Costs Since 2012

Average Annual Change in Median Household Income, and Median Housing Costs, By Income Group in San Francisco, 2012-2018



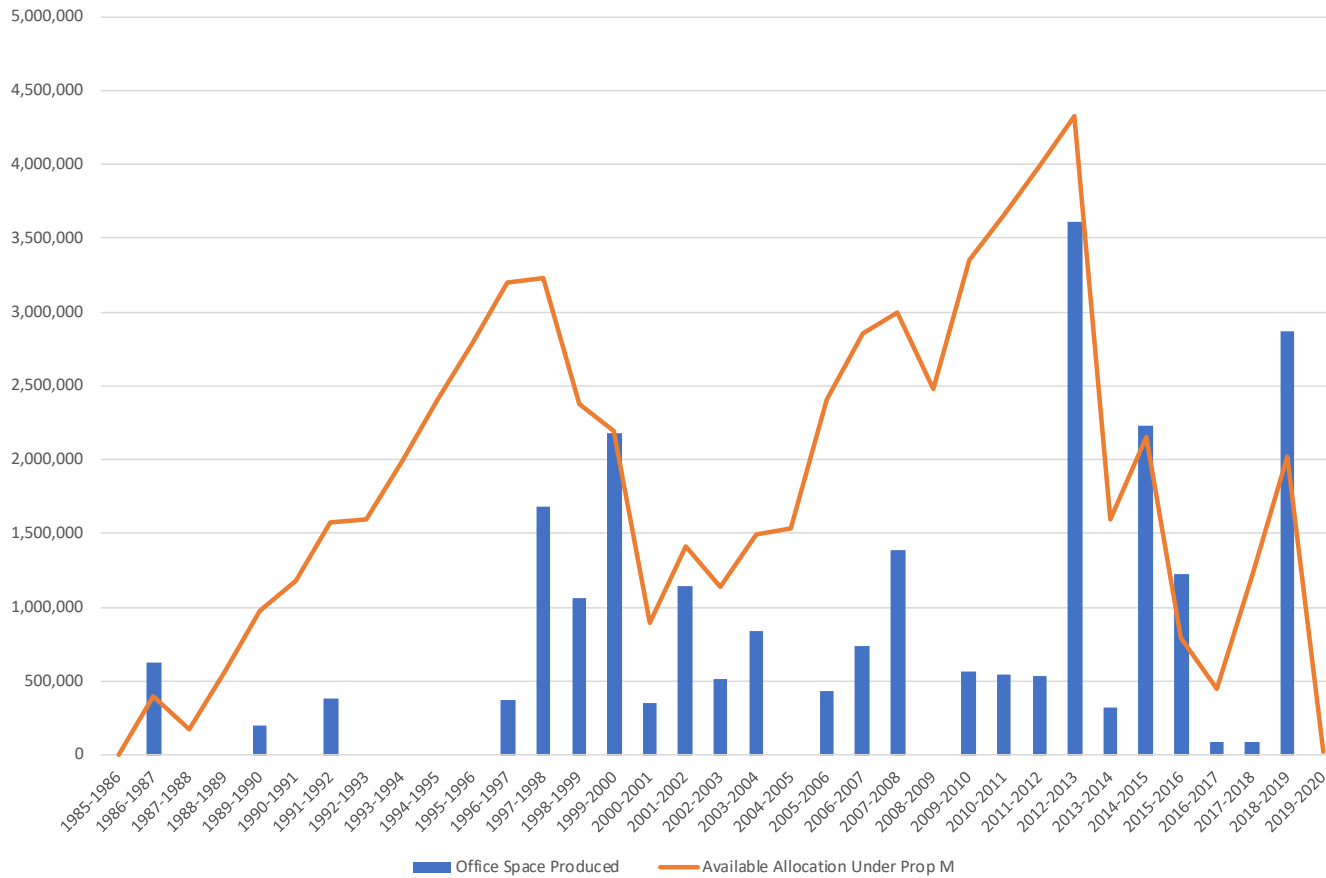
The chart to the left shows the growth in median housing costs, and median incomes, that sampled San Francisco households reported to the Census in 2012 and 2018. In the chart, households are broken out by income group. A gap where income has grown faster than housing costs indicates that housing has become more affordable to the median household in that income group sample.

