

San Francisco Economic Strategy Update: Phase I Findings

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Introduction

- Proposition I, passed by voters in 2004, mandated that the City establish an economic development plan for the first time.
- The first edition of the strategy, *Sustaining Our Prosperity: The San Francisco Economic Strategy*, was released by the Office of Economic & Workforce Development in 2007.
- Prop I also requires regular updates to the economic development plan.
- The Controller's Office of Economic Analysis has assisted OEWD in the update to the plan by analyzing the city's economy, workforce, demography, and relative competitiveness.

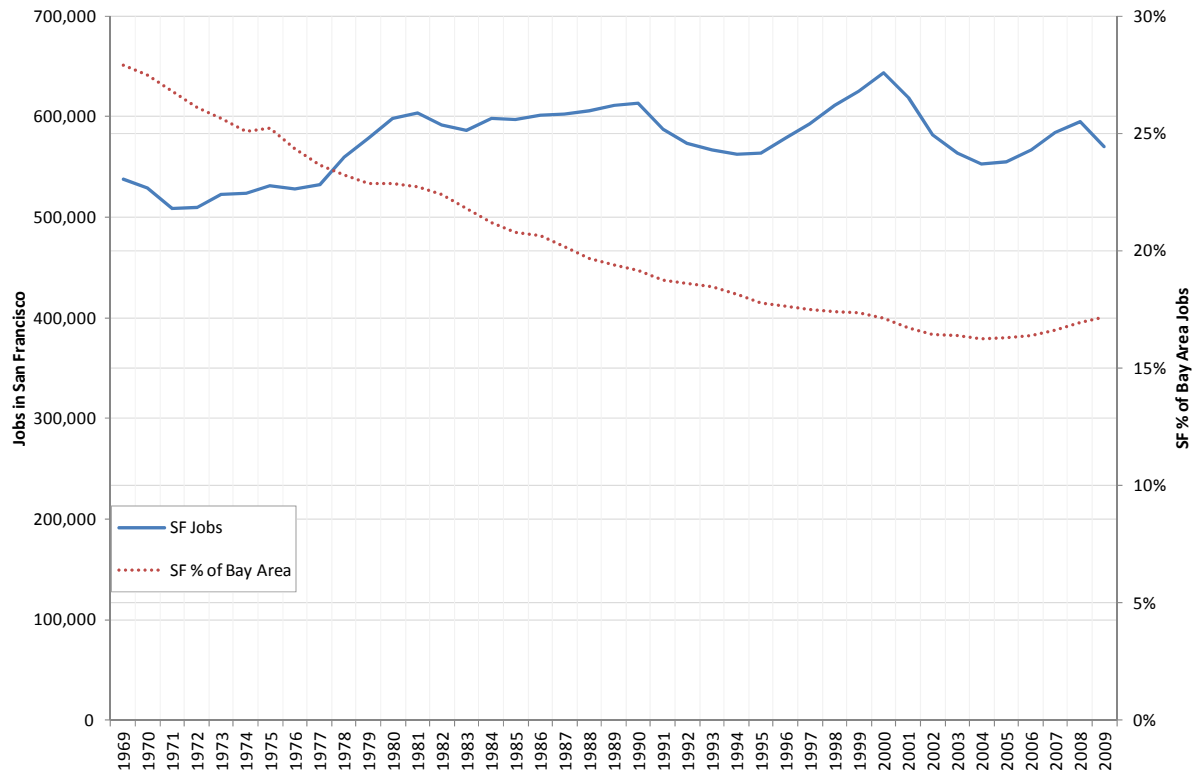


I. San Francisco's Economy in Context



San Francisco's Employment Has Lagged the Bay Area Rate for Forty Years

**San Francisco Employment, 1969-2009:
Total City Jobs, and as a Share of the Region**



Source: Bureau of Economic Analysis

Employment has changed little in San Francisco for 30 years. The city had fewer jobs at the 2008 peak of its business cycle than it did at its peak in 1981.

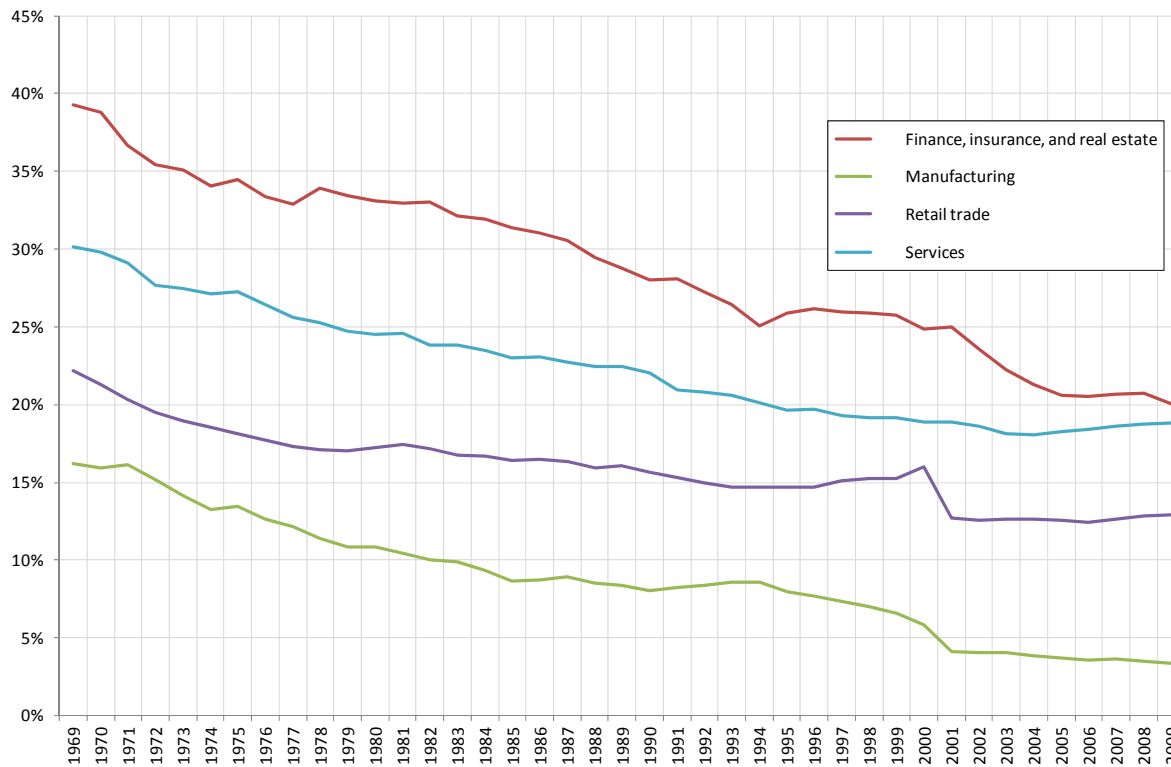
San Francisco's employment base has been growing more slowly than the rest of the Bay Area for at least the last forty years. In 1969, 28% of the jobs in the Bay Area were located in the city. In 2009, only 17% of jobs were in San Francisco.

While San Francisco's percentage of regional jobs has increased slightly since 2005, this has more to do with slower regional growth and the severity of the recession in other parts of the region.



San Francisco Has a Declining Share of Bay Area Jobs in Every Sector of the Economy

San Francisco's Share of Bay Area Employment, 1969-2009:
Four Major Industry Sectors



Source: Bureau of Economic Analysis

Some of San Francisco's relatively slow employment growth can be attributed to population growth in the other Bay Area counties.

As their population grows, they have a greater need for local-serving industries, such as retail trade, than San Francisco does.

