CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Margaret McCahan

SUBJECT: **SEE BELOW**

DATE: June 7, 2018

Approved D. DSyL

Date 6/8/18

SUBJECT: ADOPTION OF A RESOLUTION IN COMPLIANCE WITH ARTICLE XIIIB OF THE CONSTITUTION OF THE STATE OF CALIFORNIA AND AS MODIFIED BY PROPOSITION 111 AND SB 88 ELECTING THE POPULATION AND INFLATION FACTORS AND ESTABLISHING THE FISCAL YEAR 2018-2019 APPROPRIATION LIMIT

RECOMMENDATION

Adopt a resolution taking the following actions with respect to the City's 2018-2019 "Gann Limit":

1. Elect the per capita income index as the inflation factor for 2018-2019 on a provisional basis, with the option to adjust the Limit, if necessary, once the non-residential assessment data is available from the County Assessor; and

2. Elect the County of Santa Clara population growth index as the population factor for 2018-2019; and

3. Establish the Fiscal Year 2018-2019 Appropriation Limit at $1,152,520,200 in compliance with Article XIIIB of the State Constitution.

OUTCOME

The establishment of the 2018-2019 Appropriation Limit ("Gann Limit") is necessary to comply with Article XIIIB of the State Constitution.

BACKGROUND

California voters approved an initiative on November 6, 1979 that added Article XIIIB to the State Constitution. The provisions of this article place limits on the amount of revenue that can be appropriated by all entities of government. The Appropriation Limit is based on actual appropriations during the 1978-1979 fiscal year, as increased each year using specified population and inflationary growth factors.

The original legislation implementing the provisions of Article XIIIB became effective January 1, 1981. In accordance with that legislation, the governing body of each government jurisdiction must, by resolution, establish its annual Appropriation Limit for the coming year (prior to July 1) at a regularly scheduled meeting or noticed special meeting.

The original Article XIIIB (Proposition 4) and its implementing legislation Chapter 1205/80 were modified by Proposition 111 and SB 88 (Chapter 60/90). Significant changes imposed by Proposition 111 include the following:

- The provision of a choice in methodologies for determining the annual inflation factor between (1) growth in California per capita income, or (2) growth in non-residential assessed valuation due to new construction within the City.

- The provision of a choice in methodologies for determining the annual population growth factor between (1) City population growth, or (2) County population growth.

- Regulations allowing the exclusion of "qualified capital outlay" expenditures from the calculation of the Limit.

- Provision of a process for avoiding tax refunds if a city falls sufficiently below the Limit in the next fiscal year. The revised language provides two years, beyond the second year, to refund any remaining excess during which jurisdictions can seek to obtain a successful override vote.

ANALYSIS

The State Constitution (Article XIIIB) specifies that the Appropriation Limit restricts the amount of revenue that can be appropriated. Not all revenues are restricted by the Limit, only those that are "proceeds of taxes". The majority of the major General Fund revenue sources (Sales Tax, Property Tax, Utility Taxes, Business Taxes, Telephone Line Tax) are classified as proceeds of taxes, and are, therefore, subject to the Limit. A number of special fund and capital fund revenue sources are also subject to the Limit, such as local construction tax and conveyance tax revenues. Each revenue source is reviewed annually for classification as subject to, or exempt from, this Limit.

Appropriation Limit Adjustment Factors

In addition, proceeds of taxes may be spent on several types of appropriations that do not count against the Limit. The law allows a city to spend tax proceeds on voter-approved debt, costs of complying with court orders and federal mandates, with certain restrictions, and expenditures for qualified capital outlay. Appropriations for these excludable categories do not count against the Limit.

As a result of Proposition 111, the City is required to choose between two annual inflation factors and two population growth factors.

The choice offered for the annual inflation factor is the greater of (1) the growth in California per capita income or (2) the growth in non-residential assessed valuation due to new construction within the City. The data necessary to calculate the increase in non-residential assessed valuation is not currently available from the County Assessor. Until such information is available, it is recommended that the City approve the 2018-2019 Appropriation Limit on a provisional basis using the inflation factor of California per capita income.

The choice offered for the annual population growth factor is the greater of the growth in City or County population. The California State Department of Finance provided the 2018 population growth rates for both the City of San José and County of Santa Clara at 0.82% and 0.99%, respectively. Based on these growth rates, it is recommended that the City Council approve the 2018-2019 Appropriation Limit using the County's population growth factor.

Calculation of the 2018-2019 Appropriation Limit

The application of the annual growth factors to the 2017-2018 Limit result in a 2018-2019 Limit of $1,152,520,200:

2017-2018 Appropriation Limit	$1,100,821,936
Inflation factor	X 1.0367
Population factor	X 1.00990
2018-2019 Appropriation Limit	$1,152,520,200

Based on these calculations, the City Attorney, as required by the State Constitution, has prepared a resolution for City Council consideration that would establish the 2018-2019 Appropriation Limit for the City of San José at $1,152,520,200.

Appropriations Subject to the Limit

The amounts in the City's 2018-2019 Proposed Budget subject to the Limit (net proceeds of taxes) total $871,993,191, which represent 76% of the Appropriation Limit. This amount is approximately $280.5 million below the required Limit:

2018-2019 Appropriation Limit	$ 1,152,520,200
2018-2019 Appropriations Subject to Limit	(871,993,191)
Amount Under Limit	$ 280,527,009

When the annual budget is prepared each year for the City of San José, the appropriations subject to the Appropriation Limit are typically well below the Appropriation Limit as shown below:

Fiscal Year	Appropriation Limit	Appropriations Subject to the Limit*	Amount Under Limit
2017-2018	$1.10 billion	$796 million	$304 million
2016-2017	$1.05 billion	$699 million	$353 million
2015-2016	$986 million	$664 million	$322 million
2014-2015	$937 million	$616 million	$321 million
2013-2014	$923 million	$608 million	$315 million

* Actual data used for 2013-2014 through 2016-2017; Proposed Budget data used for 2017-2018.

Over the last five years, and including 2018-2019, the City's appropriations subject to the Appropriation Limit have remained well below the Appropriation Limit, with these appropriations totaling between 66% and 76% of the Appropriation Limit. Given the size of this gap, it is unlikely that the City will exceed the Appropriation Limit in the upcoming years without significant changes to the City's tax structure.

EVALUATION AND FOLLOW-UP

At the end of the 2018-2019 fiscal year, the Finance Department will reconcile actual revenues and expenditures to ensure compliance with the Gann Limit.

PUBLIC OUTREACH

This memorandum is posted on the City's website for the June 19, 2018 Council Agenda.

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

COMMISSION RECOMMENDATION/INPUT

No commission recommendation is associated with this action.

CEQA

Not a project.

Margaret McCahan

MARGARET MCCAHAN
Budget Director

For questions, please contact Margaret McCahan, City Manager's Budget Office, at (408) 535-8142.