



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Lee Wilcox

**SUBJECT: POTENTIAL REAL PROPERTY  
TRANSFER TAX MEASURE**

**DATE:** November 21, 2019

Approved

*D. D. S. L.*

Date

*11/22/19*

## RECOMMENDATION

Adopt a Resolution of the City Council:

- (a) Calling and giving notice, on its own motion, for a Special Municipal Election to be consolidated with the statewide primary election occurring in the County of Santa Clara held on March 3, 2020, to submit to the electors of the City of San José a measure to enact a real property transfer tax with the following statement of the measure to be printed in the ballot:

*To fund general City of San José services, including providing affordable housing for seniors, veterans, disabled, and low-income families and helping homeless residents move into shelters/ permanent housing, shall an ordinance be adopted enacting a real property transfer tax including unrecorded transfers at these rates: transfers valued up to \$2,000,000 EXEMPT, \$2,000,000.01 to \$5,000,000 at 0.75%, \$5,000,000.01 to \$10,000,000 at 1.0%, and over \$10,000,000 at 1.5%; generating approximately \$70,000,000 annually, until repealed, with all money staying local?*

- (b) Directing the City Clerk to, pursuant to Elections Code Section 12111, cause a synopsis of the proposed measure to be published at least one time not later than one week before the election in the *San Jose Mercury News*, a newspaper of general circulation within the City of San José, instead of printing the full text of the measure in the Sample Ballot;
- (c) Authorizing the Mayor to submit a ballot argument in support of the measure, pursuant to Elections Code Section 9282;
- (d) Authorizing the submittal of rebuttal arguments pursuant to Elections Code Section 9285;
- (e) Directing the City Attorney to prepare an Impartial Analysis of the measure, where, as authorized under Elections Code Section 9280, the following statement will be printed in the Impartial Analysis to be prepared by the City Attorney: "If you would like to read the

full text of the measure, see <http://www.sanjoseca.gov/index.aspx?nid=5694> or call 408-535-1260 and a copy will be sent at no cost to you.”; and

- (f) Directing the City Clerk to take all other actions necessary to place this measure on the March 3, 2020 ballot.

### **OUTCOME**

Approval of this item will result in the City placing the proposed Real Property Transfer Tax measure on the March 3, 2020 citywide ballot.

### **BACKGROUND**

On November 19, 2019, the City Council discussed the potential Real Property Transfer Tax measure and gave direction to the City Manager and City Attorney to return on December 3, 2019 with a proposed ballot question, ordinance, resolution, and other items required for the City Council to call an election to place the tax measure on the March 3, 2020 ballot.

The Council also accepted the Administration’s proposed tax structure of:

- a) A floor of \$2 million of value of a property transfer, exempting any property transfer of \$2 million or less, which would exempt 95% of all real property sales in San José according to 2017-2018 data, and
- b) Three tiers at the following rates:
  - i. 0.75% for transfers valued from \$2,000,001 to \$5,000,000,
  - ii. 1.0% for transfers valued from \$5,000,001 to \$10,000,000, and
  - iii. 1.5% for transfers valued more than \$10,000,000.

In addition, the Council directed the Administration to:

- Return in early 2020 for a discussion of funding priorities, including:
  - Requiring a two-thirds Council vote for amendment of spending priorities related to the proposed Real Property Transfer Tax;
  - Consideration of amendments to Council Policy 1-18, Operating Budget and Capital Improvement Program Policy; and
- Conduct stakeholder outreach to labor representatives and non-profit affordable housing developers regarding appropriate labor standards policy related to the expenditure prioritization plan to ensure quality jobs are developed from the use of these public funds;
- Add an Oversight Committee requirement to the proposed Real Property Transfer Tax ordinance; and

- Explore alternatives for addressing inflation and rising housing costs tied to the exemption of real property transfers up to \$2 million and bring forward a recommendation on December 3, 2019, including:
  - Indexing the \$2 million threshold to the Consumer Price Index;
  - Reviewing and potentially “right-sizing” the \$2 million threshold every few years; and
  - Reviewing and amending the threshold when the median sales price of a home in San José reaches \$2 million.

## ANALYSIS

### *Real Property Transfer Tax*

A real property transfer tax is a tax paid on each deed or other recorded instrument transferring real property, such as the sale of real property. In addition, some jurisdictions apply the tax to unrecorded transfers. It is staff’s recommendations that this tax apply to recorded and unrecorded transfers.

