File No. 110155

Committee Item No. 1
Board Item No. 8

COMMITTEE/BOARD OF SUPERVISORS
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Committee: Budget and Finance SUB-Committee **Date:** March 23, 2011

Board of Supervisors Meeting **Date** April 5, 2011

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Completed by: Victor Young **Date:** March 18, 2011
Completed by: Victor Young **Date:** 3-24-11

An asterisked item represents the cover sheet to a document that exceeds 25 pages. The complete document is in the file.

Amendment of the whole in committee. 3/23/11

FILE NO. 110155 ORDINANCE NO.

[Business and Tax Regulations Code - Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area]

Ordinance amending Article 12-A of the Business and Tax Regulations Code by adding Section 906.3 to establish a payroll expense tax exclusion for businesses located in the Central Market Street and Tenderloin Area and requiring persons with an annual payroll expense of over $1,000,000 to enter into a Community Benefits Agreement with the Office of Economic and Welfare Development .

NOTE: Additions are *single-underline italics Times New Roman*; deletions are ~~*strike-through italics Times New Roman*~~. Board amendment additions are double-underlined; Board amendment deletions are ~~strikethrough normal~~.

Be it ordained by the People of the City and County of San Francisco:

Section 1. Findings. The Board of Supervisors hereby finds that:

(a) In January of 2010, Mayor Gavin Newsom announced the Central Market Partnership – a public/private initiative to renew and coordinate efforts to revitalize the Central Market neighborhood (from approximately Fifth Street to Tenth Street) with a focus on cultivating an eclectic, community-serving arts district.

(b) As part of the Central Market Partnership, the City has developed the following tools to assist with this effort:

(1) An $11.5 million loan fund for low-interest loans to small businesses in the area;

(2) Coordinated incentives, including a renewed effort to generate tax increment financing through a Redevelopment Area;

(3) The Better Market Street initiative, which will overhaul the streetscape and repave the corridor in 2014;

(4) Technical assistance and limited funding for arts groups looking to relocate to Central Market;

(5) An NEA grant to undertake visible arts-oriented activities that will generate positive foot traffic; and

(6) Partnerships with recently established Community Benefit Districts and other Community Benefit Organizations whose focus is on improving the neighborhood as well as an Interagency Working Group to target City attention and resources to the neighborhood.

(c) Therefore, attracting businesses to the Central Market Street neighborhood is a key component in the revitalization of the area.

Section 2. The San Francisco Business and Tax Regulations Code is hereby amended by adding Section 906.3, to read as follows:

SEC. 906.3. CENTRAL MARKET STREET AND TENDERLOIN AREA PAYROLL EXPENSE TAX EXCLUSION.

(a) ~~The amount of~~ An exclusion from the *payroll expense tax* ~~due under this Section~~ *shall be*~~:~~

~~(1) For any~~allowed for each *person* ~~maintaining~~who maintains *a fixed place of business* ~~in~~within *the Central Market Street and Tenderloin Area* ~~on the effective date of this ordinance, such person~~for payroll expense attributable to that fixed location; provided, however, that in no event *shall* ~~owe~~ *the* ~~lesser of that~~ tax exclusion reduce a *person's* ~~payroll expense~~ *tax liability* ~~for 2010 or that~~to less than the *person's* Base Year *payroll expense tax* ~~liability for the year they are claiming the exclusion, including zero;~~liability.

~~(2) For any person who commences to maintain a fixed place of business in the Central Market Street and Tenderloin Area after the effective date of this legislation, such person shall owe the lesser of that person's payroll expense tax liability for the tax year prior~~

~~to the date the person commenced to maintain a fixed place of business in the Central Market Street and Tenderloin Area or that person's payroll expense tax liability for the year they are claiming the exclusion, including zero; or~~

~~(3) For any person who commences to maintain a fixed place of business in the Central Market Street and Tenderloin Area after relocating to San Francisco, such person shall owe the lesser of the amount that person paid in payroll expense tax for that person's initial year in San Francisco and that person's payroll expense tax liability for the year they are claiming the exclusion, including zero.~~

(b) For purposes of this Section, the following terms shall have the meanings set forth below:

(1) "Central Market Street and Tenderloin Area" means the area located in downtown San Francisco, generally including: parcels fronting the south side of Market Street from Eleventh Street to Sixth Street; a portion of the parcels fronting the south side of Market Street from Sixth Street to Fifth Street (odd numbered addresses from 999 to 933 Market Street); parcels fronting the north side of Market Street from Van Ness Avenue to Eighth Street; 875 Stevenson Street; and parcels in the area bordered by: Geary Street, from Polk Street to Taylor Street (south side only); Taylor Street, from Geary Street to Ellis Street (west side only); Ellis Street, from Taylor Street to Mason Street (south side only); Mason Street, from Ellis Street to Market Street (west side only); Market Street, from Mason Street to Charles J. Brenham Place (north side only); Charles J. Brenham Place, from Market Street to McAllister Street (east side only); McAllister Street, from Charles J. Brenham Place to Larkin Street (north side only); Larkin Street, from McAllister Street to Eddy Street (east side only); Eddy Street, from Larkin Street to Polk Street (north side only); and Polk Street, from Eddy Street to Geary Street (east side only). The exclusion applies exclusively to the following Assessor's Lots: the entirety of Blocks 0317, 0318, 0319, 0320, 0321, 0322, 0322A, 0323, 0324, 0331, 0332, 0333, 0334, 0335, 0336, 0337, 0338, 0339, 0340, 0342, 0343, 0344, 0345, 0346, 0347, 0348,

0349, 0350, 0716, 0717~~,~~and *0740*~~, and 0835~~*; Block 0813, Lots 7, 8, 9 and 10;* Block 0835, Lots 1, 2 and 3; *Block 3701, Lots 50*~~,~~ and *59* ~~and 65~~*; Block 3702, Lots 1,* ~~44, 44A,~~ *45, 46, 47, 48, 48A*, and *53* ~~and 54~~*; Block 3703, Lots 1, 56, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 70, 74, 75, 76, 78 and 88; Block 3704, Lots 70, 69, 68, 67 and 78; Block 3507, Lots 39*~~, 40~~ *and 41; Block 3508, Lots 1 and 39; Block 0355, Lots 3, 4, 5, 6, 7, 8, 9, 10 and 15; and Block 0351, Lots 1, 22, 39, 41, 46, 47, 49 and 51.*

(2) ~~An employee is a "qualified employee"~~"Base Year" means the 2010 tax year *for* ~~purposes~~a person who maintains a fixed place *of* ~~computing~~ business in San Francisco on the effective date of *this* ~~exclusion if the employee spends at least 90% of work time on activities directly related~~ordinance. For a person who moves *to the* ~~conduct of a trade or business located within the~~ *Central Market Street and Tenderloin Area* ~~and performs at least 90% of work time within~~from another part of San Francisco, Base Year means that person's full tax year for *the* ~~boundaries of~~year prior to entering into a lease agreement or buying real property in *the* ~~Central Market Street and Tenderloin~~ *Area. For* ~~purposes~~a person who commences to maintain a fixed place of business in San Francisco after the effective date *of this* ~~Section, outside independent contractors shall not be considered employees of the business.~~ordinance, Base Year means that person's first full tax year in the Area.

(c) In order to be eligible for the payroll expense tax exclusion authorized under this Section, persons wishing to claim the exclusion must:

(1) Complete and submit an initial application to the Office of Economic and Workforce Development for review and evaluation. The Office of Economic and Workforce Development will use this application to verify that applicants claiming the payroll expense tax exclusion under this Section meet the eligibility requirements outlined in ~~subsections~~subsection *(b)*~~(1) and (b)(2~~*) of this Section. The Office of Economic and Workforce Development* and the Office of the Treasurer and Tax Collector *shall* ~~have the authority to~~ *prescribe the form of the application and, consistent with this ordinance, the rules and regulations regarding eligibility for the*

Central Market Street and Tenderloin Area payroll expense tax exclusion, which shall include participation in the City's First Source Hiring Program as defined in Section 83.4 of the Administrative Code.

(2) File an annual affidavit with the Office of Economic and Workforce Development affirming that they continue to meet the eligibility criteria as determined by the Office of Economic and Workforce Development. The annual affidavit should detail the total number of individuals hired during the year, the number of individuals who were referred by the San Francisco Workforce Development System during the year, and the duration of employment for each individual hired during the year. *The affidavit must be filed with the Office of Economic and Workforce Development on or before January 31 of each year subsequent to the Office of Economic and Workforce Development's initial approval of the application.*

(3) Maintain records and documents in *a* ~~reasonable method of documentation that~~manner acceptable to *the Tax Collector* ~~can review or verify.~~ Such records and documents must *objectively* ~~that tracks employees whose compensation qualifies for the Central Market Street and Tenderloin Area~~substantiate any *exclusion*~~, and provide such documentation~~ claimed under this Section and be provided *to the Tax Collector upon request.*

(4) File an annual Payroll Expense Tax Return with the Tax Collector regardless of the amount of tax liability, if any, shown on the return after claiming the exclusion provided for in this Section.

(5) Any person whose annual payroll expense exceeds one million dollars ($1,000,000) shall enter into a binding Community Benefit Agreement with the Office of Economic and Workforce Development in order to be eligible for the payroll expense tax exclusion under this Section. Such Community Benefit Agreement may include commitments to engage in community activities in the Central Market Street and Tenderloin Area as well as participation in workforce development opportunities.

(d) The Office of Economic and Workforce Development shall:

(1) Together with the Office of the Treasurer and Tax Collector, ~~No later than the effective date of this ordinance,~~ *adopt rules, regulations and forms regarding eligibility and the application process for the Central Market Street and Tenderloin Area payroll expense tax exclusion. The* ~~Office of Economic and Workforce Development may amend such~~ *rules, regulations and forms* may be amended *from time to time as necessary.*

(2) Review all applications for completeness and upon approval, issue a certificate of eligibility to the applicant. The decision of the Office of Economic and Workforce Development regarding eligibility for the exclusion ~~shall~~may not *be* ~~final~~appealed by an applicant.

(3) Provide the Tax Collector with a list of persons eligible to claim the tax exclusion authorized under this Section for the preceding tax year by March 1 of each year.

(e) The Tax Collector shall verify that any exclusion claimed pursuant to this Section is appropriate.

(~~e~~f) The Central Market Street and Tenderloin Area exclusion authorized under this Section shall be available to and may be taken by each person for each tax year that person holds a valid certificate of eligibility for a period not to exceed six years from the effective date of this ordinance or the commencement of the person's business in the Central Market Street and Tenderloin Area, whichever is later. The date the Tax Collector first received the person's application for a business registration certificate for the person's Central Market Street and Tenderloin Area business shall be presumed to be the date of commencement of such business unless the person establishes a different commencement date to the satisfaction of the Tax Collector.

(~~f~~g) The Central Market Street and Tenderloin Area exclusion authorized under this Section shall expire on the eighth anniversary date of the effective date of this Section. A person may not use or claim any unused portion of the Central Market Street and Tenderloin Area exclusion after the expiration date of this Section. Unless exempted under Sections 906 of this Article, every person

engaging in a business in the Central Market Street and Tenderloin Area in the City shall pay the tax imposed under this Article on the full amount of the person's payroll expense attributable to the City from and after the expiration of this Section.

(~~g~~h) If a person's calculated liability for the ~~P~~payroll ~~E~~expense ~~T~~tax does not exceed the ceiling specified in Section 905-A for the tax year after applying the Central Market Street and Tenderloin Area exclusion under this Section, the person shall be exempt from payment of the ~~P~~payroll ~~E~~expense ~~T~~tax for that tax year as provided in Section 905-A.

(~~h~~i) The Tax Collector shall submit an annual report to the Board of Supervisors for each year for which the Central Market Street and Tenderloin Area exclusion authorized under this Section is available that sets forth aggregate information on the dollar value of the Central Market Street and Tenderloin Area exclusions taken each year, the number of businesses taking the exclusion and the change in the number of businesses located in the Central Market Street and Tenderloin Area of the City.

(j) The Office of Economic and Workforce Development shall submit an annual report to the Board of Supervisors for each year for which the Central Market Street and Tenderloin Area exclusion authorized under this Section is available that sets forth any and all Community Benefit Agreements that have been entered into with the Office of Economic and Workforce Development during that year.

(~~i~~k) The Assessor-Recorder shall submit an annual report to the Board of Supervisors for each year for which the Central Market Street and Tenderloin Area exclusion authorized under this Section is available that sets forth any identifiable increases in property value resulting from businesses' location, relocation or expansion to or within the Central Market Street and Tenderloin Area.

(~~j~~l) The Controller, not later than ~~after~~ *three years after the effective date of this ordinance, shall perform an assessment and review of the effect of the Central Market Street and Tenderloin Area*

payroll expense tax exclusion on the Central Market Street and Tenderloin Area. Based on such assessment and review the Controller shall prepare and submit an analysis to the Board of Supervisors. The analysis shall be based on factors that the Controller deems relevant, and may include, but shall not be limited to, data contained in the annual reports to the Board of Supervisors as required by subsections ~~(h) and~~ *(i),* (j) and(k) *of this Section.*

(~~k~~m*) The Central Market Street and Tenderloin Area payroll expense tax exclusion set forth in this Section may not be claimed concurrently with any other payroll expense tax exclusion.*

(~~l~~n*) A misrepresentation or misstatement by any person regarding eligibility for the Central Market Street and Tenderloin Area payroll expense tax exclusion authorized by this Section that results in the underpayment or underreporting of the payroll expense tax shall be subject to penalties* ~~as provided in Section 6.17-2 of Article 6 of the San Francisco Business and Tax Regulations Code~~.

APPROVED AS TO FORM:
DENNIS J. HERRERA, City Attorney

By: ____________________
STEPHANIE PROFITT
Deputy City Attorney

FILE NO.

LEGISLATIVE DIGEST

[Business and Tax Regulations Code - Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area]

Ordinance amending Article 12-A of the Business and Tax Regulations Code by adding Section 906.3 to establish a payroll expense tax exclusion for businesses located in the Central Market Street and Tenderloin Area.

