



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Lee Wilcox
Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: January 28, 2020

Approved

Date

1/31/20

SUBJECT: DRAFT FRAMEWORK RELATED TO NONPROFIT TRANSFERS AND THE PROPOSED REAL PROPERTY TRANSFER TAX

RECOMMENDATION

- (1) Consideration and discussion of the draft framework related to certain transfers of real property to nonprofits and the proposed real property transfer tax on the March 3, 2020 ballot; and
- (2) Should the voters of San José approve Measure E on the March 3, 2020 ballot, direct the Administration to return to Council with a report on how it would implement the framework approved by the Council.

OUTCOME

If Council approves this item and Measure E passes on March 3, 2020, the Administration would return to Council with a report on how it would implement the framework providing City assistance in certain instances when property is transferred to a 501(c)(3) nonprofit to construct, preserve, or expand affordability in housing that is affordable to individuals and families earning 80 percent or less of the area median income (AMI).

Additionally, this memorandum clarifies that donations of property, where the value of the consideration of the property transferred is zero, are exempt from the real property transfer tax. Further, the real property tax ordinance exempts all transfers where the value of consideration is under \$2 million.

BACKGROUND

On December 3, 2019, the City Council voted to place a new real property transfer tax on the March 3, 2020 ballot. The proposed real property transfer tax would fund general City of San José services and be set at the following rates:

- Transfers valued under \$2 million: exempt (adjusted for inflation)
- Transfers from \$2 million to \$5 million: 0.75%
- Transfers from \$5,000,000.01 to \$10 million: 1.0%
- Transfers over \$10 million: 1.5%.

The Santa Clara County Registrar of Voters has given this ballot measure the designation of Measure E.

On January 8, 2020, the Rules and Open Government Committee and Committee of the Whole (the “Rules Committee”) considered a memorandum from Mayor Sam Liccardo recommending that the Administration bring forward recommendations regarding exempting transfers of real property to or from 501(c)(3) nonprofit organizations from the proposed real property transfer tax when the real property is:

- a. Donated, rather than sold, to a tax-exempt 501(c)(3) organization, or
- b. To be used for building or preserving affordable housing, improving economic equity and access, or other publicly articulated City objectives.

At the Rules Committee meeting, the City Attorney and City Manager informed the Rules Committee members that a true donation or gift of real property, where the value of the consideration of the real property transferred is zero, would be exempt from the provisions of Measure E.

At the Rules Committee meeting, the City Attorney also clarified that the proposed real property transfer tax cannot be amended at this time prior to the March election because the deadline for submitting the measure to the Registrar of Voters was December 6, 2019. However, if the measure passes enacting a new real property transfer tax ordinance, the provisions of the measure allow the Council to amend the ordinance to add exemptions.

The Administration stated at the Rules Committee meeting that it could bring forward a policy framework prior to the election to outline the parameters for handling potential nonprofit transfers related to development of affordable housing. The City Manager provided the Rules Committee with a work-load assessment that “green-lit” bringing this policy work forward, noting that it could impact the timeliness of other Council Policy Priority work.

The Rules Committee then voted to approve the Mayor’s memo and directed staff to continue outreach efforts to the nonprofit housing community to ensure that their concerns are addressed in the event Measure E passes.

ANALYSIS

According to the IRS website, there are 2,348 public charities; 57 private operating foundations; and 36 supporting organizations registered in the City of San José. Additionally, there are 235 private foundations registered in San José.

An outright donation or gift of real property to a nonprofit (or to a for-profit for that matter) would not be subject to the proposed real property transfer tax where the value of the consideration of the property donated or gifted is zero. Further, Measure E, if approved by the voters, exempts all transfers of real property where the value of the consideration of the property transferred is less than \$2 million.

In exploring the policy goals put forward in the Mayor's memo, the Administration evaluated the following:

- Which types of nonprofits would be eligible?
- How many property transfers could be impacted? What would the fiscal impact be?
- How could the production or development of affordable housing be encouraged?
- How could the preservation or expansion of housing affordability be encouraged?
- How could the City ensure that those receiving benefits under the program meet the goal of constructing, preserving, or expanding affordable housing in San José?

Eligibility

For this framework, the term "nonprofit" shall mean those organizations defined under Section 501(c)(3) of the Internal Revenue Code, which includes public charities and private foundations.

Fiscal Impacts

Given the thousands of nonprofits in San José and the vast array of charitable giving vehicles, it is challenging to quantify how many property transfers could be impacted in a year or what the fiscal impact could be if a tax exemption were introduced. For this reason, the Administration recommends Council begin with an approach that focuses on transfer of real property for the purposes of the development or preservation of affordable housing.

The Housing Department analyzed the eleven affordable housing developments selected for funding in the City's recent \$100 million Notice of Funding Availability to determine estimated transfer tax costs scenarios had these transfers been subject to Measure E. All of these properties sites were acquired to develop and construct affordable housing and would not be impacted by Measure E. Developers include both nonprofit and for-profit developers.

