



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: November 15, 2021

Approved

Date

11/18/21

SUBJECT: MEASURE E REAL PROPERTY TRANSFER TAX REFUND PILOT PROGRAM FOR QUALIFYING NONPROFIT REAL PROPERTY TRANSFERS

RECOMMENDATION

Approve an ordinance adding a new Section 4.59.230 to Chapter 4.59 of Title 4 of the San José Municipal Code to provide a refund under certain circumstances to:

- (a) Charitable organizations that:
 - a. Provide direct services or make grants in the areas of education, health, housing, or human services serving extremely low-income San José residents, and
 - b. Irrevocably use or endow the proceeds from the conveyance of real property subject to the real property transfer tax for a charitable community purpose, and
 - c. Within three years of the property sale, fund direct services or make grants in the areas of education, health, housing, or human services serving extremely low-income San José residents in an amount equal to three times (300%) of the Measure E tax paid and refunded.

- (b) Charitable organizations, or limited partnerships with a general partner charitable organization, who purchase a qualifying affordable housing site and satisfy certain other requirements.

OUTCOME

If the City Council approves this ordinance, the Department of Housing will implement a pilot program, under which qualifying nonprofit organizations may apply for a refund of the Measure E real property transfer tax if the real property sale proceeds are used for charitable purposes and the nonprofit satisfies the requirements of the program. In return, the nonprofit will guarantee that it will provide direct services or grant funding equal to three times (300%) the

refund to benefit extremely low-income residents of San José in one or more of the eligible focus areas. Those areas are education, community-based health services, affordable housing, and human services as defined in the ordinance.

In addition, the refund may be granted to affordable housing developers who purchase property for the purpose of creating new affordable housing or preserving existing affordable housing for at least 30 years.

The pilot program would operate retroactively from January 1, 2021 through June 30, 2023. Staff would return to City Council in Fiscal Year 2022-2023 with data on the pilot program and recommendations for continuing or discontinuing the program.

BACKGROUND

On March 3, 2020, San José voters approved Measure E, creating a new real property transfer tax, with more than 53% support. This new tax funds general City of San José services and is 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 new transfer tax went into effect on July 1, 2020. In FY 2020-2021, the City collected \$50 million in Measure E revenues. Per City Council action on [November 10, 2020](#), monies from Measure E are allocated to fund affordable housing and homelessness prevention, with 45% for permanent supportive housing for extremely low-income families, 35% for low-income rentals, 10% for middle-income housing, and 10% for homelessness prevention programs.

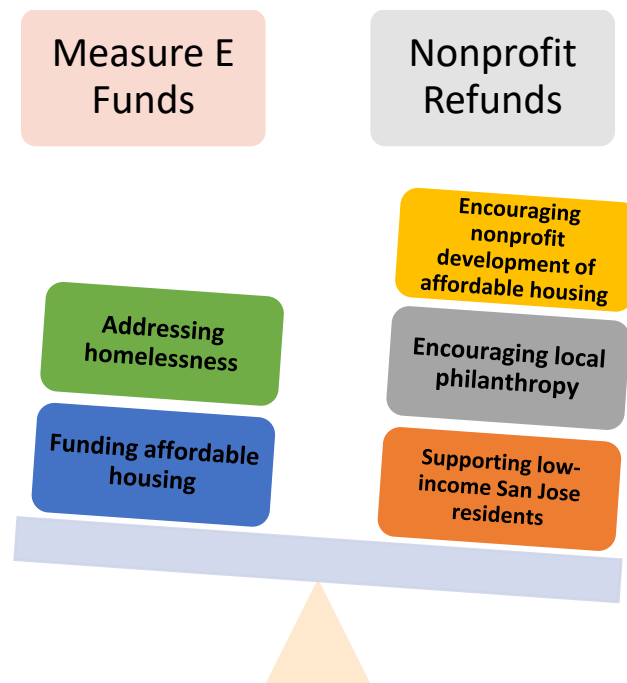
Throughout the policy discussions around the real property transfer tax, the City Council has raised questions about the impact of the tax when nonprofit organizations are buying or selling property for charitable purposes. On January 5, 2021, City Council considered a draft framework for covering the cost of the tax when a nonprofit organization's property transfer involved producing, preserving, or expanding affordable housing and housing affordability.