Existing Law

San Francisco imposes a payroll expense tax on business entities based on the compensation they pay to employees and others for work or services performed in San Francisco. (Business and Tax Regulations Code Section 901 et seq.) The tax rate is 1.5% of taxable payroll expense. This tax is determined each year based on the payroll expenses of the entity.

Amendments to Current Law

The proposed amendment would amend Section 906 to establish a payroll expense tax exclusion for qualified employees employed by businesses in the Central Market Street and Tenderloin Area. For a business located in the Central Market Street and Tenderloin Area, its payroll expense tax liability shall be the lesser of its payroll expense tax liability for 2010 or the year it is claiming the exemption, including zero. For a business that moves to the Central Market Street and Tenderloin Area from another part of San Francisco, its payroll expense tax liability shall be the lesser of its payroll expense tax liability for the tax year prior to its move to the Central Market Street and Tenderloin Area or the year it is claiming the exclusion, including zero. A business that moves to San Francisco, and specifically to the Central Market Street and Tenderloin Area, shall pay the lesser of the amount it paid in payroll expense tax for its initial year in San Francisco and its payroll expense tax liability for the year it is claiming the exclusion, including zero. The exclusion will be available for a period of 8 years from the effective date of this legislation and employers may avail themselves of the exclusion for 6 years. After the legislation expires, no unused portions of the exclusion may be claimed.

Background Information

Under Business and Tax Regulations Code Section 901 et seq., businesses pay a payroll expense tax based on the compensation paid to employees and others for work or services rendered in San Francisco. (Section 901.1) This proposed amendment would amend Section 906 to establish a payroll expense tax exclusion for the purpose of encouraging entities to retain and hire employees to work in the Central Market Street and Tenderloin Area.

Item 1 **File 11-0155** *(Continued from March 16, 2011)*	**Department(s):** Office of Economic and Workforce Development Treasurer/Tax Collector

EXECUTIVE SUMMARY

Legislative Objective

- The proposed ordinance would amend the Business and Tax Regulation Code to establish a Payroll Expense Tax exclusion for businesses in the Central Market and Tenderloin Area.

Key Points

- Businesses currently pay Payroll Expense Taxes to the City of 1.5 percent of the firm's payroll expenses for work or services performed in San Francisco. Businesses with an annual payroll of $250,000 or less and certain biotechnology and clean energy technology businesses are currently exempt from the Payroll Expense Tax.
- The proposed Payroll Expense Tax exclusion would be available for a period of eight years from the effective date of the proposed ordinance; however, individual businesses could only claim the Payroll Tax exclusion for a maximum of six years.
- The proposed Payroll Expense Tax exclusion would only apply to net new employees hired by businesses (a) already located in the Central Market and Tenderloin Area, or (b) that relocate to the Central Market and Tenderloin Area from another San Francisco location. The proposed Payroll Expense Tax exclusion would also apply to all employees of businesses that relocate to the Central Market and Tenderloin Area from outside the City.
- Twitter, presently located at 795 Folsom Street, is currently seeking a new headquarters of approximately 150,000 square feet of space with options to expand up to 500,000 square feet in future years. Twitter currently has 350 employees, expects to reach 750 employees by July 2011, and estimates having 1,500 employees by July 2012 and 3,000 employees in 2013. Twitter is considering relocating to the SFMart on Market Street between 9th and 10th Streets.

Fiscal Impacts

- If Twitter relocates to the Central Market and Tenderloin Area, Twitter would still pay its existing base Payroll Expense Tax of approximately $535,500 (350 employees with an average annual salary of $102,000) annually to the City. However, Twitter would not pay any additional Payroll Expense Taxes on the estimated 1,150 additional employees (1,500 projected less 350 currently), resulting in forgone City Payroll Tax revenues of $1,759,500 in 2012; or the estimated 2,650 additional employees (3,000 projected less 350 currently) resulting in forgone City Payroll Tax revenues of $4,054,500 in 2013.
- The Tax Collector's Office estimates (a) initial one-time General Fund expenditures of approximately $162,000, and (b) annual General Fund expenditures of $81,000 would be required to implement and administer the proposed ordinance.

Recommendations

- As requested by the Tax Collector's Office, amend Section 906.3(3) to allow the Tax Collector to disallow the requested Payroll Tax exclusion, if businesses do not maintain their records and documents in a manner acceptable to the Tax Collector's Office to objectively substantiate any Payroll Tax exclusion claim and provide such records, when requested.

- Approval of the proposed ordinance, as amended, is a policy decision for the Board of Supervisors, given the potential short-term loss of Payroll Expense Tax revenues for the City relative to the potential economic stimulus for the Central Market and Tenderloin Area.

MANDATE STATEMENT / BACKGROUND

Mandate Statement

In accordance with the City's Business and Tax Regulations Code Section 902.1[1], currently, San Francisco businesses pay Payroll Expense Taxes to the City of 1.5 percent of the firm's payroll expenses for work or services performed in San Francisco. Each San Francisco businesses' tax liability is determined annually based on the payroll expenses of the entity. Business and Tax Regulations Code Section 905-A provides an exemption for businesses with a payroll of $250,000 or less from the Payroll Expense Tax liability. Sections 906.1 and 906.2 of the Business and Tax Regulations Code also provide exclusions for businesses engaged in certain biotechnology enterprises and clean energy technology, respectively.

Charter Section 2.105 provides that all legislative acts in San Francisco be by ordinance, approved by a majority of the Board of Supervisors.

Background

According to Ms. Jennifer Matz, Director of the Office of Economic and Workforce Development (OEWD), the City has faced challenges concerning the Central Market Street Area[2] and the adjacent Tenderloin for decades. To exemplify the challenges, the OEWD provided the following statistics concerning the Central Market Street and Tenderloin Area: (a) empty and underutilized buildings and storefronts, including a 31 percent storefront vacancy rate in 2010 on Market Street between 5th and 8th, which is the highest rate tracked in the City; (b) poor building conditions with little "leasable" space, such that 33 of the buildings between 5th and 8th Streets are over 100 years old, most with long deferred maintenance; (c) relatively high rents given the downtown location and transit access; (d) lack of retail or services for neighborhood residents and workers (i.e. no full-service grocery store); and (d) negative street activity and lack of foot traffic. Additionally, the OEWD advised that the Tenderloin is one of the most economically disadvantaged neighborhood in the City, with (a) one out of three residents living in poverty, (b) more than half of the residents without a salary or wage income, (c) most of the business activity comprised of low-end convenience or liquor stores, and (d) significant illegal street activity.

[1] Business and Tax Regulations Code Section 902.1(a) specifically defines Payroll Expense as compensation paid to individuals including shareholders of a professional corporation or a Limited Liability Company (LLC), for salaries, wages, bonuses, commissions, property issued or transferred in exchange for the performance of services (including but not limited to stock options), compensation for services to owners of pass-through entities, and any other form of compensation, who during any tax year, perform work or render services, in whole or in part in the City.

[2] The Central Market Street Area is identified as approximately Fifth Street to Tenth Street, along Market Street.

As a result, Ms. Matz advises that a public-private initiative, called the Central Market Partnership was created in January 2010 with a focus on cultivating an eclectic, community-serving arts district in the Central Market and Tenderloin Area. According to Ms. Matz, other planned components of the Central Market Partnership include (a) $11,500,000 of Department of Housing and Urban Development Section 108-guaranteed loan proceeds for low-interest loans for small businesses[3], (b) coordinated incentives, including a renewed effort to generate tax increment financing through the proposed creation of a Redevelopment Area, (c) the Better Market Street Initiative with a focus on overhauling the streetscape and plans to repave the corridor in 2014, (d) technical assistance from OEWD for arts groups to relocate to the area, (e) a $250,000 National Endowment of the Arts grant for visible arts-oriented activities to increase foot traffic[4], (f) partnerships with Community Benefit Districts and other organizations with a focus on improving the neighborhood, (e) establishment of an Interagency Working Group to target City attention and resources to the neighborhood.

DETAILS OF PROPOSED LEGISLATION

The proposed ordinance would amend Article 12-A of the City's Business and Tax Regulation Code by adding Section 906.3 to establish a Payroll Expense Tax exclusion for any (a) new business that is started in or (b) relocates to the Central Market Street and Tenderloin Area. The proposed ordinance would become effective at least 30 days after the Board of Supervisors approves the proposed ordinance, estimated to be approximately May 15, 2011. On March 16, 2011 the Budget and Finance Committee approved an Amendment of the Whole to the proposed ordinance, which included the previous Budget and Legislative Analyst recommendations, Controller recommendations and OEWD recommendations.

According to Ms. Matz, the proposed ordinance is intended to encourage entities to retain and hire employees to work in the Central Market and Tenderloin Area, and is considered part of the above-noted Central Market Partnership, a public/private initiative to renew and coordinate efforts to revitalize the Central Market and Tenderloin neighborhoods.

The Central Market Street and Tenderloin Area is specifically defined in the proposed ordinance and shown in the attached Map. This Area was amended to now specifically exclude large commercial buildings on Market Street, primarily between Van Ness and 8th Street (see Policy Considerations, Increasing Vacancies in the Central Market and Tenderloin Area below).

[3] As of January 2011, the Central Market Cultural District Loan Fund (CDLF) has only announced one loan, Pearl's Deluxe Burgers, 1001 Market Street. Although the Fund aims to assist art programs, many entities do not have the capital or income to meet the loan requirements and the terms of loans are linked to job creation, essentially a new job must be created for every $50,000 borrowed within five years.

[4] In July 2010, the National Endowment for the Arts awarded $250,000 grant to the San Francisco Arts Commission from Mayors' Institute on City Design 25th Anniversary Initiative (MICD25) to support the revitalization of the Mid Market neighborhood.

In accordance with the proposed amended ordinance:

- Eligible businesses that are currently paying Payroll Expense Taxes that are located in the Central Market and Tenderloin Area would continue to pay the same base Payroll Expense Taxes for current employees for 2010;

- Eligible businesses that are currently paying Payroll Expense Taxes that are located elsewhere in the City would continue to pay the Payroll Expense Taxes for the year prior to entering into a lease or buying real property in the Central Market and Tenderloin Area; and

- Eligible businesses that are not currently located in San Francisco would establish their base Payroll Expense Taxes the first year in the area following their relocation into the Central Market and Tenderloin Area.

The proposed Payroll Expense Tax exclusion could not be concurrently claimed by a business that claims any other Payroll Expense Tax exclusion, such as the existing biotechnology or clean energy Payroll Expense Tax exclusions. In addition, the proposed Payroll Expense Tax exclusion would be available for a period of eight years from the effective date of the proposed ordinance, or until approximately May 15, 2019. However, individual businesses could only claim this Payroll Tax exclusion for a maximum of six years. After the proposed ordinance expires in eight years, no unused portions of the exclusion can be claimed.

In order to be eligible for the Payroll Expense Tax exclusion, businesses must (a) apply to the OEWD for evaluation and certification of eligibility, (b) participate in the City's First Source Hiring Program[5], and (c) enter into a binding Community Benefit Agreement with the OEWD if their payroll expense exceeds $1,000,000. Based on the proposed Twitter Community Benefit Agreement provided by Ms. Matz, such Community Benefit Agreements are likely to include activities related to the Central Market Partnership, Community Business Development, Neighborhood Amenities, Workforce Development, San Francisco Unified School District Partnership, Bridging the Digital Divide, Corporate Volunteer Program and Implementation and Monitoring. If eligibility is approved, the individual businesses would be required to (a) file an annual Payroll Expense Tax Return with the Tax Collector's Office regardless of the amount of tax liability shown on the return after claiming the exclusion; (b) file an annual affidavit with OEWD affirming the continued eligibility of the business to receive the exclusion; (c) maintain a reasonable method of documentation that tracks employees whose compensation qualifies for the Payroll Expense Tax exclusion; and (d) provide the documentation to the Tax Collector's Office upon request.

Under the proposed ordinance, the Tax Collector is required to report to the Board of Supervisors each calendar year the amount of payroll excluded from the City's Payroll Expense Tax liability for businesses in the Central Market and Tenderloin Area that are authorized to receive the

[5] The City's First Source Hiring Program, established in Chapter 83 of the City's Administrative Code, connects low-income San Francisco residents with businesses that have entry-level jobs that are generated by the City's investment in contracts or public works, or by business activity subject to approval by the City's Planning Department or the Department of Building Inspection.

exclusion, identifying (a) the number of businesses eligible for the exclusion and (b) the change in the number of all businesses within the Central Market and Tenderloin Area. Under the proposed ordinance, the OEWD would also be required to annually report to the Board of Supervisors on all Community Benefit Agreements that have been established in that year. Under the proposed ordinance, the Assessor-Recorder is required to annually report to the Board of Supervisors any "identifiable increases in property value resulting from businesses' location, relocation, or expansion to or within" the Central Market and Tenderloin Area. In addition, no later than three years following the effective date of the proposed ordinance, the Controller would be required to perform an assessment and review of the effect of the Central Market and Tenderloin Area Payroll Expense Tax exclusion, and subsequently submit the analysis to the Board of Supervisors.

FISCAL ANALYSIS

Prospective Businesses and Payroll Tax Impacts

OEWD has identified the following prospective businesses that might benefit from the proposed Payroll Expense Tax exclusion: (a) Twitter, (b) Black Rock LLC (Burning Man), (c) two hotel chains, (d) a new youth hostel, (e) a mixed-use theater project potentially anchored by the American Conservatory Theater, and (f) a full-service grocery store. The Budget and Legislative Analyst notes that both Twitter and Black Rock LLC would be relocating from other locations in the City. The proposed new youth hostel has already received approval from the Planning Department but is currently raising money for this project.

Of all the identified prospective projects for the revitalization of the Central Market and Tenderloin Area, a lot of attention has recently been given to the pending Twitter relocation. Twitter was founded in San Francisco in 2006 and is currently located at 795 Folsom Street. According to Ms. Matz, Twitter is currently selecting a location for a new headquarters of approximately 150,000 square feet of space with options to expand up to 500,000 square feet in future years. Ms. Matz reports that Twitter currently has 350 employees, expects to reach 750 employees by July 2011, and estimates having 1,500 employees by July 2012 and 3,000 employees in 2013. According to Ms. Matz, Twitter is considering two buildings in San Francisco and two buildings south of San Francisco, with the reported leading contenders to be the SF Mart on Market Street between 9th and 10th Streets[6] and the former Walmart.com building in Brisbane. On March 15, 2011, Twitter sent a letter to Mayor Lee, Board of Supervisors President David Chiu and Supervisor Jane Kim stating that "Twitter has signed a Letter of Intent (LOI) with the Shorenstein group to lease a large block of space at the historic Furniture Mart building on Market and 9th Streets. This LOI is contingent on the Board of Supervisors' approval of the payroll tax exemption as part of the revitalization efforts, without which Twitter would not be able to justify the cost burden of staying in San Francisco."