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Subject: Nonprofit Transfers/Real Property Transfer Tax

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Proposed Development	Land Cost	Transfer Tax Rate	Estimated Tax Amount
Gallup Mesa	1,736,802	0.00%	0
226 Balbach	2,405,000	0.75%	18,038
The Kelsey	3,050,000	0.75%	22,875
The Dahlia	3,331,000	0.75%	24,983
Page Street Alum Rock Family Housing	3,987,157	0.75%	29,904
Roosevelt Park	4,107,000	0.75%	30,803
Tamien Station	4,419,400	0.75%	33,146
West San Carlos	3,663,677	1.00%	36,637
Blossom Hill	5,912,500	1.00%	59,125
961 Meridian	9,976,132	1.00%	99,761
	16,101,500	1.50%	241,523
Total			596,792

Affordable Housing Production

It can take several years for an affordable housing developer to construct new affordable housing. The steps in that process may include:

- Identifying and acquiring a site;
- Obtaining entitlements (depending on zoning and general plan designation);
- Obtaining financing, which may come from multiple sources;
- Recording affordability restrictions on the property, including the number of affordable housing units, the term of affordability (typically 55 years), and the definition of affordability governing the project;
- Completing design and construction documents;
- Obtaining building permits; and ultimately,
- Constructing the development.

Some projects go through the early phases of this process without being constructed. While the new landowner may have the best of intentions, circumstances may cause a project to not come to fruition. For this reason, the Administration cannot recommend a simple exemption from the real property transfer tax because a nonprofit declares upon recording the transfer that it will be constructing affordable housing in the future.

Instead, the Administration recommends that when a property is transferred to a nonprofit for the purpose of constructing affordable housing, the nonprofit would be eligible for predevelopment

assistance from the San José Housing Department, which could include covering the amount of the transfer tax among other predevelopment costs. This would require the nonprofit to enter into a predevelopment agreement with the City, which would include how many units are intended to be built, the depth of affordability restrictions, and the term of affordability. Funding for this option would be subject to the availability of funds.

Additionally, the Administration recommends that this programmatic option apply only to sites where 100 percent of the units would have minimum affordability for those at or below 80 percent of AMI for at least 55 years.

Affordable Housing Preservation

San José has experienced situations where housing affordability restrictions have expired on an existing development. To encourage nonprofits to acquire such developments and preserve the existing affordability restrictions, the Administration recommends the following:

- If a property is transferred to a nonprofit for the purposes of preserving affordability restrictions, the nonprofit will be eligible for assistance from the Housing Department equal to the amount of the real property transfer tax at the time that affordability restrictions are recorded, subject to the availability of funds.
- The Administration recommends that this programmatic option apply only to sites where 100 percent of the units would have minimum affordability for those at or below 80 percent of AMI for at least 55 years.

Expanding Affordable Housing Protections

At times, nonprofits have acquired existing apartment complexes or developments and converted them to affordable housing. To encourage nonprofits to acquire such developments and create new affordability restrictions, the Administration recommends the following:

- If a property is transferred to a nonprofit for the purposes of creating affordability restrictions, the nonprofit will be eligible for assistance equal to the amount of the real property transfer tax at the time that affordability restrictions are recorded, subject to the availability of funds.
- The Administration recommends that this programmatic option apply only to sites where 100 percent of the units would have minimum affordability for those at or below 80 percent of AMI for at least 55 years.

Administration of the Program

Given the complexities related to ensuring that affordability restrictions are met and recorded, the Administration cannot recommend an upfront exemption program. The County collects transfer taxes at the time a transfer is recorded (typically by a title company). Administering exemptions in addition to the exemptions included in Measure E would require significant additional work on the County's part and likely increase the administrative fees passed on to the City. Additionally, the Administration would need to ensure that promises of affordability are actually met which would require annual monitoring.

For these reasons, the Administration recommends the framework as outlined above. Nonprofits would be eligible to participate if they met the requirements of the program and constructed, preserved, or expanded affordability, including recording deed restrictions on the property.

CONCLUSION

The Administration recommends focusing the proposed program to production, preservation, and expansion of affordable housing. Once the City has some experience with impacts on revenues as well as successes in meeting the goals around affordable housing, additional policy goals can be assessed.

EVALUATION AND FOLLOW-UP

This action addresses the City Manager's Enterprise Priority goal of Creating Housing and Preventing Homelessness. If Council approves the proposed action and if Measure E passes on March 3, 2020, the Administration would return to the Council with a report on how it would implement the policy framework.

CLIMATE SMART SAN JOSE

This proposal does not impact Climate Smart San José goals.

COORDINATION

This memorandum was coordinated with the City Attorney'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

Under the framework described above, the predevelopment assistance to an eligible non-profit/project would be funded by revenues collected under Measure E in an amount equal to the real property transfer tax collected.

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.

/s/
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/s/
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Director, Housing Department

For questions, please contact Rachel VanderVeen, Deputy Director, Housing Department, (408) 535-8231 or Michelle McGurk, Assistant to the City Manager at (408) 535-8254.