

**SPECIAL REORGANIZATION OF THE HOLLYWOOD AREA**  
**EXECUTIVE OFFICER'S REPORT ON REQUESTS FOR RECONSIDERATION**

TO THE

LOCAL AGENCY FORMATION COMMISSION  
FOR LOS ANGELES COUNTY

July 19, 2002

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## TABLE OF CONTENTS

EXECUTIVE OFFICER'S RECOMMENDATION .....	1
Recommendation: .....	1
INTRODUCTION .....	2
REQUESTS RELATED TO APPROVAL OF THE SPECIAL REORGANIZATION .....	4
First Request: Finding on Fiscal Viability .....	4
Second Request: Fiscal Impact on the City of Los Angeles.....	9
Third Request: Approval of the Hollywood Special Reorganization.....	21
REQUESTS SEEKING MODIFICATIONS TO THE RESOLUTION.....	23
Fourth Request: Regulation of Utility Service Rates.....	23
Fifth Request: Proposition K .....	24
Sixth Request: Severability.....	25
Seventh Request: At-Large City Council Members.....	26

## ***EXECUTIVE OFFICER'S RECOMMENDATION***

The City of Los Angeles has requested that the Commission disapprove the Hollywood Special Reorganization and has proposed seven specific modifications to the Resolution.

Each of the City's proposed changes is discussed in this report. Based on the reasons stated in this report, it is the Executive Officer's recommendation that the Commission reject, in its entirety, the City's Request for Reconsideration.

### **Recommendation:**

The Executive Officer recommends that the Commission:

- 1) disapprove, for the reasons stated in the Report and based on the testimony and information provided to the Commission during these hearings, the Request by the City of Los Angeles for Reconsideration of and Amendments to the Resolution Making Determinations for Approval of the Hollywood Special Reorganization; and
- 2) conduct the protest hearing in accordance with Government Code section 57000, *et seq.*

## **INTRODUCTION**

### **Purpose**

Pursuant to the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (the “Hertzberg Act”) a local agency formation commission is required to consider written requests for reconsideration of a resolution making determinations that set forth the specific modification to the resolution being requested and what new or different facts that could not have been presented previously, or applicable new law, are claimed to warrant the reconsideration.<sup>1</sup> All such requests must be filed within thirty (30) days of the adoption of the resolution.<sup>2</sup> The Local Agency Formation Commission for Los Angeles County (the “Commission”) has received a timely written request from the City of Los Angeles for reconsideration of the Resolution Making Determinations for Approval of the Hollywood Special Reorganization (the “Resolution”).<sup>3</sup> The Commission has not received any other requests complying with Government Code section 56895 or the Guidelines adopted by the Commission for the filing of requests for reconsideration.<sup>4</sup> The objective of this report is to provide the Commission with its Executive Officer’s analysis and recommendations regarding the written requests by the City of Los Angeles for reconsideration of the Resolution.

### **Context**

The Commission staff released its report making recommendations on the Hollywood Special Reorganization (the “Hollywood Special Reorganization”) terms and conditions on March 25, 2002. The Executive Officer released his report making recommendations on the Hollywood Special Reorganization on May 28, 2002. On May 31, 2002, the Executive Officer released his supplemental report with fiscal allocations for the alternative boundary scenarios, and on June 3, 2002, the Executive Officer released his supplemental report on the combined effects of the San Fernando Valley and Hollywood special reorganizations.<sup>5</sup> Between May 31, 2002 and June 4, the City of Los Angeles responded to the Executive Officer’s Report<sup>6</sup> and submitted proposed modifications to the Resolution.<sup>7</sup> The Commission adopted the Resolution on June 5, 2002, approving the Hollywood Special Reorganization.

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<sup>1</sup> Government Code section 56895.

<sup>2</sup> Government Code section 56895.

<sup>3</sup> Frederick N. Merkin, City of Los Angeles Office of the City Attorney, *Request for Reconsideration of and Amendments to the Resolution Making Determinations for the Proposed Secession of Hollywood*, dated July 5, 2002, submitted with the required fee of \$4,000.

