



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Lee Wilcox
Jacky Morales-Ferrand

SUBJECT: SEE BELOW

DATE: December 14, 2020

Approved

Date

12/17/20

REPLACEMENT

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

REASON FOR REPLACEMENT

This item was originally agendized for February 11, 2020 and was deferred until after the March 3, 2020 election. It was re-agendized for March 17, 2020, then deferred due to the COVID-19 pandemic. The Recommendation language and references to Measure E have been updated to reflect the voters' approval of Measure E on March 3, 2020 and update other time references.

RECOMMENDATION

Consideration and discussion of the draft framework related to certain transfers of real property to nonprofits and the real property transfer tax approved on the March 3, 2020 ballot.

OUTCOME

As a result of Measure E's passage on March 3, 2020, the Administration is returning to City 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 would be affordable to individuals and families earning 80% 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. The Administration will return prior to the end of the 2020-2021 fiscal year with a proposed

approach for transfers to or from nonprofits where a portion of the proceeds of the sale are donated for an affordable housing purpose.

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 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 Santa Clara County Registrar of Voters gave 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:

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

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.

- The City Attorney also clarified that the real property transfer tax could not be amended 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 passed 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 affect 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.

- This memorandum was agendized for Council consideration on February 11, 2020, then deferred until March 17, 2020 after the election. On March 17, the item was deferred again due to the emerging COVID-19 pandemic, public health emergency, and shelter-in-place orders.

On March 3, 2020, San José voters approved the Transfer Tax with over 53% support, adding a new chapter 4.59 to the San José Municipal Code. This new tax went into effect on July 1, 2020. The revenue estimate for 2020-2021 is \$30 million given the uncertainty of the economic environment.

On [June 16, 2020](#), Council Policy 1-18 (Operating Budget and Capital Improvement Program Policy) was formally amended to add the Measure E allocations as Section 22, Real Property Transfer Tax Revenue, through incorporation of Manager's Budget Addendum #19 as part of the City Council-approved Mayor's June Budget Message for Fiscal Year 2020-20201.

On [November 10, 2020](#), City Council approved a plan to allocate money from Measure E 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. The City Clerk was directed to agendize for future Council discussion and consideration the "Draft Framework Related to Nonprofit Transfers and the Proposed Real Property Transfer Tax," (item 3.3 on the March 17, 2020 Council agenda), which had not yet been re-agendized due to the pandemic response.

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 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 affected 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 (11) 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 (**Table 1**). All of these properties’ sites were acquired to develop and construct affordable housing and would not be affected by Measure E. Developers include both nonprofit and for-profit developers.

Table 1: Affordable Housing Developments Selected for Notice of Funding Availability to Determine Estimated Transfer Tax Costs Scenarios

Proposed Development	Land Cost	Transfer Tax Rate	Estimated Tax Amount
1. Gallup Mesa	1,736,802	0.00%	\$0
2. 226 Balbach	2,405,000	0.75%	18,038
3. The Kelsey	3,050,000	0.75%	22,875
4. The Dahlia	3,331,000	0.75%	24,983
5. Page Street	3,987,157	0.75%	29,904
6. Alum Rock Family Housing	4,107,000	0.75%	30,803
7. Roosevelt Park	4,419,400	0.75%	33,146
8. Tamien Station	3,663,677	1.00%	36,637
9. West San Carlos	5,912,500	1.00%	59,125
10. Blossom Hill	9,976,132	1.00%	99,761
11. 961 Meridian	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 when 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% of the units would have minimum affordability for those at or below 80% of AMI for at least 55 years and the proposed development must be located on a site consistent with the City's Affordable Housing Siting Policy.

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% of the units would have minimum affordability for those at or below 80% 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% of the units would have minimum affordability for those at or below 80% 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.

Nonprofit Property Sales Resulting in Donated Funds for Affordable Housing Purposes

The Administration will return with a proposed approach for transfers to, or from a nonprofit where a portion of the proceeds of the sale are donated to an affordable housing purpose by the end of the 2020-2021 fiscal year. Additional analysis and evaluation will be needed to determine the recommended approach.

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.

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EVALUATION AND FOLLOW-UP

This action addresses the City Manager's Enterprise Priority goal of Creating Housing and Preventing Homelessness. The Administration will return to the Council with a report on how it would implement the policy framework and on a proposed approach for transfers to, or from a nonprofit where a portion of the proceeds of the sale are donated to an affordable housing purpose.

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/

LEE WILCOX

Chief of Staff to the City Manager

/s/

JACKY MORALES-FERRAND

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.