



EL DORADO COUNTY GRAND JURY 2009-2010

MUNICIPAL INCORPORATION PROCESSES AND THE ALLOCATION OF COSTS

Case No. GJ-09-035

REASON FOR REPORT

Municipal incorporation in California is an expensive and time-consuming process. Even before a local community in California or, in particular, El Dorado County gets the opportunity to vote on becoming a city or municipal corporation; it has to complete a lengthy and costly process.

The Grand Jury investigated how the power to allocate the cost of incorporation has been exercised in El Dorado County.

BACKGROUND

In 2004-2005 El Dorado Hills, with over twenty percent of the total county population, attempted to incorporate as a city. Had the effort been successful, it would have become the third community in El Dorado County to become a city.

The incorporation effort was contentious and controversial. The local incorporation committee was charged substantial fees even prior to the campaign for the ballot measure. A lawsuit was initiated to clarify the incorporation process and lay down milestones. The campaign was clouded by accusations of varying credibility.

Cities obtain and exercise local authority over at least three key services: law enforcement, planning, and public works (streets and roads). Communities that are not cities are described as unincorporated. Public services are provided by the county government in unincorporated areas. Various special districts may also provide governmental services within both incorporated and unincorporated communities.

New cities capture and retain more revenues in the local community than do unincorporated areas. Cities are funded through sales tax, a share of property tax, vehicle license fees, and other revenue sources.

Local communities become cities for a variety of reasons. Key rationales for incorporation often include:

- Local control over the provision of basic governmental services;
- Keeping locally generated tax dollars closer to home;
- More accountability and greater responsiveness of local government officials more familiar with the community;
- Convenience for local residents in dealing with and engaging in governmental processes;
- Fostering greater civic identity, visibility, and representation with regional governmental and quasi-governmental entities; and
- To better identify, protect, and promote the interests of the community.

It is invariably the belief that the community will be enhanced and the lives of its residents improved that motivates a successful drive for city hood.

There is an extended process requirement for municipal incorporations in California. The three most significant events in the process are the required Comprehensive Financial Analysis (or Financial Feasibility Study) to determine whether a new city is financially viable; a California Environmental Quality Act (CEQA) study and report to determine whether there are significant adverse environmental impacts caused by a new city (such a determination is inherently speculative); and ultimately whether the whole incorporation issue qualifies or meets the threshold requirements for the ballot and a vote of all the registered voters within the proposed boundaries of the new city.

A group of local citizens typically spearheads an effort to become a city. While some efforts may be well financed and enjoy the support of local businesses and/or civic associations, prominent individuals or groups, others may consist of a small group of relatively inexperienced volunteers with meager financial resources. At the same time, local incorporation drives have to run through a gauntlet of costs for consultants, legal counsel, required studies, application fees and deposits, petition drives, advertising and promotion efforts. These costs can easily overwhelm a local incorporation effort. Most incorporation efforts fail due to insufficient planning, volunteers, inadequate campaigns, and ultimately a lack of funds. There is little opportunity to control necessary expenditures. The cost of meeting all the requirements of an incorporation process can easily deplete financial resources, even before incurring the substantial costs of a campaign on a ballot measure.

While the demand for county governments to provide services is lessened by a new city takeover, revenues to the county are also lessened. "Revenue neutrality" requirements have been implemented in California in recent years requiring a new city to negotiate an agreement, assuring that an acceptable level of revenue still flows from the new city to the county government over an extended period of time (typically 15 to 25 years). In this way, there is no significant fiscal impact for the county as a result of a municipal incorporation. While such agreements shield the county government from adverse fiscal

consequences caused by a new city, they correspondingly decrease the fiscal advantages of becoming a city.

Local Agency Formation Commissions (LAFCO) essentially oversee or govern the incorporation process through which a community becomes a city. Over recent years it has become more difficult for any local community to incorporate. Laws have been changed making the process more expensive, time-consuming, and difficult. Therefore the creation of new cities has considerably slowed.

LAFCO exists in every county of California. LAFCO in El Dorado County, a powerful but little known agency, is authorized by the State of California to determine if any local community within the county will ever be able to actually vote on incorporating or becoming a city. This enormous power is exercised in a variety of ways. One of the key levers of power is a LAFCO decision about how required costs of incorporation are to be shared among the major stakeholders within the county. LAFCO can literally make or break any local community effort to achieve a greater degree of local control over functions like law enforcement, planning, and public works within their new city. It can do so by allocating the significant costs incurred during an incorporation process. This can be done in a balanced manner among all stakeholders, or by assessing a disproportionate share of all such costs to the community group seeking to incorporate.