<sup>4</sup> The Commission received a request for reconsideration dated July 5, 2002 from J.H. McQuiston, Planning Representative for the East Hollywood Community Association. This request does not comply with the reconsideration guidelines in that it lacks a specific proposed modification to the resolution and in that it was not accompanied by the reconsideration processing fee.

<sup>5</sup> Larry J. Calemine, Executive Officer, *Special Reorganization of the San Fernando Valley and Hollywood: Combined Effects. Executive Officer’s Supplemental Report*, June 3, 2002.

<sup>6</sup> Merkin, Frederick N. *Certain Legal Issues Raised by the Proposed Resolution Making Determinations Now Before LAFCO for the Secession (Special Reorganization) of Hollywood*. City of Los Angeles: Office of the City Attorney, dated May 31, 2002. City of Los Angeles Office of the City Administrative Officer. *Draft Resolution of Determination and LAFCO Executive Officer Report regarding Hollywood Special Reorganization*, dated May 28, 2002. City of Los Angeles Office of the City Administrative Officer. *Los Angeles County LAFCO Hollywood Proposal for Special Reorganization; Executive Officer’s Report dated May 29, 2002 [sic]*, dated May 31, 2002. Hamilton, Rabinovitz & Alschuler, Inc. *Revenue Neutrality Issues Related to the Proposed Hollywood Secession*, dated May 31, 2002.

<sup>7</sup> Frederick N. Merkin, City of Los Angeles Office of the City Attorney, *The Proposal for the Secession of Hollywood: Legal Issues Raised by the Draft Resolution Making Determinations*, dated June 4, 2002.

On July 5, 2002, the City of Los Angeles filed a request for reconsideration with the Commission, requesting that the Commission modify its findings regarding the fiscal viability of the proposed new city, the impact of the special reorganization on the City of Los Angeles, and the adequacy of the mitigation payment. The City contends that the Commission should have disapproved the Hollywood Special Reorganization because it would have a \$73 million negative fiscal effect on the City of Los Angeles and would not be fiscally viable. In the alternative, the City requested modifications to certain terms and conditions in the Resolution, should the Commission not disapprove the special reorganization.

**Caveats**

This Report provides analysis and recommendations on the items that the City of Los Angeles has requested that the Commission reconsider with respect to the Hollywood Special Reorganization. The decision whether or not to modify the Resolution rests entirely with the Commission. This Report is not a substitute for those discretionary decisions yet to be made by the Commission.

This Report and the recommendations herein are subject to revision and reconsideration as may be directed by the Commission during the course of its deliberations.

## **REQUESTS RELATED TO APPROVAL OF THE SPECIAL REORGANIZATION**

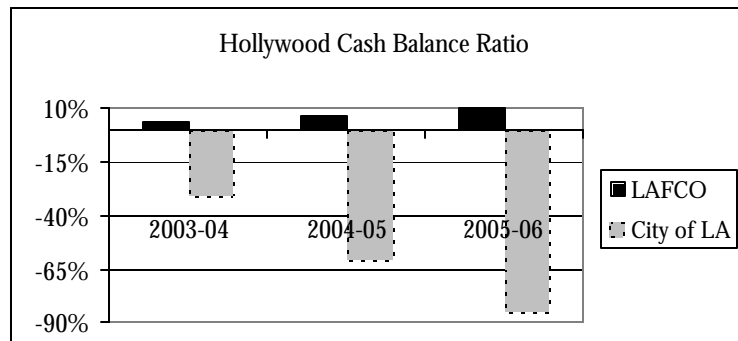
### **FIRST REQUEST: FINDING ON FISCAL VIABILITY**

The City of Los Angeles has requested that the Commission reconsider its finding that the proposed new city is expected to generate sufficient revenue to provide public services, facilities and a reasonable reserve during the three fiscal years following incorporation.<sup>8</sup> The City has raised three factual bases for reconsideration: (1) utilizing the City's estimate of the fiscal mitigation payment would render the proposed city financially insolvent, (2) the City had previously expressed concerns about the adequacy of LAFCO's fiscal analysis, and (3) the City lacked backup data on LAFCO's fiscal allocations.

