



LEGISLATIVE ANALYST REPORT

TO: The Honorable Board of Supervisors
FROM: Clarice Duma, Sr. Legislative Analyst
HEARING: Small Business, Economic Vitality and Consumer Services Committee
HEARING DATE: May 18, 2000
RE: File No. 000508- Non-profit and small business rents

Summary of Request

A motion approved by the Board of Supervisors (the Board) requests the Office of the Legislative Analyst to prepare a report that surveys other comparable locales to find solutions for assisting non-profits and small businesses in dealing with escalating rents and operating costs, and maintaining and creating leasing opportunities in a hot market economy.

Background

In many major cities, including San Francisco, Los Angeles, and New York, the demand for commercial space has reached an all time high. In San Francisco, the demand for office space has spilled over to historically less affluent areas of the City such as the Mission and South of Market districts. These areas, with their low rents, have in recent years caught the interest of many high technology or "dot com" firms that are locating in San Francisco. The spill over has however, clashed with some long-time tenants, such as neighborhood-serving non profit organizations and small businesses, which have long-standing relationships with residents of these areas. Several local non profits in the Mission such as the Cartoon Art Museum, the Dancers' Group, and the Joe Goode Performance Group have lost their space. A group of non profits at the Bay View Bank Building in the same district also faces the prospect of displacement. There is concern that as rents continue to escalate, many non profits and small businesses will be squeezed out of the rental market, and that services they provide to the City's under-served communities will be curtailed.

According to the City's Division of Real Estate (DRE), with vacancy rates for commercial space currently between 1 and 2 percent, rates for commercial space in San Francisco have escalated exponentially in the last 3 to 5 years. In *San Francisco Office Market*, CB Richard Ellis reports a tight office market in San Francisco for first quarter 2000. This commercial real estate company reports an average vacancy rate of 1.1% for all office space in San Francisco, with an even lower vacancy rate of 0.6% for Class A space. CB Richard Ellis also states that the average availability rate for office space citywide is 3%, and reports the average asking price for office space at around \$59/square foot per year. (See attachment for additional information on this report)

Non profits and the San Francisco's Real Estate Market

Various City agencies hold contracts with over 350 local non-profit intermediaries who deliver direct services to residents of San Francisco. Many of the nonprofit organizations provide services in the City's low- and

moderate-income communities such as the Tenderloin, mid- and South Market, and the Mission districts, among others. These are areas of the City which, in recent years, have attracted many new businesses, especially high technology firms. In response to concerns about rent hikes and the displacements of non profits, the Mayor's Office of Community Development (MOCD) has begun compiling survey data on the effects of the current real estate market on San Francisco's non profit organizations.

The MOCD Survey & Findings

Last November 1999, MOCD designed a survey instrument which was distributed to approximately 120 non profits that are recipients of MOCD's Community Development Block Grants (CDBG). The survey sought to identify non profits by their property status (that is, whether they own or rent their space), anticipated space needs, current rental sites and clusters, those contemplating purchasing buildings, their current and anticipated rental costs, and trends in lease patterns. With 65 organizations (or approximately 55%) responding, the initial survey findings indicate the following:

- Non profit survey respondents ranged from service providers to housing providers who serve youth, seniors, immigrants, and other specific populations and neighborhoods.
- 58 organizations (or approximately 89%) were renting their office space.
- Monthly lease rates ranged from \$0.26 to \$3.87/sq. ft. Approximately 35% of the leases were under \$1/sq. ft. Additionally, a few of the leases under \$1/sq. ft were held with either religious or other non-profit organizations.
- Almost 50% of the leases would expire by year 2000.
- Approximately 62% of the nonprofit respondents lease between 1000 and 3000 sq. ft. of space. The remaining 38% of the respondents occupy over 3000 sq. ft.
- The total square footage for all the respondents' offices amounts to 215,000/sq. ft.
- 25 of the 32 leases (or 78% of the leases) reported in the period 1983 to 1998 were for 5 or more years.
- Of the 11 leases renegotiated in 1999, over 50% had lease terms of 1 year or less, and 3 were for 5 or more years.
- Approximately 70% of the leases will expire in the next 3 years.
- In mapping rental sites for the respondents, MOCD observes two cluster zones representing one quarter of the respondents:
 - Zone 1: On Market and Mission Streets, between 7th and 3rd Streets.
 - Zone 2: On Mission Street from the 1500th to the 1900th blocks.

Based on these initial findings, MOCD concludes that there is urgency for the City to adopt short and long term strategies, including the location of permanent space, in order to "alleviate the rent crisis."