The City Council did not approve the staff-recommended framework and instead directed the City Manager and City Attorney to explore how to rebate or refund the transfer tax for real estate transactions that are executed for charitable community-serving purposes for education, health, and human services targeting low-income residents (in summary, "charitable purposes"). This direction included requiring that any proceeds from the sale of real property be used for charitable purposes within six months of the recorded transaction and that a "substantial number" of the low-income beneficiaries live in the City of San José.

ANALYSIS

In developing today's recommendation, staff found ourselves balancing critical and competing needs:

- 1) The importance of Measure E Funding to addressing the housing crisis and homelessness.
- 2) The importance of supporting local nonprofits and encouraging local philanthropy, particularly programs and grantmaking that benefits San José's most vulnerable residents.
- 3) The importance of encouraging nonprofit development and acquisition of affordable housing.



Our goal was to ensure that for each refund of the Measure E tax, the benefits to the community will outweigh the loss of funding and services in the Measure E program. The nonprofit and philanthropic sector is complicated, and we did not want to create unintended consequences for the Measure E program. We also don't know how many refund requests the City will receive. For these reasons, we are recommending that the refund program be a pilot program.

Who is Eligible for the Nonprofit Seller Refund?

There are more than 2,600 nonprofit organizations based in the City of San José, according to the IRS website. These nonprofits include hospitals, educational institutions, houses of worship, charitable foundations, and direct service providers. Some are quite small, with no paid staff. Some may be based in San José but do their charitable work outside of the City.

The City Council directed that we explore a more narrowly focused refund program: Cases where the nonprofit sold property and would use the sales proceeds within six months to fund education, health, and human services targeting low-income residents in San José.

We are recommending defining these categories as outlined in the chart below and given the Council’s prior policy direction for Measure E, adding affordable housing as an eligible category. With each category we attempted to look at how it could be defined in a way that benefited the same types of vulnerable residents who would otherwise be benefiting from the Measure E programs. Income restrictions are included in each definition to ensure that the nonprofit is serving communities of need.

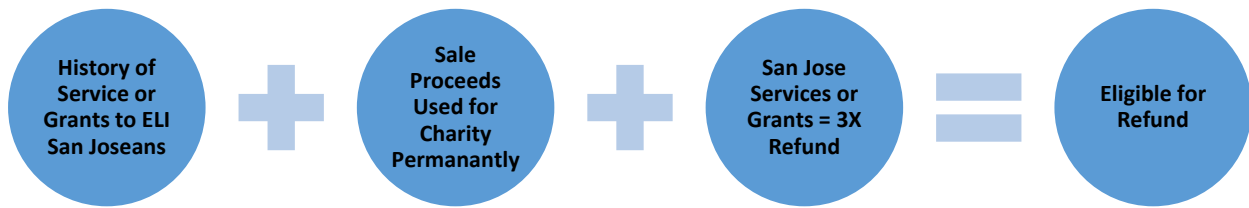
Definition of Eligible Charitable Purposes

To be eligible, the nonprofit must provide direct services or fund grants in one or more of the following service areas as defined in the ordinance

Category	Definition
Education	A public preschool or public Kindergarten-12 th grade school located in the City of San José with at least 51% of the students enrolled being from extremely low-income San José households
<i>Rationale: While there are many worthy educational institutions and causes in San José, public schools are available to all children at no cost.</i>	
Community-based health service	A community-based health or mental health clinic or patient services program located in the City of San José with at least 51% of the patients/clients being extremely low-income San José residents. It does not include hospitals.
<i>Rationale: Nonprofit community-based clinics and patient services programs typically are designed to provide care that is accessible to particular communities of need. There are many well-funded large healthcare institutions and providers that are nonprofits where the community benefits of a refund may not outweigh the loss of Measure E funds.</i>	
Affordable housing	A nonprofit providing 1) emergency shelter provided in the City of San José to persons who are homeless and where on-site supervision is provided whenever such shelter is occupied or 2) deed-restricted affordable housing located in the City of San José in which at least 51% of residents are extremely low-income.
<i>Rationale: Supporting nonprofits in this category aligns with the Council-adopted guidelines for spending Measure E revenues.</i>	
Human services	Services provided in the City of San José to help residents in the areas of homelessness prevention and accessing permanent housing; services for survivors of gender-based violence or sexual assault; or services for seniors or residents with disabilities in which at least 51% of the clients being extremely low-income San José residents.
<i>Rationale: While many other programs might be considered “human services,” prior Council policy and funding actions guided development of this definition.</i>	