In California, counties and general law cities are authorized to impose a real property transfer tax under the Documentary Transfer Tax Act at the rate of \$0.55 per \$500, for transactions with a value exceeding \$100.

San José, as a Charter City, has authority under the State Constitution to impose a transfer tax and is not limited to the tax rate specified under the Documentary Transfer Tax Act. The City currently charges a real property transfer tax (the Real Property Conveyance Tax, Chapter 4.58 of the Municipal Code) at a rate of \$1.65 per \$500 (\$3.30 per \$1,000) for transactions with a value exceeding \$100. The revenues from the City’s Conveyance Tax are allocated to libraries, fire protection facilities, parks, maintenance yards, communications facilities, and general municipal improvements.

The State’s Documentary Transfer Tax and the City’s Conveyance Tax operate similarly as both were modeled after the Federal Documentary Stamp Tax. Exemptions under both the Documentary Transfer Tax and the City’s Conveyance Tax include inheritance, gifts, certain government transactions, and divorce. These exemptions are included in the proposed Real Property Transfer Tax ordinance.

In Santa Clara County, transfer taxes may be paid by either the buyer or the seller of the property, or may be split between the two.

### ***Proposed Tax Rates***

As approved by Council, the proposed Real Property Transfer Tax measure would exempt transfers with a value of \$2 million and under. Based on 2017-2018 data, this would exempt 95 percent of all real property sales in San José.

For transfers above \$2 million, the tax includes three tiers:

- 0.75% for transfers valued \$2,000,000.01 to \$5,000,000;
- 1.0% for transfers from \$5,000,000.01 to \$10,000,000;
- and 1.5% for transfers above \$10,000,000.

In dollar values (as expressed in the existing conveyance tax ordinance), the proposed percentage rate would translate to:

- \$3.75 per \$500 of transfer value from \$2,000,000.01 to \$5,000,000;
- \$5 per \$500 of transfer value from \$5,000,000.01 to \$10,000,000; and
- \$7.50 per \$500 of transfer value for transfers above \$10,000,000.

The proposed ballot question has been modified slightly for clarity to break each tier at the penny mark. The draft ordinance corresponds to this change.

The proposed tax would apply to the full value of consideration. The proposed tax would, if passed by the voters, take effect on July 1, 2020. As Council directed, the draft ordinance requires appointment of a Community Oversight Committee (Section 4.59.370). Specifically, Section 4.59.370 provides that the City Council will appoint a Community Oversight Committee comprised of residents of the City to provide community oversight over the expenditure of the tax revenues. The size, composition and specific responsibilities of the Community Oversight Committee will be determined by separate action of the City Council prior to July 1, 2020.

### ***Alternatives Related to the \$2 million Exemption Threshold***

Following the City Council discussion on November 19, 2019, staff examined the three scenarios outlined in Council direction. Council's primary concerns were addressing the needs of first-time homebuyers and managing future escalation in housing prices. While the current \$2 million exemption threshold exempts approximately 95 percent of all real property transfers, and would exempt a greater percentage of single-family, condominium, and townhome sales, Councilmembers were concerned about a future time where \$2 million might become the price of an entry-level home.

Staff explored building in automatic inflation escalators into the ordinance, or creating triggers to change the tiers automatically. Staff also examined the City's other existing tax ordinances to look for potential policy options for Council to consider.

As a result of this work, staff has included Section 4.59.420, Amendment or Repeal, in the draft ordinance.

Under Section 4.59.420 of the proposed Real Property Transfer Tax ordinance, the City Council may take the following actions without voter approval, provided, Council’s action does not increase the tax rate or reduce the exemption threshold below \$2,000,000:

- Repeal or suspend the tax;
- Reduce the rate of the tax and later restore the rate of the tax to a rate that is no higher than that approved by the voters;
- Interpret or clarify the methodology of the tax so long as the interpretation or clarification does not increase the rate of the tax;
- Add exemptions; and
- Increase the exemption threshold of the tax.

Accordingly, this Section would allow the Council to:

- Raise the \$2 million exemption threshold (see Table 1 below for an example);
- Change the tier structure, so long as tax rates stay the same or are lowered;
- Lower the tax rates within a single tier or multiple tiers; and/or
- Temporarily take any of the above actions (for example, during a severe downturn).