### **Fiscal Mitigation**

Since the Commission adopted its Resolution, the City of Los Angeles has released a report finding that the Hollywood Special Reorganization would have a \$73 million negative fiscal effect on the City of Los Angeles.<sup>9</sup> If the new city were required to make the fiscal mitigation payment proposed by the City of Los Angeles, the new city would have a \$130 million budget deficit at the end of its third year. Such a deficit would constitute 85 percent of the proposed city's general fund revenues.

By comparison, the Executive Officer found that the special reorganization would have a \$21 million negative fiscal effect on the City of Los Angeles. After making an appropriate fiscal mitigation payment to the City of Los Angeles, the new city would have a budget surplus of \$2.2 million. By the end of its third fiscal year, the new city's cash balance would be ten percent of general fund revenues.



If the Commission were to adopt the City's proposed fiscal mitigation payment, the proposed city would not be financially self-sufficient as

defined in the Government Code. As discussed in the next section of this Report on the fiscal mitigation payment, the Executive Officer recommends that the Commission deny the City's request to increase the fiscal mitigation payment from \$21 million to \$73 million. Thus, the fiscal mitigation payment would remain the same as contemplated in the Resolution adopted by the Commission, and there would be no effect on the expected financial viability of the proposed city.

### **Adequacy of Fiscal Analysis**

Another factual foundation raised by the City for reconsideration of the fiscal viability finding references a series of documents submitted by the City prior to adoption of the Resolution. Most of those documents had been submitted by the City of Los Angeles in advance of the completion of the Executive Officer's fiscal analysis and adoption of the Resolution. The only document included in this list which was submitted after the Executive Officer released his supplemental report with

<sup>8</sup> Finding B(2) of the Resolution.

<sup>9</sup> Hamilton, Rabinovitz & Alschuler, Inc., *The Division of Service Cost Burdens Following Separation of the Hollywood Area from the City of Los Angeles: An Independent Appraisal*, Report to the City of Los Angeles, July 3, 2002.

final fiscal allocations for the various boundary alternatives<sup>10</sup> was a June 5, 2002 letter from the City Administrative Officer regarding the Hollywood and Highland development.<sup>11</sup>

The June 5, 2002 letter from the City Administrative Officer discussed the allocation of revenue and debt related to the parking facility at the Hollywood and Highland development, as well as the revenue and debt related to the theater facility at that development. The Executive Officer notes that LAFCO staff and City staff had been verbally discussing this facility for several weeks prior to adoption of the Resolution. Given the complexity of the Hollywood & Highland development financial arrangements, the City was not prepared to issue a specific proposal until June 5, 2002. At the June 5, 2002 Commission meeting, the City presented proposed modifications to the Hollywood Resolution related to this facility. The Commission revised the Hollywood Resolution to accommodate the City's concerns about this development prior to adoption of the Resolution.

### **Procedural Issues**

As part of its request for reconsideration of the fiscal viability finding, the City has alleged that LAFCO has denied "backup data" to the City preventing the City from verifying the Executive Officer's fiscal allocations. More specifically, the City alleges that it was prevented from expressing confidence in the fiscal analysis because the Executive Officer switched the financial basis of the fiscal allocations from the projected fiscal year 2000-01 budget to the actual financial data for that fiscal year in a report released one week prior to adoption of the Resolution. Further, the City alleges that uncertainty regarding the final geographic boundaries of the Hollywood Special Reorganization Area hampered its ability to verify LAFCO's fiscal analysis. Additionally, the City alleges that the Commission's adoption of the City of Los Angeles proposal to limit the transition period to twelve months constitutes abandonment of the conceptual model used in the CFA, and that there was no State Controller review of the Executive Officer's final fiscal allocations.

#### *City Requests for Backup Data*

The City has repeatedly alleged that its requests for "backup data" have been denied. Staff is aware of only three City requests for backup data. The first request did not relate to the Executive Officer's allocations or to Hollywood. The second request was vague. The third request was made after adoption of the Resolution, and LAFCO has responded to that request.

