October 15, 2002

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Dear Supervisors:

HACIENDA HEIGHTS APPLICATION FOR CITY INCORPORATION
(ALL DISTRICTS AFFECTED) (3 VOTES)

IT IS RECOMMENDED THAT YOUR BOARD:

1. Authorize the Chief Administrative Office to request a review of the Comprehensive Fiscal Analysis by the Office of the State Controller pursuant to Government Code 56801 based on the findings identified by the County, and authorize payment for the review from Non-Departmental Special Accounts.

2. Adopt policies regarding the Hacienda Heights proposed incorporation to provide guidance to County staff in revenue neutrality negotiations with the Hacienda Heights Cityhood Organization.

PURPOSE/JUSTIFICATION OF RECOMMENDED ACTION

Background

Upon receipt of an application for incorporation of a new city, it is the role of the Local Agency Formation Commission (LAFCO) staff to: analyze the merits of the proposal; conduct the environmental review; prepare or cause to be prepared a Comprehensive Fiscal Analysis (CFA) which addresses the fiscal viability of the proposed city and revenue neutrality with regard to other affected jurisdictions; and prepare the Executive Officer's report.

Hacienda Heights Proposal

The Hacienda Heights Cityhood Organization (HHCO) applied to LAFCO for incorporation of Hacienda Heights (population 53,122) on December 8, 1999. On November 16, 2000, LAFCO's consultant requested that the Chief Administrative Office (CAO) provide information from the most recent fiscal year available (1998-99), in accordance with Government Code Section 56800, in order to initiate the preparation of a CFA for Hacienda Heights. The 1998-99 data was provided; however, due to delays and the requirement to provide information from the most recent fiscal year available, LAFCO subsequently requested that the CAO update the data to 1999-00. LAFCO's consultants subsequently released a preliminary draft CFA on March 29, 2001 which concluded that the proposed city of Hacienda Heights would not be able to sustain a positive operating balance unless other funding sources were identified; would not be able to maintain a minimally acceptable unappropriated reserve fund; and could not budget funds for non-road related capital improvement projects.

Based upon additional input from HHCO, LAFCO determined that another CFA would be prepared. On April 12, 2002, LAFCO notified the CAO that the Commission had adopted a motion to go forward with the preparation of a final CFA for the proposed Hacienda Heights incorporation. LAFCO requested that the CAO provide within 60 days the necessary updated information from the most recent fiscal year available (2000-01) for all affected departments except the Sheriff; LAFCO coordinated directly with the Sheriff to obtain their fiscal data. Accordingly, the CAO compiled data from the Departments of Animal Care and Control, Parks and Recreation, Public Works, and Regional Planning. The Auditor-Controller and the Treasurer and Tax Collector provided supplemental information related to the incorporation area.

On August 28, 2002, the CFA was presented at the LAFCO hearing (Attachment I) with a staff recommendation to continue the Hacienda Heights incorporation matter for final action until October 23, 2002 so that the applicant and the County could meet and determine whether or not a mutually acceptable agreement regarding revenue neutrality mitigation payments could be reached. LAFCO has targeted the June 2003 ballot for the election on the proposed incorporation of Hacienda Heights.

It should be noted that only one of the three scenarios in the CFA approaches true revenue neutrality – Scenario 3, which stipulates mitigation payments for the longest period of time (25 years). In this scenario, the new city would not be fiscally viable starting in year eight due to the calculation of Motor Vehicle In-Lieu fees reverting to a calculation based upon the actual population level, rather than three times the number of registered voters, resulting in a significant decrease in city revenues.

Based on our review of the CFA, we have identified the following issues which we believe need to be resolved before further consideration of the proposed incorporation proceeds:

- The Sheriff did not provide the most recent fiscal year information (2000-01) in accordance with Government Code Section 56800 for the CFA. This data is utilized to determine current service level, the calculation of property tax transfer, and the revenue neutrality payment.