Jurisdictional Approaches to Addressing Escalating Rents and Operating Costs

Various jurisdictions have undertaken aggressive steps to retain and attract businesses to their communities, while acting to preserve the character of their neighborhoods. Following are examples from various cities in California and New York of services provided to small businesses, including non-profits:

- ***Palo Alto:*** In the mid 1990s, Palo Alto's commercial real estate market was characterized by higher rents and lower vacancy rates for office and retail space compared to the rest of the Peninsula and South Bay. Commercial rents in downtown Palo Alto typically were as much as 50 percent higher than nearby communities. Concern over out-of-control rents led Palo Alto to establish citywide goals which include

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modest business growth that is compatible with the City's residential character. Given the strong demand for non-residential space, the City has faced the challenge of carefully balancing the needs of business against those of neighborhoods in making growth decisions. Palo Alto has consequently adopted limits on the amount of nonresidential floor space that may be added, based on the results of its 1989 Citywide Land Use and Transportation Study. It also adopted redevelopment goals that require the City to provide various incentives in order to encourage owners to upgrade commercial properties. Incentives include reduced parking requirements, credit for on-street parking, and increases in allowable floor area. However, such incentives may be used only where they are needed to stimulate redevelopment or to contribute to housing or community design goals. Thus far, 3 areas of the City have been identified for such redevelopment.

- **San Jose:** San Jose created The Enterprise Network (TEN), a non profit dedicated to promoting new business and economic growth in the greater Silicon Valley through public/private collaboration. Member services include office facilities, Internet access, telecommunications, professional services, and assistance for new start-ups. San Jose's Office of Economic Development reports that the City also provides an online listing of brokers that is available to any firms that need commercial space.

San Jose has also reached out to the State for assistance. State Assemblyman Tony Cardenas (D-Sylmar) has drafted AB 77 which seeks to provide economic development opportunities to San Jose, Santa Ana, and the San Fernando Valley. These regions were reported to be in most need of business development services

by the State Trade and Commerce Agency (TCA) in its analysis of capital needs in California in relation to the State's small business loan guarantee program. If approved, AB 77 would appropriate \$1.5 million from

the general fund to the Small Business Expansion Fund for the purpose of operating satellite offices of existing small business development corporations in these 3 areas.

- **Sunnyvale, CA:** Sunnyvale, located in the heart of Silicon Valley, has been ranked the "most attractive American big city in which to operate a business" by *Business Development Outlook Magazine*. The City has developed a strong economic development customer service program committed to supporting local businesses or businesses that wish to expand or locate in Sunnyvale. Additionally, decisions affecting new development, including office development, must include input from residents and businesses regarding issues of aesthetics and functionality. Sunnyvale's land use goals, adopted by the City Council in 1993, also address the concentration of commercial space and pedestrian environments and maintenance of the residential character of surrounding neighborhoods. For new developments, Sunnyvale conducts extensive studies of traffic, air quality and fiscal impacts to the City.
- **Oakland, CA -** Oakland has been gearing itself up as a magnet for new firms that seek to locate in the Bay Area. In the last 3 years, over 300 technology-related firms have settled in Oakland. Because of Oakland's significantly lower Class A, B and C office rents, compared to other regions in the Bay Area, the City is attracting many companies. Oakland has created the Development Action Team, comprising a team of professionals, charged with streamlining all economic development, redevelopment, planning, zoning, building services, and housing development processes. Additionally, projects located in redevelopment areas benefit from tax increment financing and other special benefits managed by the Redevelopment Agency.

Business incentives also help Oakland remain competitive in the regional market place, and include an industry-specific business tax abatement program and assistance with locating space. The City employs

federal and state programs to provide business incentives and has a municipal lending unit that supports local businesses. For small businesses and potential owners, Oakland provides assistance and training opportunities some of which are offered at no cost, or at low cost.

A One Stop Small Business Center works closely with other local agencies and institutions to provide small businesses with a comprehensive scope of services, which include preparing a business plan to compiling financial reports needed for obtaining financing. The City's One Stop Capital Shop, supported by resources

from the US Small Business Administration (SBA), aims to attract, strengthen and retain the City's base of small businesses.