Local Agency Formation Commissions are independent and not a part of county government. Each commissioner is independent when weighing and reviewing information and when making determinations (Attorney General Opinion 98.802). The mission of the El Dorado County LAFCO is to act by implementing the Cortese-Knox-Hertzberg Act (California Government Code [CGC] §56001 and §56381).

El Dorado County LAFCO is a seven member body comprised of two commissioners from cities within the County, two members of the County Board of Supervisors, two special district members, and one public member.

LAFCO coordinates logical and timely changes in local governmental boundaries (CGC §56001); conducts special studies which review ways to reorganize, simplify and streamline governmental structures (CGC §56031); and prepares spheres of influence for each city and special district within the County (CGC §56425). The Commission promotes the provision of efficient and economical services while encouraging protection of agricultural and open space lands (CGC §56001 and §56300). Further efforts include discouraging urban sprawl and encouraging orderly formation and development of local agencies based upon local conditions and circumstances (CGC §56301).

METHODOLOGY

The key focus of this investigation was how costs for municipal incorporations in El Dorado County are allocated and why. In an effort to better understand the entire incorporation process, various parties were interviewed and documentation referenced.

Interviews included:

- Executive Officer, El Dorado County LAFCO
- Institute of Governmental Affairs, UC Davis, public policy specialist and faculty member
- Member, El Dorado County Board of Supervisors, District One
- President, PMC, Rancho Cordova, CA; a municipal services consulting corporation
- Principals of the El Dorado Hills Incorporation Committee

Documentation included:

- California Department of Finance Population Estimates, 2009;
- California Government Code §§57375-57385 dealing with municipal incorporations;
- California Government Code §§56650-56668.5 dealing with petitions before LAFCO for change in organization or reorganization;
- El Dorado LAFCO Policies and Guidelines, adopted November 7, 1988 and last revised July 22, 2009;
- Impartial Analysis of Measure P El Dorado Hills Incorporation Ballot from Local Agency Formation Commission (LAFCO), November 8, 2005 election;
- Local Agency Formation Commission staff, Sacramento County, email communications March 4-11, 2010.

FINDINGS

The population of El Dorado County grew from 123,900 in 1990 to 156,300 in 2000. That was an increase of over 20 percent in ten years. El Dorado County had an estimated population in 2010 of over 180,000. Various population projections estimate the County population will exceed 218,000 by 2015.

The County has only two cities, South Lake Tahoe and Placerville. Placerville, which as of the 2000 Census had a population of 9,610, became a city in 1854 and became the county seat in 1857. As of the 2000 Census, South Lake Tahoe had a population of 23,609, and became a city in 1965. The County had only one city for over 155 years, and has had just two cities over the last 45 years.

There are various population centers in El Dorado County beyond the cities of Placerville and South Lake Tahoe, and the community of El Dorado Hills. The Cameron Park/Shingle Springs area is estimated to have a population approaching 20,000. The Georgetown Divide (412 square miles) had an estimated population of approximately 13,400 as of the 2000 Census. The Pollock Pines community population is estimated at approximately 5,000.

There are communities in El Dorado County of a reasonable size and population currently governed by a Community Services District (CSD). A CSD is the closest form of government to a municipal corporation. A CSD is less powerful than a municipal corporation because it provides a relatively limited range of services and has fewer revenue sources. The larger communities of El Dorado Hills and Cameron Park have a local CSD.

Two of the most recently incorporated cities in Northern California are in adjoining Sacramento County. The City of Elk Grove, incorporated in 2000, is the second largest city in Sacramento County with a population of over 136,000. Rancho Cordova more recently became a city in 2003, and has an estimated population of approximately 60,000.

Within the past thirteen years, neighboring Sacramento County experienced three successful incorporations: Citrus Heights, Elk Grove, and Rancho Cordova. As of this writing, an incorporation effort for Arden Arcade is in process.