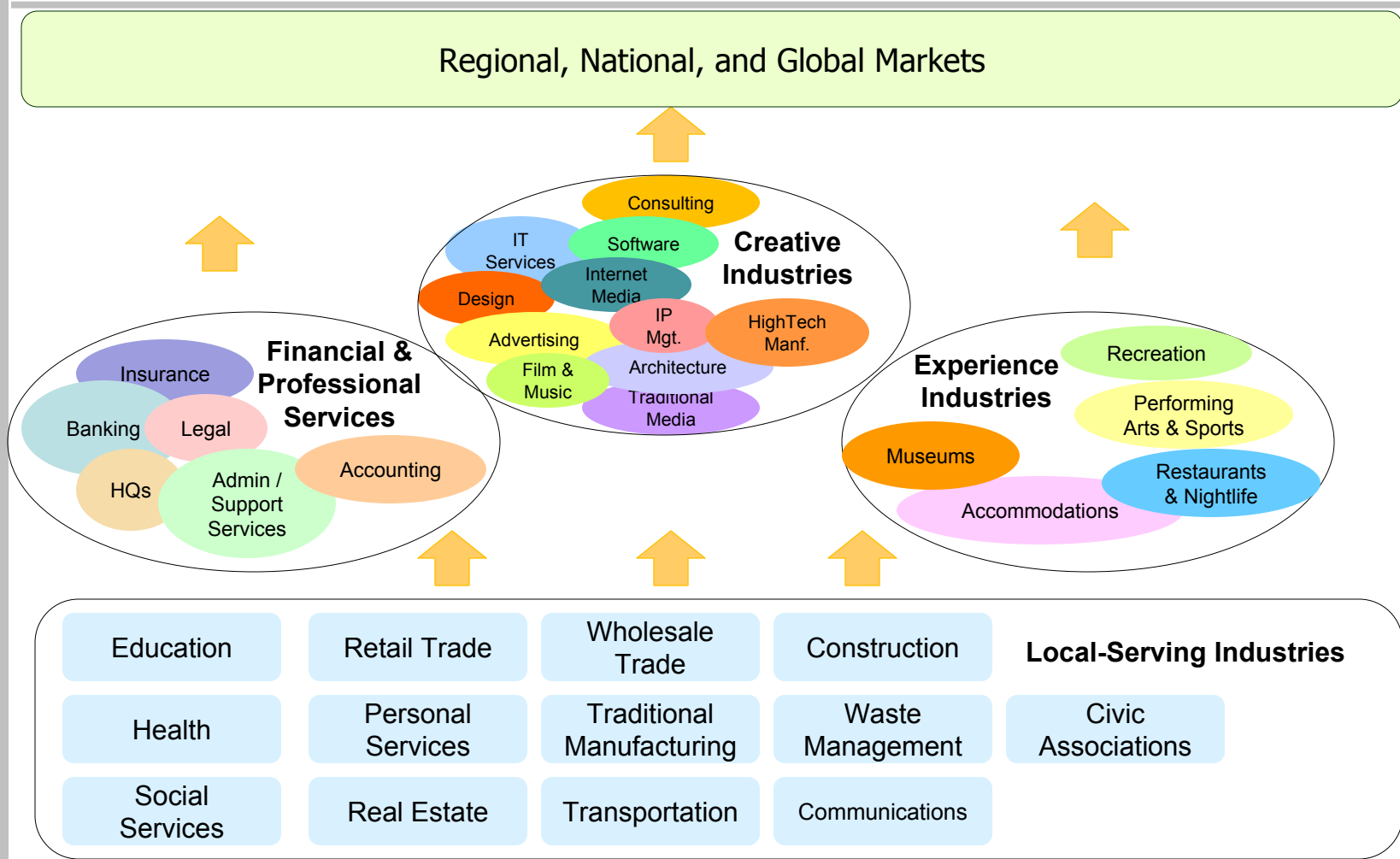
However, San Francisco has not only seen slower growth in local-serving industries, it has also seen lower growth in key parts of its economic base that are not tied to the local population, such as advanced financial and professional services.



2. Structure of San Francisco's Economy

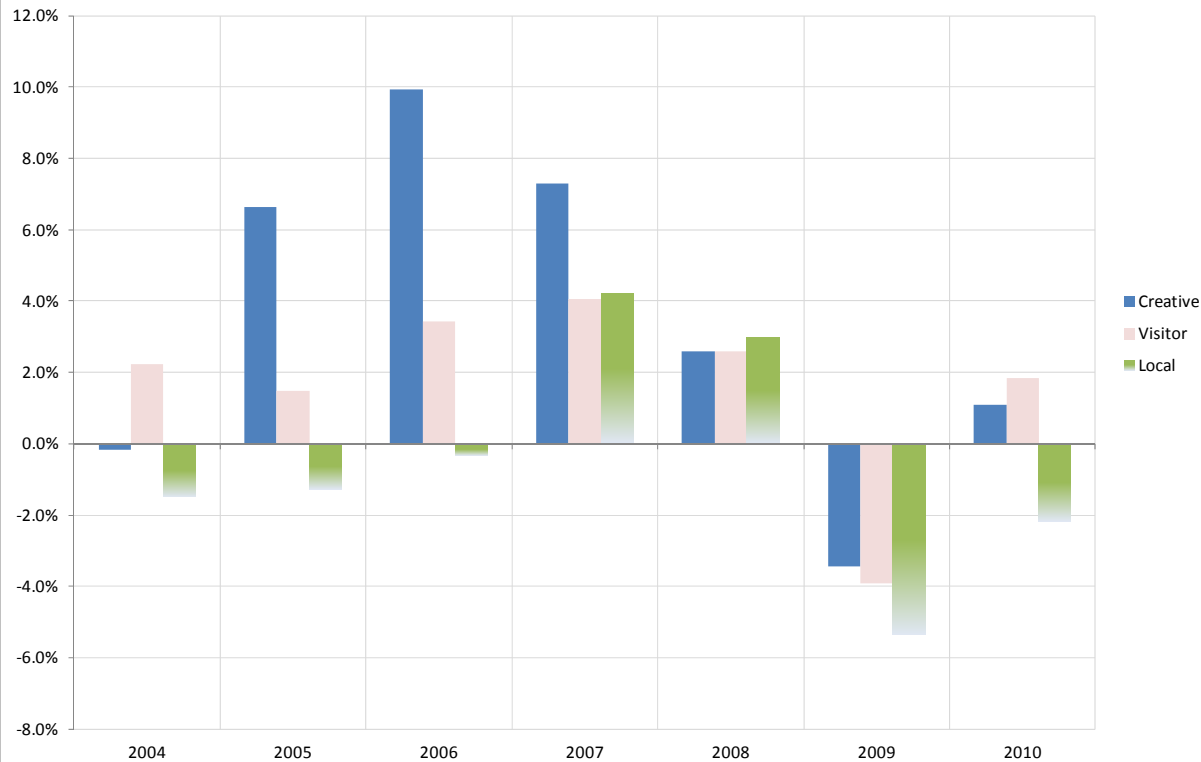


Structure of San Francisco's Private Sector



The Export-Based Sectors Have Driven San Francisco's Overall Employment Through Business Cycles

Average Annual Change in Employment:
Creative, Visitor, and Local-Serving Industries, 2004-2010

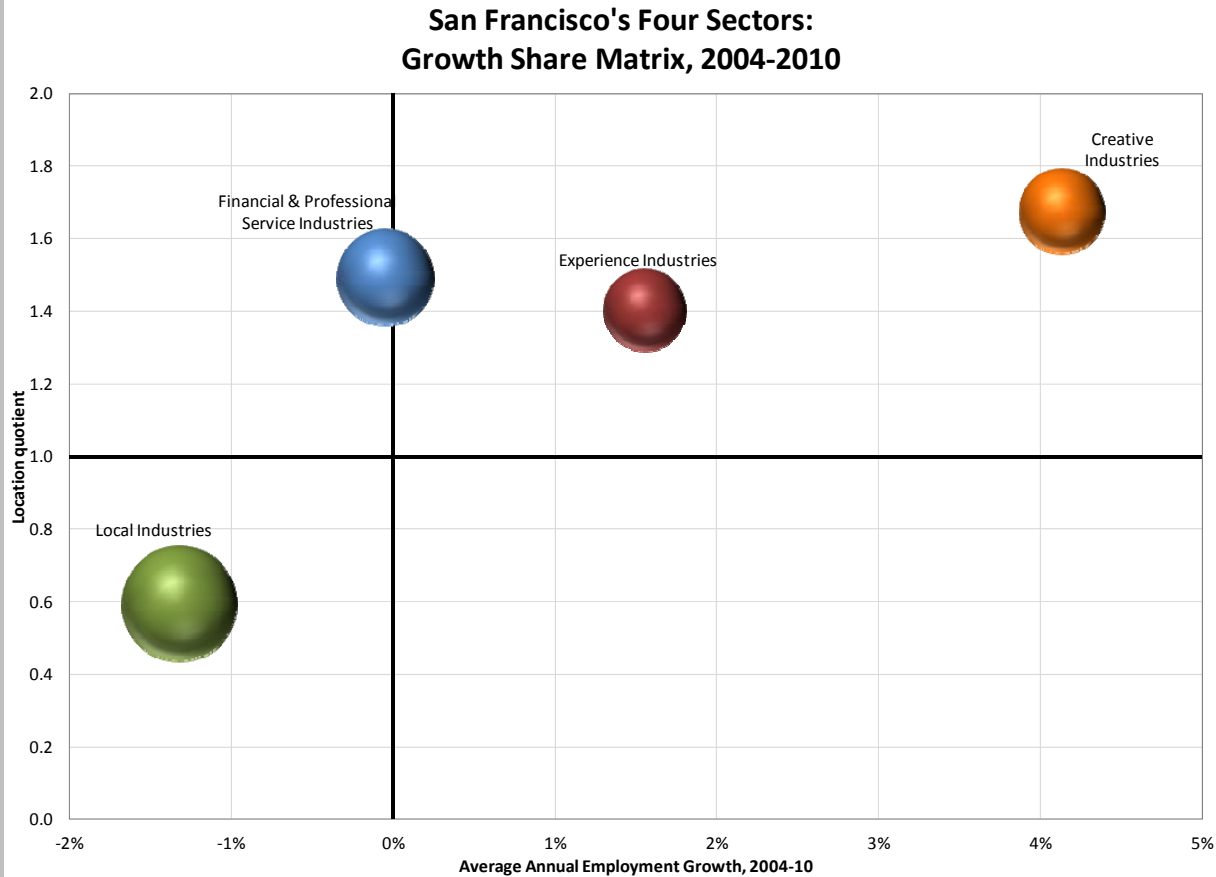


Because the city's export base industries draw in spending from outside of the region, their competitiveness strongly determines how much the city's businesses and residents can afford to spend on imported goods not made here (such as food and many manufactured goods).

