



City Council Agenda Item Staff Report

CITY OF SAN BRUNO

DATE: June 7, 2022

TO: Honorable Mayor and Members of the City Council

FROM: Jovan D. Grogan, City Manager

SUBJECT: Conduct First Public Hearing Regarding Proposed City Charter and Commercial Real Property Transfer Tax

BACKGROUND: As part of the City Council's strategic planning sessions, the City Council has discussed becoming a charter city to assure on-going fiscal stability by implementing a commercial real property transfer tax, which only charter cities are authorized to levy. This staff report summarizes the progress to date, including the results of the March 29, 2022 City Council Study Session, outlines the general characteristics of a charter city, and the process that the City Council may use to present a charter to the voters, as required by state law, which contains a commercial real property transfer tax as an integral feature. This meeting also constitutes the first of two public hearings that the City Council is required to conduct before the City Council can place the charter on the ballot.

General Law Cities vs. Charter Cities

In California, there are two types of cities: general law cities and charter cities. General law cities get their corporate powers from the general laws passed by the State legislature. Charter cities, on the other hand, get their corporate powers from the California Constitution's home rule provision, which allows them to preside over all "municipal affairs," limited only by their own charters and State law on "matters of statewide concern." Attachment 1 highlights the features of general law and charter cities.

Unfortunately, the California Constitution does not define "municipal affairs." What constitutes a municipal affair has been interpreted by the courts on a case-by-case basis. The League of California Cities created a detailed chart that is attached, which describes various municipal issues and applicability to general law and charter cities.

Courts have found the following to constitute municipal affairs:

- The form of city government.
- Procedural aspects of resolution and ordinance adoption.
- Local elections, including qualifications for office and public funding of campaigns.
- Some aspects of zoning and land use.
- The process of contracting for public works.

- Scope of authority related to taxes and assessments.

Over time, the differences between general law cities and charter cities have been reduced. For instance, the Legislature has extended to general law cities many of the same powers as charter cities. In addition, the Legislature has characterized many laws affecting cities as matters of statewide concern, and hence, applicable to all cities, both general law and charter.

Generally, a matter is of “statewide concern,” as opposed to a “municipal affair,” when its impact is “primarily regional,” even if its impacts are not truly statewide. The following is a list of matters determined by the courts to be matters of “statewide concern” and hence not amenable to modification by charter:

- Educational school systems
- Traffic and vehicle regulations
- Tort claims against a governmental entity
- The Ralph M. Brown Act open meetings law
- The Meyers-Miliias-Brown Act regarding employee organization
- The California Environmental Quality Act
- The exercise of the eminent domain power

One of the primary tangible benefits of becoming a charter city is the ability to implement a real property transfer tax. General law cities are not legally authorized to impose real property transfer taxes.

Process to Become a Charter City

To become a charter city, a city must adopt a charter. The California Constitution authorizes the voters to adopt a city charter. There are two ways to draft a charter: (1) the City Council drafts the charter; or (2) the City’s voters elect a charter commission to draft the charter. (Gov. Code, §§ 34451, 34458.) In either case, the charter is not adopted by the City until it is ratified by a majority vote of the City’s voters at a statewide regular election. (Gov. Code, §§34457, 34458.) To streamline the process, the City Council has directed staff to propose a charter for consideration and approval by the City Council, which would then be placed before the voters at the November 2022 general election. There is therefore no need to create a charter commission.

After the proposed charter has been drafted by the City Council, it may be sent to the voters for ratification at the next established statewide general election, provided there are at least 88 days remaining before the election. (Gov’t Code § 34458.) Before a proposal to adopt a charter is submitted to the voters, the City Council must hold at least two public hearings on the proposal of a charter and the content of the proposed charter. Notice of the public hearings shall be given by publication twice in a newspaper designated by the City Council and circulated throughout the city, and by posting notice in three public places within the city at least 21 calendar days prior to the date of each public hearing. The second public hearing shall be held at least 30 days after the first public hearing. At least one of the public hearings shall be held outside of normal

business hours to facilitate public participation. The City Council shall not conduct a vote on whether to approve the submission to the voters of the proposal to adopt a charter until 21 days after the second public hearing. (Gov. Code, § 34458.) If the charter includes a tax, as this charter is proposed to do, then a 2/3 majority of the City Council, or four affirmative votes, are needed to place the charter on the ballot per Government Code section 53734(b). A simple majority of voters must vote in favor of the proposed charter for the charter and tax to be adopted. (Gov. Code, § 34459.)