[6] The SF Mart, formerly known as the Western Furniture Exchange and Merchandise Mart, was acquired by ADCO in 1968, and offers 890,000 square feet of commercial space, 200,000 square feet of retail space, and 450 underground parking spots. According to media reports, Shorenstein Properties LLC has agreed to buy the property; however, the deal is not confirmed and not yet public.

If the proposed ordinance is approved, and Twitter decides to relocate to the Central Market and Tenderloin Area, although Twitter would not be required to pay the Payroll Expense Tax on any new hires, Twitter would still pay its existing base Payroll Expense Tax of approximately $535,500 (350 employees with an average annual salary of $102,000) annually to the City. However, Twitter would not pay any additional Payroll Expense Taxes on the estimated 1,150 additional employees (1,500 projected less 350 currently) to be hired by 2012 or the estimated 2,650 additional employees (3,000 projected less 350 currently) by 2013.

Assuming Twitter was able to relocate into the Central Market and Tenderloin Area immediately, and there was no change in the average annual Twitter salary of $102,000, this would result in approximately $1,759,500 (1,150 additional employees x $102,000 annual salary x .015 Payroll Expense Tax) of forgone Payroll Expense Taxes to the City in 2012 and approximately $4,054,500 (2,650 additional employees x $102,000 x .015) in 2013. However, this assumes that Twitter would remain in the City without the Payroll Expense Tax exclusion. If the number of employees at Twitter remains relatively stable at approximately 3,000 employees, when the Payroll Expense Tax expires, Twitter would pay approximately a total of $4,590,000 ($535,500 annual base Payroll Expense Tax plus $4,054,500 of excluded Payroll Expense Tax) annually to the City.

In 2004, the Board of Supervisors approved Ordinance 26-04 (File 03-1990) amending the definition of "Payroll Expense" to include bonuses and property issued or transferred in exchange for the performance of services, including but not limited to stock options. As a result, San Francisco companies are required to pay a Payroll Expense Tax on gains from employee stock options when companies go public. The inclusion of stock options as payroll expense increases the differential between the City and every other city in the Bay Area for the cost of doing business. Mr. Ted Egan of the Controller's Office advises that Twitter is one of only a few companies in the City that could be going public and at such time could include stock options as a part of their payroll expenses. However, under the proposed ordinance, if Twitter relocated to the Central Market and Tenderloin Area and went public within the six years of their participation in the proposed Payroll Expense Tax exclusion, the value of such stock options would also be excluded, such that Twitter would only pay their base Payroll Tax of approximately $535,500 annually.

Administrative Impacts and Costs

Based on the provisions in the subject ordinance, the OEWD would both initially and annually determine the eligibility of businesses to qualify for the proposed Payroll Expense Tax exclusion, based on businesses filing an annual affidavit with the OEWD. Ms. Matz estimates that OEWD can absorb these additional responsibilities within their existing budget.

Each business would also be required to file an annual Payroll Expense Tax Return with the Tax Collector's Office regardless of the amount of the tax liability, after claiming the requested exclusion. Mr. Greg Kato, of the Treasurer/Tax Collector's Office reports that their office cannot estimate the number of businesses that may qualify for the proposed Payroll Expense Tax exclusion in the Central Market and Tenderloin Area. Therefore, Mr. Kato cannot accurately determine the administrative costs to implement the proposed ordinance.

Ms. Tajel Shah of the Treasurer/Tax Collector's Office advises that initial one-time General Fund expenditures of approximately $162,000 would be necessary to create the necessary forms and establish procedures to verify each businesses employment and payroll data and provide refunds in the first year. In addition, Ms. Shah estimates that the proposed ordinance would require approximately $81,000 of General Fund expenditures each year to review and audit the proposed Payroll Expense Tax exclusions. Under the proposed amended Section 906.3(3) businesses would be required to maintain their records and documents in a manner that is acceptable to the Tax Collector to objectively substantiate any Payroll Tax exclusion claimed under this Section and to provide such documents to the Tax Collector upon request. Ms. Shah requests that the proposed ordinance be further amended to allow the Tax Collector to disallow the requested Payroll Tax exclusion, if businesses do not comply with this specific provision.

POLICY CONSIDERATIONS

Loss of City Payroll Taxes versus Increased Economic Stimulation

The Budget and Legislative Analyst notes that if the proposed Payroll Expense Tax exclusion is not approved, Twitter may not stay and grow their business in San Francisco, such that San Francisco will lose the existing estimated $535,500 annual Payroll Taxes that Twitter currently pays to the City. On the other hand, if Twitter relocates to the Central Market and Tenderloin Area and grows their business as discussed above, and the proposed Payroll Expense Tax exclusion is approved, the City would potentially forego up to $4,054,500 of excluded Payroll Expense Tax annually. Over a six-year period, the time period that Twitter could obtain a Payroll Expense Tax exclusion under the proposed ordinance, this could result in up to $22,032,000 [$1,759,500 in 2012 + $20,272,500 ($4,054,500 in 2013-2017)] of forgone Payroll Taxes to the City, which are General Fund revenues.

Yet, if Twitter relocates to the Central Market and Tenderloin Area and grows their business as discussed above, and the proposed Payroll Expense Tax exclusion is approved, after Twitter receives the Payroll Expense Tax exclusion for six years, the City would begin to receive potentially significantly greater Payroll Taxes from Twitter. As noted above, based on an estimated 3,000 employees, at the current 1.5 percent Payroll Tax rate and assuming a constant $102,000 average annual salary, the City would receive an estimated $4,590,000 of annual Payroll Taxes.

In addition, San Francisco could receive other future benefits of having Twitter based in San Francisco, such as the creation of additional jobs and the direct and indirect economic benefits associated with such job growth. According to Ms. Matz, an estimated additional $1,320,000 would be generated in the first year of Twitter's presence in the Central Market and Tenderloin Area, increasing to $1,726,585 in the sixth year of direct tax revenues to the City. Although indirect economic impacts are more difficult to project, OEWD expects Twitter to have a significant multiplier effect with the generation of jobs to meet the goods and services needs of Twitter and its employees. However, the Budget and Legislative Analyst notes that if Twitter does not expand at the rate that is being projected, the additional future benefits of having Twitter in the Central Market and Tenderloin Area could be significantly diminished.

While Agreeing to Payroll Tax Exclusions, Additional Potential Costs to the City Are Being Proposed

In negotiations between Twitter and OEWD, the OEWD has agreed to provide additional City services to address Twitter's concerns regarding public safety, transportation, and neighborhood conditions in the Central Market and Tenderloin Area, which could result in additional costs to the City. For example, the Police Department has agreed to expand its Mid-Market foot patrol boundary on Market Street that currently extends from 4th Street to 9th Street to 10th Street. In addition, the San Francisco Municipal Transportation Agency (SFMTA) has been requested to provide a 47A service line, an express service during prime commuting hours between the Caltrain Station at 4th and King Streets and the Civic Center BART Station at 9th and Market Streets. According to Mr. John Haley of the MTA, providing such commute hour MUNI service would cost MTA approximately an additional $234,000 annually. OEWD advises that these two proposed City improvements, coupled with the actions of the Central Market Partnership discussed previously, are anticipated to address Twitters concerns regarding neighborhood conditions. However, as the City is experiencing significant budgetary shortfalls, if Twitter does not expand at the rate projected, the Budget and Legislative Analyst questions whether the City will be able to deliver increased levels of services to meet the demands of a large company while potentially reducing Payroll Tax revenues.

Increasing Vacancies in the Central Market and Tenderloin Area

The Budget and Legislative Analyst also notes that in addition to the major challenges already facing the Central Market and Tenderloin Area discussed above in the Background section, there are anticipated to be significant additional vacancies in this area over the next several years, due to the vacating of (a) the State Compensation Building at 1275 Market Street on the corner of 9th Street, (b) the Bank of America Building at 1455 Market Street at 11th Street, and (c) the City's Public Utilities Commission Building at 1155 Market Street between 7th and 8th Streets. Therefore, there is anticipated to be significantly increased office space available in the Central Market and Tenderloin Area over the next several years, which will likely result in reduced rents from this increasing supply. The combination of increased supply and reduced rents in major office buildings in the Area may encourage new businesses to locate or relocate to this Area, without the added benefit of the proposed Payroll Expense Tax exclusion.

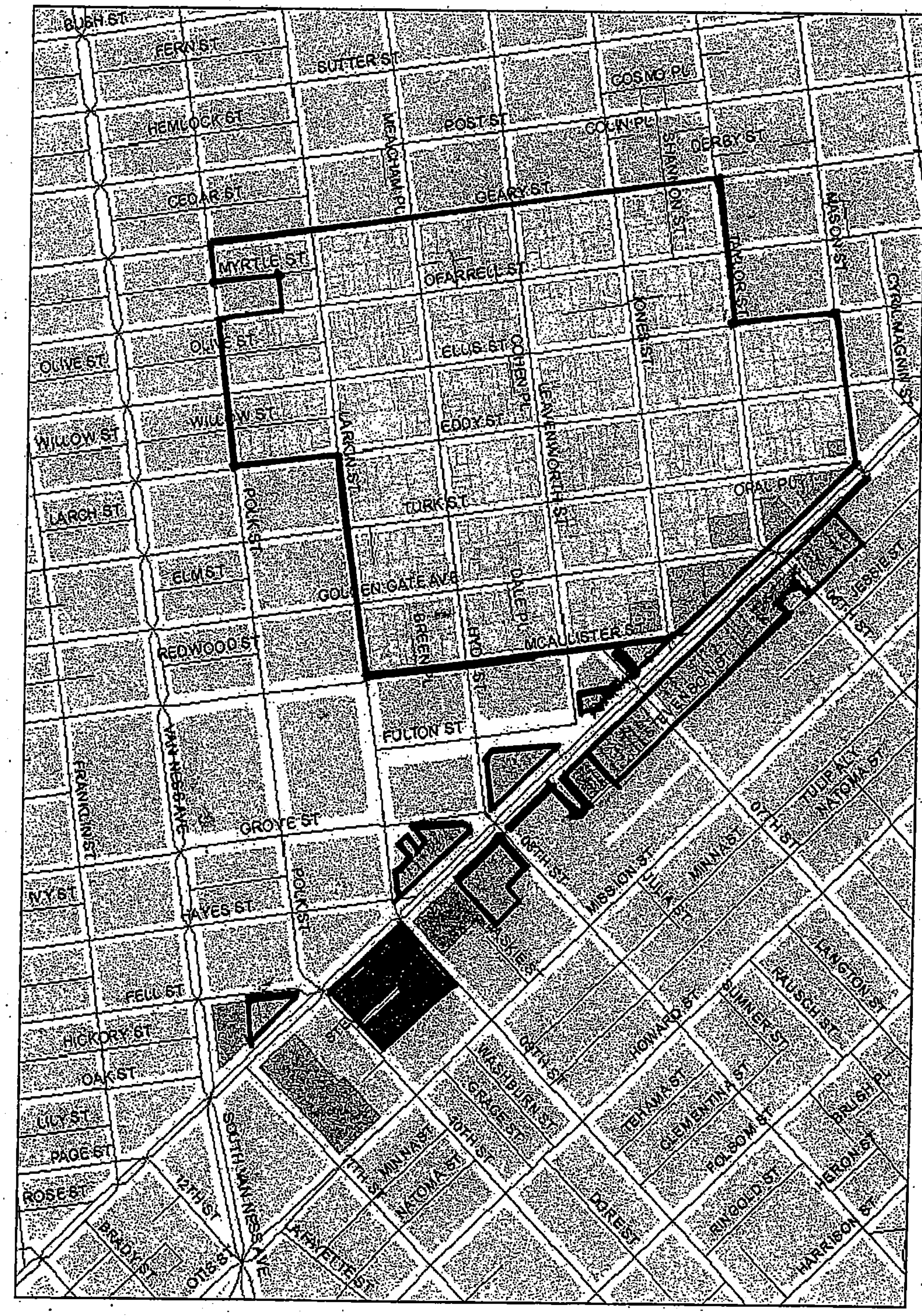
As a result, the proposed amended ordinance specifically deletes the three buildings identified above, which are (a) 1275 Market Street, (b) 1145 Market Street, (c) 1155 Market Street, as well as two additional commercial buildings located at (d) 1455 Market Street, and (e) 30 Van Ness Avenue.

RECOMMENDATIONS

1. As requested by the Tax Collector's Office, amend Section 906.3(3) to allow the Tax Collector to disallow the requested Payroll Tax exclusion, if businesses do not maintain their records and documents in a manner acceptable to the Tax Collector's Office to objectively substantiate any payroll tax exclusion claim and provide such records, when requested.

2. Approval of the proposed ordinance, as amended, is a policy decision for the Board of Supervisors.

Map: The Central Market and Tenderloin Area Payroll Expense Tax Exclusion Boundaries



Source: Office of the Controller, Office of Economic Analysis, *Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area: Economic Impact Report,* March 15, 2011. Revised as amended, March 17, 2011.

SMALL BUSINESS COMMISSION
OFFICE OF SMALL BUSINESS

CITY AND COUNTY OF SAN FRANCISCO
EDWIN M. LEE, MAYOR

March 15, 2011

Ms. Angela Calvillo, Clerk of the Board
Board of Supervisors
City Hall room 244
1 Carlton B. Goodlett Place
San Francisco, CA 94102-4694

Re: File No. 110155 [Business and Tax regulations Code- Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area.]

Small Business Commission Recommendation: **Approval**

Dear Ms. Calvillo:

On March 14, 2011, the Small Business Commission unanimously voted to recommend approval of Board of Supervisors File No. 110155.