In this way they also affect the performance of local-serving industries. In the last recovery, both the Creative and Visitor industries led the city's economy out of recession, and the local-serving industries followed later. In the 2008 recession, the creative and visitor industries actually declined first, before growing again in 2010 to lead the city's economy out of recession again.



Performance of the Four Sectors, 2004-2010



Source: Bureau of Labor Statistics

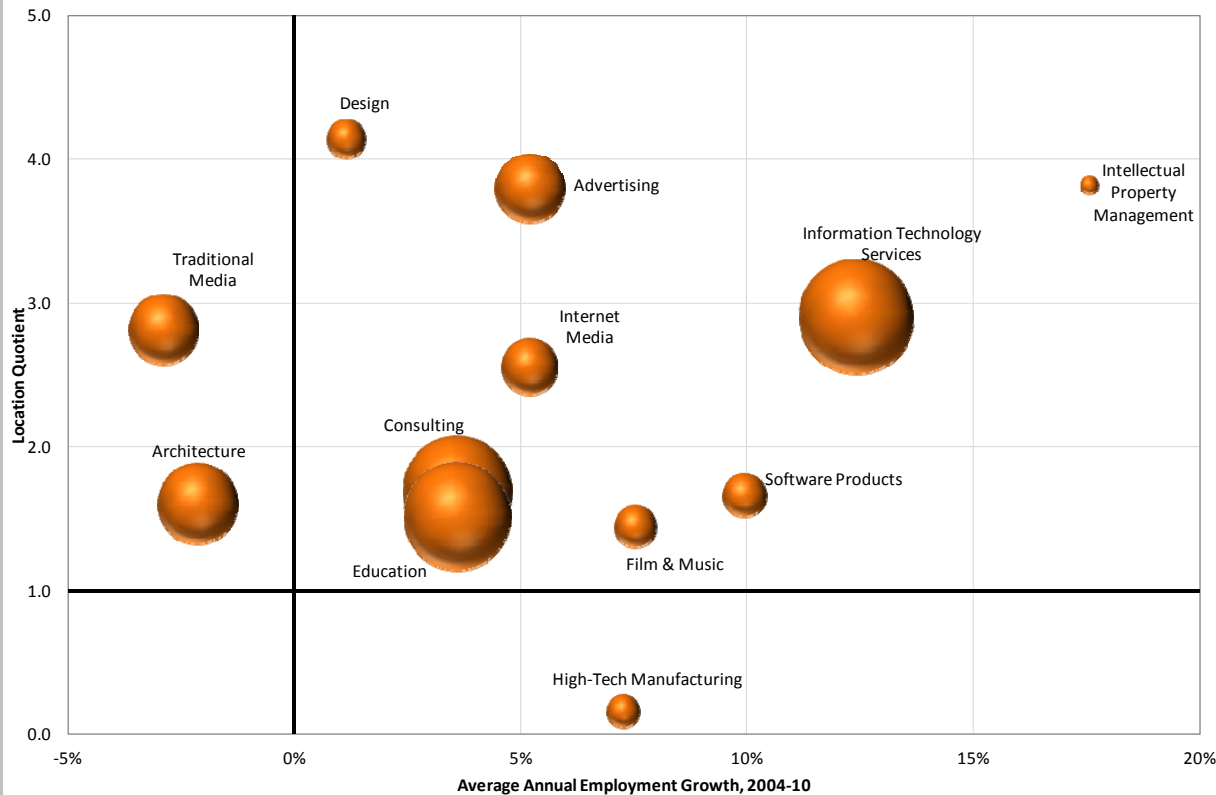
Two of the three clusters in San Francisco's economic base can be termed Established Clusters. Creative Industries (69,000 jobs) grew at over 4% per year over the past business cycle (2004-2010), and San Francisco's concentration is 70% more than the national average. Experience industries (78,000 jobs) grew at 1.5% per year during that period and are 40% more concentrated than the U.S. average.

The city's financial and professional service industries (107,000 jobs) remain concentrated but lost jobs during the last business cycle. The set of local-serving businesses (186,000 jobs) are losing jobs and have a low concentration, indicating weak competitiveness.



Creative Industries

**Creative Industries:
Growth Share Matrix, 2004-2010**



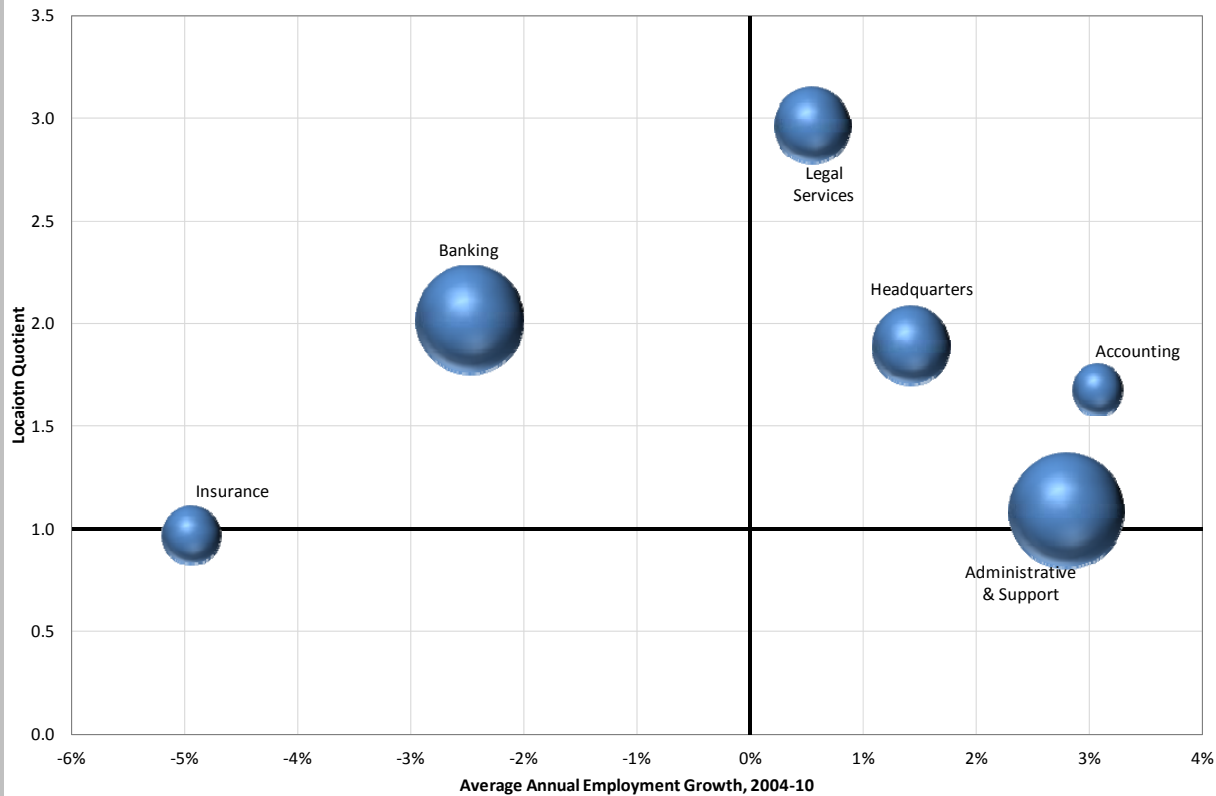
Within the creative industries cluster, Information Technology services is both the largest industry and its most successful major component. Over the last business cycle, covering the Great Recession, the industry grew over 10% per year. Consulting and private-sector education are also major sources of employment in this cluster.

Among creative industries, only traditional media (newspapers, magazines, radio and television) and architecture lost jobs over the last business cycle.

Source: Bureau of Labor Statistics

Financial & Professional Services

**Financial & Professional Service Industries:
Growth-Share Matrix 2004-2010**



The financial and professional services cluster is split between the relatively healthy growth of corporate headquarter establishments and traditional professional and business services such as law and accounting, and the decline of banking and insurance.

