

Agenda Item 4A

SACRAMENTO LOCAL AGENCY FORMATION COMMISSION
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May 2, 2007

TO: Sacramento Local Agency Formation Commission
FROM: Peter Brundage, Executive Officer
RE: Arden Arcade Funding Options

RECOMMENDATION

1. Require the Arden Arcade Incorporation Proponents to pay all of the costs to complete the necessary incorporation studies and pay legal costs incurred by Commission Counsel related to the incorporation.
2. Payments will be made prior to commencement and continuation of work. The proponents shall make deposits in advance of all work.
3. Payment schedule is to be determined based on contracts between the consultants and LAFCo.
4. Proponents shall make a \$5,000 deposit for future legal expenses plus all costs incurred to date.
5. Proponents will be billed actual legal expenditures monthly.
6. All work will stop if deposits are not sufficient to cover the invoices submitted by LAFCo's consultants and legal counsel.
7. LAFCo staff time will be absorbed. However, if Arden Arcade incorporates, the new city will reimburse LAFCo for staff costs incurred to process the Arden Arcade Incorporation proposal.

DISCUSSION

Incorporation Fee Policy Adopted April 4, 2007

At the regularly scheduled hearing, on April 4, 2007 the Sacramento Local Agency Formation Commission amended its incorporation fee policy previously adopted on November 3, 2005. The amended fee policy requires incorporation proponents to pay for the entire cost of incorporation proceedings prior to issuance of the Executive Officer's Report and Public Hearings.

The applicants will be required to deposit funds to cover the entire estimated cost of the proposed incorporation proceedings. The projected costs include Registrar of Voter's charges to verify the incorporation petition, legal expenses incurred by LAFCo, LAFCo staff time, environmental consultants, financial consultants, costs related to the Municipal Services Review, and any other costs related to the incorporation study as required by the Commission.

The Commission may allow proponents to make payments based upon a payment schedule, mutually agreed upon by staff and the proponents, approved by the Commission. Under any payment schedule, deposits shall be made in advance of any work being performed by LAFCo or its consultants. ***All work will cease if funding arrangements are not current.*** Incorporation proponents will be required to pay in full, the actual costs incurred prior to any public hearings.

Intent Motion for Arden Arcade Incorporation Cost Recovery

In consideration of LAFCo budgetary constraints, yet to be flexible to the Arden-Arcade Incorporation Proponents, LAFCo adopted an Intent Motion that directed the Executive Officer to meet with the Arden-Arcade Incorporation Proponents to discuss the LAFCo Incorporation Fee Policy adopted April 4, 2007, as set forth above. The Commission directed me to inform the proponents that they would be required to provide full cost recovery for the Arden-Arcade incorporation proposal. However, LAFCo would try and find a plan to provide flexibility to the current incorporation proponents with regard to payment schedule, amount of costs to be recovered and/or type of costs recovered.

In summary, the proposed modifications to the LAFCo Incorporation Fee Policy adopted April 4, 2007 based on the Intent Motion per my understanding are as follows:

The Proponents shall pay the following costs:

- Costs of signature verification charged by the Registrar of Voters
- Costs of the Environmental Documentation
- Costs of the Comprehensive Fiscal Analysis
- Costs of legal services provided by Commission Counsel and/or other LAFCo legal consultants
- Costs related to Municipal Services Review

- *LAFCo staff time will be absorbed within LAFCo Budget*

Based on Commission direction that all costs should be recovered except LAFCo staff time, I was not able to find a solution other than to develop a payment plan method that would allow proponents to pay costs incurred by LAFCo by making progress payments that maintain an adequate deposit to cover estimated expenditures.

The proponents shall make payments as follows:

- Full payment of required studies
- Schedule to be determined based on payment plans required by the consultants.
- Legal costs will be billed monthly; the proponents shall submit a \$5,000 deposit in advance and reimburse LAFCo for costs incurred to date.

The proponents will need to make deposits in advance to cover all work-in-progress. Payments for consultants and legal costs would be made from the deposit as invoices are submitted. Additional funds would need to be paid to LAFCo to maintain an adequate deposit to cover any work-in-progress.