This approach meets Council’s direction to provide a means for the \$2 million exemption threshold to be adjusted to meet market conditions, and it provides flexibility for future unforeseen circumstances, while not diluting revenues over time. Table 1 illustrates the potential future scenarios that the Council discussed on November 19, 2019. In this illustration, median home prices have increased. In an effort to protect first-time homebuyers and long-time property owners in the newly defined median range, Council has taken action to adjust the exemption and each tier upward by \$300,000.

<b>Table 1: Example of Potential Amendment of the \$2 million Exemption Threshold</b>		
<b>Initial Transfer Value Tiers</b> <i>Applied to the full value of consideration</i>	<b>Amended Transfer Value Tiers</b> <i>Applied to the full value of consideration</i>	<b>Tax Rate</b>
Up to \$2 million	Up to \$2,300,000	Exempt
\$2,000,000.01 to \$5,000,000	\$2,300,000.01 to \$5,300,000	0.75%
\$5,000,000.01 to \$10,000,000	\$5,300,000.01 to \$10,300,000	1.0%
Above \$10,000,000	Above \$10,300,000	1.5%

Additionally, to ensure that the Council is receiving regular updates about the tax, economic conditions, and the real estate market, staff has included Section 4.59.355 Annual Report of the City Manager, requiring the City Manager to include in the Annual Report “the amount of tax revenues received by the City from the tax imposed pursuant to this Chapter [4.59], the median home sales price for the prior fiscal year, and any other economic factors related to the sale price of real property in the City that the City Manager may choose to present or that the City Council may request. In connection with the Annual Report, the City Manager may recommend that the City Council consider an increase to the exemption threshold set forth in Section 4.59.100.”

This will provide the Council with the information necessary to assess whether to adjust the \$2 million exemption or decrease the tax rates. While Section 4.59.420, Amendment or Repeal, provides Council flexibility in adjusting the tax exemptions threshold or tax brackets, staff believes changes should be limited to every five or ten years, given the complexities associated with the tax collection by the County and the cyclical nature of the real estate market.

The Administration believes this approach provides Council with the ability to address all the potential scenarios identified during the Council discussion (inflation, rising median home prices, first-time homebuyer needs, etc.) while still maintaining resources to address City Council and community priorities. It also aligns with the authority provided in other tax measures that San José voters have approved that gives the Council the ability to decrease tax rates or to provide for additional exemptions.

As an example, on May 6, 2019, the Administration recommended and City Council approved amending the Cannabis Business Tax in response to changing economic and industry conditions. The Council approved changing the rate structure from a flat 10 percent gross receipts tax for all cannabis businesses to reduced rates for cultivation (4 percent), manufacturing (3 percent), distribution (2 percent), and laboratory testing (0 percent).

An example of how these recommendations in the proposed Real Property Transfer Tax ordinance may apply is shown in Attachment A: Hypothetical Scenarios for Rate Adjustment Methodologies.

### ***Potential New Revenues from a Real Property Transfer Tax***

This measure would be a general tax, requiring approval of a simple majority (50 percent plus 1 vote), and revenues would be allocated to the General Fund and available to be spent on any City purpose. Potential new revenues, modeled on existing San José conveyance tax revenues and recorded transfers, are shown in Table 2 below.

**Table 2: Potential Revenue Scenarios from a New Transfer Tax**

Transfer Value	New Tax Rate	Projected New Revenues		
		Recessionary Scenario*	20-Year Average Scenario**	2017-2018 Tax Year Model Scenario***
Up to \$2 million	Exempt	0	0	0
\$2,000,000.01 to \$5,000,000	0.75%	\$5 million	\$6.2 million	\$9.1 million
\$5,000,000.01 to \$10,000,000	1.0%	\$2 million	\$2.5 million	\$3.7 million
\$10,000,000.01+	1.5%	\$15.1 million	\$41 million	\$60.3 million
<b>Total Projected New Revenues</b>		<b>\$22.1 million</b>	<b>\$49.7 million</b>	<b>\$73.1 million</b>

\* Based on lowest 3-year Great Recession Average, with additional decline in \$10M+ transfers  
 \*\* Based on 20-year average conveyance tax revenue  
 \*\*\*Based on 2017-2018 conveyance tax revenues

It is important to note that revenues from real property transfer taxes are driven by the strength and health of the local real estate market. As shown by the City’s experience with the Conveyance Tax, these revenues are volatile and vary significantly from year-to-year, especially during an economic downturn. While the revenue generated would be substantial, the City would need to carefully estimate and budget expenses taking into account this volatile revenue stream within the General Fund. The real property transfer tax is more sensitive to economic cycles than property or sales tax. For example, the City would not want to be in a situation where \$70 million of ongoing General Fund revenues were assumed and allocated, only to have the real estate market drop off during a recession and creating a deficit that could approach \$50 million.