- **Emeryville, CA** - In recent years, Emeryville has experienced an increase in business activity, particularly from high technology companies drawn to lower rents in this Bay Area location. While not experiencing an office space crunch at the same level as San Francisco, the City works in conjunction with local real estate agents to provide the Real Estate Map (REM), a web application that helps prospective tenants and purchasers find available property. The REM also enables businesses to gain access to economic, market and demographic data on Emeryville. The REM data are updated periodically by real estate professionals and property owners.
- **Los Angeles, CA:** The Office of the Mayor has created various programs aimed at assisting local businesses. It established the Los Angeles (LA) Business Team, a citywide business assistance program charged with retaining, attracting and supporting firms which do business and provide new jobs in Los Angeles. Since 1996, the Business Team has assisted over 1,300 companies representing more than 200,000 jobs, and assisted more than 500 potential new development projects. The City launched the \$126.5 million Valley Business Lending Partnership, a joint effort of 16 local banks, and the Valley Economic Development Center to loan millions to small businesses in San Fernando Valley.

The City has also established the Community Development Bank (CDB) to spur economic growth in low and moderate income areas of LA. CDB received initial funding of \$430 million from the federal government and \$210 million from local banks, and these funds will provide loans, venture capital and other

funding options, as well as technical assistance, largely through community development organizations. The City also provides incentives to local businesses that make Los Angeles more competitive than other surrounding cities. Through its strategic industry and government alliances, the City links businesses to a network of opportunities including financing, tax incentives, real estate, low-interest loans, job training programs, permits and outreach to federal and state agencies. The City also leverages its resources with those of the local commercial real estate community to help find strategic locations for local businesses, including information regarding low-interest loans for property acquisition and construction.

- **New York City** - For over a decade, New York City has faced a hot real estate market marked by high rents. In Manhattan, lease rates for Class B office space are as high as \$35 to 40/square foot per year. When many non profits were being priced out of the real estate market, the City began a special program with private property owners who were willing to lease space to non profit organizations at affordable rates. Benefits to participant owners were in the form of property tax exemptions. Other private sector efforts include involvement by firms such as CSI Consultants, Inc., a real estate brokerage service that helps small and mid-size non profits locate and retain office space. CSI also assists non profits with limited real estate experience to negotiate favorable lease terms with landlords. CSI's services are provided to non profits at no cost or at reduced rates. The City has also supported the purchase of buildings by non profits.

Summary: Jurisdictional Approaches

As illustrated above, many cities have taken aggressive steps to support their local businesses, while concentrating their efforts and resources at business retention and attraction activities. Among the cities surveyed by our office, we found that many had either launched similar programs or adopted similar strategic approaches, such as the following:

- *Non Profit Assistance:* New York City has successfully launched a program that specifically addresses the needs of non profits. New York also encourages private businesses to provide affordable space to non profits. Incentives, in the form of property tax exemptions, have made the program attractive to participating businesses.
- *Land Use and Business Growth:* In many cities, land use and local growth decisions and policies reflect a commitment by public officials to balance business growth with the need to preserve neighborhood character, including neighborhood-serving enterprises. Palo Alto, for example, has adopted recommendations from its 1989 Land Use Study which limit the amount of new nonresidential floor space. Sunnyvale conducts careful planning in making decisions about new development, including office development. It also solicits and incorporates input from its residents and local businesses in land use and redevelopment issues.
- *Public/Private Collaboration:* In all surveyed cities, local businesses benefit from a myriad of resources and assistance, such as financing, technical assistance, and referral services, that are generated through public/private sector collaborations. In Oakland, the One Stop Capital Shop, supported by resources from the US Small Business Administration (SBA), is charged with the attraction, strengthening and retention of the City's base of small businesses. Business development strategies in these cities succeed because they are fostered within the structure of overarching business development corporations such as the Development Action Team in Oakland, the Mayor's Business Team in Los Angeles, and The Enterprise Network in San Jose. Additionally, these entities work closely with their local governmental agencies, such as Economic Development and Redevelopment Agencies, which are authorized to spearhead innovative redevelopment efforts. Cities such as Emeryville with its REM, and Los Angeles also work closely with local real estate groups, mostly by providing a referral service for small businesses that need relocation assistance and affordable commercial space.
- *Business Incentives:* In various cities, local, state, and federal incentives are available for small businesses and for businesses that participate in community development efforts. In Palo Alto, business incentives are available only for activities that stimulate redevelopment or that promote housing and community design goals. The New York model provides property tax exemptions to businesses that house local non-profits at affordable lease rates. In Los Angeles, business incentives are a business attraction tool that gives the City a competitive urge against other neighboring cities.

Conclusions

With many non profits and small businesses faced with the prospect of displacement or expiring leases, the City must employ both short term and long term strategies to address the current crunch in San Francisco's commercial space. Intradepartmental collaborations focused on business retention, the provision of business incentives together with public/private alliances to encourage the private sector to provide affordable space to

non profits and small businesses, and a willingness to assess the efficacy of current zoning controls - these are approaches which have been adopted in other jurisdictions, and which could also be considered in San Francisco.