In any situation, LAFCo will not incur any financial liability related to the proposed Arden-Arcade Incorporation other than LAFCo staff time. Work will stop if money is not deposited to cover work-in-progress. Also, LAFCo will not conduct any public hearings related to the Arden-Arcade Incorporation Proposal until the actual costs for all studies and consultants have been paid in full.

The Arden Arcade Incorporation proponents support Option No. 1 of the funding options shown in the following table. The proponents strongly believe that the Commission should process this incorporation proposal based on the LAFCo Fee Policy adopted November 5, 2003. They believe this is the only option that is fair and equitable because their petition was submitted under the November 5, 2003 Fee Policy. The Fee Policy and history are found in Appendix I of this report. Commission Counsel has stated that the Commission can amend its Fee Policy at any time.

I have met with a sub-committee of the Incorporation Committee. The Incorporation Committee is meeting Monday, April 30, 2007 to discuss this report and the options that are presented. They will submit a written response and present their position at the May 2, 2007 Public Hearing.

The Commission could modify the above payment plan proposal or approve an alternative funding option. I have provided several possible funding options below that may be considered by the Commission.

Funding Options

The following table illustrates several possible funding options. Each of these options has advantages and disadvantages and in some cases may not be viable. Some of the options listed below may lower the cost of incorporation studies but increase the risk. Risk of legal challenge, as well as risk that these studies will not provide adequate information for the Commission to render a decision.

Even if additional funds are available to conduct exhaustive studies, it is still possible that these studies will be challenged considering the perception of potential negative impacts to the County of Sacramento. **Even with comprehensive studies, it may not be possible to accurately anticipate all possible impacts on many issues or be able to validate or not-validate the impacts because of their subjective nature.**

The analysis to determine if a proposed area is a viable city is a relatively straight forward study. The environmental evaluation for a developed area should also be a relatively straight forward evaluation. *However, it may be relatively difficult to prove the degree of negative impacts to the remaining unincorporated territory if the incorporation is approved or if further balkanization exacerbates regional problems. These questions have not yet been specifically or definitively addressed in previous incorporations. These and similar questions may be difficult if not impossible to answer until years after any changes have occurred.*

For example, the California Institute of Public Policy has conducted several research studies regarding local government structure. This study analyzed governance models in Los Angeles County, including cities, and special districts. The study indicated that there was no conclusive evidence to indicate if any one form of governance structure was superior, more efficient or more cost-effective than another. One of the studies even looked at governance structures within other states in comparison to California cities and counties. There appear to be all types and combinations of governance structures that are effective and efficient: some with multiple layers of government and others with fewer layers of government.

Finally, the question of whether this area should be annexed to the City of Sacramento rather than incorporate has been raised. This question has not been analyzed before in context of an incorporation proposal. **While LAFCo cannot approve an annexation based on the current application (petition), it could deny the incorporation.** This “alternative” will likely increase the costs of the Comprehensive Fiscal Analysis and environmental analysis. Conversely, LAFCo has never studied whether an area should incorporate rather than annex to an existing city in context of an annexation proposal. Potentially, there are endless possibilities and combinations that could be studied for every proposal that comes before LAFCo.

Nonetheless, it may be possible to lower the costs with the understanding that there may be increased risks associated with this type of approach. It would be possible to limit the analysis, do the best given limited resources, and proceed.

I spoke with County Staff about some of these options. They do not support several of these options. Therefore, without county support, some of these options may not be feasible unless the county reconsiders its position or greater risk is accepted by LAFCo and the Proponents.

In addition, the Commission may consider other options or possible combinations that are not included in this table.

All of the options listed below, assume that the proponents pay the Registrar of Voters for signature verification. The total cost to verify the signatures was \$19,906. The proponents have paid \$12,000 of this amount. An invoice has been sent requesting the \$7,906 balance.

Funding Option Table

See next page.