The Administration will explore ways to mitigate this risk during the future Council discussion on spending priorities and potential amendments to Council Policy 1-18 in early 2020.

***Election Requirements***

Posted with this staff report are the resolution calling and giving notice of a Special Municipal Election to be consolidated with the statewide primary election occurring in Santa Clara County on March 3, 2020. This resolution must be adopted and submitted to the Santa Clara County Registrar of Voters by December 6, 2019 for the measure to be included on the March 3, 2020

ballot. Staff is recommending Council approve the staff recommendations regarding additional items related to this Special Municipal Election. Each of these recommendations are based on past practices in other elections, most recently in November of 2018.

- Publishing a synopsis of the proposed measure in the *San Jose Mercury News*, a newspaper of general circulation within the City of San José, instead of printing the full text of the measure in the Sample Ballot;
- Authorizing the Mayor to submit a ballot argument in support of the measure;
- Authorizing the submittal of rebuttal arguments;
- Directing the City Attorney to prepare an Impartial Analysis of the measure, and to make the full text of the measure available online or by mail, for free, by calling the City Attorney's Office; and
- Directing the City Clerk to take all other actions necessary to place this measure on the March 3, 2020 ballot.

However, Council also has the option under the Elections Code to print the full text of the measure in the voter information guide, at additional cost; authorize other members of the Council to draft and submit ballot arguments instead of the Mayor; and/or decline to allow the submission of rebuttal arguments.

## **CONCLUSION**

The exploratory poll results indicate that the potential real property transfer tax has a strong likelihood of being viable in the March 3, 2020 primary election. Given the serious needs San José faces, with a variety of issues, including homelessness and the lack of affordable housing, emergency response, the Administration recommends that the Council place this potential measure on the March 3, 2020 ballot.

## **EVALUATION AND FOLLOW-UP**

If the Council votes to place this measure on the ballot, the City Manager, City Attorney, and City Clerk will prepare and the City Clerk will deliver the measure to the Santa Clara County Registrar of Voters for placement on the March 3, 2020 ballot prior to the deadline of 5 p.m. on Friday, December 6, 2019.

Additional deadlines are:

- Ballot Arguments are due to the Registrar on December 10, 2019; and
- The City Attorney's Impartial Analysis and Rebuttals, if authorized by Council, are due to the Registrar on December 17, 2019.

The Primary Election is Tuesday, March 3, 2020.



### **CLIMATE SMART SAN JOSE**

This proposal does not impact Climate Smart San José goals.

### **PUBLIC OUTREACH**

The City Council voted to move forward with the potential Real Property Transfer Tax at the November 19, 2019 City Council meeting. In addition, the City's survey research firm (Fairbanks, Maslin, Maullin, Metz & Associates or FM3) conducted an exploratory public opinion poll both online and by telephone in English, Spanish, and Vietnamese. The Administration also held discussions with various stakeholders, including nonprofit housing advocacy organizations, representatives of labor, realtors, and large office/property owners. This memorandum will be posted on the City's Council Agenda website for the December 3, 2019 Council Meeting.

### **COORDINATION**

This memorandum was coordinated with the City Attorney's Office, the City Clerk's Office, the City Manager's Budget Office, and the Finance Department.

### **COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

### **COST SUMMARY/IMPLICATIONS**

As described above, should the ballot measure pass, approximately \$22 million to \$73 million in new General Fund revenues are projected to be generated annually. Spending priorities for these revenues, as well as potential modifications to Council Policy 1-18 that guides the budget development process, will be brought forward for City Council consideration in early 2020.

The Santa Clara County Registrar of Voters estimates that the cost of placing a ballot measure on the citywide ballot in the March 3, 2020 will total approximately \$1,692,893 based on a projected voter registration of 526,000 San José voters. These costs will be paid from the Elections and Ballot Measures City-Wide appropriation in the General Fund, which has a current balance of \$2.7 million.

HONORABLE MAYOR AND CITY COUNCIL

November 21, 2019

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**CEQA**

Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no commitment to a specific project which may result in a potentially significant physical impact on the environment. (City Manager)

/s/

LEE WILCOX

Chief of Staff to the City Manager

For questions, please contact Lee Wilcox, Chief of Staff, at (408) 535-4873, or Michelle McGurk, Assistant to the City Manager, at (408) 535-8254.