

---

# How The Deck Is Stacked Against Citizens Wanting To Self-Govern



*by Roberta MacGlashan*

**On January 1, 1997, Citrus Heights became California's newest city, marking the culmination of a 12-year incorporation struggle that became legendary among the state's local agency formation commissions (LAFCOs). But this is not just the story of Citrus Heights. It is the story of obstacles that citizens must overcome to achieve the goal of local self-government: Along the way, changes in the incorporation process took place that affect the way new cities are formed and must function in California today.**

In many counties, new city incorporations are noncontroversial. Some counties actually pay to make them happen, as Nevada County did for the City of Truckee. But Sacramento County has vast urban density suburbs, developed in unincorporated areas and receiving mostly county services. Prior to Citrus Heights, it had been 50 years since a new city incorporated in Sacramento County. With a population of 88,000, Citrus Heights is one of the largest cities ever to incorporate in California, and possibly the largest without a pre-existing community services district or other locally elected governing body.

## Obstacles to Incorporation

Some of the obstacles faced by the Citrus Heights Incorporation Project (CHIP) and the new City of Citrus Heights are unique to Sacramento County and Citrus Heights. But others that evolved over the course of this incorporation process apply to all prospective cities, especially those that face organized opposition, including costs, litigation and revenue neutrality.

### *Costs*

Costs associated with the incorporation process are high. When CHIP submitted the original petitions in 1985, fees were nominal. Worsening county (hence LAFCO) budget pictures and ever-increasing procedural requirements have combined to make the process cost prohibitive. High costs stopped incorporation efforts for towns such as Aptos in Santa Cruz County.

A survey of LAFCOs revealed a wide variety in the type and amount of fees throughout the state. Most LAFCOs bill fiscal impact studies and environmental impact reports (EIRs) at cost plus LAFCO administrative and review fees. It is not unusual for fees to top \$100,000.

CHIP held more than its share of garage sales, scrap metal drives, barbecues and dinner dances to raise funds throughout the years. However, it became necessary to tap organizations and businesses that could make relatively large (\$5,000 to \$25,000+) cash contributions to pay the fees that came due in a relatively short period of time. CHIP negotiated a maximum fee of \$55,000 for "round two" of LAFCO hearings, a formidable sum for a middle-class community. There needs to be an easier way for a serious group of citizens to exercise their right to self-government.

### *Litigation*

If the affected county, which has much deeper pockets than the incorporation group, is interested in stopping the incorporation, litigation can effectively delay the process for years. Even after LAFCO has approved an incorporation, it requires a majority vote of the board of supervisors to set the matter for election. The City of Malibu was held up by the refusal of the Los Angeles County Board of Supervisors to place the matter on the ballot. When the Sacramento County Board of Supervisors refused to set the Citrus Heights incorporation for election in 1987, a CHIP member sued the county to require the board to do so. The county responded by suing LAFCO and CHIP on two issues:

1. *Who should be allowed to vote on the incorporation:* The Cortese-Knox Local Government Reorganization Act provides that only voters within the area proposed for incorporation can vote; the county argued that all voters within the unincorporated area should have the right to vote, aided by a League-coordinated friend-of-the-court briefing effort. The California Supreme Court upheld the existing law. The county appealed to the U.S. Supreme Court, which let the state Supreme Court ruling stand. Had the county's argument prevailed, it would have sounded a death knell for new city formations.
2. *Whether an EIR should be prepared to address the environmental impacts of incorporation:* Even though LAFCOs throughout the state commonly do not require EIRs for incorporations -- because incorporation represents a change in the political body and the provider of local governmental services, not a physical impact on the environment -- the courts ordered preparation of an EIR for the Citrus Heights incorporation.

This litigation lasted six years and cost hundreds of thousands of dollars. The delay and costs could easily have worn the incorporation group into the ground. Counties and other parties who feel threatened by incorporation can devote the time and the taxpayers' money to seemingly endless litigation. Incorporation groups must seek competent pro bono legal counsel and often pay direct expenses such as travel, expert witnesses and filing fees. In the Citrus Heights case, because the county did not prevail on the right to vote issue, the county ultimately had to pay CHIP's attorneys' fees.

Other issues could have been litigated, but were not. A change in the composition of the board of supervisors, and the strong support of the supervisor in whose district the new city was located, led to a negotiated settlement among the parties allowing the incorporation process to proceed.

