



COUNCIL AGENDA: 2/4/20  
FILE: 20-112  
ITEM: 3.3

## Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jim Shannon

**SUBJECT:** SEE BELOW

**DATE:** January 22, 2020

Approved

*J. D. S. L.*

Date

*1/22/2020*

**SUBJECT: POTENTIAL AMENDMENTS TO CITY COUNCIL POLICY 1-18,  
OPERATING BUDGET AND CAPITAL IMPROVEMENT PROGRAM  
POLICY, RELATED TO PROPERTY TRANSFER TAX REVENUES  
AUTHORIZED BY MEASURE E**

### **RECOMMENDATION**

Adopt a resolution approving revisions to City Council Policy 1-18, Operating Budget and Capital Improvement Program Policy, to set forth a spending plan related to the revenues from a new real property transfer tax if approved by a majority of voters on March 3, 2020.

### **OUTCOME**

Should Measure E pass, approval of the recommended action will facilitate the budgeting of the new General Fund revenues from the real property transfer tax ("Transfer Tax") for the following fiscal year as part of the 2020-2021 Proposed Budget development process accordingly, and thereafter.

### **BACKGROUND**

On December 3, 2019, the City Council adopted a resolution to place a measure (Measure E) on the March 3, 2020 ballot to enact a real property transfer tax in San José with the following statement of the measure to be printed in the ballot:

*To fund general City of San José services, including 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: EXEMPT transfers under \$2,000,000 adjusted for inflation, \$2,000,000 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to \$10,000,000 at 1.0%, and over \$10,000,000 at 1.5%; generating approximately \$70,000,000 annually, until repealed, with all money staying local?*

At its meeting on December 10, 2019, the City Council also directed staff to provide amendments to City Council Policy 1-18, Operating Budget and Capital Improvement Program Policy, to incorporate the identified spending priorities of the anticipated General Fund revenue if Measure E were to pass, and to require a 60-day notice and at least two public hearings prior to the City Council taking action on any proposed change to the spending priorities. Recommended amendments to City Council Policy 1-18 in alignment with this direction are discussed below.

As the Mayor's March Budget Message for Fiscal Year 2020-2021 is scheduled for release on March 6<sup>th</sup> and the City Manager's 2020-2021 Proposed Operating Budget is scheduled for release on May 1<sup>st</sup>, this discussion is being brought forward now, prior to the election, to efficiently facilitate the inclusion of the City Council's spending priorities for the Transfer Tax revenues into the 2020-2021 Proposed Budget development process should the measure be passed by the voters.

## **ANALYSIS**

The entirety of City Council Policy 1-18, including the recommended amendments, is included in the accompanying resolution. The addition of Section 22 related to potential revenues from Measure E is copied below. The proposed policy amendment contains two important clarifications regarding the direction received on December 10, 2019.

The first is related to estimating Transfer Tax revenue. The Administration recommends that the revenue estimates included in the Proposed Budget be conservative. Given the historical volatility of the real estate market, revenues from the Transfer Tax could have dramatic swings, especially during an economic downturn. On an annual basis, the Administration will estimate a revenue amount that can comfortably be received, allowing for a predictable baseline level of programmatic and administrative activities.

The second clarification is related to the potential use of the up to 5% for administration of the funding to ensure that the City can provide the appropriate level of support for homelessness prevention and housing assistance and construction. A brief listing of the potential types of administrative support are listed in the policy. This could include staffing or contractual services within the Housing and Finance Departments, the City Attorney's Office, and/or the City Manager's Office that contribute toward the overall objective, but may not be directly attributable to a specific program or project, such as financial or program coordination support. The intent, however, will be to maximize resources for direct community programs and projects.

The recommended policy addition is listed below, followed by an example of funding allocations.

## **22. Real Property Transfer Tax Revenues**

In the event that on March 3, 2020, the voters of San José pass Measure E to enact a new real property transfer tax ("Transfer Tax") on the transfer of certain real property in the City, the provisions of this section shall apply to the allocation of Transfer Tax revenues. The Transfer Tax is a general tax and the revenues derived from the tax are unrestricted, which means the City can use the Transfer Tax revenues for any governmental purpose. While these revenues are deposited in the General Fund and can be used for any governmental purpose, the City Council intends for the revenues to be allocated towards addressing the homelessness crisis and the City's most urgent issues including, but not limited to, homeless prevention and developing new affordable housing. The approach for estimating and budgeting Transfer Tax revenues is described below.

