



BIOCOM

November 9, 2018

David Augustine, Tax Collector
Office of the Treasurer and Tax Collector
San Francisco City Hall
1 Dr. Carlton B. Goodlett Place, Room 140
San Francisco, CA 94102

Dear Mr. Augustine:

I am writing to provide Biocom's input on the Draft Tax Collector Regulation to Clarify the Application of the Early Care and Education Commercial Rents Tax to Certain Leasing Activities.

Biocom is the largest, most experienced leader and advocate for California's life science sector. We work on behalf of over 1,100 members to drive public policy, build a network of industry leaders, create access to capital, introduce cutting-edge STEM education programs, and create value-driven purchasing programs.

In the life science industry, most tenants and landlords operate under what's known as a "triple net" lease, or NNN. The three nets are taxes, insurance, and common area maintenance – these are all paid by the tenant. Most NNN leases allow the landlord to immediately pass through any tax increases to tenants. By contrast, a "gross" lease is a property lease in which the landlord agrees to pay all expenses that are normally associated with ownership, such as utilities, repairs, insurance, and (sometimes) taxes. The tenant pays a fixed amount each month, and nothing more.

Life science landlords prefer to operate under NNN leases because of the volatility of utility costs associated with doing business as a life science tenant. For example, a tenant might need to purchase freezers to keep chemicals stable at minus eighty degrees centigrade, which when purchased could increase utility costs by \$20,000 per month in the short or long term. Fifty to seventy percent of operating expenses of these tenants can be utilities, or approximately twenty percent of the total that is paid to a landlord when including base rent. Tech and office tenants typically have gross leases because they have stable operating expenses.

Most of the large landlords developing life science space that oversee NNN leases are Real Estate Investment Trusts, or REITs. In order to maintain corporate income tax exemption, REITs do not apply an administrative fee to these pass-through expenses. Rather, their profit must come from base rent only, or pass a de minimis threshold of <1% in administrative fees.

Because most companies in our industry operate under NNN leases, life science companies will be disproportionately impacted by the pass-through of this tax as an operating expense.





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Life science companies operating in the city are typically small and mid-size companies with small margins. Taxes, insurance, and maintenance costs incurred by landlords when operating a tenant occupied building are not landlord income. When this is considered income, and incurs gross receipts tax increases, those increases are immediately passed on to tenants. In San Francisco, these tenants mostly range from a few employees at a bench inside an incubator to a biotech company that does not yet have a commercialized product and is partway through the lengthy clinical trial process.

It is our hope that this issue can be revisited in order to avoid a double taxation – what is paid by tenants for operating expenses, and what is paid by the landlords to utilities, taxation agencies, and maintenance companies. We appreciate the opportunity to be involved in conversations related to gross receipts tax implementation moving forward, and would welcome your questions and concerns. Please feel free to contact me at mcohn@biocom.org or 858-832-4158.

Sincerely,

Melanie Cohn
Director of Regional Policy & Government Affairs
Biocom