### *Revenue Neutrality*

As part of its strategy against incorporation, Sacramento County was also successful in getting an amendment to the Cortese-Knox Act through the state legislature in 1992 (SB 1406, now Government Code section 56845). The most insidious provision of this statute, Government Code section 56845(b), is referred to as "revenue neutrality," or the difference between the loss of general revenues to the county and the cost of county services transferred to the new city. It reads:

"... an incorporation should result in a similar exchange of both revenue and responsibility for service delivery among the county, the proposed city, and other subject agencies ... [LAFCO] shall not approve ... an incorporation unless it finds that the following two quantities are substantially equal: (1) Revenues currently received by the local agency transferring the affected territory which, but for the operation of this section, would accrue to the local agency receiving the affected territory. (2) Expenditures currently made by the local agency transferring the affected territory for those services which will be assumed by the local agency receiving the affected territory.

Only two cities have incorporated under this provision: Shasta Lake and Citrus Heights.

Interpretation of revenue neutrality is wide open; no litigation has resolved major points of contention, such as length of payment period and what types of funds should be included in the calculation. In the City of Shasta Lake, Shasta County LAFCO required "mitigation" payments from the city to the county for a period of 10 years, with the amount of the payment to be reduced each year. In a recent article in the CALAFCO *Sphere*, Paul Hahn of Sacramento LAFCO argues that changes in the law "... to address issues such as the length of the mitigation payment, indirect costs, how payments might be adjusted etc., would go a long way toward reasonable implementation of incorporation law., the long-range impacts of Citrus Heights' incorporation on other would-be cities and on LAFCOs statewide are yet to be measured."

The method used for calculating the revenue neutrality mitigation payment for Citrus Heights was developed by Sacramento LAFCO when processing the failed Elk Grove incorporation. The original LAFCO staff proposal provided for a payback period of 10 years. Staff was directed to go back to the drawing board by the county supervisors. What emerged and was ultimately approved for Citrus Heights was a 25-year payback period with annual payments of \$5.6 million increasing each year tied to an index based on the consumer price index for the San Francisco Bay Area. This method gives the new city no credit for capital assets, which were funded in part by Citrus Heights taxpayers.

Beyond these procedural questions, there is the overarching issue of equity. Of California's 471 cities, 469 were incorporated without this requirement. Counties may argue that new cities take away revenue sources while still using county services such as administration, county jails, courts, health and welfare. Yet the four other cities in Sacramento County receive the same county services but do not face this financial obligation to the county. This equivalent of an adjustable mortgage robs the residents of the ability to finance desired *new* or *enhanced* services for a quarter century.

The conclusion of the fiscal impact analysis that cost savings to the county from reduced services provided to Citrus Heights are less than the tax revenues lost illustrates two points: that the county either does not have the ability or the will to make the necessary budget cuts to account for the reduced level of service, and that tax revenues from Citrus Heights have routinely been redistributed to serve other areas of the county. Both are powerful arguments for self-government.

The real fault for structural financial problems that incorporations may cause counties lies with the way local government is financed. Develop a logical formula for funding local government and education, stop shifting local Government's share of property taxes to support the state budget, reduce or drop unfunded state mandates on local government, and "revenue neutrality" need no longer be an issue with counties.

Citrus Heights recently marked assumption of full responsibility for service delivery in a celebration that coincided with the Independence Day holiday. While a six-month startup period was ambitious, citizens and city staff demonstrate that it can be done. With the deck stacked heavily against incorporation, forming a new city today is not impossible, but remains a formidable challenge.

*Roberta MacGlashan is vice mayor of the City of Citrus Heights, past president of the Citrus Heights Incorporation Project, and a principal planner with QUAD Consultants. She is also a former LAFCO executive officer.*

==== sidebar =====

## **Revenue Neutrality -- Cortese-Knox Act Modifications Create Future Liability for the State**

*by Michael Oliver*

The Cortese-Knox Local Government Reorganization Act of 1985 establishes procedures for changes in local government organization, including city incorporation. Cortese-Knox was amended by the state legislature in 1992 to include the "revenue neutrality" statute (Government Code 56845), which dramatically shifted the economics of incorporations to favor counties.

The statute was not the result of careful study nor were cities a part of the adoption process; instead, revenue neutrality is largely a creation of county lobbyists and a willing state government. Revenue neutrality became law in 1992, immediately after the state legislature -began approving property tax shifts that reduced funds received by counties. As part of a relief package for counties, the legislature took several steps to help compensate counties for that significant tax shift. These new powers included allowing counties to:

- Institute utility user taxes;
- Impose business license taxes; and
- Retain, on certain conditions, any historic financial surplus from the territory within the boundaries of a newly incorporated city (i.e., revenue neutrality).

The revenue neutrality statute states that LAFCO:

" ... shall not approve a proposal that includes an incorporation, unless it finds that the following two quantities are substantially equal:

1. Revenues currently received by the local agency transferring the affected territory which, but for the operation of this section would accrue to the local agency receiving the affected territory.
2. Expenditures currently made by the local agency transferring the affected territory for those services which will be assumed by the local agency receiving the affected territory.