- In determining the base property tax allocation, the Auditor-Controller determines the proportion that the amount of property tax revenue derived by the County bears to the total amount of revenues from all sources received by the County during the prior fiscal year, and available for general purposes. At issue is whether or not the County's share of the Tobacco Settlement and the State Educational Revenue Augmentation Fund (ERAF) reimbursement are general-purpose revenues. The consultant excluded these revenues from the ratio as non-general fund revenues, resulting in a higher percentage of property tax allocation to the proposed city, 54.564 percent as opposed to 51.990 percent, a 2.574 percent differential. County Counsel has opined that the Tobacco Settlement and State ERAF reimbursements are general-purpose revenues.

- The CFA assumes that County departmental services would be ongoing beyond the first mandated year of service via contract. The Department of Parks and Recreation has indicated that they will not provide services beyond the first year. Should your Board adopt the position that the parks be transferred to the new city, the County would be relieved of all further responsibility for those facilities. All operation and maintenance of the parklands and their facilities will be the sole responsibility of the incorporated City of Hacienda Heights. Additionally, the transfer should stipulate unconditional use of the parkland and its facilities for all County residents.

- The CFA did not take into account capital improvement projects that may be necessary if incorporation were to occur. There was no in-depth analysis pertaining to infrastructure needs and, therefore, no budget for capital improvement projects, which over a 10-year period, will likely be required. This level of detail would require a separate engineer's report, which is recommended for both public works, and park related capital projects.

- A contingency fund of 5 percent is identified in the CFA; however, State LAFCO Incorporation Guidelines recommend a minimum contingency fund of 10 percent of estimated expenditures. Additionally, there is no cash flow reserve set aside to cover for revenue "dry" periods when monthly fund payouts exceed revenue receipts. The State LAFCO Incorporation Guidelines recommend researching the past experience of comparable new cities with a minimum reserve of at least 10 percent recommended. These considerations are critical since a new city has no historical track record on the cost or level of services required to meet the expectations of a newly incorporated community; unanticipated expenditures could occur due to major disasters, emergencies, liability claims, and litigation settlements; local finances may be subject to change based on the State's budget; and funds may have to be budgeted for capital improvement projects, vehicles, or major equipment.

- The CFA suggests that an increased property tax split or reduction in contracted service levels could be negotiable. Due to the County's fiscal position and recent impacts related to the State budget, the County is not in a position to negotiate in either of these areas. Furthermore, contract service levels must be determined at the sole discretion of the County department providing the service, particularly in light of liability concerns that will also need to be reviewed by the CAO. This issue is critical since all three scenarios in the CFA indicate that Road expenditures exceed revenues that will affect the proposed city's viability.

- Fines and Forfeiture revenues are overstated in the CFA based on the CAO's review of actual data in the Sheriff's budget.

- The CFA indicates that Scenarios 1 and 2 are based on payment methodologies utilized in other incorporations. However, the proposals in the CFA would result in far greater impacts to the County as discussed below.

The CFA states that Scenario 1 is based on a similar payment method selected by LAFCO for the City of Los Angeles' special reorganizations. Scenario 1 assumes the revenue neutrality mitigation payment will be reduced by 10 percent per year over the life of the projections, which results in the total depletion of the revenue neutrality mitigation payment in year 11. Under the City of Los Angeles' special reorganization scenario, the revenue neutrality mitigation payment would be reduced by 5 percent per year over the life of the projections which results in the total depletion of the revenue neutrality mitigation payment in year 21. Therefore, Scenario 1 identified in the CFA has a far greater impact on the County than would the City of Los Angeles' special reorganizations. If the proposed City of Hacienda Heights were to adopt the City of Los Angeles' scenario it would not be a viable incorporation.

The CFA indicates that Scenario 2 is based on a similar payment method utilized by the County of Orange for the Aliso Viejo incorporation. Scenario 2 assumes a full revenue neutrality mitigation payment for seven (7) years whereas Orange County calculated the mitigation liability based on a fourteen (14)-year term, and then compressed the actual payments into the first seven (7) years following incorporation. Viability of the proposed City of Hacienda Heights would be highly questionable under this scenario and requires further analysis.

