



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Jennifer A. Maguire

SUBJECT: SEE BELOW

DATE: June 10, 2016

Approved

D. D. Syl

Date

6/10/16

SUBJECT: ADOPTION OF A RESOLUTION IN COMPLIANCE WITH ARTICLE XIII B 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 2016-2017 APPROPRIATION LIMIT

RECOMMENDATION

It is recommended that the City Council adopt a resolution taking the following actions with respect to the City's 2016-2017 "Gann Limit":

1. Elect the per capita income index as the inflation factor for 2016-2017 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 2016-2017; and
3. Establish the Fiscal Year 2016-2017 Appropriation Limit at \$1,051,760,606 in compliance with Article XIII B of the State Constitution.

OUTCOME

The establishment of the 2016-2017 Appropriation Limit ("Gann Limit") is necessary to comply with Article XIII B of the State Constitution.

BACKGROUND

California voters approved an initiative on November 6, 1979 that added Article XIII B 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 XIII B 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 XIII B (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 XIII B) 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 Tax, 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 2016-2017 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 2015 population growth rates for both the City of San José and County of Santa Clara at 1.17% and 1.26%, respectively. Based on these growth rates, it is recommended that the City Council approve the 2016-2017 Appropriation Limit using the County's population growth factor.

Calculation of the 2016-2017 Appropriation Limit

The application of the annual growth factors to the 2015-2016 Limit result in a 2016-2017 Limit of \$1,051,760,606:

2015-2016 Appropriation Limit	\$ 985,739,131
Inflation factor	X 1.0537
Population factor	<u>X 1.0126</u>
2016-2017 Appropriation Limit	<u>\$1,051,760,606</u>

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 2016-2017 Appropriation Limit for the City of San José at \$1,051,760,606.

Appropriations Subject to the Limit

The amounts in the City's 2016-2017 Proposed Budget subject to the Limit (net proceeds of taxes) total \$743,345,380, which represent 71% of the Appropriation Limit. This amount is approximately \$308 million below the required Limit:

2016-2017 Appropriation Limit	\$ 1,051,760,606
2016-2017 Appropriations Subject to Limit	<u>(743,345,380)</u>
Amount Under Limit	<u>\$ 308,415,226</u>

The 2016-2017 appropriations subject to the limit amount incorporates additional sales tax of \$30 million anticipated in 2016-2017 from the sales tax measure approved by the voters in June 2016.

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
2015-2016	\$986 million	\$676 million	\$310 million
2014-2015	\$937 million	\$616 million	\$321 million
2013-2014	\$923 million	\$608 million	\$315 million
2012-2013	\$864 million	\$510 million	\$354 million
2011-2012	\$821 million	\$515 million	\$306 million

* Actual data used for 2011-2012 through 2014-2015; Proposed Budget data used for 2015-2016.

Over the last five years, and including 2016-2017, the City's appropriations subject to the Appropriation Limit have remained well below the Appropriation Limit, with these appropriations totaling between 59% and 71% 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 2016-2017 fiscal year, the Finance Department will reconcile actual revenues and expenditures to ensure compliance with the Gann Limit.

HONORABLE MAYOR AND CITY COUNCIL

June 10, 2016

Subject: Adoption of a Resolution Establishing the Fiscal Year 2016-2017 Appropriation Limit

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PUBLIC OUTREACH

This memorandum is posted on the City's website for the June 21, 2016 Council Agenda.

COORDINATION

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

CEQA

Not a project.

Margaret McCahan for

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Senior Deputy City Manager/
Budget Director

For questions, please contact Margaret McCahan, City Manager's Budget Office, at (408) 535-8132.