The Commission recognizes that this proposed tax exclusion will provide benefits to businesses of all sizes both within the exclusion area as well throughout the City of San Francisco.

Much of the attention on this tax exclusion has been placed on the attracting of Twitter to the Central Market area. The economic benefit of having upwards of 2,500 new Twitter employees in this area, along with potentially thousands of additional employees from other companies that follow, will have significant benefit to local small businesses. These employees will both shop and eat in the immediate area surrounding their workplace, which will benefit existing businesses and attract new ones to Central Market and the Tenderloin area. In addition, many of these employees will reside in residential areas throughout the City and will shop and eat local in their own neighborhoods. These multiplier affects will additionally benefit the retail, services, entertainment, and hospitality sectors inside and outside the vicinity of Central Market and the Tenderloin. Also, reduced storefront vacancies within the program area will have additional benefits, including reduced blight and safety improvements which will benefit residents and businesses across all social economic spectrums.

Small businesses will also qualify for the tax exemption and will have an incentive to either locate to this exclusion area or add additional employees. Small Businesses of 5 employees or more often qualify for the payroll tax and they will be incentivized to either locate to the program area or add additional employees. One sector that is poised for growth and utilization of the significant amount of office space are businesses to business companies, including technology and related firms. These businesses will bring an entrepreneurial spirit to the area and will hope to grow using this tax credit and expanded business to business opportunities as catalyst to locate to Central Market and the City.

Comments include recommending that the Board of Supervisors support this type of tax exclusion in additional areas in the city that are in need of economic stimulation and ask the Office of Economic and Workforce Development to explore this topic. This may become especially important should the

SMALL BUSINESS COMMISSION
OFFICE OF SMALL BUSINESS

CITY AND COUNTY OF SAN FRANCISCO
GAVIN NEWSOM, MAYOR

successful enterprise zone program, which has benefited a significant number of small businesses, is reduced or eliminated through upcoming or future state budget cuts.

The Commission thanks Supervisor Kim for his informative presentation at our March Small Business Commission meeting.

Sincerely,

Regina Dick-Endrizzi
Director, Office of Small Business

cc. Supervisors Kim, Chiu, Farrell
Jason Elliott, Mayor's Office
Jennifer Matz, Director, Office of Economic and Workforce Development

SMALL BUSINESS ASSISTANCE CENTER/ SMALL BUSINESS COMMISSION
1 DR. CARLTON B. GOODLETT PLACE, ROOM 110 SAN FRANCISCO, CALIFORNIA 94102-4681
(415) 554-6481

CITY AND COUNTY OF SAN FRANCISCO
OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

March 15, 2011

The Honorable Board of Supervisors
City and County of San Francisco
Room 244, City Hall

Angela Calvillo
Clerk of the Board of Supervisors
Room 244, City Hall

RECEIVED
BOARD OF SUPERVISORS
SAN FRANCISCO
2011 MAR 15 PM 2:27
BY

Re: Office of Economic Analysis Impact Report for File Number

Dear Madam Clerk and Members of the Board:

The Office of Economic Analysis is pleased to present you with its economic impact report on file number 100155, "Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area: Economic Impact Report." If you have any questions about this report, please contact me at (415) 554-5268.

Best Regards,

Ted Egan
Chief Economist

cc Victor Young, Committee Clerk, Budget & Finance Committee

415-554-7500 City Hall • 1 Dr. Carlton B. Goodlett Place • Room 316 • San Francisco CA 94102-4694 FAX 415-554-7466

City and County of San Francisco

Office of the Controller - Office of Economic Analysis

Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area:

Economic Impact Report

File No. 101155

March 15, 2011

City and County of San Francisco

Office of the Controller - Office of Economic Analysis

Payroll Expense Tax Exclusion in Central Market Street and Tenderloin Area: Economic Impact Report — **March 15, 2011**

Main Conclusions

San Francisco levies a 1.5% payroll expense tax (or "payroll tax") on all businesses that operate in the city and whose annual payroll expense exceeds $250,000. The proposed legislation would establish a zone, south and west of the financial district, within which businesses could exclude new payroll from the payroll tax for up to six years. In other words, businesses with premises in the area would be responsible for paying only their base year payroll tax, and could increase their payroll without additional tax for up to six years.

The proposed legislation can be understood as a variation on the policy of enterprise zones. These policies have been criticized for using tax revenues to subsidize business location in a depressed area, without stimulating a genuine process of long-term economic development that can survive the expiration of the subsidy. Unlike traditional enterprise zones, however, the possibility that Twitter might move to the Central Market area would likely increase its attractiveness to other businesses, leading to job and tax revenue growth after the expiration of the legislation.

Twitter is growing rapidly and reportedly needs a new location. It is said to be choosing between the San Francisco Mart building, at Market and 10th Street, or locations in San Mateo County. Analysis of rent, commuting, labor, and tax costs suggests that San Francisco's higher business tax could create a significant incentive for Twitter to leave the city. San Francisco's payroll tax covers all compensation to employees, including stock options. Twitter is currently valued in secondary markets in excess of $7 billion, after being valued at only $250 million in February 2009. The compensation associated with its stock options could be sizable in the future, and the accompanying payroll tax could reach into the tens of millions of dollars. If that is the case, it would appear to make a San Francisco location more expensive for the company than an alternative in San Mateo County.

Because of this, the legislation was analyzed based on the assumption that Twitter would leave the city if it was not enacted, and would move to the SF Mart if it was. Under these two scenarios, the long-term payroll tax growth associated with the formation of an technology industry cluster in the Central Market area outweighs the payroll tax growth that could reasonably expected to occur without Twitter, by approximately $2.7 million per year on average over twenty years. In addition, the legislation can be expected to lead to higher job growth and property values in the area, which will also increase sales, hotel, utility user, property, and transfer tax revenues.

This research suggests that two changes to the proposed legislation could reduce risks of an adverse economic impact, and increase the benefit to the General Fund while maintaining its economic benefits. In addition, two related policy ideas are offered for the consideration of decision-makers.

1. Requiring multi-location businesses to apportion their payroll, such that they are only eligible to exclude net new payroll within the area.

2. Removing large commercial properties, other than the SF Mart, from the area. If the large properties were excluded, the net payroll tax gain for the City would rise to an estimated $5.5 million a year, as the City would no longer lose the payroll tax growth that would happen at these properties naturally.

3. As a policy idea that is not directly tied to the proposed legislation, the City could structure a parcel tax on vacant commercial property, which would not apply to occupied commercial property. This would encourage owners of vacant commercial property to be flexible on rent, and thereby maximize occupancy and employment in the city. This tax could not be included in the proposed legislation, as it would have to be submitted to the voters pursuant to Proposition 218. Nevertheless, it is mentioned here as a future policy consideration.

4. Finally, this analysis suggests that an important variable in the fiscal and economic success of the proposed legislation is Twitter's decision to locate in the Central Market area instead of moving out of San Francisco. In turn, Twitter's potential future payroll tax liability associated with its stock options appears to be the largest cost factor weighing against a San Francisco location. The City should consider modifying the payroll expense tax, to reduce the incentive for successful technology companies to move out of San Francisco.

INTRODUCTION

Summary of the Proposed Legislation

San Francisco levies a 1.5% payroll expense tax (or "payroll tax") on all businesses that operate in the city and whose annual payroll expense exceeds $250,000. Currently, the tax applies to approximately 9,000 businesses and generated $345 million during fiscal year 2009-10. After the Property Tax, the payroll expense tax is the second-largest revenue source in the City's General Fund.

The proposed legislation would establish a zone, south and west of the financial district, within which businesses could exclude new payroll from the payroll tax for up to six years. In other words, businesses with premises in the area would be responsible for paying only the payroll tax in their base year, and could increase their payroll without additional tax for up to six years. A business's base year is defined in one of three ways, depending on where the business was located on the effective date of the policy.

1. For businesses that are already located in the area, on the effective date, the base year is 2010.
2. For businesses located elsewhere in San Francisco that move to the area after the effective date of the policy, the base year is the year prior to their move.
3. For businesses located outside of San Francisco that subsequently relocate to the area, the base year is their first year in San Francisco.

The legislation expires after eight years. A business can select up to six years of its choosing to utilize the exclusion.

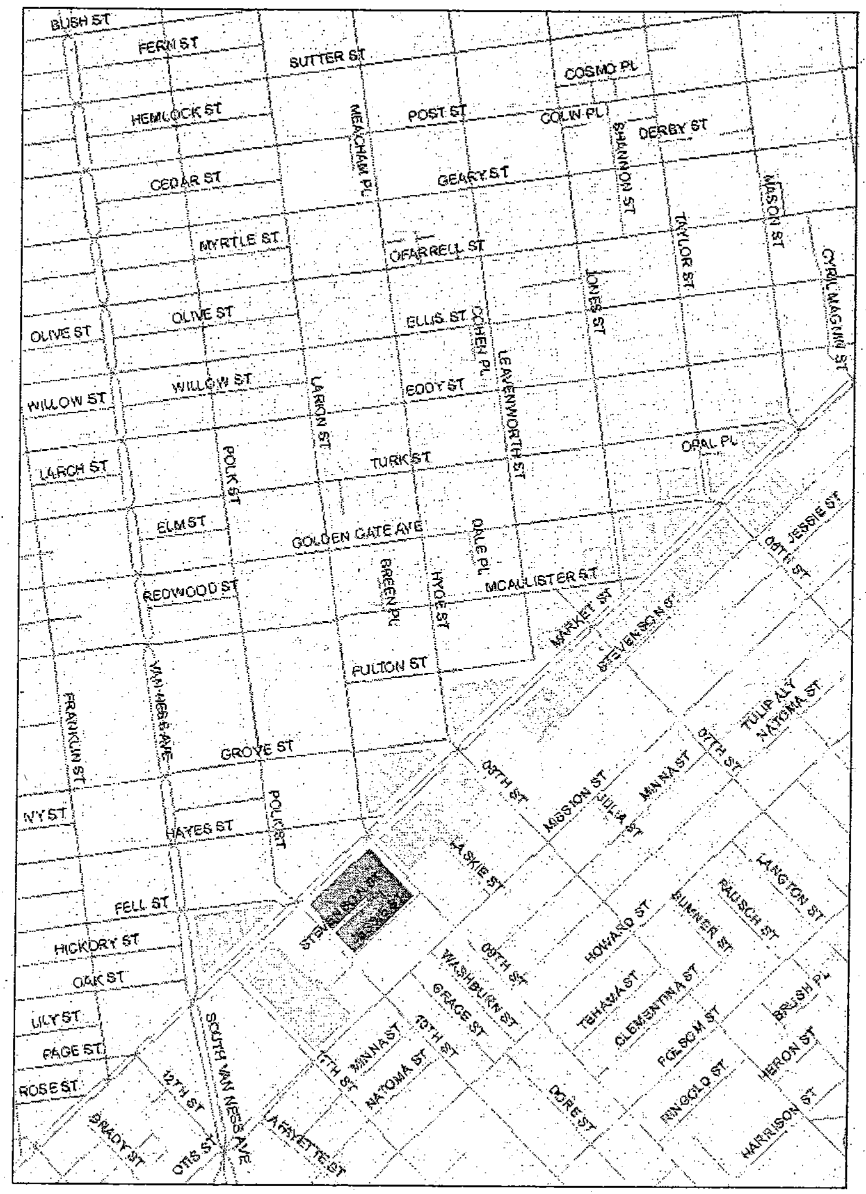
For many years the area, particularly along Market Street from 5th to 8th street, has experienced notably lower levels of commercial occupancy and activity than other sections of Market Street.

The City has recently undertaken a series of initiatives in an attempt to stimulate commercial development in the corridor, ranging from a small business loan fund, to streetscape improvements, to technical assistance to arts organizations. The proposed legislation can be viewed as an additional policy measure to encourage business location and employment growth within the area.

Map of the Central Market Street and Tenderloin Area

The area consists of most properties along Market street from Fifth street southwest to Van Ness Avenue. In addition, most properties in the Tenderloin area bounded by McAllister Street, Polk Street, Geary Street, and Mason Street are included, as indicated in Figure 1.

FIGURE 1 Map of the Proposed Central Market and Tenderloin Area



Source: Legislation Text

For reasons that will be detailed later in this report, it is useful to highlight four distinct sub-areas in the Central Market Tenderloin Area:

1. The San Francisco Mart building, 1455 Market Street, highlighted in red above. Twitter, the social media company now located on Folsom Street, is reportedly considering relocating to this property[1]. The Mart had previously served as a wholesale

[1] John Cote, "Mid-Market tax break plan in works to lure Twitter," San Francisco Chronicle, February 8, 2011, A-1.

furniture showroom until the mid-2000s, but is currently 95% vacant. It is envisioned for retail/office uses in the future, although it has not served those functions in the past, and would require significant renovations to accommodate those uses. The main Mart building fronting Market Street has 805,000 square feet[2].

2. Other large commercial buildings on Market Street largely southeast of 8th street to Van Ness. These properties constitute the bulk of the potential new employment to the area, and the majority of the space will be vacant and seeking tenants in the next 1-2 years. These properties include:

    a. 1155 Market Street, where the San Francisco Public Utilities Commission is now based. The PUC will be vacating in the next 1-2 years, for a new building on Golden Gate Avenue. The building has approximately 160,000 square feet.

    b. 1145 Market Street, which also hosts the SF PUC, the San Francisco Health Services System, other City agencies, and private tenants. CoStar reports that the building is currently 85% leased, and contains 145,000 square feet.

    c. 1275 Market Street, owned the State Compensation Insurance Fund (SCIF). SCIF has announced plans to vacate the building[3]. The building has approximately 350,000 square feet.

    d. 1455 Market Street, until recently owned and occupied by the Bank of America. It is also expected to entirely vacate in the next year. The building has approximately 1 million square feet of office space.

    e. 30 Van Ness, at the corner of Market and Van Ness, which is owned and occupied by the City and County. The building contains approximately 150,000 square feet.

2. Other commercial properties along Market Street, largely northwest of 7th street, highlighted in green. In general these are smaller office or non-office properties which are unlikely to host large numbers of new employees. Many of the smaller commercial properties have no tenants and have been vacant and blighted for many years.

[2] Source: CoStar market reports.