State Controller Review

As an interested agency, the County may request a review of the CFA by the State Controller within 30 days from the date that the LAFCO Executive Officer provides notice that the CFA is complete and available for review. That notice was published by the Executive Officer on September 23, 2002 and, therefore, the County has until October 23, 2002 to make its request. Based on the above-identified issues, it is our determination that a review is warranted and, therefore, we are requesting that your Board authorize the CAO to formally request the State Controller review of the CFA.

Within 45 days of receiving the CFA, as stipulated under Government Code 56801(c), the State Controller must issue a report to the LAFCO Executive Officer regarding the accuracy and reliability of the information, methodologies, and documentation of the CFA.

HHCO Proposal

On September 23, 2002, the HHCO submitted their proposal for revenue neutrality provisions, which does not reflect any of the scenarios discussed in the attached CFA, but rather proposes more severe impacts to the County including:

- Capping the revenue neutrality payment at $8.75 million to be paid in equal annual installments over a seven-year period without interest. The $8.75 million is 50 percent of the calculated revenue neutrality amount identified in Exhibit 3 of the CFA. In effect, based on the annual revenue neutrality mitigation requirement of $2.6 million identified in the CFA, the HHCO proposal provides the County less than 3.5 years of full mitigation.

- Requiring the County to waive reimbursement for all transition period costs.

- Requiring the County to provide all road maintenance services at the current service level at no cost to the city through June 30, 2006.

- Requiring the County to maintain responsibility for provision of maintenance and program services for the Senior Center at Steinmetz Park at no cost to the city, pending further negotiations.

- Allowing a provision whereby the city can amend the negotiated agreement if unanticipated revenue loss or material increases in services are incurred by the city.

- Allowing a provision that in the case of natural disaster the city would not be required to make payments to the County.

- Allowing a provision that would allow the city to renegotiate payments, future revenues, and/or costs if there were errors or omissions in the data utilized for the development of the CFA.

County Principles of Revenue Neutrality for Negotiation of Incorporation

Attachment II provides additional detail on the issue of revenue neutrality with regard to proposed negotiations. As Hacienda Heights is the first proposed incorporation in the County under the reformed State statutes on city incorporation, the County currently has no policies guiding County staff in entering into negotiations with cityhood proponents. The County is facing continuing and increasing fiscal crisis, making issues of revenue neutrality all the more critical.

Prior to entering into discussions with the proposed City of Hacienda Heights, it is recommended that your Board adopt policies regarding this proposed incorporation to provide guidance to County staff. These proposed policies are as follows:

- Assure the initial fiscal feasibility of the City.

- Minimize potential negative impacts on the County resulting from incorporation.

- Assure that the service levels of either the City or the County will not be decreased for its constituents.

Based upon your Board's approval of these policies, we will offer to negotiate with HHCO with regard to revenue neutrality. However, we should be clear that, based upon our analysis of the CFA as outlined above, we do not believe at this point that a city of Hacienda Heights could be fiscally viable without significant subsidization by the County.

Implementation of Strategic Plan Goals

These recommendations are consistent with the following Strategic Plan Goals and Strategies:

Goal No. 3: Organizational Effectiveness
Strategy No. 3, Collaborate across functional and jurisdictional boundaries.

Goal No. 4: Fiscal Responsibility
Strategy No. 1, Manage effectively the resources we have.

FISCAL IMPACT/FINANCING

Pursuant to LAFCO's adopted procedures for requesting State Controller's review of a CFA, the requesting party is required to bear the cost of the review, including State Controller, LAFCO staff, and consultant costs. The County will be required to make a deposit to cover the costs associated with the review at the time it submits the request to the LAFCO Executive Officer, along with an indemnification for any additional costs that may be incurred as a result of the request. LAFCO will contract with the State Controller for review of the CFA, which will specify the elements to be reviewed. If the State Controller identifies a need for an additional deposit, the County shall be notified and will be responsible for depositing any additional amounts with the LAFCO Executive Officer. If the actual costs associated with the review are less than the monies deposited with the Executive Officer, the unexpended funds will be returned to the County.