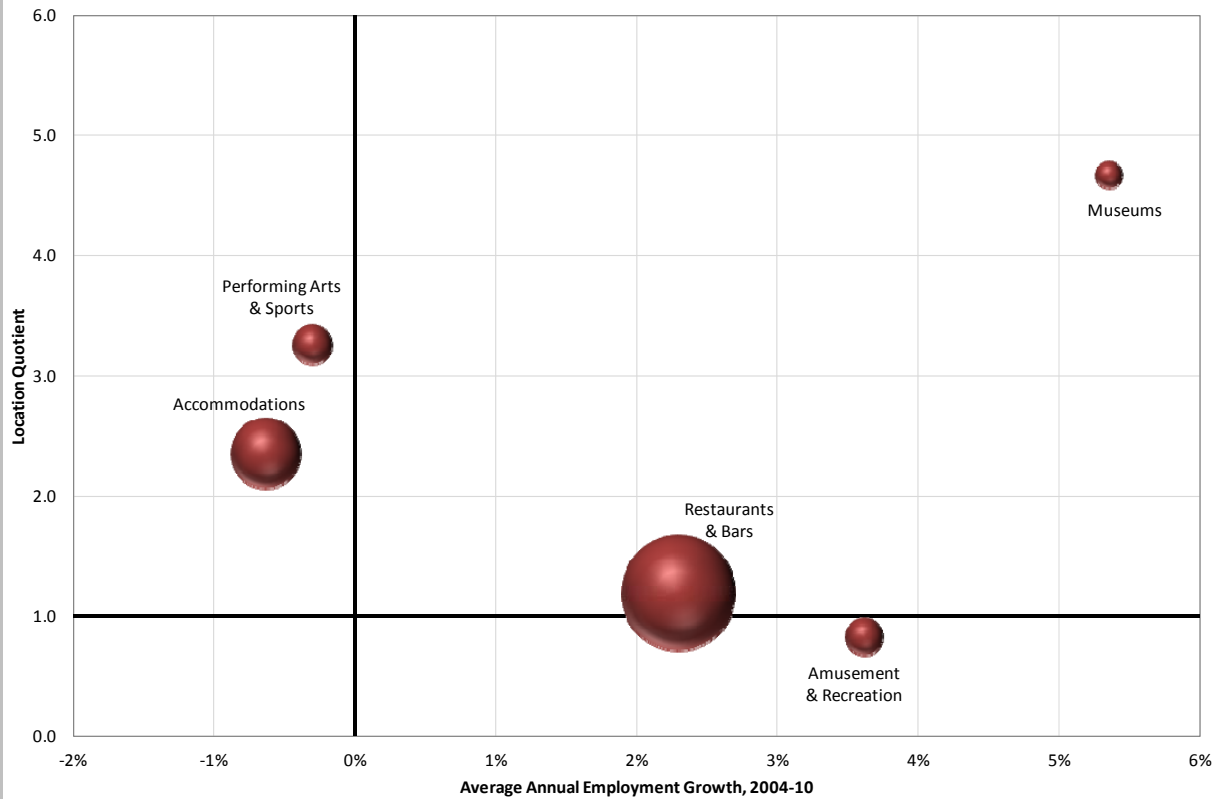
Financial services was hard-hit across the country during the past recession, but the decline in San Francisco has been a longer-term trend.

Source: Bureau of Labor Statistics



Experience Industries

Experience Industries: Growth Share Matrix 2004-2010



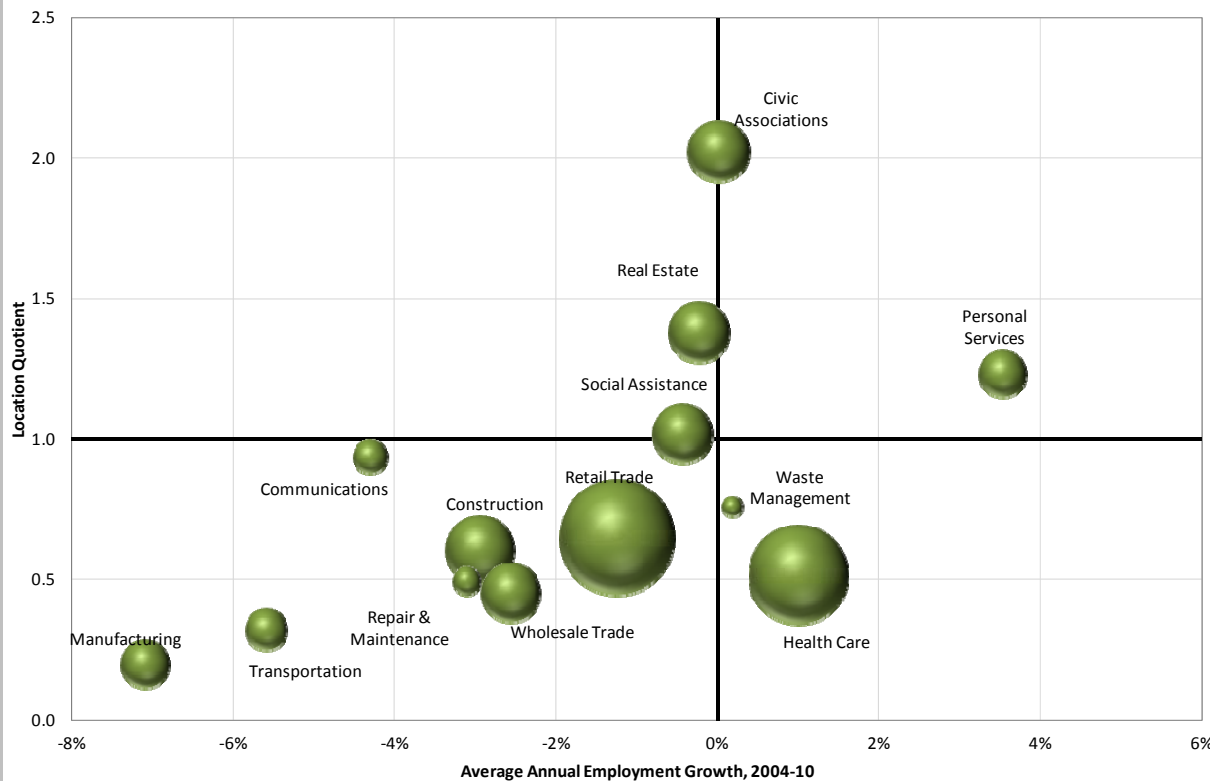
Restaurants and bars make up the bulk of the city's experience industry cluster, and that industry's growth was a healthy 2.3% annually between 2004 and 2010. The growth in the city's museums and recreation businesses offset declines in performing arts and accommodations.

Source: Bureau of Labor Statistics



Local-Serving Industries

Local-Serving Industries: Growth Share Matrix 2004-2010



As mentioned earlier, local serving businesses as a group lost jobs during the last business cycle. Personal services (e.g. laundry, beauty salons) grew at a significant pace, and the large private health care industry added jobs, but these were exceptions.

Other industries, including retail trade, wholesale trade, transportation, and manufacturing, both lost jobs and have significantly fewer jobs in San Francisco than in an average city of its size. This suggests that in many industries import substitution is not working to further diversify the city's economy: the local-serving industries increasingly weak, leading to increasing leakage of consumer and business spending.

Source: Bureau of Labor Statistics



3. Workforce Implications



Employment by Hourly Wage and Educational Level: Creative Industries

	Low Wage ($< \$17.50/\text{hr}$)	Med. Wage ($\$17.50\text{-}35/\text{hr}$)	High Wage ($\$35/\text{hr} +$)	Total
Low Education (HS or less)	2%	3%	3%	7%
Med. Education (Some College)	1%	4%	6%	11%
High Education (4 yrs. +)	1%	20%	60%	81%
Total	4%	27%	69%	100%

Source: IPUMS / ACS



Employment by Hourly Wage and Educational Level:
Experience Industries

	Low Wage ($< \$17.50/\text{hr}$)	Med. Wage (\$17.50-35/hr)	High Wage (\$35/hr +)	Total
Low Education (HS or less)	33%	9%	2%	43%
Med. Education (Some College)	15%	7%	2%	25%
High Education (4 yrs. +)	12%	12%	8%	32%
Total	61%	28%	12%	100%

Source: IPUMS / ACS



Employment by Hourly Wage and Educational Level:
Financial & Professional Services

	Low Wage ($< \$17.50/\text{hr}$)	Med. Wage (\$17.50-35/hr)	High Wage (\$35/hr +)	Total
Low Education (HS or less)	7%	4%	3%	13%
Med. Education (Some College)	4%	6%	7%	17%
High Education (4 yrs. +)	3%	13%	53%	69%
Total	13%	23%	63%	100%

Source: IPUMS / ACS



Employment by Hourly Wage and Educational Level: Local-Serving Industries

	Low Wage ($< \$17.50/\text{hr}$)	Med. Wage ($\$17.50\text{-}35/\text{hr}$)	High Wage ($\$35/\text{hr} +$)	Total
Low Education (HS or less)	14%	14%	4%	31%
Med. Education (Some College)	7%	10%	5%	21%
High Education (4 yrs. +)	6%	19%	23%	47%
Total	26%	42%	32%	100%

Source: IPUMS / ACS



Industry Trends and Workforce Implications: Conclusions

- San Francisco's two strongest industry clusters—the Creative Industries and the Experience Industries—tend to create high-paying jobs for the highly-educated, and low-paying jobs for the workers with a high school education or less.
- To a somewhat lesser extent, Financial & Professional Services has a similar workforce impact as the Creative Industries.
- The industries that create a more balanced distribution of job opportunities are, generally, in the local-serving sector of the economy, which has largely declined in recent years.
- Key workforce opportunities include local-serving industries with the potential for job growth in the next several years, including Health Care, Construction, and Retail Trade.