Notwithstanding [the above], [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.
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.

The statute expands county control over incorporations beyond the already existing powers held by LAFCO to administer annexations. Counties increasingly use control of annexations as long-term fund-raising mechanisms. These revenues end up coming from property that ultimately falls outside county control and service responsibility.

### **Mandated LAFCO Fiscal Analysis**

The revenue neutrality provisions of the Cortese-Knox Act require LAFCO officers and commissioners to fulfill conflicting roles. The beneficiary of a fiscal analysis is rarely asked to determine the amount of the benefit it deserves. Prior to revenue neutrality, LAFCO was required to make a finding of financial viability before it approved incorporations. After revenue neutrality, LAFCO's fiscal role has been significantly expanded to include determining city revenues far into the future.

The Cortese-Knox Act requires county staff to create a budget for the new city, project revenues and expenditures and establish baseline service levels *without* the benefit of city fiscal experience or objective outside professional expertise. An example is the recent Citrus Heights incorporation in which the LAFCO staff made no provision for a capital improvement program for the city. No funds were allocated for facilities, city hall, vehicles, furniture, desks, equipment, etc, but the city was found to have approximately \$5.6 million excess annual revenue, which was due the county. The county's need for revenue was inherently embedded in the LAFCO financial analysis.

### **Ambiguity of Revenue Neutrality Language**

Because the revenue neutrality statute is unclear as to how LAFCO must make the financial calculations, cities will be constantly seeking to fiscalize land use, obtain funding from the state and develop new revenue sources. The revenue neutrality payment expected by Sacramento County from Citrus Heights represents more than 30 percent of the city's general purpose general fund revenue.

Imagine growing cities throughout the state allocating 30 percent of their revenue to counties for an undetermined period. Not only does the Citrus Heights' revenue neutrality payment extend for 25 years; it also has an embedded growth rate that compounds by the consumer price index and the population growth rate for the county. In year 25 the city would have an estimated annual revenue neutrality payment to the county of more than \$12,500,000.

### **What is Needed from the State**

The revenue neutrality provisions of Cortese-Knox should be changed. The Cortese-Knox Act's revenue neutrality provisions are fundamentally at odds with California's constitutional system of government. The state constitution recognizes citizens' right to organize into cities and achieve local self-government. Revenue neutrality is another example of the state's effort to shift its financial obligations and problems to cities. Like full reversal of the property tax shift, the revenue neutrality provisions of Cortese-Knox are bad policy that the legislature would be wise to reconsider.

*Michael Oliver is interim city manager for the City of Citrus Heights*

==== end of sidebar ====

## **DOs OF INCORPORATION**

- Form a nonprofit corporation.
- Recruit experts into your incorporation group (financial, legal, political and fund raising).
- Cultivate relationships with potential allies (for example, sympathetic politicians, LAFCO staff, Chamber of Commerce, other incorporation groups and community groups).
- Work with local media to keep your story in front of the public.
- Keep the community informed and involved and your group members active.
- Give your incorporation group leader authority to make necessary on-the-spot decisions.
- Retain the best pro bono attorney you can find (someone who will impress people).
- Identify sources of financial support (who will benefit from incorporation?)
- Raise funds constantly (you will need them).
- Negotiate and compromise when necessary.
- Be prepared to decide on city boundaries, form of municipal government (for example, council/manager strong mayor), name of your city, election of council members by district or at large, and time frame for taking full control of services.
- Place the incorporation measure and city council elections on the same ballot (but keep the campaigns separate). City council candidates will be campaigning for the Incorporation as well as for themselves, and the public will know who their choices are for a city council.
- Use a professional campaign consultant.
- Be prepared for last-minute negative campaign tactics.

## **DON'Ts OF INCORPORATION**

- Underestimate your adversaries.
- Forget that you need a majority vote of the board of supervisors to set the matter for election.
- Include areas in your boundaries that don't want to be included.
- Compromise too easily.
- Negotiate in the press.
- Let unacceptable terms "slip into" the incorporation resolution.
- Let anything slip by, such as expert testimony or new state legislation, without responding.
- Share confidential information injudiciously.
- Mortgage your house to raise funds.
- Give up!

This article was scanned and OCR'd from a mixed quality photocopy from the September 1997 Western City magazine. Some OCR errors may not have been caught.

(c) 2007 Western City magazine. All rights reserved. Reprinted with permission from the September 1997 issue of Western City magazine, the monthly publication of the League of California Cities.

For more information, visit [www.westerncity.com](http://www.westerncity.com).