Based on similar studies, the State Controller's review is estimated to cost between $20,000 and $30,000. We are recommending that funding for the study be provided from Non-Departmental Special Accounts.

FACTS AND PROVISIONS/LEGAL REQUIREMENTS

Attachment II provides additional detail regarding the legal requirements for an incorporation once an application is received by LAFCO.

IMPACT ON CURRENT SERVICES (OR PROJECTS)

Adoption of this Board letter will allow the State Controller to evaluate the CFA and determine whether or not there will be significant negative fiscal impacts on the County affecting current critical services as a result of the proposed city incorporation of Hacienda Heights.

Respectfully submitted,

DAVID E. JANSSEN
Chief Administrative Officer

DEJ:LS
MKZ:DSP:os

Attachments (2)

c: Sheriff
Auditor-Controller
County Counsel
Director of Animal Care and Control
Director of Parks and Recreation
Director of Public Works
Director of Planning
Treasurer and Tax Collector

PROCEDURAL ISSUES REGARDING CITY INCORPORATIONS

Comprehensive Fiscal Analysis (CFA)

One of the key components of the Local Agency Formation Commission's (LAFCO's) Executive Officer's report is the CFA. The fiscal data for the CFA identifies existing service levels, expenditures, and revenues associated with the proposed incorporation area. This information is used to establish the base year costs and revenues. The base year costs are the costs that would have been incurred to provide municipal level services if the incorporation area had been a city during that base year. In addition to the base year costs, the contingency and reserve funds are determined in the CFA so that an appropriate expenditure level can be established. The primary revenue source is the property tax transfer, which is calculated in proportion to the services responsibilities assumed by the new city. Other revenues included in the transfer are the property transfer taxes, sales taxes, transient occupancy taxes, State Motor Vehicle In-Lieu and off-highway vehicle license taxes, franchise fees, road fund subventions, transportation related sales taxes, and other smaller revenue sources. Ultimately, an appropriation level is calculated based on the determination of expenditures and revenues.

Revenue Neutrality

Revenue neutrality was added to the statutes governing city incorporation in 1992 after many years of difficult but resolved advocacy by counties throughout the State. The purpose of revenue neutrality was to stem the tide of city incorporations that were only fiscally viable by taking from counties a portion of their regional service property tax revenues through the incorporation process. Prior to the reform, LAFCO was required to split the property tax revenues among affected agencies that, due to property tax constraints after Proposition 13, resulted in a net loss to counties because it did not take into account the continuing cost of countywide services, such as elections, jail operations, social and health services and probation. The revenue neutrality reform seeks to ensure an equitable tax allocation by requiring LAFCO to ensure that counties are held harmless from new incorporations.

Pursuant to Government Code Section 56815, LAFCO cannot approve a proposal for incorporation unless it finds that the amount of revenues the new city receives from the county after incorporation would be substantially equal to the amount of savings the county would attain from no longer providing services to the proposed incorporation area. Counties may negotiate an agreement with the incorporation proponents, in accordance with a policy adopted by the local LAFCO, to ensure a reasonable mitigation payment plan in the form of a tax sharing agreement, lump sum payment, payments over a fixed period of time or any other term and condition such as assumption of debt or contract responsibilities. LAFCO may approve a proposal that includes an incorporation if it finds either of the following: 1) the county and all of the subject agencies agree to the proposed transfer; or 2) the negative fiscal effect has been adequately mitigated by tax sharing agreements, lump-sum payments, payments over a fixed period of time, or any other terms and conditions pursuant to Government Code Section 56886.