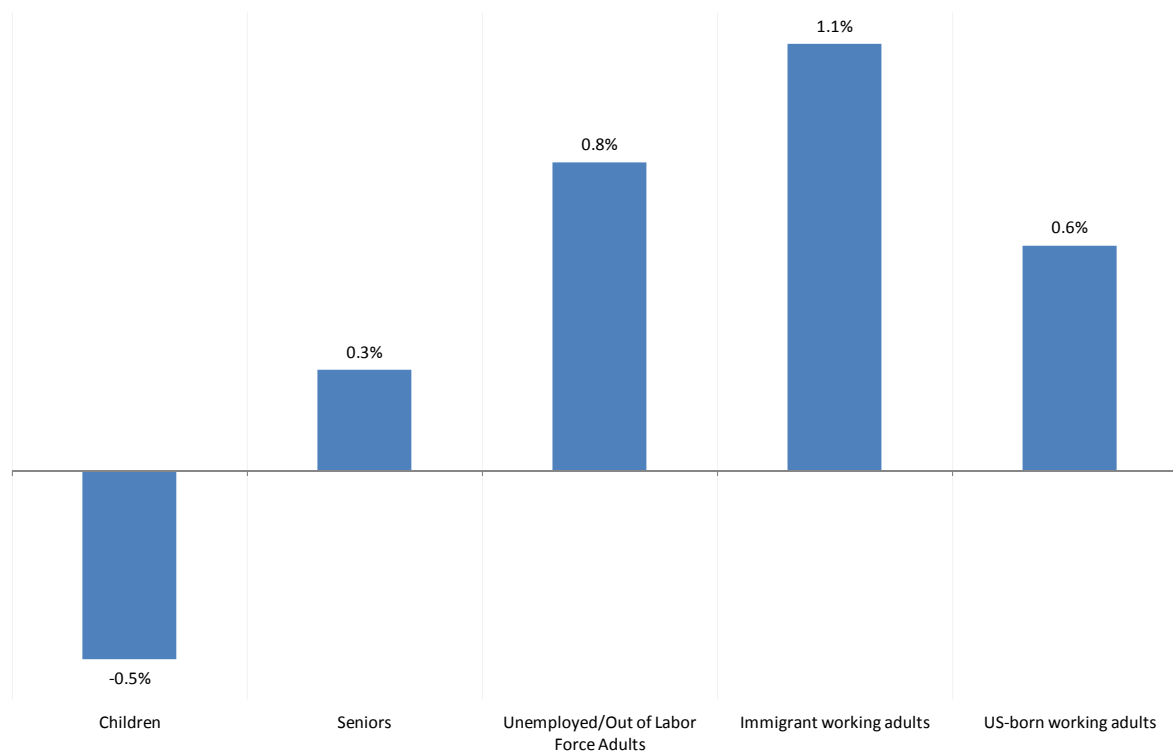


4. Demographic Implications



Demographic Trends, 1990-2010

Average Annual Growth Rate, San Francisco Population Categories, 1990-2010



Over the past twenty years, immigrant working adults have been the fastest growing segment of the city's population.

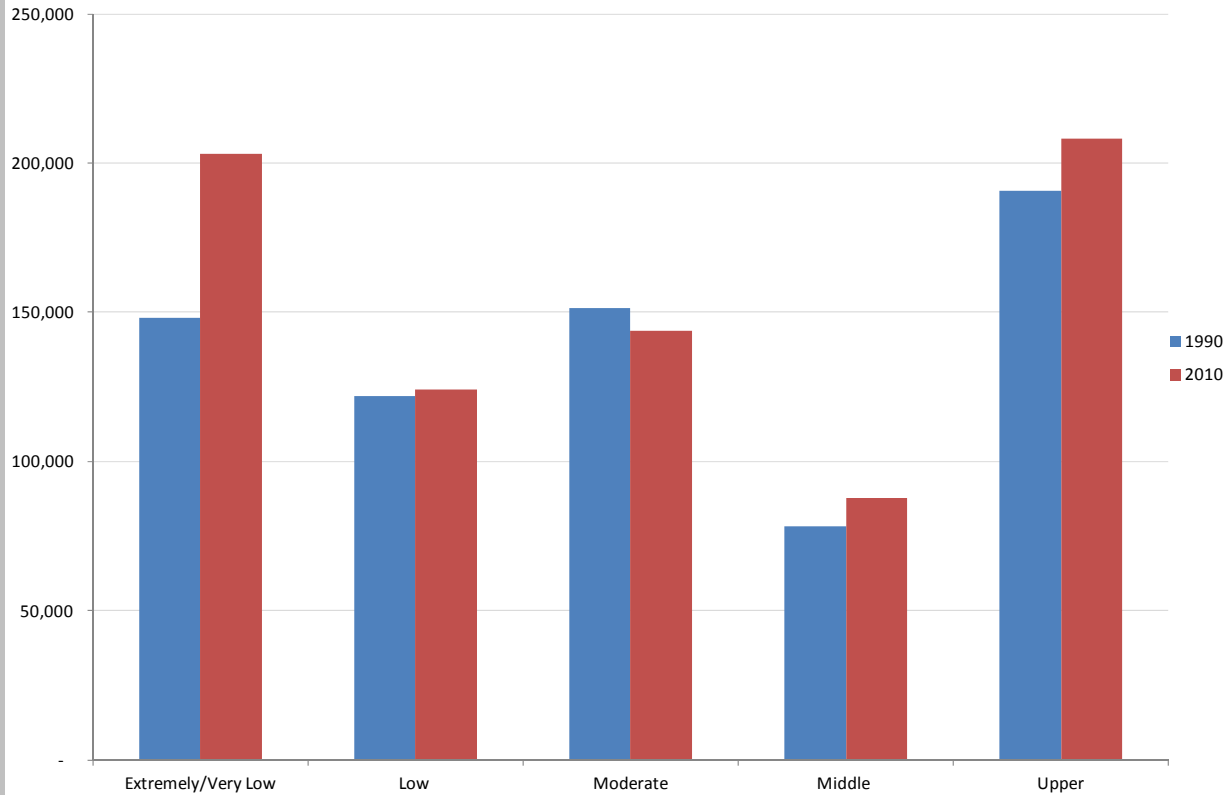
The number of seniors has grown very slowly, and the number of children has declined significantly at 0.5% per year.

Source: IPUMS / ACS



Population by Household Income Trends

San Francisco Population by Household Income Category, 1990 & 2010



Source: IPUMS / ACS

Given the trends of growth in high-wage and low-wage employment, and a decline of middle-wage employment, it is not surprising that the income distribution of the population has moved in the same directions.

The population living in Extremely Low / Very Low income households (those earning less than 50% of Area Median Income) has grown the most. Growth has also been seen in households earning over 150% of area median income, and, to a lesser extent, in those earning 120-150% of AMI. The low income population (50-80% of AMI) has seen very slight growth, and the moderate income population (80-120%) experienced a decline in absolute numbers.