Above-moderate income households, making over 120% of the area median income, have the widest gap, indicating the most growth in housing affordability.

However, extremely/very low, and low income groups also have experienced income growth exceeding their growth in housing costs since 2012. Only moderate income households, from 80-120% of the area median income, have seen essentially the same growth in housing costs and income since 2012.

Available Office Allocation Under Prop M

San Francisco Large Office Development, and Available Prop M Allocation, 1985/86 to 2019/20



Prop M establishes an annual allocation for new office space, and any amount that is unused is available for projects in later years.

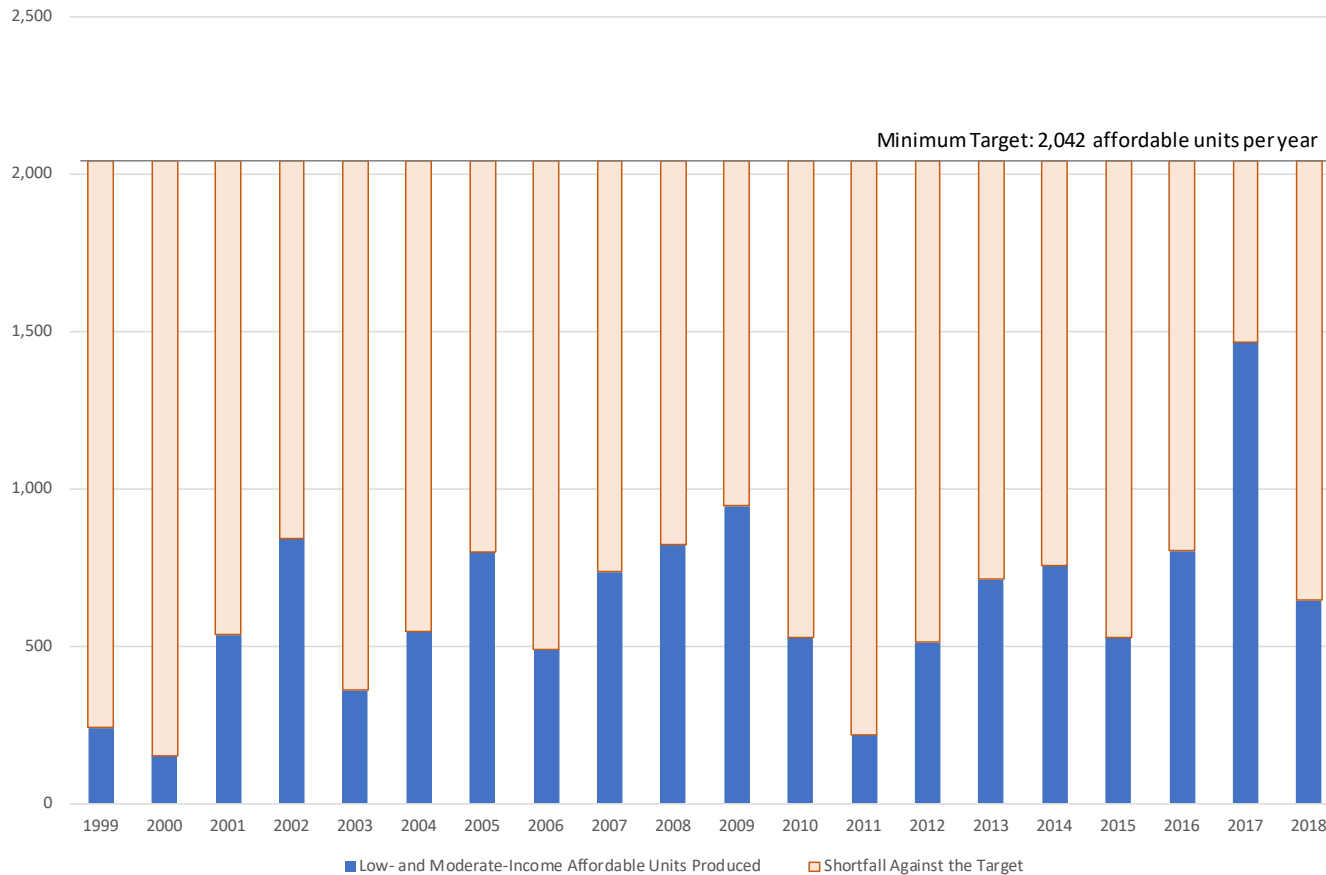
In fact, Prop M's impact on office development has been very limited until the present year, 2019-20.