Shortly after the release of the Comprehensive Fiscal Analysis for the San Fernando Valley Special Reorganization ("CFA"), Mayor Hahn's Chief of Staff requested supporting data for the cost allocations in the San Fernando Valley and Harbor CFAs.<sup>12</sup> The cost allocation information requested by the City was included in the CFA in the form of detailed tables enumerating the cost allocations for each of the City's departments and budget categories, text describing the methodology used to allocate direct and indirect costs, as well as text and appendix tables providing the detailed cost allocations for special purpose funds and the Capital Finance Administration Fund at a similar level of detail as is listed in the City's budget. LAFCO's consultant provided the City with electronic copies of the cost allocation tables in the CFAs. Further, the State Controller reviewed the CFAs on behalf of the City, and had access to all CFA work product germane to the

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<sup>10</sup> Larry J. Calemine, Executive Officer, *Special Reorganization of Hollywood Executive Officer's Supplemental Report*, May 31, 2002.

<sup>11</sup> William T. Fujioka, City of Los Angeles Office of the City Administrative Officer, *Hollywood Secession—Impact on City-Financed Project Components of Hollywood & Highland Development*, dated June 5, 2002.

<sup>12</sup> Letter from Timothy B. McOsker to LAFCO Executive Officer Larry Calemine, dated January 16, 2002.

review.<sup>13</sup> The City did not provide any additional specificity on the nature of the backup data requested or any explanation as to why the CFA tables were inadequate for the City's review of the CFA.

In a letter from the City Administrative Officer dated May 31, 2002, the City indicated that LAFCO "should show us their detailed working papers and the linkage they found to the savings the City can realize."<sup>14</sup> The Executive Officer considered this request both general and vague, and did not consider this request to be specific as to the nature of back-up data desired by the City.

Three weeks after the Commission adopted the Resolution, the City of Los Angeles requested the CFA and Executive Officer's employee and debt allocation tables for both the Valley and Hollywood Special Reorganizations.<sup>15</sup> On June 26, 2002, the Executive Officer provided employee allocation tables to the City of Los Angeles for each division in each department at the same level of detail as had been presented in the CFA, and consolidated the information on debt allocation into a single table for the City. Public Financial Management is preparing tables in response to the City's request for employee allocations at the civil service job title level of detail, and anticipates completing that response by July 19, 2002.

The Executive Officer notes that the City did not inform LAFCO as to the specific nature of additional detail that the City desired in the Executive Officer's fiscal allocation tables. The City had verbally requested backup data in a generic fashion without any specificity, and the Executive Officer responded to this generic request by including detailed cost allocation tables in his reports. Once the City requested additional detail on the employee allocations, the Executive Officer provided that data to the City.

The Executive Officer concludes that the City had access to all backup data for the CFA through the State Controller's review of the CFA, and that the City failed to specify the nature of backup data for the Executive Officer's fiscal allocations prior to adoption of the Resolution. The City has not challenged any of the Executive Officer's fiscal allocations.

#### *Uncertainty regarding Geographic Boundaries*

The City alleges that its ability to verify the Executive Officer's fiscal allocations was hampered by the state of flux of the Hollywood geographic boundaries.

On January 23, 2002, the Commission adopted a motion for staff to analyze two Hollywood boundary scenarios that differed from the proposed boundaries. The Hollywood CFA released on March 6, 2002 clearly identified one of those boundary scenarios (SC3) as the boundaries recommended by LAFCO.<sup>16</sup> At the April 10, 2002 Commission meeting, LAFCO staff released various minor boundary changes under consideration including all but one of the boundary adjustments that were eventually adopted,<sup>17</sup> and LAFCO staff was directed to analyze those

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<sup>13</sup> California State Controller, *California State Controller's Review of the Proposed Hollywood Special Reorganization Comprehensive Fiscal Analysis*, May 9, 2002.

<sup>14</sup> William T. Fujioka, City of Los Angeles Office of the City Administrative Officer, *Secession Proposal—Hollywood Revenue Neutrality*, dated May 31, 2002.

<sup>15</sup> E-mail correspondence from Ellen Sandt to LAFCO Special Reorganization Project Coordinator Beverly Burr, entitled "Request for Backup Information on Secession," June 14, 2002.

<sup>16</sup> Public Financial Management, Inc. *Hollywood Proposal for Special Reorganization Comprehensive Fiscal Analysis*, March 6, 2002, page 14.