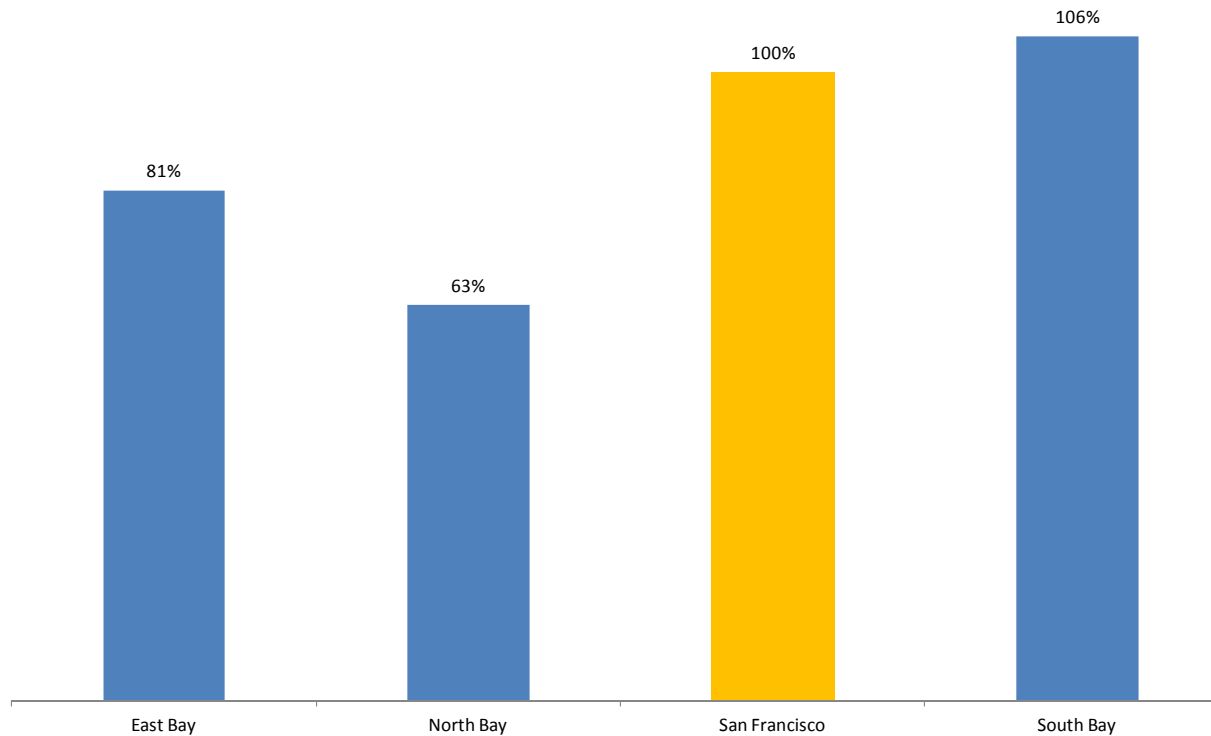
Significant Demographic Trends

- The demographic profile of San Francisco generally aligns with its industry dynamics. Increasing growth in industries paying very high and very low wages has led to growth in the upper income population,
- Changing patterns of in-commuting and out-commuting tend to exaggerate this trend however. The rising in-commuting of low and moderate income workers suggests the city is losing middle-income population faster than it is losing middle-wage jobs.
- On the other hand, as the city has established larger communities of upper and very low income people, San Francisco is increasingly a residential center for both socio-economic groups, who increasingly commute out of San Francisco to jobs elsewhere in the region.
- Across most income categories, children and seniors are declining, and working age adults are growing.
- The immigrant workforce is growing faster than US-born workforce, at every level of income.
- Immigrant and US-born workers are identical in growth trends by income, with nearly all growth at the upper and lower ends of the income spectrum.

5. Barriers to Growth

Labor Costs: San Francisco's Average Wages are Higher than Much of the Bay Area

Relative Wages in the Bay Area as a % of San Francisco, 2010:



A key reason why San Francisco's employment has been slower than the rest of the Bay Area, for most industries, is that the cost of doing business is significantly higher than it is in other locations within the region.

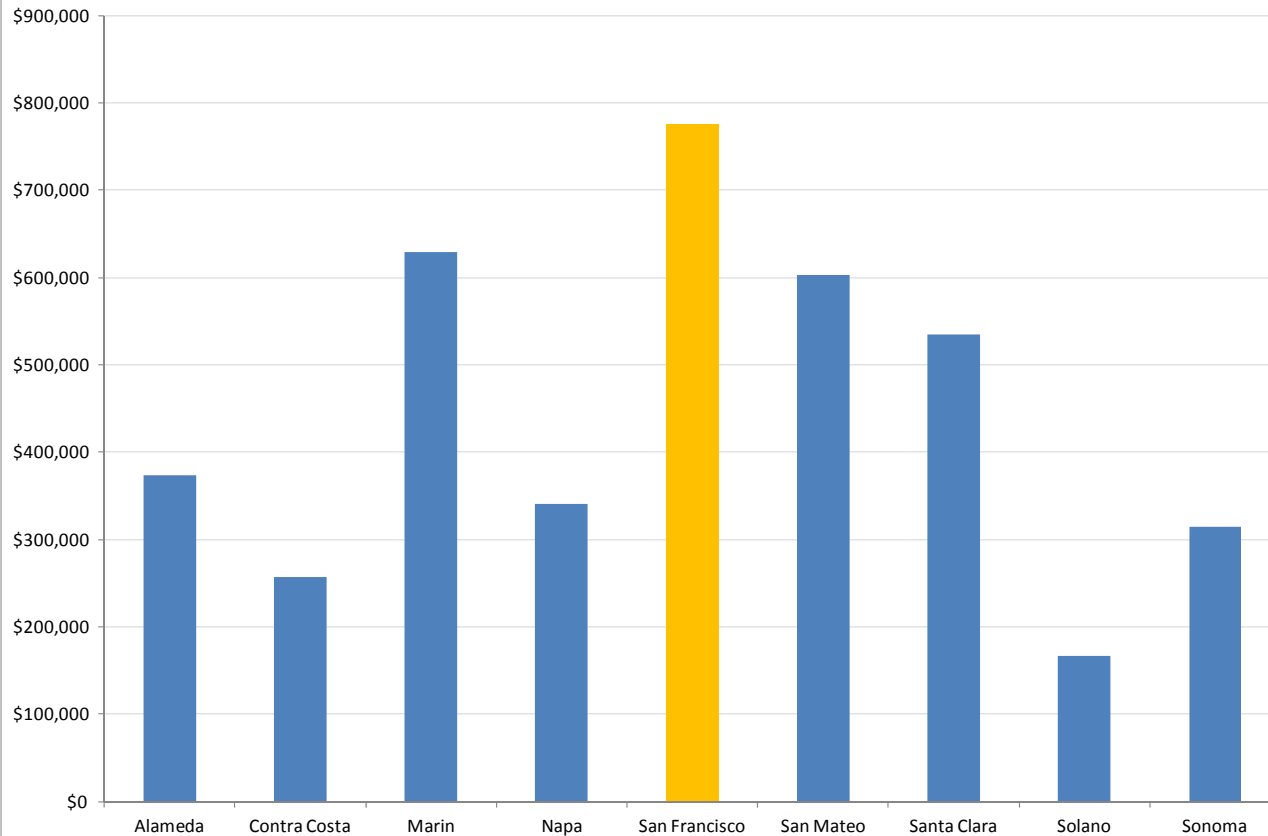
Since labor makes up the single largest expense category for most businesses, labor cost differences between San Francisco can matter the most. On an industry-weighted basis, average wages in San Francisco are 19% higher than in the East Bay, and 37% higher than in North Bay. Wages in the South Bay are 6% higher than San Francisco.

Source: Bureau of Labor Statistics



One Reason Wages are Higher in San Francisco is that Housing is More Expensive Here

Home Value Index, 3 Bedroom Units:
San Francisco and Other Bay Area Counties, Dec. 2011



Source: Zillow

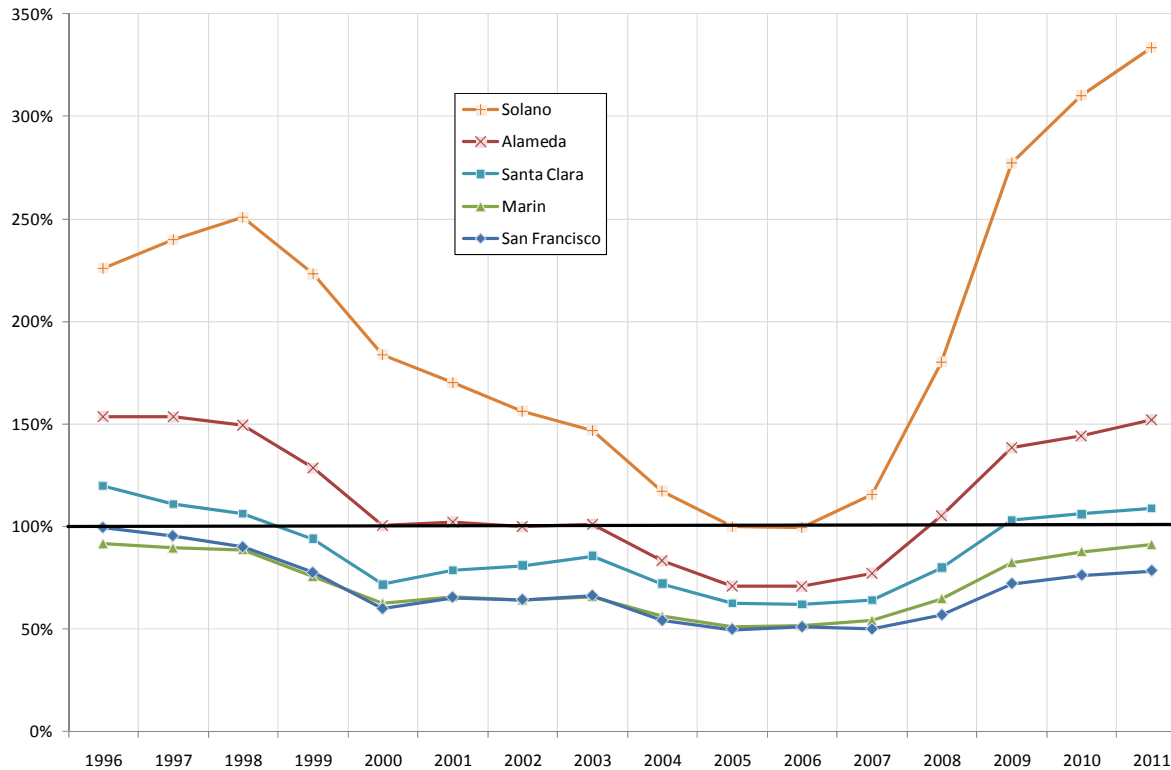
While wages make up the biggest expense for most businesses, housing makes up the biggest expense for most households. By 2011, thanks to a housing market crash that affected San Francisco less than other places, the city now has the most expensive housing in the region.