[3] J.K. Dineen, "State Fund move creates Civic Center Pain", San Francisco Business Times, December 9, 2010.

3. Parcels in the Tenderloin, highlighted in light orange. The majority of the commercial tenants in the area are smaller, neighborhood-serving businesses, or public or non-profit sector organizations. None of these types of tenants would be affected by the proposed legislation, as the payroll tax does not apply to small businesses, non-profit organizations, or government organizations.

POLICY BACKGROUND

Tax Incentives and Job Creation: Enterprise Zone Policies

The proposed legislation can be understood as a variation on the policy of enterprise zones. First proposed in the late 1970s to stimulate the commercial redevelopment of blighted areas in Britain and the U.S., they generally involve reducing the tax burden of businesses who locate jobs within an economically-depressed area.

Research on the impacts of enterprise zones has been mixed[4]. While the general principle that reducing the business tax burden can encourage private-sector job growth is fairly uncontroversial among economists, this does not necessarily mean that zone-based policies create jobs, and the policy has been criticized on several grounds[5].

In some cases, tax incentives have been shown to be insufficient to stimulate growth in areas that have suffered severe economic downturns, due to deindustrialization, for example. Since it was precisely this problem that they were originally developed to rectify, it led many to conclude that tax incentives alone have a limited capacity to transform depressed areas and local economies. Since this research concerned national-level taxes which are far more costly to businesses than San Francisco's 1.5% payroll tax, it suggests locally-funded enterprise zones may have even more limited effect, in isolation[6].

On the other hand, when applied to less-depressed areas, enterprise zones are also subject to the criticism that they provide a tax subsidy to business location decisions that would have happened anyway[7]. In that context, a tax incentive that applies to specific areas can be understood as a form of commercial rent subsidy, particularly when it applies to existing occupiable space that does not require extensive investment or redevelopment. Reducing the business tax burden at a specific location increases the desirability of the site for businesses, and the increased competition for the site tends to raise rents. The public investment, in such cases, benefits property owners and does not create jobs.

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[4] See for example, Alan H. Peters and Peter S. Fischer, *State enterprise zone programs: have they worked?* (Kalamazoo: Upjohn Institute, 2002).

[5] It must be pointed out that most enterprise or empowerment zone policies target the tax incentives to employees who are unemployed or have barriers to employment. This is not the case with the current policy, which likely increases its effectiveness in job creation *per se*, though obviously not for the workers who are targeted in enterprise zone policies.

[6] Neumark and Kolko (2010), for example, found that California's state enterprise zone program have no effect, on average, on job creation. See David Neumark and Jed Kolko, "Do enterprise zones create jobs? Evidence from California's enterprise zone program", Journal of Urban Economics 68 no.1 (2010) 1-19.

[7] Recognizing this, policy evaluations of enterprise zones focus on—and are highly sensitive to—the choice of "control areas". These are economically-similar areas that did not receive a tax incentive, and whose employment changes are used to establish a benchmark for those areas that do.

The economic function of the industrial and commercial real estate markets is to ensure the utilization of built infrastructure by establishing market rents that businesses want to pay and property owners can accept to offset their capital costs. The introduction of a "market-closing" tax subsidy is only warranted, according to this line of reasoning, when a significant market failure exists that has caused significant underutilization of infrastructure for an extended period of time.

Other objections to enterprise zones address the efficacy and role taxes play in affecting business decisions and the overall process of urban economic development. Enterprise zones have also been criticized for encouraging business location but not creating "real" economic development in the targeted areas. Consequently, when the subsidies expire, businesses lose the incentive to locate in the area, jobs decline again, and the area reverts to a *status quo ante* situation[8].

By contrast, in areas that attract businesses without a subsidy, business location and expansion decisions often invite businesses and residences to follow suit, in a clustering process. As the area succeeds at attracting businesses, more businesses and workers want to be there. According to this logic, tax incentives alone are insufficient to initiate this clustering dynamic, and yet without clustering, the long-term economic benefits of tax incentives will not materialize.

This research on enterprise zones suggests that the job-creation benefits of geographically-focused tax incentives can be maximized, and their negative consequences minimized, by targeting the policy in three primary ways:

1. Avoid using tax incentives as a stand-alone policy, in areas where they are too small to have a real effect.
2. Limit tax incentives to areas where a significant market failure exists, as evidenced by a history of high vacancy rates and underutilized infrastructure.
3. Utilize tax incentives only when there is a significant likelihood of attracting businesses that can catalyze a genuine, sustained process of local economic development once the subsidies expire.

Special Characteristics of the Central Market Area

In some respects, the Central Market and Tenderloin area has some of the characteristics that could lead to a successful enterprise zone strategy, if the policy is targeted with sufficient care.

In the first place, as discussed above, the tax incentive is not

[8] See, for example, Suzanne O'Keefe, "Job creation in California's enterprise zones: a comparison using a propensity score matching model", Journal of Urban Economics 55 no. 1, (2004): 131. This generally positive assessment of the short-term employment impacts of enterprise zones concluded that the long-term impacts are negative

the only policy initiative the City has undertaken to encourage investment and economic activity in the area. Secondly, there are many properties in the area that have remained vacant for many years, either because the structures themselves need a large amount of new investment to be occupiable, or because of lack of demand from tenants. The existence of such areas suggests that growth in most properties in the Central Market area won't "happen anyway".

However, by far the most significant element in the potential impact that could occur in the area is the attraction of Twitter. The company has become one of the leaders in social media, which has been one of the fastest-growing segments in the information technology in recent years. In only three years, Twitter's valuation—the implied value of all of its stock—has risen to $3.7 billion in December 2010[9]. It has recently been reported that the company has turned down an acquisition offer in the $8-10 billion range, suggesting the company believes its true value will eventually exceed that figure[10].

Based on published media reports, Twitter is planning to vacate its existing space on Folsom Street because it wishes to expand its workforce. Based on information provided to the OEA by the Office of Economic and Workforce Development, Twitter is interested in leasing approximately 400,000 square feet of real estate over the next five years. Depending on the layout of the space, this could support 2,000 – 2,500 jobs. The average compensation in Twitter's industry in San Francisco is approximately $100,000 per year, about 35% higher than the average private sector salary in San Francisco of $73,000.[11]

There is no other large private sector company in the Central Market/Civic Center area, and certainly not one that is likely to add 2,000 jobs in the next several years. Moreover, because of Twitter's importance in the rapidly-growing field of social media, its growth is highly likely to generate a cluster of businesses in the same field.

If this cluster development happens in the wake of a potential Twitter relocation to the area, it would make it very unlikely that Central Market would revert to a *status quo ante* situation after the proposed legislation expires. The new presence of other technology companies and related businesses could, by themselves, make the area a more desired business location that it is now, with our without the proposed tax incentive.

None of this is to say that the proposed legislation would be

[9] Amir Efrati, "Profit Elusive, but Twitter gets $3.7 Billion Value" Wall Street Journal, December 15, 2010.

[10] Spencer E. Ante, Amir Efrati and Anupreeta Das, "Twitter as Tech Bubble Barometer", Wall Street Journal, February 10, 2011.

[11] Bureau of Labor Statistics, *Census of Employment and Wages* for San Francisco County. Twitter's industry classification (NAICS) code is 5182.

decisive in Twitter's decision to locate in the Central Market or to expand outside of San Francisco. While this question is vital in assessing the potential impact of the legislation, the OEA does not possess any inside information on the subject. The publically-available data bearing on this question will be reviewed in the next section.

Twitter's Situation

If Twitter does elect to move out of San Francisco, it would not be an unprecedented move for a company of its size. San Francisco has a history of struggling retain its larger businesses, while its small business sector has become an increasingly large share of total employment.

Recently-acquired data from the National Employment Time Series, which tracks individual businesses across locations and time, confirms this. Proportionally more San Francisco businesses moved out of the city during the last economic upswing, than from other Bay Area counties, while more businesses have left. As Table 1 indicates, 3.6% of all businesses in San Francisco in 2003 moved out during the economic upswing from 2003-8, the highest figure among the five largest Bay Area counties.

Rates of Business Move-outs, San Francisco and Other Bay Area Counties, 2003-8

	San Francisco	Alameda	Contra Costa	San Mateo	Santa Clara
# of Establishments, 2003	65,569	87,111	56,086	48,315	105,980
# of businesses moved out, 2003-8	2,393	2,235	1,593	1,528	1,952
as % of 2003 total	3.6%	2.6%	2.8%	3.2%	1.8%

Source: NETS/Edward Lowe Foundation

Employee Stock Options and San Francisco's Payroll Tax

As stated in the introduction, San Francisco taxes payroll expense at 1.5% for businesses with total employee compensation above the small business exemption amount. Payroll expense includes all compensation to employees, including stock option grants.

It is common practice in the information technology industry to compensate employees with stock options. These options grant the right to purchase a specific number of shares in the company at a specific price, called the *strike price*. The shares come from among those internally held by the company itself, as opposed to those held by outside investors. A common practice for an early-stage, privately-held company is to grant its employees options at a low strike price, in the hope that the company will rise in value as it grows. Employees have the right to *exercise* the options, meaning they pay the strike price and receive shares that are usually equal or close to the market price of the stock at that time.

For example, the option may be structured such that if an employee is granted 10,000 options at a strike price of $1, and the company goes public, the employee has the option to exercise the option. If he or she does so at an exercise price of $50/share, the employee pays the company $1 x 10,000 or $10,000, and receives shares worth $50 x 10,000 or $500,000. After exercising the options, the employee receives shares that he or she can either hold or sell. The company's equity is reduced by $490,000, and the employee's equity is increased by the same amount.

The widespread practice of granting options in the technology industry stems from the belief that offering stock creates a greater incentive for employee performance than salary compensation, and from the belief that it allows the company to reduce its risk. Stock options create a liability for the company only if the company is successful, and the market value of the shares rises.

Twitter has received five publically-reported rounds of outside investment (see Table 2). During those rounds, the implicit market value of the company has risen from approximately $20 million to $3.7 billion. In each round, a share of the company is sold to private investors. An estimate of the total amount of the company held by outside investors can be adding up the share of the company that is sold in each round. Based on media reports, roughly half of Twitter is owned by outside investors, suggesting that the remainder is still owned by or optioned to company founders and employees.

TABLE 2 Twitter's Reported Funding Rounds

Date	Investment ($M)	Valuation ($M)	% of Equity
Jul-2007 [1]	$1	$20	5%
May-2008 [2]	$15	$80	19%
Feb-2009 [3]	$35	$250	14%
Sep-2009 [4]	$100	$1,000	10%
Dec-2010 [5]	$200	$3,700	5%
		Total:	53%

1 Michael Arrington, "Twitter Gets Their Venture Round", TechCrunch, July 26, 2007. Value is estimated.
2 Michael Arrington, "Twitter Announces Their Funding, Calls Itself A Communication Utility", TechCrunch, June 24, 2008.
3 Mark Hendrickson, "Twitter Raises $35 Million Series C From Benchmark and IVP", TechCrunch, February 13, 2009.
4 Brad Stone, "Twitter Confirms New Funding", New York Times, September 25, 2009
5 Spencer E. Ante, Amir Efrati and Anupreeta Das, "Twitter as Tech Bubble Barometer", Wall Street Journal, February 10, 2011.

Twitter's actual payroll expense tax liability depends upon its market value at the time employees exercise their options, and this is highly uncertain. At the time of writing, Twitter's stock options are being traded on a secondary market[12] at a company valuation of $7.3 billion. Twitter has reportedly rejected takeover rumors at a valuation of $10 billion, suggesting the company believes it would be worth more in the future[13].

As the only city in California to levy a payroll expense tax, San Francisco is the only city that imposes a local tax on stock options. The differences in business tax liability between San Francisco and other Bay Area locations are magnified for companies that grant stock options that are likely to be valuable in the future. If Twitter moved to the City of South San Francisco, for example, it would pay that city $15 per employee per year, or $37,500 a year for 2,500 employees.

Differences in tax liabilities between cities are important to business location decisions, but they are not the only consideration and cannot be considered in isolation. Commercial rent and tenant improvement cost differentials may offset tax differences, as may direct and indirect labor cost differentials. Intangible factors may also matter, but are hard to quantify by definition. If a business can access a broader labor force at lower wages in one city versus another, or workers incur lower commuting costs to one job site versus another, these costs factors can offset differentials in local taxes or commercial rents. Such tangible considerations are analyzed in the next section. Intangible factors, such as the branding value of a San Francisco location, are not analyzed in this report.

Commercial Rent Differentials

Based on published reports, the company is considering the SF Mart building in the Central Market area, and two locations in San Mateo County: the former Walmart.com building in Sierra Point in Brisbane, and the Centennial Towers in South San Francisco[14]. While the OEA does not have any information about Twitter's negotiations, or the Brisbane property, published asking rents for two of the properties on CoStar probably give a reasonably clear indication of the trade-off between Centennial Towers and the SF Mart.

The listed asking rents in the South San Francisco are actually considerably higher than those at the San Francisco Mart building, primarily because Centennial Towers is a new property, and includes thousands of free parking spaces. However, because of its greater age, and history of use as a furniture showroom and not an office building, the Mart will require expensive tenant improvements. These costs are generally borne by the tenants, and we have estimated them

[12] Sharespost.com

[13] Spencer E. Ante, Amir Efrati and Anupreeta Das, "Twitter as Tech Bubble Barometer", Wall Street Journal, February 10, 2011.

[14] Alexia Tsotsis, "Twitter Considers Moving Its Headquarters. To Brisbane, CA?" TechCrunch, January 13, 2011.

at $100/square foot, compared with $35/square foot in South San Francisco.

This brings the six-year occupancy costs in the two alternatives into closer alignment, although South San Francisco is still more expensive. As stated in the previous section, San Francisco's payroll tax covers all compensation to employees, including wages and salaries, stock options, and any other property or consideration. When only Twitter's business tax on its expected wages and salaries are considered, the two locations differ by $2.4 million over six years, as detailed in Table 3. San Francisco's higher business tax rate is offset by lower rents at the SF Mart location.