On April 12, 2022, the City Council appointed a subcommittee consisting of Vice-Mayor Mason and Councilmember Marty Medina to discuss conducting a survey of likely voters regarding the contents of a proposed charter, and specifically a commercial real property transfer tax. The survey results conducted by a polling firm retained by the City revealed support for such a measure.

DISCUSSION:

Contents of Proposed Charter

General provisions

While there are no particular provisions required to be in a city charter, cities often reserve the greatest amount of power possible when they adopt charters. Under the California Constitution, it is sufficient to provide in any city charter that the city governed under it may make and enforce all ordinances and regulations regarding municipal affairs, subject only to restrictions and limitations provided in the charter. (Cal. Const. art. XI, § 5, subd. (b).)

At the March 29, 2022 study session, the City Council determined that the proposed charter should not include provisions implementing a rotational mayor, term limits, campaign contribution limits, or alternative voting mechanisms. The City Council directed that staff continue working on separate ballot measures for November 2022 to transition to a rotational mayor and to implement term limits. The City Council also directed that staff prepare an ordinance for City Council consideration implementing campaign contribution limits, and that staff should discontinue efforts at this time to explore alternative voting mechanisms.

Accordingly, staff recommends a charter that generally provides that the City will follow California law in all areas except those stated in the charter; and specifically that the charter should authorize the City to implement a commercial real property transfer tax if approved by the voters as an integral part of the charter. A draft charter is provided as Attachment 2. This procedure links the required voter approval of the charter to the required voter approval of the tax, so that both would be approved or disapproved in one ballot measure, avoiding the problem of inconsistent votes on two separate ballot measures. The City of El Cerrito successfully used this strategy in adopting its charter.

However, staff has recently become aware of the possibility that a statewide initiative may qualify for the November 2022 ballot, which if adopted by the voters could substantially affect many taxes, rates, and fees adopted by local agencies. If the initiative does qualify for the ballot, it is unclear whether it would affect the validity of a tax enacted as part of a newly adopted charter. To mitigate this potential risk, the City Council could consider placing a separate tax measure on the ballot, but as explained above, this creates the possibility that voters could adopt the charter but not the tax. Placing the tax on the ballot as a separate measure would require four affirmative votes of the City Council, while placing the charter on the ballot without an integral tax would require three affirmative votes of the City Council. As more information will become available regarding whether the statewide measure will qualify for the November 2022 ballot, staff has proceeded with drafting the charter to include an integral commercial real property transfer tax, as previously directed by the City Council.

Prevailing Wage

One additional topic addressed in the charter is prevailing wage, which state law requires contractors to pay on most public projects. Charter cities are not bound by state prevailing wage requirements when exclusively municipal projects are undertaken and state and federal funds are not involved. (*Vial v City of San Diego* (1981) 122 CA3d 346; see Labor Code §1771.) The California Supreme Court held that a charter city may exempt itself from the state's prevailing wage requirements on the city's locally funded public works projects because the wage levels of contract workers constructing locally funded public works are a "municipal affair." (*State Bldg. & Constr. Trades Council v City of Vista* (2012) 54 C4th 547.) However, Labor Code section 1782 prohibits charter cities from receiving or using state funding or financial assistance for construction projects if the charter city has a charter provision or ordinance authorizing noncompliance with state prevailing wage laws, or if it has awarded a public works contract within the prior 2 years that did not require compliance with prevailing wage requirements. Limited exceptions apply to funding or contracts awarded before January 1, 2015, and for certain contracts of \$25,000 or less. Labor Code section 1782 was upheld against a home rule challenge by a number of charter cities. (*City of El Centro v Lanier* (2016) 245 CA4th 1494.) Because the City has a strong history of supporting prevailing wage on all qualifying public projects, and to avoid uncertainty or legal challenges in the future, staff recommends including a provision in the charter confirming that the City will continue to require payment of prevailing wage per the state law applicable to general law cities.