The chart to the left shows Zillow's 3-bedroom housing index for Bay Area counties. San Francisco has traditionally had lower housing prices than Marin or San Mateo counties, but this trend has reversed itself.



After the Crash, Housing has become more affordable in other parts of the Bay Area

Maximum Affordable House, 4-Person Household at 100% AMI (SF),
as % of Average 3BR Housing Prices in Selected Bay Area Counties, 1996-2011



San Francisco's high housing costs and resulting high wages have been established over many years. However, the experience of the recent housing market bubble and collapse is likely to exacerbate San Francisco's business cost premium over the long term, because so much more housing was built in outlying areas.

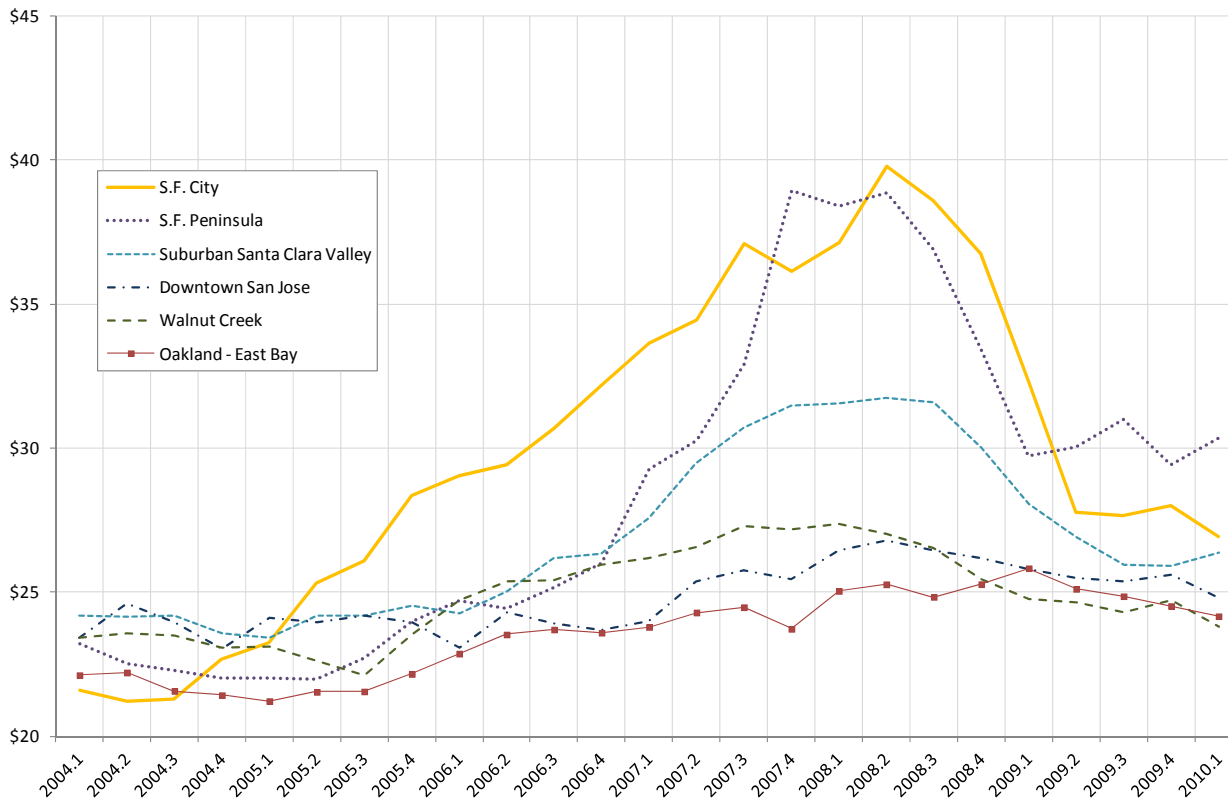
In 1996, for example, a 4-person San Francisco household at 100% of AMI could afford 100% of the average cost of a 3-bedroom house in the city. While outlying areas were more affordable, the gap was significantly less than it was today. Now, despite the correction, such a household can only afford 75% of the cost of a San Francisco house, but 150% of an average house in Alameda County, and 330% of an average house in Solano County.

"Maximum Affordable House" assumes 10% down, 90% mortgage financing at average mortgage rate for that year, with 33% of household income used for mortgage payments.
Source for housing prices for 3-bedroom units: Zillow.



Commercial Rent Differences

Average Gross Asking Rent, San Francisco and Other Bay Area Office Markets, 2004Q1 - 2010Q1



Source: CBRE Econometric Advisors

After labor costs, real estate is the cost factor that accounts for the most cost difference across Bay Area business locations.

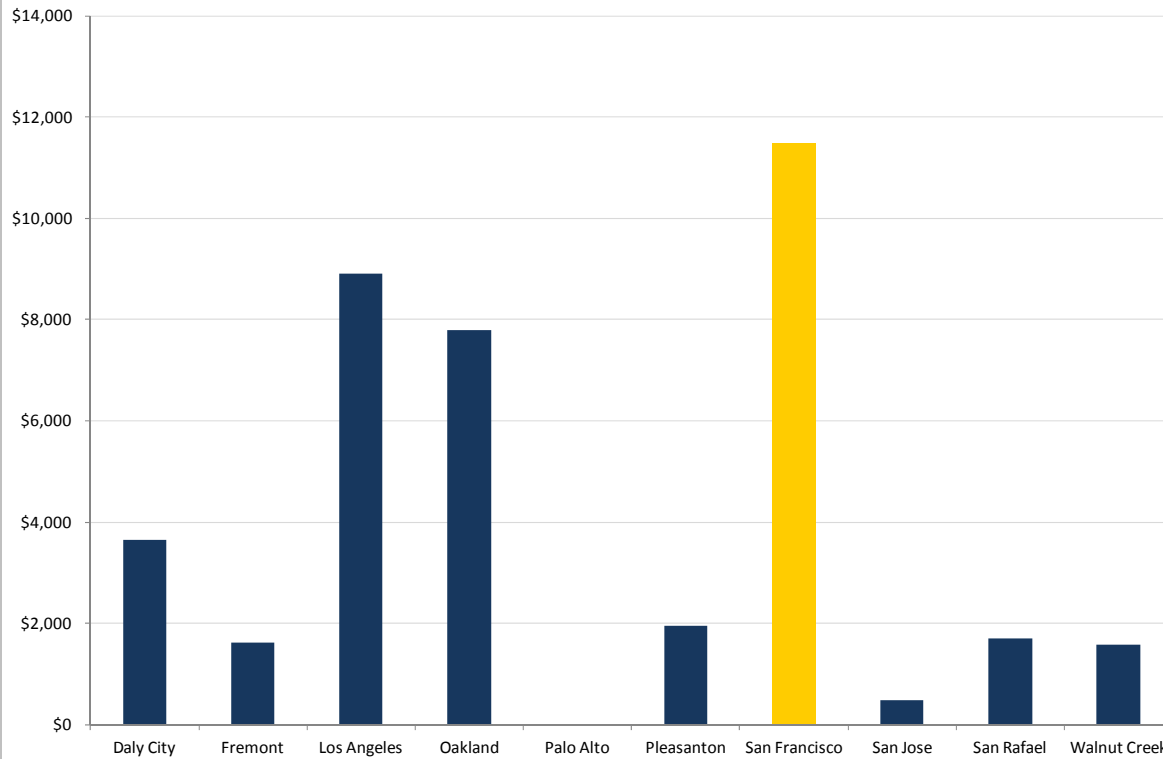
Assessing differences in commercial rent is challenging because sub-markets move at different rates. However, as an average across all office space types, and the full business cycle from 2004 to 2010, it appears San Francisco's average commercial rent is 5% higher than the Peninsula, 10% that suburban Santa Clara County, and 17% higher than Walnut Creek or downtown San Jose.