In the early 1990s, there was little demand for new office space in San Francisco, and the available allocation grew. Since 1999, San Francisco has added more than 1.2 million of square feet per year of large office space, exceeding the annual allocation, because of the amount built up in earlier years.

However, by the end of the 2018-19 period, only 21,752 square feet remained. Even if the proposed measure is not enacted, Prop M is likely to constrain office development and limit job growth in the near future.

Affordable Housing Production Versus the Target

Production of Affordable Housing in San Francisco, and Shortfall Relative to the Target in the Proposed Measure, 1999-2018



As stated earlier, the measure specifies that the city needs to produce a minimum target of 2,042 units of affordable housing annually to prevent further restrictions to office development and job growth.

The city has never met this target in a single year, and it substantially exceeds the city's track record producing new affordable housing. Over the past 10 years, San Francisco has produced between an average of 712 affordable housing units per year, which is 35% of the target.

If either these recent or longer-term trends continue in the future, the proposed measure would lead to a significant reduction in future office development and job growth.

- If past trends continue and San Francisco continues to demand significant new office space while producing affordable housing at levels below the target in the proposed measure, it will act to further constrain office development in the city, beyond the effects of Prop M.
- If this happens, office supply constraints will put further upward pressure on office rents in the city, and reduce employment below what it would otherwise be.
- In addition, reduced office construction will have a negative impact on the city's construction industry.
- Finally, the proposed measure will have a fiscal impact to the City government. A reduction in office space can be expected to reduce the City's property and business tax revenues, among others, while also reducing the City's General Fund costs of servicing new development.
- Less office development would also lead to less funding for affordable housing, through the Jobs-Housing Linkage Fee.

Potential Impact on Future Office Development

- The future impact of the proposed measure on office development depends on future demand for office space in the city, the availability of sites for new office development, and city's future level of affordable housing production, among other factors.
- To illustrate the measure's potential impact, we can estimate what would have happened if the proposed measure had been in place for the past 10 years, from 2009 to 2018. During that time, developers built 1.2 million square feet of large office space per year, and the city produced an average of 712 affordable units, equal to 35% of the target in the proposed measure.
- If these trends continued for the next 20 years, then the proposed measure would cause the city to have 560,000 fewer square feet of office space per year, or 10.6 million less after 20 years.
- This level of office development could support approximately 2,375 fewer office jobs per year, or 47,500 fewer jobs after 20 years.
- It also represents a loss of 64% of the 875,000 square foot allocation limit imposed by the original Prop M.

Potential Fiscal Impact: Revenue Loss

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- A reduction in future office space will reduce future property tax revenue. A conservative estimate of the lost revenue can be made by multiplying the annual office space reduction by the per-square foot assessed value of new office space, and the General Fund property tax rate. Using this method, we estimate the annual revenue loss at \$4.8 million per year, rising to \$95 million annually after 20 years.
- The business tax impact can be estimated, based on current business tax payments and employment in office-using industries. Again, this is a conservative estimate, because business tax revenue has grown very rapidly in recent years. We estimate an annual loss of \$6.8 million per year, rising to \$135 million annually after 20 years.
- Thus, the combined revenue loss from business and property tax would equal an estimated \$11.5 million in year 1, rising to \$231 million by year 20.
- A 560,000 square foot reduction in office space development would also lead to a loss of \$39 million per year in Jobs-Housing Linkage Fee revenue, which is an impact fee paid by new office development to fund affordable housing programs.