Details and Structure of Commercial Real Property Transfer Tax

A real property transfer tax is a tax on the sale of property that is paid when real property is conveyed, and is based on the value of the property. As noted above, only charter cities are authorized by state law to impose such a tax. This tax is distinguished from the similarly-named documentary transfer tax that the county has adopted, and

which all cities thereby became authorized to impose by ordinance. The City's documentary transfer tax is codified in Municipal Code section 3.36, which since at least since 1980, has imposed the tax at the maximum legally authorized rate of \$.55 per \$1,000 of value.

Charter cities, in enacting their own laws, may enact a real property transfer tax in place of a documentary transfer tax and provide exemptions of certain property sales. The City Council has previously directed that staff consider a real property transfer tax only on the sale of commercial properties and not on the sale of residential properties. Payment of the tax could be negotiated between buyer and seller. The tax would be owed at the time of sale of the commercial real property. The tax would be collected by the City. Both the City Charter and the tax would be approved if the ballot measure receives at least a simple majority vote of affirmative votes.

Charter cities in the Bay Area opt for a wide range of fixed and variable property transfer tax rates. In response to the City Council's direction to consider a real property transfer tax only on the sale of commercial properties, staff has analyzed the potential revenue scenarios under various options. Given the inherent difficulties with projecting the level of commercial sales activity and sale prices going forward, staff has analyzed the potential revenue that the City would have received in each of the prior 5 years based on actual sale transactions in San Bruno based on the transfer tax rates of 1%. The analysis concluded that the City would have collected annual property transfer taxes of approximately \$1.1 million, if adopting the property transfer tax rates of our neighboring cities over the last 5 years.

It is important to note that property transfer tax revenue is an elastic revenue source in that it is highly influenced by economic shifts that affect the real estate market (e.g. interest rates, inflation, recessions, economic growth cycles, consumer confidence, local construction activity, etc.).

The City Council will need to specify a specific definition for commercial properties that will be subject to the proposed transfer tax. The term "commercial property" should not be interpreted to automatically exclude all residential dwellings. In simple terms, commercial real estate is a property that has the potential to generate profit through capital gain or rental income. A commercial property can be anything from an office building to a residential duplex, or even a restaurant or warehouse.

Based on prior City Council direction, and for the purposes of the attached Property Transfer Tax Simulation Analysis, City staff defined a commercial property as any transaction involving:

- Commercial Property (office building, hotel, retail structure, etc.)
- Industrial Property (warehouses, manufacturing building, etc.)
- Multifamily Housing Dwelling of 5 units or greater
- Planned Unit Development by Residential Developers
- Vacant Land

Common property tax exemptions, such as those for religious and government properties, would apply to this definition.

Next Steps

As noted above, this is the first of two required public hearings regarding the contents of the proposed charter, with the second public hearing scheduled for June 28. Because 30 days must elapse between the second public hearing and the City Council's decision to place the charter on the ballot, the City Council will need to schedule a special meeting on August 2 to take this action. The deadline for submitting ballot measures to the County for the November 8 election is August 12.

In summary, staff requests that the City Council provide direction at this meeting regarding whether at least four members of the City Council want to propose a charter measure to the voters at the November 2022 election, which would include an integral commercial real property transfer tax.

FISCAL IMPACT: On March 9, 2022, the County elections office provided staff with an estimated range of \$93,000-\$112,000 for the upcoming municipal election plus one ballot measure. The County estimated that each additional ballot measure would add approximately \$10,000 to the cost of the election.

ENVIRONMENTAL IMPACT: There is no environmental impact. The action is not a project subject to CEQA. City Council's action is not considered a "Project" per CEQA Guidelines and therefore no further environmental analysis is required.

RECOMMENDATION: Conduct First Public Hearing Regarding Proposed City Charter and Commercial Real Property Transfer Tax

ALTERNATIVES:

1. Propose changes to the timing or recommended focus of the draft charter.
2. Do not move forward with a draft charter.

ATTACHMENTS:

1. League of California Cities Charter Analysis
2. Draft City Charter