Summary of Possible Funding Options for the Arden Arcade Incorporation

FUNDING OPTIONS	CFA	CEQA/EIR	Legal	Staff Time
1	LAFCo pays for CFA under Fee Policy adopted November 5, 2003	Proponents pay for CEQA under Fee Policy adopted November 5, 2003	LAFCo absorbs legal costs	LAFCo absorbs staff costs
2	LAFCo pays 80% Proponents pay 20% Develop payment schedule with advance deposit	Proponents pay 100%	LAFCo pays 80% Proponents pay 20% Develop payment schedule with advance deposit	LAFCo absorbs staff costs
3	Proponents contract directly with consultant Proponents pay for LAFCo peer review	Proponents contract directly with consultant Proponents pay for LAFCo peer review	Proponents contract directly with legal counsel Proponents pay for LAFCo peer review	LAFCo absorbs staff costs
4	County prepares CFA Proponents pay LAFCo for peer review	Proponents pay cost of Environmental Document	Proponents pay cost of LAFCo Commission Counsel	LAFCo absorbs staff costs

5	Split costs 50/50 Develop payment schedule Deposit money in advance of incurring costs	Split costs 50/50 Develop payment schedule Deposit money in advance of incurring costs	Split costs 50/50 Develop payment schedule Deposit money in advance of incurring costs	LAFCo absorbs staff costs
6	Proponents pay LAFCo to prepare CFA Develop payment plan Deposit money in advance of incurring costs	Proponents pay LAFCo to prepare Environmental Document Develop payment plan Deposit money in advance of incurring costs	Proponents pay LAFCo legal costs Develop payment plan Deposit money in advance of incurring costs	LAFCo absorbs staff costs

Under any option, appropriate payment schedules will be developed and if the city incorporates, the city will reimburse LAFCo for costs incurred and not paid under the proposed options.

Analysis of Options

None of these options, except No. 6, eliminate LAFCo’s contribution as set forth in the April 7, 2007 Intent Motion. However, they provide some possible compromises based on Commission direction to try and find some flexibility for the pending Arden Arcade Incorporation. Incorporations within Sacramento County are expensive in light of past litigation of the CEQA review process resulting in the preparation of an EIR versus a Negative Declaration or Mitigated Negative Declaration. During the most recent incorporation effort in El Dorado Hills, the proponents raised and spent over \$400,000 and lost the election. The costs of the Arden Arcade Incorporation effort could even be higher.

Cost of Environmental Analysis

One option that was not identified in the table is whether or not LAFCo should attempt to use a Mitigated Negative Declaration. It may be possible to significantly reduce the cost of the environmental analysis if we prepare a Mitigated Negative Declaration in place of

an Environmental Impact Report. All incorporations within Sacramento County have used an Environmental Impact Report based on litigation from the first Citrus Heights incorporation. The California State Supreme Court upheld the Superior and Appellate Courts decisions that Sacramento should have prepared an Environmental Impact Report for the project because more information is better than less.

In summary the California State Supreme Court wrote:

Both the trial and appellate courts found substantial evidence in the record that incorporation will inevitably lead to changes in land use within the new city. As the Court of Appeal noted, “the importance of land use decision-making in the incorporation proposal suggests that simple perpetuation of existing County policies is unlikely.” . . . proponents would like more local control: control over revenues. . . , and control over land use and planning decisions. . . “.

CEQA Guidelines hold that the Lead Agency (Sacramento LAFCo) is (shall be) responsible for determining whether an environmental impact report, a negative declaration, or a Mitigated Negative Declaration shall be required for any project which is subject to this division. That determination shall be final and conclusive on all persons, including responsible agencies, unless challenged as provided in Section 21167.

Prior to determining whether a negative declaration or environmental impact report is required for a project, the lead agency shall consult with all interested parties, responsible agencies and trustee agencies.

LAFCo and the proponents could agree to assume the risk and prepare a Mitigated Negative Declaration provided an Initial Study indicates that the incorporation of Arden-Arcade would not result in any significant environmental impacts. **As with every CEQA document, a third party can challenge or litigate the CEQA document whether it is an EIR, Mitigated Negative Declaration or Negative Declaration.**

Most if not all incorporations in southern California have used Negative Declarations or Mitigated Negative Declarations. In these cases, the proponents usually paid for the Comprehensive Fiscal Analysis. Typically, this approach has minimized the cost to LAFCo. Under this situation, the proponents would pay the cost of the more expensive study and it would be more feasible for proponents to fund most of the studies. Consequently, LAFCo’s share could be minimal and the proponents may have the ability to raise the necessary funds.