It is important to note that some of these categories are the primary responsibility of other governmental agencies, such as school districts and the County of Santa Clara, rather than the City of San José. As staff analyzes the impacts of the pilot rebate program, we may explore how the refunds granted align with the City's core services.

Requirements to Get a Nonprofit Seller Refund



As illustrated in the chart above, the proposed eligibility requirements for the Nonprofit Seller Refund have three parts:

1. **The nonprofit must have a track record in San José:** They must demonstrate that they have either provided direct services or made grants in San José in the eligible categories for at least three years prior to the sale of the property. In those three years, the total value of services or grants provided in San José must be equal to or greater than the total refund requested.

Why this recommendation: It is not difficult to create a nonprofit organization, and there are more than 2,600 nonprofits in San José. Our goal is to ensure that the organizations receiving refunds are truly doing work to benefit communities of need in San José.

2. **The nonprofit must use the proceeds for charitable purposes:** Within six months of the property sale, the nonprofit must either have used the proceeds of the sale for charitable purposes or irrevocably endowed the proceeds for charitable purposes in accordance with IRS requirements.

Why this recommendation: Council direction recommended requiring proceeds of the property sale be used within six months. We are recommending expanding that to include an option to endow the proceeds. All sales subject to the Measure E tax are those totaling more than \$2 million. If a nonprofit receives proceeds of several million dollars, it is likely more prudent to use that over time rather than all at once.

Ultimately, nonprofits are held accountable by the IRS and its requirements. We did consider more narrow requirements, such as restricting how the charity would commit to using the proceeds in perpetuity. However, after consulting with key stakeholders in local

philanthropy and assessing our internal capacity to monitor how the organization uses the funds years down the road, we determined our primary concern is the funds that the City otherwise would have gotten through the Measure E tax.

- 3. The nonprofit must use funds for San José:** Within three years of the property sale, the nonprofit must either provide direct services or made grants in San José in the eligible categories in an amount equaling three times (or 300% of) the total Measure E refund provided.

Why this recommendation: If the City is going to refund Measure E dollars, which are targeted toward affordable housing and homelessness, we want to ensure that there is a significant community benefit in return.

Who is Eligible for the Affordable Housing Development Refund?

In addition to the nonprofit refund, we are recommending a refund for affordable housing developers who purchase property for the purpose of creating or preserving affordable housing (with rents at or below 30% of 80% of Average Median Income) in the City of San José. To qualify for this refund, the following requirements must be met:

- **Affordable Housing** – The buyer of the property must use the property to preserve or create affordable housing through new construction or acquisition/rehabilitation restricted to low income residents (80% of the Area Median Income or below) for at least 30 years. The site must be either real property or an interest in a ground lease with a term of at least 60 years.
- **Nonprofit Buyer** – The entity purchasing the property must be either a charitable organization or a limited partnership with a charitable organization as a general partner.

The process for receiving the refund for the purchase of property for affordable housing development is consistent with the nonprofit refund, which must be requested within six months of the transaction and the requester must provide all relevant documentation. Required documentation includes:

- A copy of the recorded deed and memorandum of lease;
- A receipt or other evidence of having paid the tax;
- A statement showing the value of the consideration on which the tax due was computed;
- A copy of the recorded covenant or regulatory agreement meeting all the criteria establishing the site as a qualifying affordable housing site.
- Documentation that the refund provided will be reinvested in renovations at or services to residents of the property subject to the Measure E rebate.