Cost Savings and Total Fiscal Impact

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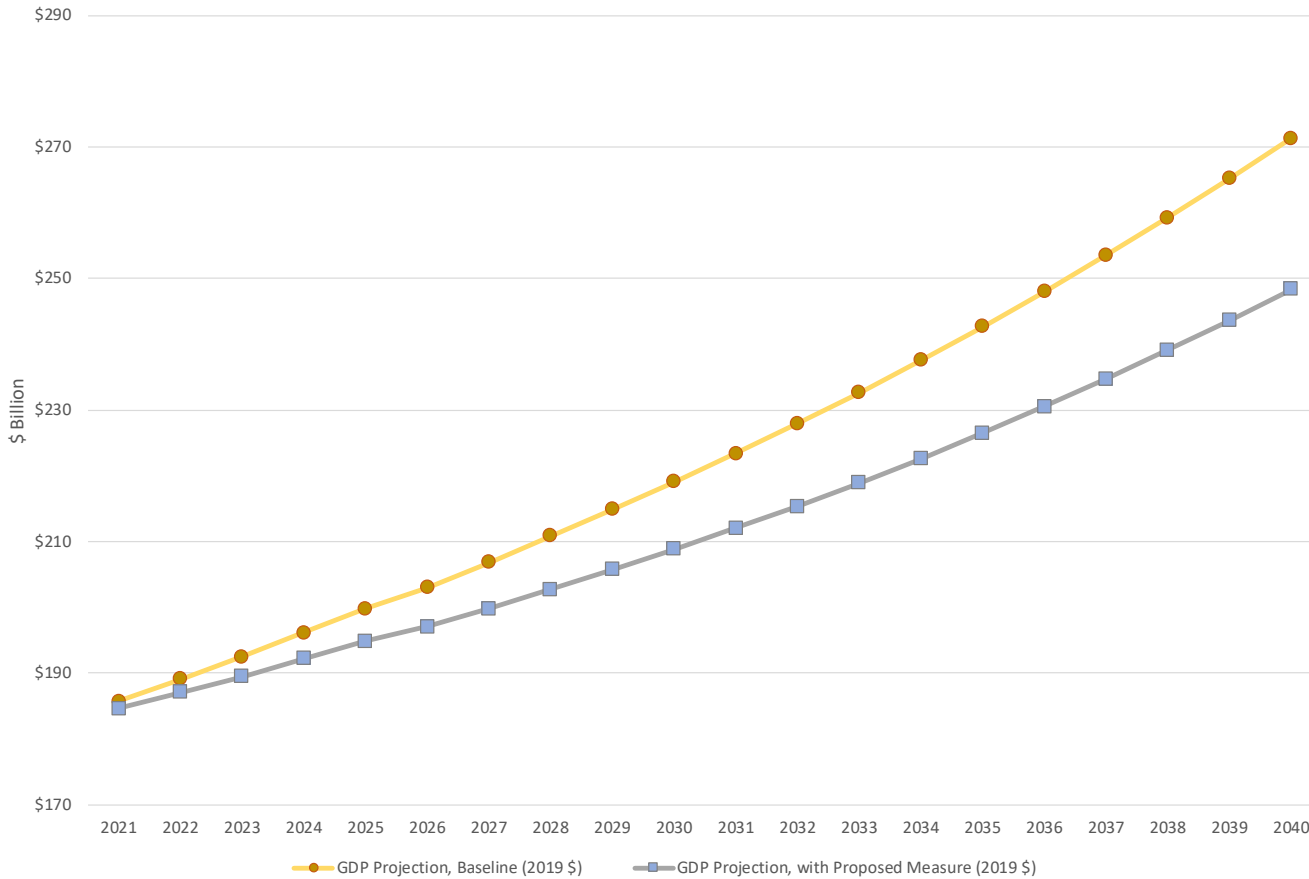
- A proper accounting of the fiscal impact needs to reflect the fact that a slowdown in future office development will also lead to cost savings for the City, as fewer employees will require services paid for by the City's General Fund, such as police, fire, parks, and libraries.
- A common way to approximate this cost impact is to divide tax-funded General Fund expenditures by the City's "service population", often defined as the city's daytime population, but with a reduced weighting for in-commuters, out of a belief that they use City services like police, fire, and parks less than residents do.
- Assuming the cost of serving an in-commuter is 50% of the cost of serving a city resident, the City would save \$4.4 million in year 1, rising to \$87 million by year 20. If, conservatively, in-commuters were assumed to use City services to the same degree as residents, the City would save \$7.3 million in year 1, rising to \$146 million by year 20.
- Either way, when the revenue losses on the previous page are considered, the proposed measure would lead to a negative net fiscal impact to the City, of between \$4.2 and \$7.2 million in year 1, rising to between \$84 - \$146 million annually by year 20.