Executive Officer's Report and Public Hearing

The Executive Officer must prepare a final report on the incorporation application with recommendations to approve or disapprove the incorporation. The report must minimally include the incorporation boundaries, the CFA, and the results of the State Controller's review, if any. The Executive Officer's report must include findings and can specify terms and conditions. A public hearing is scheduled within 90 days of when the LAFCO Executive Officer issues a Certificate of Filing, which indicates that the application is complete. The hearing process may be continued but may not be postponed more than 70 days from the date specified in the original public hearing notice. At the hearing, the Commission has the authority to approve, deny or approve with modifications the proposed incorporation after considering the report and public testimony. If LAFCO approves the incorporation proposal, the Commission's action must include a series of findings and determinations specifically addressing incorporation issues in the resolution minimally including revenue neutrality, modification of incorporation boundaries, acceptance or rejection of the recommendations and findings of the Executive Officer's Report and CFA, terms and conditions, an environmental determination in compliance with the California Environmental Quality Act, property tax determination and a provisional appropriations limit. If the Commission denies the proposed incorporation, no similar application can be filed for at least one year, unless the prohibition is waived by the Commission.

Request for Reconsideration

Any person or agency may file a "Request for Reconsideration" with the LAFCO Executive Officer within 30-days after adoption of a resolution by LAFCO. The request must state the specific change requested and what new or different facts or applicable new law warrant the reconsideration. The Executive Officer must place the request on the agenda of the next LAFCO meeting. The hearing may be continued but the continuance shall not exceed 35 days from the date in the public hearing notice. At the conclusion of its consideration, the Commission may approve or disapprove with or without amendment, wholly, partially, or conditionally, the request. The determination of LAFCO is final and conclusive.

Conducting Authority Hearing

LAFCO is designated by law as the "conducting authority" for city incorporations. A conducting authority has the responsibility to hold a public hearing to count protests received for an incorporation proposal. Within 15 days of LAFCO's adoption of its resolution of approval, LAFCO issues a hearing notice for the purpose of collecting and counting written protests from registered voters residing within the incorporation area. Within 30 days of the conclusion of the hearing LAFCO will terminate the proceedings if more than 50 percent of the registered voters residing in the incorporation area submit written protest; or order the incorporation subject to confirmation by the voters if written protest is submitted by less than 50 percent of registered voters residing in the incorporation area. If proceedings are terminated by majority protest or by the voters, no substantially similar proposal for the same territory may be filed within two years of the date of adoption of the resolution terminating proceedings.

Election

If LAFCO orders the incorporation subject to confirmation by the voters, it will request that the Board of Supervisors adopt a resolution calling for an election on the issue of incorporation. The County Registrar prepares the incorporation for a vote at the next general election date occurring at least 88 days after the election is called. The election of city council members will occur at the same time because the applicant has not requested postponement of city council elections. The incorporation measure will also refer to the provisional appropriation limits set by LAFCO as required by State law. A simple majority of those voting is required to approve the incorporation. Following confirmation of the proposed incorporation by the voters, LAFCO must certify the election results by adoption of a resolution ordering the change of organization, and the Executive Officer, as a final action, files the Certificate of Completion with the County Registrar-Recorder/County Clerk.

Effective Date

LAFCO must establish an effective date for the incorporation and city council swearing in. The city council begins to organize the new city's administrative structure at their first meeting by adopting existing ordinances of the County. These ordinances will remain in full force for 120 days following incorporation or until the new city council adopts ordinances superseding the County ordinances, whichever occurs first.

Transition Period

Under State law, the new city does not assume direct responsibility for providing services during the transition period between the effective date of incorporation and July 1 following the effective date. The county continues to provide municipal level services during the transition period while the new city prepares to take over this responsibility. To ensure equity between costs and revenues for the county during the transition period, the county can request reimbursement for the net cost of services provided during the transition period (Government Code Section 57384). If the county requests reimbursement, LAFCO is required to impose it as a term of approval. The new city has up to five years to reimburse the county for the net cost, unless waived by the county.