



May 1, 2023

San Francisco Board of Supervisors
Budget and Finance Committee
1 Dr. Carlton B. Goodlett Place
City Hall, Room 244
San Francisco, CA 94102-4689

Re: Commercial Rents Tax Sublease Exemption Proposal—SUPPORT

Dear Budget Committee Members,

I write you on behalf of BOMA San Francisco regarding the current challenges facing the downtown economy in San Francisco and Mayor Breed's proposed tax measures to address these challenges. It is our hope that you please consider supporting a modified version of the temporary pause on the commercial rents tax for new subleases as well as the temporary 0.45% gross receipts tax deduction for businesses opening office space in San Francisco for the first time.

BOMA acknowledges the challenges presented by the current budget deficit. Many of the core government services that rely on the revenue generated from our existing tax policies are critical for advancing socioeconomic equity in our city. Furthermore, for many San Franciscans—including the business community—these investments in childcare and early education, housing and homelessness services, efficient public transportation, and world-class green spaces are a statement of progressive values and a point of civic pride. It is precisely with these critical investments in mind that BOMA writes to you to express our concern regarding the future sustainability of our city's business tax base.

We remain bullish regarding downtown San Francisco's economic recovery and future. However, we believe that the trajectory of this recovery requires investments that leverage near-term business tax incentives for longer-term business activity and tax revenue. The impacts of this downturn go well beyond the commercial real estate industry or our general fund revenues. Many of our partners in labor remain the most impacted due to the lack of new tenant improvements or office tenants requiring a wide array of services. We believe the following recommendations balance the need to maintain our service obligations in the budget and spur economic recovery downtown.

Please find our specific comments regarding Mayor Breed's proposal to temporarily allow the deduction of the commercial rents tax from subleases (File No. 230660) and Mayor Breed's proposal to provide a gross receipts tax credit for businesses opening a new office in San Francisco for the first time (File No. 230155).

Commercial Rents Tax Relief for Subleases Proposal

Before discussing the merits of this proposal, BOMA wishes to again underscore our sensitivity to the importance of the investments in childcare and early education that are funded through the commercial

rents tax. Not only does robust access to affordable programs advance equity in our city, but it also allows us to grow our workforce by providing options for parents and caregivers who would otherwise not be able to work full time due to childcare responsibilities. To this end, we agree that any temporary changes to the tax be as narrow as possible to maximize potential economic benefits while minimizing impacts on programs and future revenue. BOMA suggests the following changes to achieve that goal:

- Limit the incentive to only new subleases so that this tax would not apply to existing sublease agreements. This would dramatically decrease the estimated cost of the incentive, particularly in the first year that the incentive would be in effect.
- Consider amending the legislation to have it sunset in 3-5 years. Most sublease agreements are typically signed for a period of 3-5 years. Ending the incentive in the nearer term would ensure that benefits are received immediately—while there is still a substantial amount of sublease space on the market—while reducing total cost.

BOMA also wishes to address some of the misconceptions regarding the current way in which the commercial rents tax is applied in commercial leasing as well as the potential economic benefits that we believe this tax incentive could generate.

- *Who typically pays the tax*—The vast majority of existing commercial lease agreements in San Francisco contain provisions that stipulate that building owners may share or “pass through” certain operating costs with tenants. As most leases are structured this way, we wish to correct the assertion made in the City Economist’s analysis that the commercial rents tax is typically paid by the landlord. On the contrary, the commercial rents tax liability is typically paid by the tenant. Subsequently, tenants who are subleasing space still pay their original commercial rents tax obligations but then pass through their tax liability onto their subtenant. As a result, we suggest that this incentive should not be thought of as a benefit to tenants who make space available on the sublease market, but rather to the sublease tenants who occupy the space after it has been subleased.
- *Likely Sublease Tenants*—This potential savings presents a tremendous opportunity for potential sublease tenants. At the end of Q1 2023, COSTAR data showed that sublease agreements in San Francisco are made for a much lower price per square foot than direct leases. As of the end of March, subleases were priced at \$56 per square foot city-wide, compared with about \$74-\$75 per square foot for direct leases. This reduced pricing, combined with the potential 3.5% savings that would be received from the program presents opportunities for small businesses and new businesses to locate in San Francisco and grow here.
- *Indirect Economic Benefits*—Due to the changes in work trends presented by the pandemic, BOMA believes that attracting potential sublease tenants in the immediate future with this incentive would bring substantial benefits to the downtown economy. The businesses that would be subleasing space are very likely to have an in-person first approach to work. A new business does not enter a new sublease because people are working from home. They do this because they want to encourage people to come to the office. This would increase building values by increasing occupancy, generate economic activity for small businesses downtown, increase foot traffic to promote vibrancy, and increase transit ridership and revenue that our system desperately needs.

- *Longer Term Benefits*—Nearly one third of existing direct leases are set to expire by 2026. A significant amount of this space is currently available on the sublease market. The proposal, if enacted, creates a pipeline for new tenants. Generating new direct leasing activity is much easier when a space has an existing subtenant as rent costs will reset to meet the market demand and the sublease tenant can avoid moving costs. New direct leases in these spaces will be negotiated with funding for tenant improvements, generating new jobs for skilled labor. Ultimately, these subleases turning into direct leases is critically important for generating new commercial rents tax funding too.

Ultimately, the amount of revenue generated from the commercial rents tax depends on leasing activity. Due to existing lease structures, the proposed tax benefits would not go to commercial landlords, but to potential businesses with an opportunity to grow and create jobs in San Francisco. The longer-term benefits of such activity would in turn create future commercial rents tax revenue and general fund revenue for our city. BOMA believes that by narrowing the scope of this program and utilizing current unspent funds to maintain existing service levels, this tax would bring long-term benefits for downtown's economic recovery.

Gross Receipts Tax Credits for Opening a New City Office Location

One of the greatest challenges facing downtown's recovery is the perceived expense from potential businesses to locating in San Francisco. Per [research conducted by the Bay Area Council](#) the tax burden for large San Francisco companies is more than double that of Oakland and magnitudes higher than other cities in the Bay Area and in major metropolitan areas across the country. Our members who provide brokerage services hear this concern constantly, and as a result potential San Francisco companies elect to locate elsewhere in the Bay outside of San Francisco or in other cities that provide more attractive tax incentives.

Again, BOMA recognizes that our current tax policy is critical in generating the revenue for key government services to our city. We again suggest that strategic investments to signal to potential San Francisco businesses that we want them to locate here and grow here will bring important long-term benefits for our future business tax base. This proposed measure would provide a targeted tool to help recruit potential new businesses in San Francisco, generating new jobs, commercial rents tax revenue, transit ridership, and economic activity downtown.

Thank you for your consideration of these measures. Please do not hesitate to reach out if BOMA staff or our membership can answer any questions regarding the impact of these proposed measures on our industry.

Sincerely,



John R. Bryant
CEO, BOMA San Francisco