The ordinance will be retroactive to January 1, 2021, allowing refunds for transactions that took place from January 1, 2021 forward to submit a request to the Housing Department for a refund. All requests for refunds of Measure E payments that occurred prior to the effective date of the

ordinance will have until June 30, 2022 to submit their application. All future applications for Measure E refunds must be submitted within six months of the payment of the tax.

Impacts to the Measure E Program

To assess potential impacts of these proposed refund pilot programs on the Measure E fund, we reviewed all real estate transactions where Measure E was paid in two randomly selected months in 2020. We found:

- **Nonprofit sales of real estate:** In neither of those months were there transactions in which a nonprofit organization sold real estate.
- **Affordable housing development:** In the first month studied, we found three transactions in which property was acquired for affordable housing development, with a total of approximately \$137,000 in transfer tax collected. In the other month studied, there were no transactions associated with affordable housing development. In both months studied, we found three sales of older apartment buildings. These properties are the type that might fall under the preservation component of the pilot program, if a nonprofit partner were involved in the transaction. However, we are not aware of any preservation plans with these particular buildings.

Additionally, the Housing Department received a refund request from an affordable housing developer for approximately \$400,000 in Measure E taxes that occurred outside the two sample months selected.

Based on the data to date, it is difficult to project what the impacts could be on the Measure E spending plan. For this reason, we are recommending a pilot program and continued assessment of impacts on the funds and how the refunds requested intersect with the goals of the Council-adopted Measure E program.

Any future refunds from this pilot program are recommended to be funded proportionately from the Extremely Low Income, Low Income, Moderate Income, and Homelessness Prevention allocations of Measure E funds. Recommendations to appropriate funds for the refunds will be brought forward for City Council consideration as part of a future budget process.

In addition to evaluating impacts on the Measure E program, we will evaluate if property sales subject to the rebate has other impacts, such as increased or decreased property tax assessments or preservation or creation of affordable housing units.

CONCLUSION

The Measure E Nonprofit Refund Pilot Program offers an opportunity to balance competing needs. The program will provide a refund for nonprofit partners, whose work and mission align

with City goals and who serve our most vulnerable residents, when they transfer real property in the City of San José. At the same time, the pilot program considers the goals and mission the City Council has adopted for the Measure E program to increase affordable housing and prevent homelessness.

EVALUATION AND FOLLOW-UP

The proposed program will be a two-year pilot. Staff will report on the number of refunds sought and awarded in the Housing Investment Plan. In 2022-2023, staff will recommend next steps based on the data, which could include extending, amending, or discontinuing the pilot. Any recommended appropriation adjustments that are necessary to implement the pilot program will be brought forward for City Council consideration as a part of the 2021-2022 Mid-Year Budget Review.

CLIMATE SMART SAN JOSE

The recommendation in this memo may negatively impact one or more Climate Smart San José energy, water, or mobility goals by decreasing the potential funding available for developing affordable housing, including more dense housing located near transit. These impacts may be offset by affordable housing developers receiving the refund building or preserving affordable housing, or by nonprofits receiving the refunds whose work that meets other critical City goals.

PUBLIC OUTREACH

In preparing this recommendation, we sought input from nonprofits with experience in using real property for philanthropic purposes. This memorandum and proposed ordinance will be posted on the City's Council Agenda website for the November 30, 2021 Council Meeting.

COORDINATION

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

COMMISSION RECOMMENDATION/INPUT

There is no commission recommendation or input associated with this action.

FISCAL/POLICY ALIGNMENT

This pilot program has the potential to reduce the Measure E tax revenues available to meet the Council-adopted goals related to affordable housing and homelessness prevention. In exchange for this potential cost, however, there is a potential benefit to extremely low-income residents of San José since nonprofits selling property will be providing direct services or grant funds for a charitable community purpose, focused on education, health, housing, and human services, that target extremely low-income residents of the City. The affordable housing development refund directly aligns with the adopted goals for Measure E revenues.

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/
JACKY MORALES-FERRAND
Director, Housing Department

The primary author of this memorandum is Michelle McGurk, City Manager's Office. For questions, please contact Rachel VanderVeen, Deputy Director, Housing Department, at (408) 535-8231.