- The Office of Economic Analysis uses the REMI model to estimate the net economic impact of new City legislation. The estimates below are sensitive to the assumptions made about the future demand for new office space, and the future production of affordable housing in the city. This forecast is based on the office and affordable housing production trends of the last ten years. The specific impacts modelled include:
 - A reduction, relative to a baseline forecast, of 2,375 office jobs, spread proportionally across major office-using industries in the city. This job reduction will grow each year, as more office development is reduced, to a loss of 47,500 jobs after 20 years. Accompanying this is a reduction in office construction spending, estimated at \$625 per square foot.
 - A reduction of \$5.7 million in General Fund spending, the midpoint of the negative fiscal impact discussed on the previous page. Again, this rises over time, to \$114 million after 20 years.
 - A reduction of \$39 million per year in affordable housing funding through the Jobs-Housing Linkage Fee program. Unlike property and business taxes, this is a one-time fee paid when construction is completed, and this economic loss does not grow over time.

- REMI estimates impacts relative to a baseline economic forecast of long-term growth. In 2040, the city's GDP would be 8.5% smaller than it would be relative to the baseline, or \$23 billion less in today's dollars. Disposable personal income is expected to be 5.9% less, and the city's population would be 5.8% smaller than under the baseline.
- Similarly, total employment in the city would decline by 7.9% after 20 years, relative to the baseline forecast, which is equivalent to 91,000 jobs in 2040.
- In terms of relative job losses by industry, large office-using industries like professional services, technology, and financial services, would experience the greatest job losses, about two-thirds of the total.
- In percentage terms, lower-paying office-using industries like administrative services, real estate, and non-profits would be the hardest hit, each suffering more than 10% job loss, relative to the baseline.
- Because of multiplier effects, non-office industries like construction, retail trade, hospitality, and health care would all lose more than 2,000 jobs by 2040, again relative to the baseline.

City GDP: Baseline and Policy Forecasts

Projected San Francisco GDP, 2021-40:
Baseline Projection and Under Proposed Measure



The chart to the left illustrates projected GDP growth in San Francisco, under both a baseline forecast and the proposed measure.

While the initial difference is small, the city's economy would be 8.5% smaller by 2039, as noted on the previous page.

In this forecast, the measure is projected to reduce office development each year, leading to a widening divergence between the two forecasts.

This cumulative effect is what gives this particular policy its unusually large negative economic impact.

- By tying future office development to an affordable housing target that the city has never met, the proposed measure is likely to lead to higher office rents, reduced tax revenue, reduced incomes, and reduced employment across the city's economy.
- The city's recent history suggests that employment growth has been associated with rising incomes. For most income groups in the city, median income growth since 2012 has exceeded the growth in median housing costs.
- While the near-term impact of the proposed measure is likely to be greatly limited by the exemption of many Central SoMa office projects that already underway, the cumulative effect of the measure over the long term gives it an unusually large negative fiscal and economic impact.
- These impacts are relative to a baseline forecast of long-term growth, and are sensitive to assumptions of future economic growth in the city. If future demand for office space is less than it has been in the past, or the city's production of affordable housing is higher, then the measure's negative impacts would be less than forecast in this report.

1. Large cap office projects are defined as buildings with more than 50,000 square feet.
2. Low- and moderate-income households in San Francisco were identified using ACS PUMS data from ipums.org, and annual unadjusted income limits from the Mayor's Office of Housing and Community Development.

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