However, the future value of Twitter's stock options is unknown, but likely very large given their current value and the company's recent growth. Its future payroll tax liability for that form of compensation could be significant, perhaps reaching into the tens of millions of dollars over several years. If that is the case, the company's payroll tax would make a San Francisco location significantly more costly than a San Mateo County alternative.

TABLE 3

Twitter's Estimated Building Occupancy and Tax Costs, San Francisco Mart and South San Francisco Location, Excluding Stock Options

	Year						6-Year
	1	2	3	4	5	6	Total
Rent-SF Mart	$2.92	$2.92	$2.92	$2.92	$2.92	$2.92	
Monthly Rent - South SF	$4.25	$4.25	$4.25	$4.25	$4.25	$4.25	
Twitter's Anticipated Occupied Square Footage	200,000	300,000	400,000	400,000	400,000	400,000	
Annual Rent Payment - SF Mart ($M)	$7.0	$10.5	$14.0	$14.0	$14.0	$14.0	$73.6
Annual Rent Payment - South SF ($M)	$10.2	$15.3	$20.4	$20.4	$20.4	$20.4	$107.1
Tenant Improvements - SF Mart ($M)	$20.0	$10.0	$0.0	$0.0	$0.0	$0.0	$30.0
Tenant Improvements - South SF ($M)	$7.0	$3.5	$0.0	$0.0	$0.0	$0.0	$10.5
Total Annual Occupancy Costs - SF Mart ($M)	$27.0	$20.5	$14.0	$14.0	$14.0	$14.0	$103.6
Total Annual Occupancy Costs - South SF ($M)	$17.2	$18.8	$20.4	$20.4	$20.4	$20.4	$117.6
Business Tax excluding stock options - SF Mart ($M)	$1.6	$2.4	$3.2	$3.2	$3.2	$3.2	$16.6
Business Tax - South SF ($M)	$0.02	$0.02	$0.03	$0.03	$0.03	$0.03	$0.2
Occupancy Costs and Taxes - SF Mart ($M)	$28.6	$22.9	$17.2	$17.2	$17.2	$17.2	$120.2
Occupancy Costs and Taxes - South SF ($M)	$17.2	$18.8	$20.4	$20.4	$20.4	$20.4	$117.8
						SF Premium	$2.4

Sources: For asking rents: CoStar reports. For Twitter absorption: OEWD.
Assumptions:
Tenant improvements: $100/sf for the SF Mart, $35/sf for South SF location.
SF Business tax excluding stock options: Absorption divided by 190 sf/employee (equaling headcount) x $100,000 annual salary x 1.5%.

While this analysis cannot definitively indicate how Twitter perceives its options, if these numbers are roughly correct, it suggests that the proposed legislation would have a significant financial benefit for Twitter.

Asking rent data for the property on Marina Boulevard in

Brisbane is not available on Costar. However, that property is 25 years old and is unlikely to rent for more than the new Centennial Towers. To the extent that they rent for less than Centennial Towers, it only exacerbates the affordability gap that San Francisco faces because of its payroll tax.

Transportation Costs

There still may be other tangible and intangible factors that the company might consider in making its decision. Among the tangible factors is labor access and cost. The SF Mart and South San Francisco locations offer different levels of transportation service and accessibility to workers. Workers who commute to jobs in San Francisco are far more likely to travel by transit, biking, or walking. These modes of transportation offer much lower operating costs than driving to work, which most workers in San Mateo county do. However, those workers who do commute by car to jobs in San Francisco—and 35% of the city's IT workers are in that category—must generally pay for parking, which adds to that costs. In suburban office locations, parking is usually free.

Table 4 summarizes an analysis of census data from 2005-9. This data allows for the direct cross-tabulation of results of a survey that the census sends to 1% of U.S. residents each year. The sample is restricted to IT workers who commute to jobs in either San Mateo or San Francisco counties, and calculates the split of workers by mode of transportation, and their average one-way commuting time by mode. Operating cost / trip is estimated based on published monthly transit prices, and current monthly new auto lease, insurance, fuel prices.

Commuting Time and Operating Costs: Information Technology Workers commuting to San Francisco and San Mateo Counties

	Work in San Francisco			Work in San Mateo County		
	% of commuters	Average commute time	Cost/Trip	% of commuters	Average commute time	Cost/Trip
Auto from within SF	14%	21	$11.80	11%	41	$9.74
Auto from outside SF	21%	47	$13.51	80%	31	$9.67
Transit from within SF	22%	30	$1.50	2%	60	$1.61
Transit from outside SF	31%	58	$5.60	3%	53	$1.07
Bike/Walk	11%	20	$0.02	3%	20	$0.02
All modes		40	$6.64		33	$8.93

Source: IPUMS/American Community Survey, 2005-9
See Appendix A for assumptions.

On average, San Francisco commutes offer lower out-of-pocket costs, but take more time. The city's average high time cost of commuting particularly discourages workers in high-wage industries, such as information technology. Even if workers do not value commuting time at only half the value of their hourly wage, total commuting costs is still a slightly higher percentage of worker salaries than it is in San Mateo county. This means that a San Francisco location—despite is centrality in the region, and despite the variety of transportation options that are available—does not necessarily translate into a competitive advantage in attracting information technology workers.

TABLE 5 **Commuting Time and Operating Costs: Information Technology Workers commuting to San Francisco and San Mateo Counties**

	San Francisco	San Mateo	Difference
One-Way Average Commuting Costs	$6.64	$8.93	$2.29
Annual Commuting Costs (480 trips)	$3,186	$4,288	$1,101
One-Way Average Commuting time (min)	40	33	-7
Annual Commuting Time (hours)	319	265	-53
Average Hourly Salary	$44.54	$50.08	$5.54
% discount for commute-time valuation	50%	50%	
Annual Time Cost of Commuting	$7,100	$6,647	-$453
Annual Total Cost of Commuting	$10,287	$10,935	$648
as % of annual salary	11.1%	10.5%	-0.6%

Source: IPUMS/American Community Survey, 2005-9

Table 5 also indicates that average wages for information technology workers are considerably less in San Francisco than they are in San Mateo county. This could, in theory, be an additional source of advantage associated with a San Francisco location. However, statistical analysis of individual worker information from the census data suggests that these wage differences can fully be accounted for by differences in education, age, and other variables that affect earnings.

IT workers in San Mateo are more likely to have a graduate degree, and be older, than their San Francisco counterparts. When those differences are accounted for, the impact of a San Francisco location *per se* on wages is statistically insignificant.

Fiscal and Economic Impacts

The foregoing section focused on establishing the relative importance of business tax differences in the overall cost accounting of a San Francisco and a San Mateo County location.

It found that Twitter's business tax burden would be sufficiently large to outweigh the benefits of paying a lower rent in the SF Mart in the Central Market area. In addition, labor factors such as accessibility and costs do not appear to dramatically favor one location over another. Therefore, on balance, it appears that Twitter would stand to realize significant savings over the next several years by moving out of San Francisco.

This cannot be taken as conclusive proof that Twitter *will* leave San Francisco if the proposed legislation is not enacted, but the analysis that follows is based on the assumption that it will.

This section is focused on estimating the broader economic impact of enacting the proposed legislation, assuming that Twitter moves to the SF Mart in such a situation. The alternative scenario considered is one in which the proposed legislation is not enacted, Twitter leaves San Francisco, and the Central Market area continues as before.

The fiscal and economic impact of the legislation hinges on what one believes will happen to the large commercial properties Market Street between 7th and Van Ness if Twitter does, or does not, come to the area. Commercial real estate owners in the area have seen stagnating public sector demand, and declining private sector demand, for many years.

In addition, a great deal of commercial space will be vacated in the near future. The new San Francisco Public Utilities Commission headquarters at 525 Golden Gate will be completed in Spring 2012, leading the PUC to vacate its premises at 1145 and 1155 Market Street. The State Compensation Insurance Fund is moving out of San Francisco, vacating its office building at 1275 Market beginning in September of this year. The Bank of America has recently sold its building at 1455 Market, and will reportedly vacate all of its employees soon. Just outside of the Central Market area defined in the legislation, the AAA tower at 100 Van Ness is almost entirely vacant. Between these properties and the San Francisco Mart, approximately 3 million square feet of office space in Civic

Center is due to become vacant in the next 18 months.

How and when this space becomes re-occupied is very much an open question, yet will vitally affect the ultimate impact of this proposed legislation. Whatever net new payroll growth that occurs in the companies that occupy vacant properties would be excluded from the payroll tax by the proposed legislation. This would apply to any business that moved to the area from outside the city limits of San Francisco, and to any net payroll growth at a current San Francisco business, for six years.

If property owners react to the heightened vacancy in the district by reducing asking rents in order to fill space at all costs, then many new businesses and jobs will move into these buildings. On the other hand, property owners with a longer-term perspective may elect to hold the line on rents, tolerate higher vacancy in the short term, and wait for higher rent-paying tenants to possibly appear in the future. In this case, there may be little new employment growth in the area.

Forecasting this is highly uncertain. But it does seem reasonable to assume that if Twitter – one of the largest technology companies in San Francisco – makes a decision to locate in the Central Market area, it will legitimize the area in the eyes of other technology companies. Since the technology industry is growing rapidly in the city at the moment, it seems reasonable to assume that if Twitter moves to the area, the area could recover occupancy to a typical 85% average occupancy rate in perhaps five years. Since, as discussed in the previous section, it seems unlikely that Twitter would remain in San Francisco if the proposed legislation is not enacted, this assumed absorption of space can be considered an impact of the legislation.

If the proposed legislation is not passed, and Twitter chooses the South San Francisco location, it is less clear where demand for real estate in the area would come from. It seems reasonable to assume that it could take ten years for the 3-odd million square feet of space to be re-occupied to a slightly lower average occupancy rate of 75%. In addition, without a major private-sector magnet like Twitter, it seems unlikely that more than 50% of these future tenants would pay the payroll tax. Much of the employment base in the Central Market area now are government, non-profit, and small business employers, all of whom are exempt from San Francisco's business tax. If the area becomes the home of an information technology cluster, on the other hand, perhaps 90% of the employees would be in businesses subject to the payroll tax[15].

These assumptions are not based on any verifiable data sources, but if they are reasonably close to what might happen in both scenarios, the proposed legislation would both generate higher payroll tax revenue, and more employment, over a twenty year period.

The fiscal impact is positive, despite the fact that none of the properties are assumed to generate any payroll tax for the first six years, and even discounting future payroll tax revenue at 5% per year. This is because on year 7, in a Twitter scenario, the entire area would already be fully occupied with higher-wage employees, at a higher employment density, 90% of whom would be payroll-taxable. In a no-Twitter scenario, in year 7 the properties would still have significant vacancy, and their occupants would be lower-wage employees, similar to those in the Civic Center area now.

Given the uncertainty surrounding these assumptions, little weight should be given to the actual revenue and job estimates themselves, or the differences between the two scenarios. The primary point is that, under reasonable assumptions, the City's annual payroll tax revenue is nearly three times higher, over a 20-year period, with Twitter and the exclusion than without it. This strongly suggests that the proposed legislation, by catalyzing a new form of economic development in the Central Market area, will generate fiscal benefits for the City in the longer term.

By comparison, the job differences are slighter, and are exclusively attributable to the assumptions that office vacancy declines faster in the Twitter scenario, and that employment density is higher as well (assumed because rents will be higher in the Twitter scenario, and businesses will have a greater incentive to conserve space).

15 At an average salary of $100,000, an internet business would need only three full-time employees to be too large for the City's small business exemption to the payroll tax.

TABLE 6 Fiscal and Economic Impact of the Proposed Legislation in the Large Commercial Properties

		With Twitter	Without Twitter	
Assumptions				
	Years to absorb vacant space	5	10	
	Maximum average occupancy	85%	75%	
	Gross Square Feet / Employee	250	300	
	% of employees payroll-taxable	90%	50%	
	Average salary of payroll-taxable	$100,000	$75,000	
	Years payroll tax is not excluded	14	20	
Impacts		With Twitter	Without Twitter	Difference
	Average 20-year payroll tax revenue, discounted at 5% ($M)	$4.2	$1.5	$2.7
	Average Annual Employment, 20 years	7,604	6,460	1,144

Because the job and payroll tax impacts are both positive, other City tax revenue impacts can be expected to be positive as well. Business-driven hotel tax revenue is roughly proportional to employment, and is particularly influenced by the presence of corporate headquarters. Commercial rents and property values will indisputably rise if Twitter is attracted to the area, which will lead in time to higher property tax and transfer tax revenues. More employment should also lead to higher utility and sales tax revenues.

It is important to stress that, but for Twitter moving to the area, the proposed legislation would probably have relatively little effect on the re-occupation of these properties, analogous to a very small enterprise zone incentive. The 1.5% savings on net new payroll in the vacant land represents approximately 15-25% of currently average commercial rents in the property. This means that businesses that would benefit from the proposed legislation would pay somewhat more to be located in the area, and that property owners would earn higher rents. It does not necessarily mean that more businesses will come to the area, more hiring will take place, or the occupation of the space will take place more quickly.

It is the attraction of Twitter to the area, and not the reduction of taxes, that is fundamental to the positive fiscal and economic impacts of the proposed legislation. The proposed legislation is not a "silver bullet" to all of the shortcomings of enterprise zone policies. But because it impacts a company that has the potential to create long-term economic development in the area, it can be expected to generate both higher revenues and more jobs over the long term.

Occupational Impacts

If Twitter moves to the Central Market area and forms the focal point of an information technology cluster, the jobs created in these companies will require significantly more education, on average, than the average San Francisco job. Approximately half of the adults in San Francisco's resident workforce have a four-year university degree, or more higher education. Half have some college education but not a four-year degree, a high school diploma, or less than a full high school education.

Office employment in San Francisco has become increasingly specialized in jobs requiring high levels of education for several decades. In the 2005-9 periods, according to Census data, 29% of all workers in San Francisco office industries had a graduate degree, and another 46% had a four-year degree. Only 16% of workers had only some college education, and only 10% had a high school education or less.

The corresponding distribution for the IT industries in San Francisco is even more heavily weighed towards the university-educated: 26% had graduate degrees, 58% had a four-year degree. Only 11% had some college, and only 5% had a high school education or less.