(Note: Orange County has generally supported incorporations since its bankruptcy. Several years ago, Orange County made a policy decision that encourages annexations and incorporations).

Cost of Comprehensive Fiscal Analysis

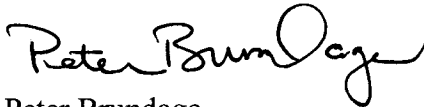
There may not be any way to reduce this cost; however, the proponents could independently find a party willing to prepare the CFA (Option No. 3). In addition, peer review would be conducted by LAFCo and it would be paid for by the proponents. In addition, the County will provide its comments on the Draft CFA regardless of who prepares the document.

Conclusion

Based on the Commission's April 7, 2007 Intent Motion, I am recommending Option No. 6 (consistent with the Intent Motion) in order to minimize the financial impact of the Arden Arcade incorporation proposal on LAFCo's budget.

SACRAMENTO LOCAL AGENCY FORMATION COMMISSION

Respectfully Submitted;

A handwritten signature in black ink that reads "Peter Brundage". The signature is written in a cursive style with a large, looping initial "P".

Peter Brundage
Executive Officer

APPENDIX I

Background

After a great deal of deliberation, on November 5, 2003, the Commission adopted a fee policy regarding processing incorporations. The Commission approved a partial cost recovery from proponents with a full cost recovery from the new city. If the incorporation proposal is successful, the new city must reimburse LAFCo for all costs funded by LAFCo. The 2003 Incorporation Fee Policy states:

<u>Event</u>	<u>Fiscal Responsibility</u>
Deposit \$25,000	Proponents
Petition Verification	Proponents
Environmental Impact Report	Proponents
Comprehensive Fiscal Analysis	LAFCo
Staff Time	LAFCo
Legal Fees	LAFCo

This fee schedule is a modified full cost recovery method. **On August 6, 2003, I had recommended the Commission adopt a Full Cost Recovery method prior to holding public hearings on incorporation proposals.** My recommendation was based on budget considerations. At that time, however, the Commission believed that the partial recovery method was the more appropriate approach because it was consistent with how LAFCo treated the Citrus Heights, Rancho Cordova and Elk Grove Incorporations.

The cost to process incorporation proposals is expensive because staff uses consultants to prepare an Environmental Impact Report and a Comprehensive Fiscal Analysis. During past incorporation proposals, the cost of the EIR has exceeded \$100,000. The cost of the CFA has ranged from \$35,000 to \$90,000. It is likely that the cost of a CFA will continue to increase because the CFA is a very critical part of the incorporation analysis. Proponents and opponents of future incorporation proposals are demanding an ever higher level of detailed accurate revenue and expenditure estimates.

During past incorporation proposals, LAFCo could absorb the cost of the CFA relatively easily. In the future, I believe it will be more difficult to absorb this cost, especially if

staff is processing two incorporation proposals simultaneously or within a relatively short period of time.

Moreover, during past incorporation proposals, the Commission has agreed to advance funds to cover the cost of preparation of the Environmental Impact Report. Public hearings were not scheduled until LAFCo was reimbursed; however, proponents have been allowed to make modest monthly payments toward this cost during the preparation of the EIR. This waiver of up-front costs to proponents creates a cash flow problem for LAFCo's budget. It also creates the potential that LAFCo will not be reimbursed by proponents because they may be unable to raise the necessary funds for this cost.

The costs of incorporations are estimated to be as follows:

	<u>Low</u>	<u>High</u>	<u>Responsible Party (2003)</u>
Registrar of Voters	\$1,500	\$20,000	Proponents
EIR	\$100,000	\$150,000	Proponents
CFA/ Consultants	\$80,000	\$100,000 +	LAFCo
Staff Time	\$20,000	\$30,000 +	LAFCo
Legal	<u>\$20,000</u>	<u>\$30,000</u> +	LAFCo
Total	\$221,500	\$330,000	

(arden-arcade funding options)