



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Board of Administration for
the Police & Fire Dept.
Retirement Plan

SUBJECT: Ordinance to Authorize Real Estate Investment in Limited Liability Companies **DATE:** 07-16-07

RECOMMENDATION

Approval of ordinance amending Section 3.36.550 of the San José Municipal Code to authorize the Board of Administration for the Police and Fire Department Retirement Plan to make real estate investments through Limited Liability Companies as title holding entities.

OUTCOME

The approval of this recommendation will give the Police and Fire Department Retirement Plan's Board more flexibility in the use of different title holding companies. This would allow them to select the title holding company that would be appropriate for the specific tax situation of the real estate investment.

BACKGROUND

Currently, Section 3.36.550 of the Municipal Code authorizes the Police and Fire Department Retirement Plan ("Plan") to investment in real estate in the following forms:

- In its own name or in common ownership with the Federated City Employees' Retirement System;
- Through title holding corporations or trusts satisfying the requirements of Internal Revenue Code Section 501(c)(25) or Section 501(c)(2).

Authorization of investment by way of a 501(c)(25) title-holding corporation was added to the Municipal Code in 1999 and the 501(c)(2) title-holding corporation was added in 2005. The main purpose for the title-holding corporation is to limit the exposure of the Plan's assets to only the assets held by the corporation.

ANALYSIS

The Board of Administration for the Police and Fire Department Retirement Plan acquired a 75% interest in two office buildings located in Anchorage, AK, collectively called the Calais Office Center, through title holding entities meeting the requirements of Internal Revenue Code Section 501(c)(2). The Board's real estate attorney (Nossaman, Guthner, Knox & Elliott, LLP) has recommended that the Board's ownership structure be converted to Limited Liability Companies ("LLCs") in order to resolve any potential tax liability issues. This structure would continue to provide insulation to the rest of the Plan assets against any liabilities that might be incurred by the LLCs in the operation of the buildings.

An LLC is a statutory entity designed to give complete limited liability to investors (such as afforded shareholders in a corporation) while providing greater flexibility to the investors to establish the rules of governance and to shape operations to meet the needs of the business. LLCs permit a retirement plan to have 100% of its ownership interest in the asset held by the LLC and they are "disregarded" for tax purposes. This means the LLC does not need to file separate tax returns, and, when the single member of the LLC is a tax-exempt entity, such as the Plan, the tax exemption automatically flows to the LLC without the need for separate tax exemption. LLCs do not work in all cases and there are situations where the 501(c)(2) or 501(c)(25) corporate form is preferable, but LLCs are valuable when entering into dynamic joint ventures or when entering into development projects. The members of the Board's Real Estate Committee and the Board Secretary will direct the operations of the LLC the same as the other title holding corporations currently in existence.

The LLCs provide an additional method for investing in real estate. It is the Board's real estate counsel's recommendation that the Plan have the flexibility to use tax exemptions offered by LLCs as well as by IRC sections 501(c)(2) and 501(c)(25), depending on the circumstances.

EVALUATION AND FOLLOW-UP

Ordinance is for a change to the Retirement Section of the San Jose Municipal Code. No follow-up action is required.

PUBLIC OUTREACH

- Criterion 1:** Requires Council action on the use of public funds equal to \$1 million or greater.
(Required: Website Posting)

- Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City.
(Required: E-mail and Website Posting)

- Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach.
(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)

The recommendation does not meet any of these criteria. However, this memorandum is posted on the City website for the August 7, 2007 Council agenda.

The draft ordinance is agendized for approval at the Board's regularly scheduled meeting of August 2, 2007.

COORDINATION

This memorandum was coordinated with the Office of the City Attorney.

COST IMPLICATIONS

The expenses will be paid from the Police and Fire Retirement Fund. In accordance with the Mayor's Budget Strategy, this proposal meets the following General Principle:

- Continue to emphasize prevention and expenditures that reduce costs to the City and our community.

CEQA

Not a Project.



EDWARD F. OVERTON
Secretary, Board of Administration

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