In the past, the Civic Center / Central Market area was one of the few employment centers in San Francisco that offered significant numbers of office jobs for those with less than a four-year education. These jobs, such as customer service support, payroll and other back office functions, bookkeeping and other clerical jobs, often require only a high school education yet offer greater career-path potential than many of the minimum wage jobs that are commonly held today by workers with a high school education.

These jobs have been leaving San Francisco for many years, though the U.S. outlook for many of these occupations is strong, and they form a significant amount of the office employment in other Bay Area locations. Several of the buildings in the Central Market area contained jobs of that type. San Francisco's inability to retain these jobs in the Central Market area, coupled with a growth of high-skill information technology jobs in the same area, suggests that the lower-skilled office jobs will disappear from the city permanently, barring some major future change in the city's competitiveness relative to other Bay Area locations.

To be sure, this is clearly not a case in which commercial property owners are actively displacing more established businesses in favor of technology companies who can pay a higher rent. The Bank of America, AAA, and SCIF buildings were all owned by the employer, and vacated on their own accord. Moreover, the low prices for which these buildings are selling suggests that they could be financed with extremely low rents. Yet their continuing high vacancy rates suggest that any tenants who could pay even those low rents simply aren't in the market. In the short term, and in the absence of a significant change in the city's competitive position, the choice in the Central Market may not between a Twitter-led information technology cluster and lower-skill office work. The choice may be between an information technology cluster, and vacant buildings.

Having said that, retaining a large technology headquarters like Twitter could have important workforce advantages in the future. San Francisco, as discussed earlier, has a reputation for incubating new businesses, and then failing to retain them as they reach a larger size. Yet it is precisely the smaller companies which rely most exclusively on the highly-skilled worker, since so much of their resources are focused on innovation and product development. Only once a company reaches a certain size is there the likelihood that it will bring in-house a wider range of office functions.

In addition, if Twitter continues to be a success, it would be in the company's interest to help organize a local workforce development system specific to its industry. Many of San Francisco's colleges, universities, and high schools have programs aimed at careers in the media and Internet industries. What such programs need to be successful is deep involvement from leading businesses in the industry.

Policy Considerations

This research suggests that two changes to the proposed legislation could reduce risks of an adverse economic impact, and increase the benefit to the General Fund while maintaining its economic benefits. In addition, two related policy ideas are offered for the consideration of decision-makers.

1. The legislation currently states that if a business has premises within the area, it is eligible to exclude its net new payroll. Because payroll tax is calculated and paid on a city-wide basis, not on a premises-by-premises basis, this creates a loophole in which a large local business could open a satellite location in the area, and deduct *all* net new payroll city-wide. This problem can be fixed by requiring multi-location businesses to apportion their payroll, such that they are only eligible to exclude net new payroll within the area.

2. Removing large commercial properties, other than the SF Mart, from the area would increase the benefits to the General Fund, while having only a minor impact on the economic benefits of the legislation. Including the SF Mart is vital to retaining Twitter in the city. Including the other properties, for which no large retention target has been identified, creates a marginal incentive at best, but still requires the City to forego the payroll tax revenue that would have happened there anyway as the buildings become re-occupied. As detailed in the previous section, the payroll tax impact of the proposed legislation is estimated to be a $4.2 million gain over the next twenty years. If the large properties (1145, 1145, 1275, 1455 Market and 30 Van Ness) were excluded, the gain would be an estimated $5.5 million a year.

3. The large amount of commercial vacancy that will appear in the area in the next few years highlights the economic importance of ensuring the maximum utilization of existing properties and infrastructure. While, as discussed in the previous section, property owners have a decision to make regarding how low to reduce rents to ensure occupancy, the economic and financial interests of the City are clearer. As a policy idea that is not directly tied to the proposed legislation, the City could structure a parcel tax on vacant commercial property, which would not apply to occupied commercial property. This would encourage owners of vacant commercial

property to be flexible on rent, and thereby maximize occupancy and employment in the city. This tax could not be included in the proposed legislation, as it would have to be submitted to the voters pursuant to Proposition 218. Nevertheless, it is mentioned here as a future policy consideration.

4. Finally, this analysis suggests that an important variable in the fiscal and economic success of the proposed legislation is Twitter's decision to locate in the Central Market area instead of moving out of San Francisco. In turn, Twitter's potential future payroll tax liability associated with its stock options appears to be the largest cost factor weighing against a San Francisco location. The City should consider modifying the payroll expense tax, to reduce the incentive for successful technology companies to move out of San Francisco.

APPENDIX A

This appendix lists the assumptions used in calculating average commuting costs by automobile by information technology workers in San Francisco and San Mateo counties.

Assumption	Value	Notes
Average auto speed in Traffic, SF-San Mateo	30	Google Maps: 94117 - San Mateo, CA (19.7 miles, 40 minutes in traffic)
Average auto speed in Traffic, SF-SF	12	Google Maps: 17th and Stanyan - 2nd and Bryant (5.0 miles, 25 minutes in traffic)
Average auto speed in Traffic, SM-SM	38	Google Maps: Sneath Lane - Foster City
Average auto speed in Traffic, East Bay-SF	20	Google Maps: College & Broadway Oakland - 2nd and Bryant (2/3) and San Mateo - 2nd and Bryant (1/3)
Auto & Insurance costs attributable to auto commuting	70%	
Auto & Insurance costs attributable to park-n-ride	15%	
Lease monthly costs	$259	Prius Northern California Lease deal, 3/2/2011
Lease upfront (to be amortized at 0%)	$2,999	Prius Northern California Lease deal, 3/2/2011
Calculated: Total Monthly lease costs	$342.31	
Average monthly insurance costs	$46.75	minimum monthly insurance costs with Progressive for new Prius
Monthly auto costs attributable to auto commuting	$272.34	
San Francisco monthly parking costs	$175	
San Mateo monthly parking costs	$0	
Average 1-way Driving Distance, SF-SF	4.2	Calculated based on assumed average speed and Census-reported time
Average 1-way Driving Distance, SF-SM	20.1	Calculated based on assumed average speed and Census-reported time
Average 1-way Driving Distance, SM-SM	19.6	Calculated based on assumed average speed and Census-reported time
Average 1-way Driving Distance, NonSF-SF	15.9	Calculated based on assumed average speed and Census-reported time
Average MPG	50	Prius Northern California Lease deal, 3/2/2011
Cost of Gasoline per Gallon	$3.80	
Repairs, registration, maintence taxes (per mile)	$0.07	
Depreciation per mile	$0.00	Vehicles are leased

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Central Market/Tenderloin Payroll Tax Exclusion

March 16, 2011

SAN FRANCISCO
Office of Economic and Workforce Development

History of City's Economic Development Work in Neighborhood

- Community Benefit Districts
- Sixth Street revitalization
- Tenderloin grocery store attraction
- Taylor Street corridor efforts
- Central Market Partnership

SAN FRANCISCO
Office of Economic and Workforce Development

Central Market Partnership

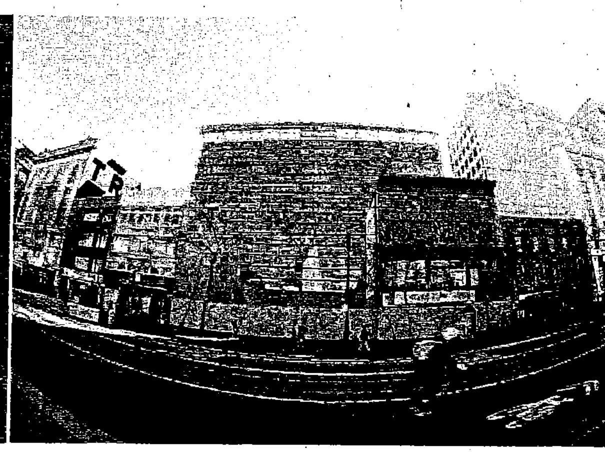
Restore Central Market as the City's downtown arts district while inviting in new retail, restaurants, services and employers to take advantage of the transit and downtown location and serve the adjacent Tenderloin and SOMA neighborhoods.

SAN FRANCISCO
Office of Economic and Workforce Development

Neighborhood Challenges

"We call it the plywood parade – the relentless march up Market Street from 5th to 8th of boarded up or erratically open storefronts, emptying offices in the upper stories and crumbling facades.

The three Mid-Market blocks look like hell."



Central City Extra, February 2010

SAN FRANCISCO
Office of Economic and Workforce Development

Neighborhood Challenges

- Empty & underutilized large buildings
- Poor building condition; little "leasable" space
- Extreme poverty among residents
- Lack of retail/services/jobs for neighborhood
- Unprogrammed open spaces and sidewalks
- High concentration of criminal activity

SAN FRANCISCO
Office of Economic and Workforce Development

Sample Vacant Buildings

A 86-98 Golden Gate
15,000 SF retail

B 172 Golden Gate
57,000 SF retail/office

C 1 Jones
Hibernia Bank
38,000 SF

D 1155 Market
SFPUC
160,000 SF office

E 1275 Market
State Fund Bldg
385,000 SF office

F 1355 Market
SFMart
1 million SF office

G 144 Taylor
Original Joe's
35,000 SF retail

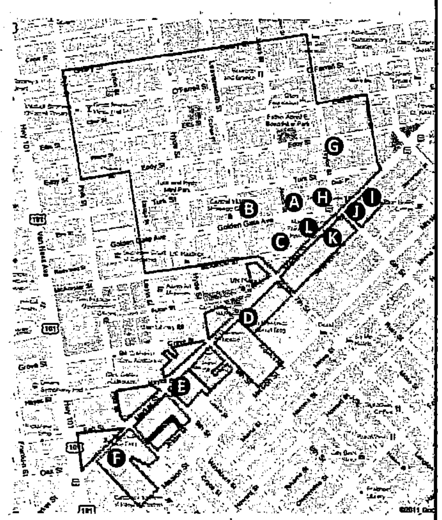
H 25 Taylor
Golden Gate Theater
44,000 SF office

I 969 Market
Pearl Art Supply
24,000 SF retail/office

J 989 Market
Blick Art Supply
Approx 70,000 SF office

K 1019 Market Street
Furniture & Carpet Bldg
70,000 SF

L 1028 Market
Hollywood Billiards
30,000 SF of retail



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Vacancy Data

COMPARITIVE COMMERCIAL DISTRICT VACANCY RATES

Central Market 31%

- Informal count yields approx 390,000 SF of vacant storefront and upper-floor office space

Compare with

- Third Street/Bayview 24.5%
- Leland Ave./Vis Valley 10.2%
- Mission Street/Excelsior 9.8%
- Taraval 9.1%

OFFICE VACANCY

- In 4 large buildings on Central Market, there is approximately **1.5 million sq/ft** of vacant or soon to be vacant office space.
- Office vacancy rate is 25%, compared to citywide rate of 15%
- Leasing up just **25%** of this space would result in an estimated **1,500** new jobs in the Central Market.