- a) Estimating Revenue from the Transfer Tax – Due to the volatile nature of a real property transfer tax such as the Transfer Tax, the City will conservatively estimate revenue from the Transfer Tax as part of the Proposed Budget process. During the course of the fiscal year, revisions to the Transfer Tax revenue estimate may be recommended to the City Council to align with actual collections.
  - b) Spending Allocations of Transfer Tax – The spending priorities for the Transfer Tax are listed below.
    1. Up to 5% of the revenues may be allocated for the administration of funding related to increased workload resulting from more robust homeless prevention efforts and the creation of more affordable housing, including, but not limited to, financial, legal, or administrative and policy programmatic support.
    2. The remaining revenue is allocated as follows:
      - i. 10% for homelessness prevention and rental assistance;
      - ii. 45% for permanent supportive and affordable rental housing for extremely low-income (ELI) households defined as earning less than 30% of area median income (AMI) as defined by the U.S. Department of Housing and Urban Development;
      - iii. 35% for affordable rental housing for 30% - 80% AMI households; and
      - iv. 10% for below market-rate for-sale housing and moderate-income rental housing up to and including 120% AMI, including but not limited to, rent-restricted Accessory Dwelling Units (ADU) forgivable loans, down payment assistance, and first-time homeownership opportunities for households up to 120% AMI.
  - c) Modifications to Spending Allocation – Any revisions to the revenue estimate, as well as a reconciliation of year-end actuals to budgeted estimates, will be applied in accordance with the spending categories described above. Modifying the percentage allocations during the Proposed Budget process or during the year requires:
    - i. A 60-day notice of the proposed effective date of the allocation change and at least two public hearings prior to City Council action on the allocation change, with a notice of each public hearing posted on the City's website at least 10 days in advance of the public hearing; and
    - ii. A two-thirds vote of the City Council.
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In the example below, the initial estimate included with the fictional year's proposed budget is \$60.0 million. A total of 5% (\$3.0 million) is allocated for administration purposes related to the funding, and the remaining amount of \$57.0 million is proportionally allocated among the other categories in accordance with the policy. At a point later in the fiscal year, the revenue estimate is increased by \$10.0 million. In this example, the amount for Administration is still deemed sufficient at \$3.0 million, so the entire \$10.0 million is allocated proportionally for direct program/project uses.

		Initial Budget	Mid-Year Budget Revisions	Difference
<b>Source</b>				
	Transfer Tax Revenues	60,000,000	70,000,000	10,000,000
<b>Total Source</b>		<b>\$ 60,000,000</b>	<b>\$ 70,000,000</b>	<b>\$ 10,000,000</b>
<b>Use</b>				
	Administration	3,000,000	3,000,000	-
<b>10%</b>	Homeless Prevention and Intervention	5,700,000	6,700,000	1,000,000
	Permanent Supportive and Affordable			
<b>45%</b>	Rental Housing (<30% AMI)	25,650,000	30,150,000	4,500,000
	Affordable Rental Housing			
<b>35%</b>	(30% - 80% AMI)	19,950,000	23,450,000	3,500,000
	Below Market-Rate For-Sale and			
	Moderate-Income Rental Housing			
<b>10%</b>	(<120% AMI)	5,700,000	6,700,000	1,000,000
<b>Total Use</b>		<b>\$ 60,000,000</b>	<b>\$ 70,000,000</b>	<b>\$ 10,000,000</b>

While it is possible that revenues could fall below the originally estimated levels, staff will recommend conservative initial estimates in any given year to minimize the impact on direct programming. As part of the City Manager's Annual Report process, staff will perform a reconciliation of budget to actuals for both revenues and expense, adding to or reducing from the following year's allocations.

**CONCLUSION**

Should Measure E be approved by a majority of voters on March 3, 2020, the recommended amendments to City Council Policy 1-18 would take effect and the allocation revenues from the Transfer Tax would be incorporated into the City Manager's 2020-2021 Proposed Operating Budget accordingly, and thereafter.

**EVALUATION AND FOLLOW-UP**

None.

**CLIMATE SMART SAN JOSE**

The recommendation in this memorandum has no effect on Climate Smart San José energy, water, or mobility goals.

**PUBLIC OUTREACH**

This memorandum will be posted on the City's Council Agenda website for the February 4, 2020 Council meeting.

**COORDINATION**

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

**COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

**COST SUMMARY/IMPLICATIONS**

As described above, the recommended amendments to City Council Policy 1-18 would only take effect if a majority of voters approve Measure E on March 3, 2020. If the measure passes, the Administration will include a revenue estimate for the transfer tax and recommend uses for the proceeds in accordance with the allocation categories defined in the policy as part of the 2020-2021 Proposed Operating Budget scheduled for release on May 1, 2020, and thereafter.

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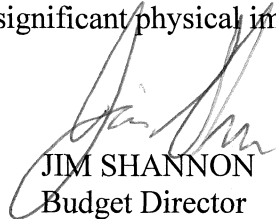
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**CEQA**

Not a Project, File No. PP17-010, City Organizational & Administrative Activities resulting in no changes to the physical Environment, and 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.



JIM SHANNON  
Budget Director

For questions, please contact Jim Shannon, Budget Director, at 408-535-8142.