A closer look at how costs of incorporation were shared in these incorporations clearly demonstrates that there are various approaches that can work based on defensible rationales. The following recent and nearby examples are from County of Sacramento LAFCO staff:

- The Citrus Heights incorporation was litigated to require that LAFCO had to prepare the Environmental Impact Report (EIR). The settlement agreement for this litigation resulted in a split of costs for the EIR between LAFCO and the incorporation committee. LAFCO prepared the required Financial Feasibility Study using their staff. The incorporation proponents were not required to reimburse LAFCO for its staff time or legal counsel.
- The Elk Grove incorporation process differed, in that LAFCO paid for the Financial Feasibility Study while incorporation proponents were required to pay for the EIR. LAFCO was not reimbursed for its staff time or legal counsel.
- The Rancho Cordova incorporation represented yet another method of cost sharing. LAFCO paid for the Financial Feasibility Study. City hood proponents were required to pay for the EIR. LAFCO was not reimbursed for its staff time or legal counsel.
- Finally, with the current Arden Arcade incorporation effort, LAFCO has agreed to contribute \$100,000 toward the Financial Feasibility Study, EIR, and other related costs. In this instance, incorporation proponents are being required to pay for LAFCO staff time and legal counsel. However, LAFCO agreed to waive reimbursements for staff time in the event that the incorporation effort was successful. If a City

of Arden Arcade results, the new city will reimburse LAFCO for staff time.

El Dorado County LAFCO has taken the position it is appropriate to require that virtually all local incorporation costs be borne by the local incorporation committee. It charges for all staff time and consultants involved or devoted to the incorporation effort.

The local incorporation committee for the most recent attempt at city hood for El Dorado Hills was assessed costs by LAFCO during the period 2003-2005 that exceeded \$440,000. This represented all but incidental costs associated with the potential impacts of incorporation, even before it was permitted to come to a vote.

There are significant arguments against the assumption that the cost of any staff time devoted to a local incorporation effort should solely be incurred at the expense of a local incorporation committee. LAFCO staff would continue to incur costs even if there was no incorporation effort. In this respect, such costs can be viewed, at least to a certain degree, as a cost of simply being operational.

There is also the concept of “displacement costs” which argues that LAFCO staff time spent on an incorporation effort could not be devoted to all other responsibilities of a LAFCO.

Required studies accrue to the benefit of more than just a local incorporation group. This type of work constitutes “the meat and potatoes” of why a LAFCO exists in the first place. There would seem to be more at work here, a wider scope of benefit and service, than just working for the benefit of a small group of would-be local incorporators.

While the potentially substantial costs of incorporation are certainly instigated by a local community’s application and petition to incorporate, there are many relevant factors to consider when undertaking a competent review or analysis of such an effort. California Government Code §56668 requires various factors to be considered by LAFCO. These factors include such issues as:

- Population and population density; land area and land use; per capita assessed valuation; proximity to other populated areas; the likelihood of significant growth in the area, and in adjacent incorporated and unincorporated areas, during the next 10 years.
- The need for organized community services; the present cost and adequacy of governmental services and controls in the area; probable future needs for those services and controls; probable effect of the proposed incorporation, formation, annexation, or exclusion and of alternative courses of action on the cost and adequacy of services and controls in the area and adjacent areas.

- The conformity of both the proposal and its anticipated effects with both the adopted commission policies on providing planned, orderly, efficient patterns of urban development, and the policies and priorities in Government Code §56377 (which concerns guiding development away from prime agricultural lands).
- The ability of the newly formed or receiving entity to provide the services which are the subject of the application to the area, including the sufficiency of revenues for those services following the proposed boundary change.

The competent study of substantial factors required to be assessed accrues to the benefit of many other agencies of government rather than just those that may be part of a newly incorporated city. Important determinations, professionally researched and investigated, inform not just a local community group wishing to incorporate, but all affected agencies. These studies provide useful information about financial impacts and how the distribution of services may be affected. This argues for a more balanced and equitable allocation of cost burdens associated with incorporation efforts.

RECOMMENDATIONS

1. It is recommended that LAFCO reconsider its present governing philosophy and policy regarding cost sharing among the major stakeholders in an incorporation process. A more balanced approach is recommended that recognizes required studies benefit many groups and governmental entities and are not the exclusive domain of local incorporation groups.
2. LAFCO, especially in light of revenue neutrality requirements in State law, should consider the possibility of greater retroactive cost sharing in the event that required studies demonstrate that a local community would indeed be financially feasible or succeed in incorporating.

RESPONSES

Responses to findings and numbered recommendations in this report are required in accordance with California Penal Code §933 and §933.05. Responses should be addressed to: The Honorable Suzanne N. Kingsbury, Presiding Judge of the El Dorado County Superior Court, 1354 Johnson Blvd., South Lake Tahoe, CA 96150.