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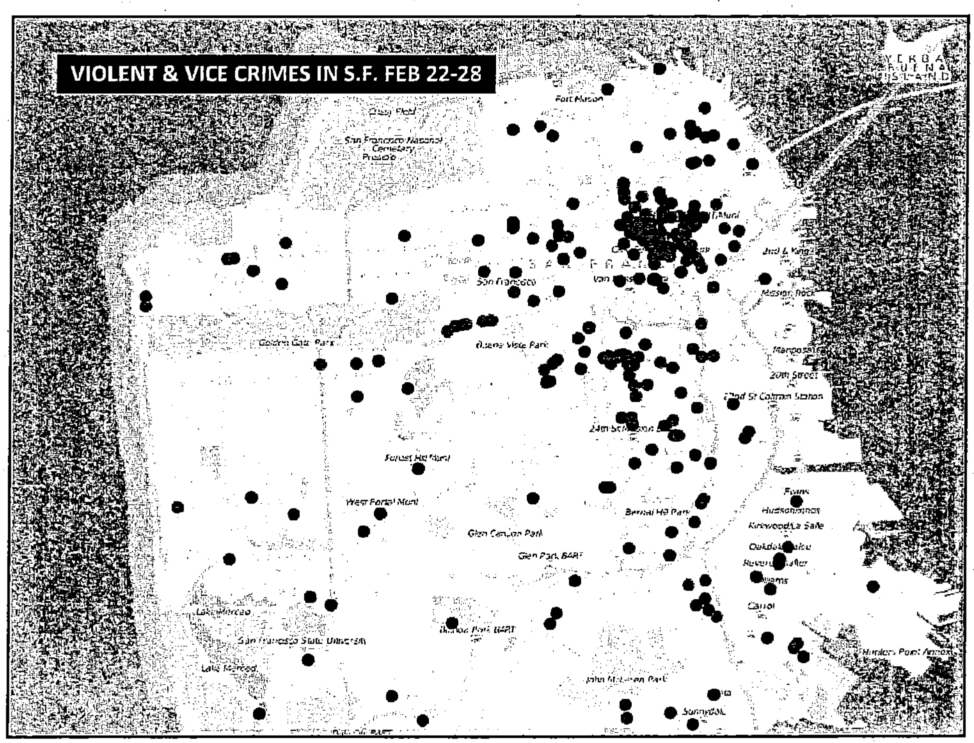
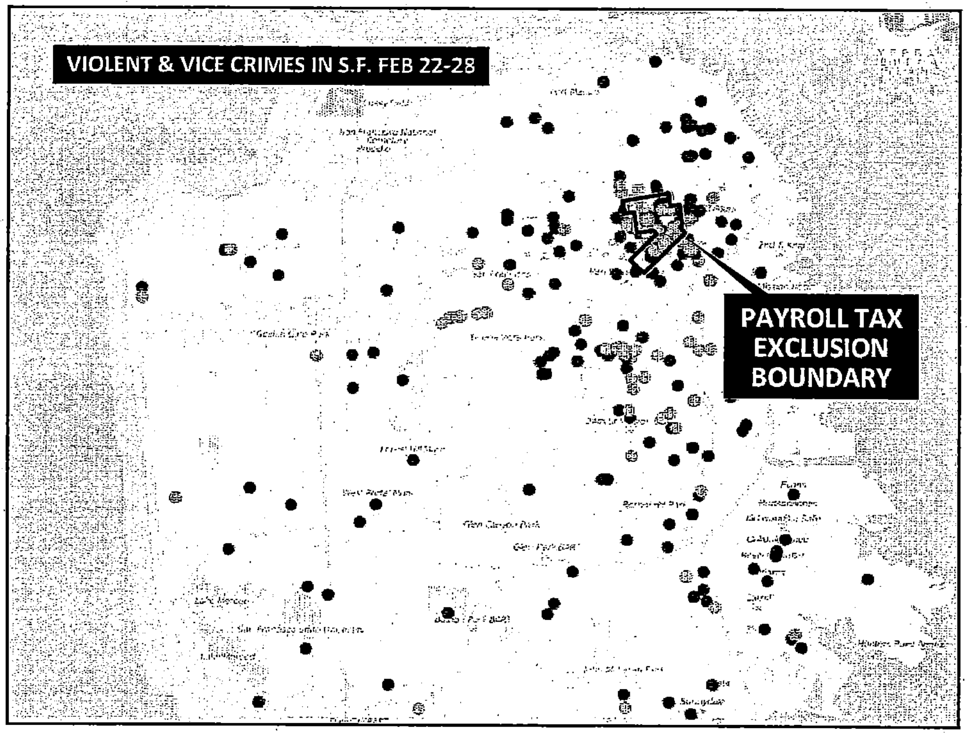
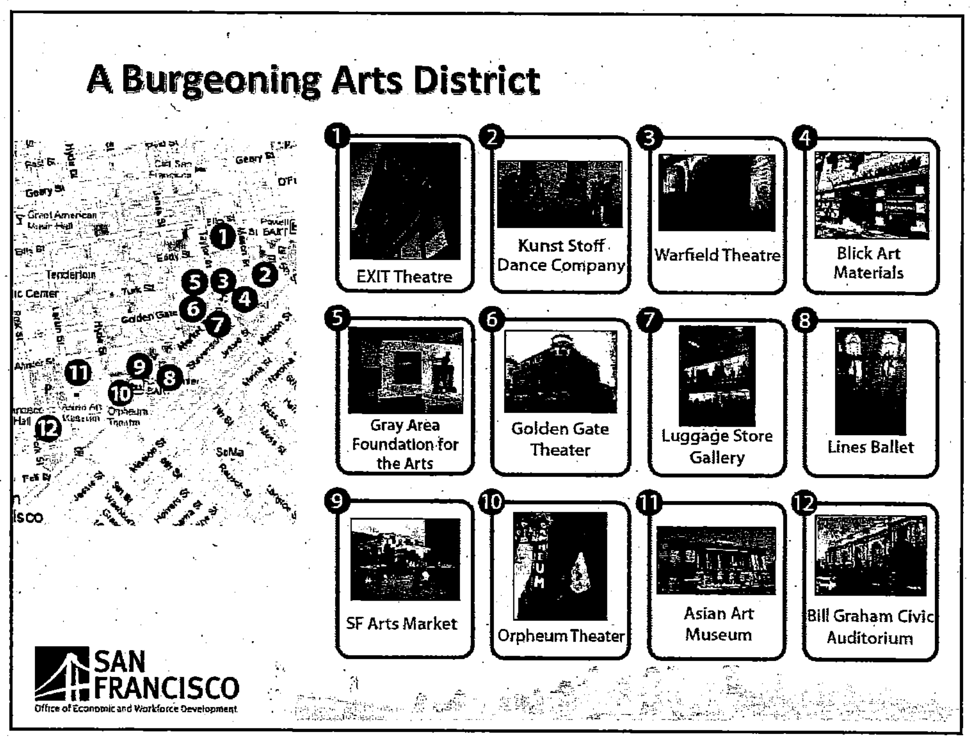



VIOLENT & VICE CRIMES IN S.F. FEB 22-28
PAYROLL TAX EXCLUSION BOUNDARY


A Burgeoning Arts District
1 EXIT Theatre
2 Kunst Stoff Dance Company
3 Warfield Theatre
4 Blick Art Materials
5 Gray Area Foundation for the Arts
6 Golden Gate Theater
7 Luggage Store Gallery
8 Lines Ballet
9 SF Arts Market
10 Orpheum Theater
11 Asian Art Museum
12 Bill Graham Civic Auditorium
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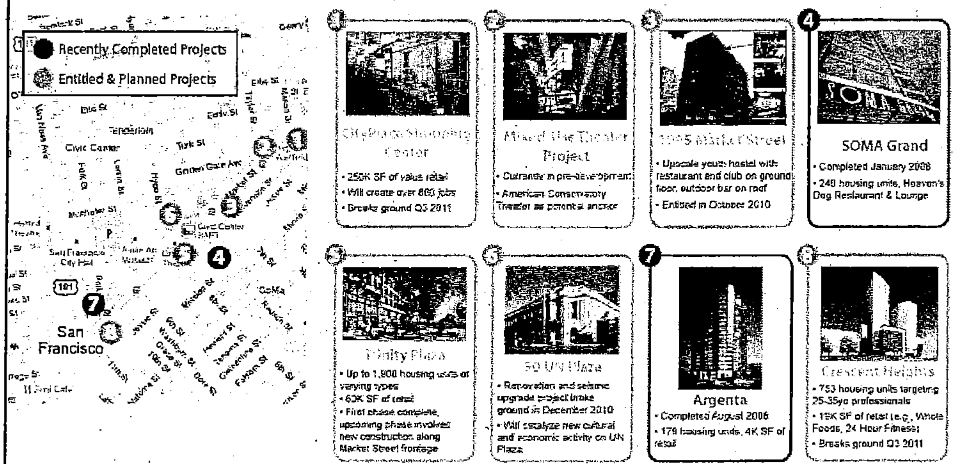
Pipeline Development Projects



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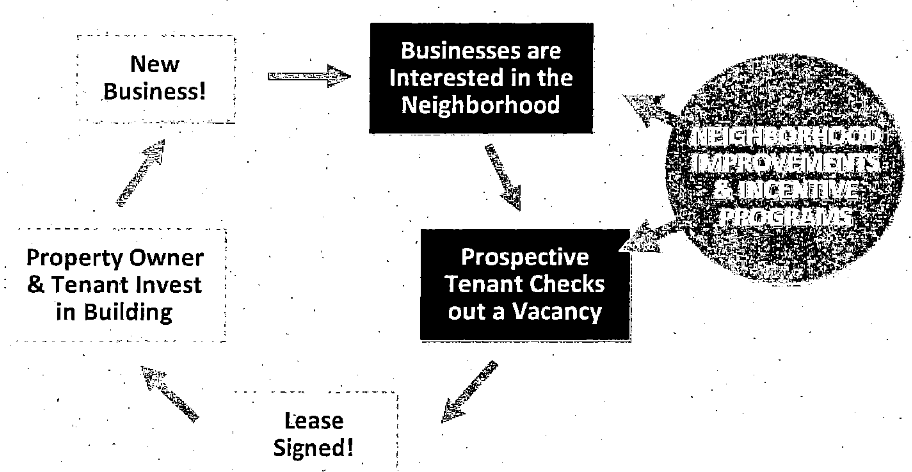
Commercial Revitalization Cycle



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Neighborhood Improvement Strategies

- Arts programming
- Catalyst arts venue development
- Cleanliness and beautification – CBDs
- Safety – Mid Market substation
- Attraction of small business, housing, big employers
- Better Market Street – redesign of streetscape

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Tools/Incentives for Revitalization

- Cultural District Loan Fund
- Other existing tax incentives
- Grant funding
- Technical assistance to business and arts groups
- Zoning to incentivize certain issues
- ~~Tax Increment Financing~~
- **Payroll Tax Exclusion**

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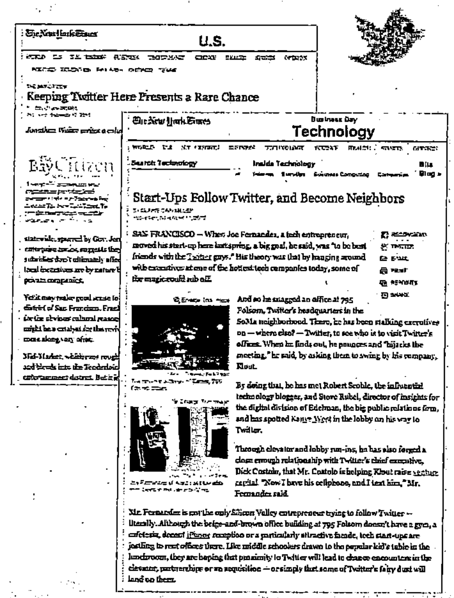
Why Twitter Matters to Central Market

- Sends a signal of neighborhood transformation
- Leads to increased retail, services, and entertainment
- Other social media companies will co-locate
- Twitter will help designate unique niche for the area – creative economy/arts
- Company will engage meaningfully with the City and the neighborhood



The New York Times

U.S.

Keeping Twitter Here Presents a Rare Chance

The New York Times

Business Day

Technology

Search Technology

Inside Technology

Start-Ups Follow Twitter, and Become Neighbors

SAN FRANCISCO — When Joe Fernandez, a tech entrepreneur, moved his start-up here last spring, a big goal, he said, was "to be best friends with the Twitter guys." His theory was that by hanging around with executives at one of the hottest tech companies today, some of the magic could rub off.

And so he snagged an office at 795 Folsom, Twitter's headquarters in the SoMa neighborhood. There, he has been stalking executives on — where else? — Twitter, to see who is to visit Twitter's offices. When he finds out, he pounces and "hijacks the meeting," he said, by asking them to swing by his company, Klout.

By doing that, he has met Robert Scoble, the influential technology blogger, and Steve Rubel, director of insights for the digital division of Edelman, the big public relations firm, and has spotted Kanye West in the lobby on his way to Twitter.

Through elevator and lobby run-ins, he has also forged a close enough relationship with Twitter's chief executive, Dick Costolo, that Mr. Costolo is helping Klout raise venture capital. "Now I have his cellphone, and I text him," Mr. Fernandez said.

Mr. Fernandez is not the only Silicon Valley entrepreneur trying to follow Twitter — literally. Although the beige-and-brown office building at 795 Folsom doesn't have a gym, a cafeteria, decent iPhone reception or a particularly attractive facade, tech start-ups are jostling to rent offices there. Like middle schoolers drawn to the popular kid's table in the lunchroom, they are hoping that proximity to Twitter will lead to chance encounters in the elevator, partnerships or an acquisition — or simply that some of Twitter's fairy dust will land on them.

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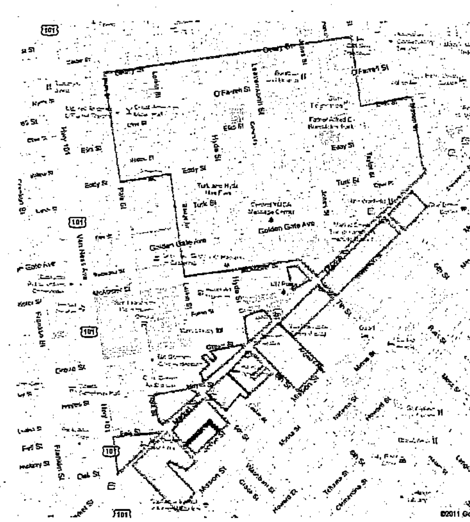
Proposed Payroll Tax Exclusion

- Currently paid by businesses with more than $250,000 in payroll
- New jobs in the area would be exempted for 6 of next 8 years
- First Source Hiring
- Modeled after SF Biotech payroll exclusion
- **Will result in no revenue loss to the City**



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Economic Impact

TWITTER JOB CREATION

1,300 jobs in its first year on Central Market and projects growth to more than 2,600 jobs over 6 years.

TWITTER TAX REVENUE

Revenue Source	Annual Average	6-Year Total	Revenue in Year 7
Base Payroll Tax	**$535,000**	**$3.21 million**	**$4.08 million**
Utility User Tax	**$163,000**	**$980,000**	**$187,000**
Sales and Use Tax	**$133,000**	**$798,000**	**$152,000**
Hotel Tax	**$261,000**	**$1.57 million**	**$299,000**
Property Tax	**$538,000**	**$3.23 million**	**$550,000**
TOTAL	**$1.63 million**	**$9.79 million**	**$5.27 million**

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Economic Impact

SPINOUT JOB CREATION

Twitter would support the creation of an additional 1,800 spinout jobs in San Francisco in the first year. This would grow to more than 3,700 jobs over 6 years.

SPINOUT TAX REVENUE

Revenue Source	Annual Average	6 –Year Total
Utility User Tax	**$229,000**	**$1.37 million**
Sales and Use Tax	**$186,000**	**$1.12 million**
Hotel Tax	**$366,000**	**$2.2 million**
Property Tax	**$2.06 million**	**$12.35 million**
TOTAL	$2.84 million	$17.03 million

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Economic Impact

TOTAL JOBS

	Year 1	Year 6
Twitter Direct	1,300	2,600
Spinout	1,800	3,700
TOTAL	3,100	6,300

TOTAL TAX REVENUE

	Annual Average	6 –Year Total
Twitter Direct	$1.63 million	$9.79 million
Spinout	$2.84 million	$17.03 million
TOTAL	$4.46 million	$26.82 million

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Economic Impact

ECONOMIC IMPACTS OF FILLING OFFICE VACANCY

1,500,000sf
Currently or Soon to be Vacant Office Space

Impact of Leasing Space	Jobs	Tax Revenue
25% of Vacant Space	1,500	$1.3 million
50% of Vacant Space	3,000	$2.7 million
100% of Vacant Space	6,100	$5.4 million

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Proven Economic Development Policy

- Quebec labor cost incentive → Over half of the video game industry now based in Quebec
- Times Square tax abatement for theater renovation
- Lower Manhattan commercial tax exclusion for post-9/11 development
- San Francisco Biotech Economic Cluster

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Sound Land Use Policy

- Promotes the concentration of employment in the urban core
- Promotes growth along a primary transit corridor
- Promotes infill development and revitalization in struggling neighborhood

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Preventing Displacement

- Permanent affordable housing
- SRO protection ordinance
- Land Use controls in the TL (and proposed for Western SoMa)
- Arts programming that is inclusive – i.e. Central City Hospitality House

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PEMANENTLY AFFORDABLE HOUSING IN S.F.