Like the higher labor costs, higher rents discourage businesses from locating in or expanding within San Francisco.



Business Taxes: San Francisco's Business Tax Burden is the Highest in the Region and State

Annual Business Tax Payment in San Francisco and Other California Cities:
Typical Small Hardware Store



San Francisco's business tax is another reason the cost of doing business is higher in the city than elsewhere in the region. Because only San Francisco charges a tax on payroll, it is difficult to generalize the extent of the difference. However, for example, a hardware store with 18 employees would pay close to \$12,000 a year in San Francisco, on average, while paying significantly less than that in Oakland or Los Angeles

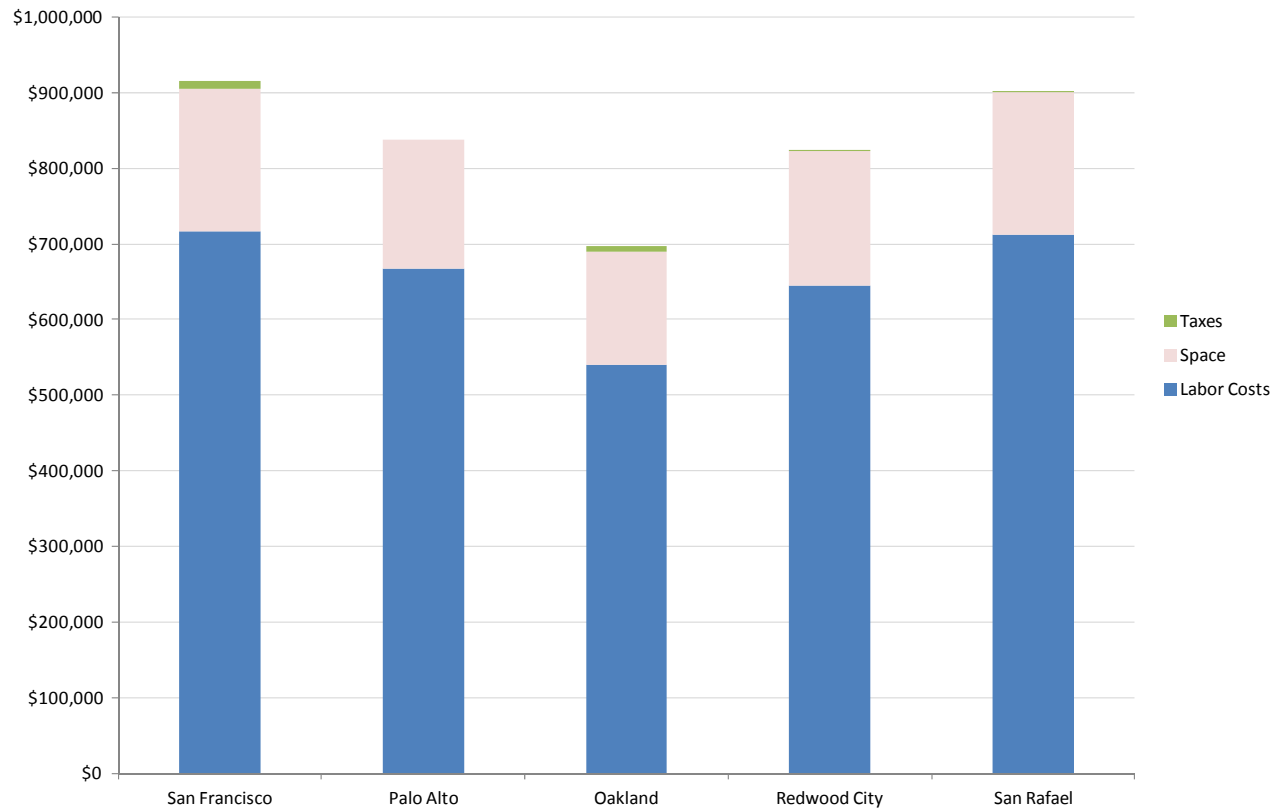
While significant, the difference in tax payments for San Francisco appears to be significantly less than the differences in labor or real estate costs.

Source: Kosmont-Rose Institute Cost of Doing Business Survey, 2009



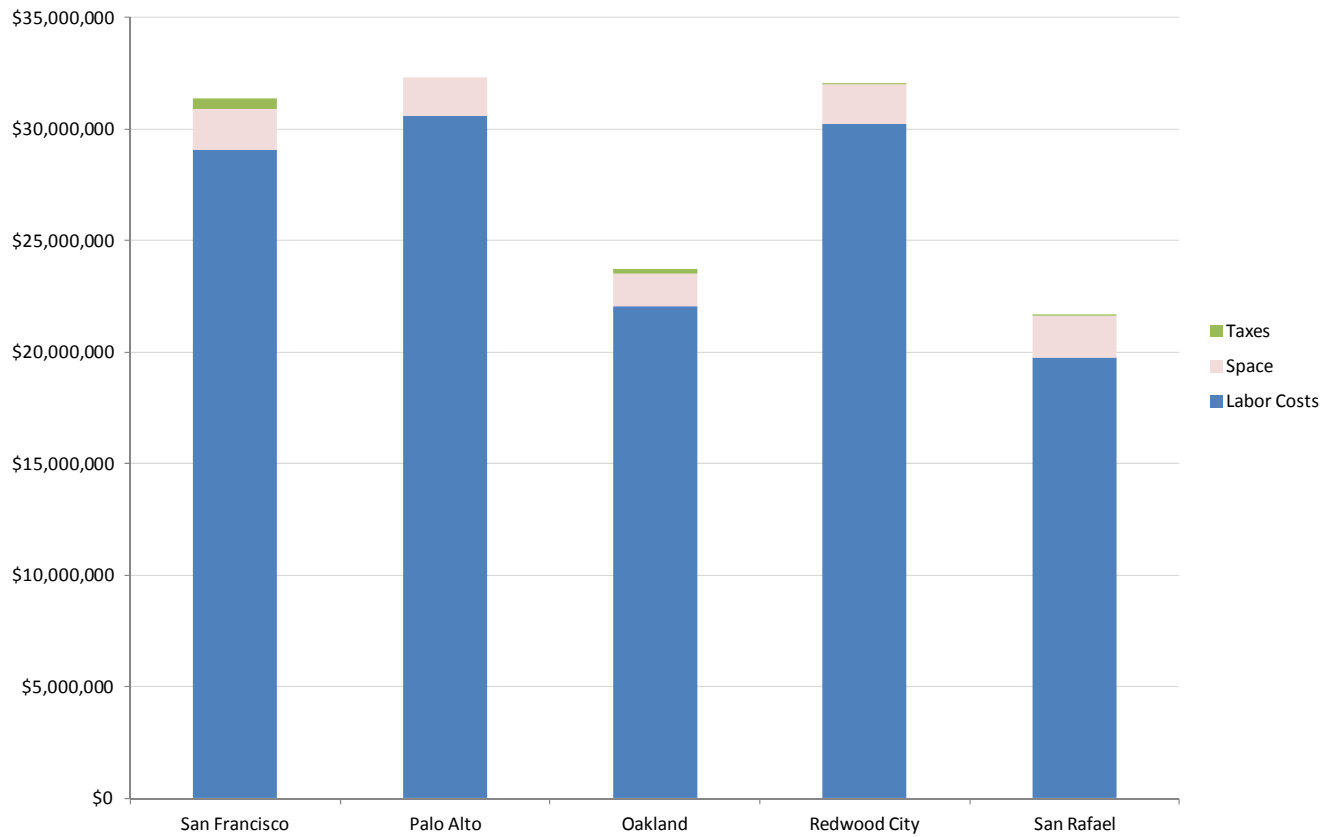
Combined Business Costs: Small Hardware Store

Combined Labor, Space, and Local Business Tax Costs:
Small Hardware Store in San Francisco and Four Other Cities



Combined Business Costs: Large Law Firm

Combined Labor, Space, and Local Business Tax Costs: Large Law Firm in San Francisco and Four Other Cities



Barriers to Growth: Conclusions

- San Francisco's slow rate of employment growth, in a region where job growth has been healthy, suggests that city-specific factors inhibit job creation here.
- On average, a business will pay significantly more for workers if it is located in San Francisco, as opposed to being located in other parts of the region. This labor cost premium discourages job creation in San Francisco.
- Since housing is a household's largest single expense, it is likely that the city's high housing costs contribute to the higher labor costs that San Francisco businesses experience.
- Secondly, commercial rents are higher in San Francisco, on average, than they are in any other office sub-market in the Bay Area. This office space premium further discourages job creation in San Francisco. However, for most businesses the office space premium will be much less than the labor cost premium.
- Thirdly, the city's business tax burden is the highest of any city in California, and many jurisdictions levy little or no business tax. Thus, the business tax is another factor that discourages job creation in the city.