<sup>17</sup> Local Agency Formation Commission for Los Angeles County. *Hollywood Boundary Adjustment SC4*, dated April 10, 2002. This map identifies all geographic boundary exclusions eventually adopted by the Commission with the exception of the Los Feliz neighborhood discussed above.

boundary adjustments. The only boundary adjustment that had not been discussed well in advance of the Resolution adoption was a small Los Feliz neighborhood with an estimated population of 634. The Los Feliz neighborhood boundary adjustment was proposed at the May 29, 2002 Commission meeting by community representatives, and was excluded from the Special Reorganization Area by the Commission when it adopted the Resolution the following week. The Los Feliz boundary adjustment, although unexpected, was relatively inconsequential to the fiscal analysis, given that the neighborhood has an estimated population of only 634 individuals, substantially less than one percent of the estimated population in the Hollywood Special Reorganization Area.

The Executive Officer acknowledges that the geographic boundaries of the Special Reorganization Area were in flux; however, the boundaries identified in March 2002 in the CFA were substantially similar to the final boundaries. There is only a three percent difference in population between the boundary scenario recommended in March 2002 and the final adopted boundaries. All but one of the minor boundary adjustments under consideration were known by the City at least two months prior to adoption of the Resolution.

The Executive Officer concludes that the City had access to the same data on potential geographic boundaries as did the Commission, with the exception of the tiny Los Feliz neighborhood adjustment which both the Commission and the City learned about one week prior to adoption of the Resolution. The Executive Officer concludes that uncertainty over boundaries should not have prevented the City from conducting fiscal analysis prior to adoption of the Resolution.

#### *Financial Basis of Executive Officer's Allocations*

The City has raised complaints about the financial basis change from budget projections to actual data in the Executive Officer's final fiscal allocations. The City of Los Angeles released the actual financial data for the base year in the Mayor's proposed budget for fiscal year 2002-03. The Mayor's budget was released in summary form the day prior to release of the Executive Officer's Report. LAFCO had requested that the City release the detailed actual financial data for the base year prior to finalization of the Executive Officer's Report; both the City of Los Angeles Mayor's office and the City Administrative Officer were aware of this request by no later than April 16, 2002.

The Executive Officer released his original San Fernando Valley report on April 24, 2002 with the fiscal allocations based on the budget data for the base year, because the actual financial data were not yet available and the Executive Officer's Report needed to be released at that time in order to keep all three proposed special reorganization proposals on schedule. In that report, the Executive Officer wrote:

If the numeric basis of the fiscal estimates were adjusted to conform with the actual use of reserves and fund balances in the special reorganization base year, the allocations would likely change significantly. The Executive Officer found that the data needed to adjust the numeric basis will not be available until the Los Angeles Mayor releases his proposed budget later this month, as the proposed budget contains the City's actual revenues and expenditures in the special reorganization financial base year.<sup>18</sup>

Subsequent to the release of the San Fernando Valley Executive Officer's Report, the City provided LAFCO with the Mayor's budget containing the actual financial data for the base year. Further,

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<sup>18</sup> Larry J. Calemine, *Special Reorganization of the San Fernando Valley Executive Officer's Report*, April 24, 2002, page 14.

LAFCO remained in contact with the City requesting clarification and revision of several actual financial items. The City was clearly aware of LAFCO's intention to switch the financial basis from budget projections to more reliable actual data seven weeks prior to adoption of the Resolution. Furthermore, the City of Los Angeles had access to the same financial data as LAFCO, and had access to that data at an earlier point in time than LAFCO.

The substance of the CFA and the Executive Officer's financial allocations were the percentage allocations of each revenue and cost item to the Special Reorganization Area. In the CFA, these percentage allocation factors were multiplied by the projected budget dollar figures for fiscal year 2000-01 because the actual dollar figures had not yet been released by the City. The percentage allocation factors were presented in both the CFA and the Executive Officer's Report. By way of example, the hotel tax revenue attributable to the Special Reorganization Area was 4.86 percent. Simple multiplication of this factor by the budget (actual) projections of hotel tax revenue in the base year yields the new city's allocation in the CFA (and the Executive Officer's Report).

The Executive Officer concludes that the switch from budget projections to actual financial data as the financial basis for the new city's financial allocations was known by the City at least seven weeks prior to the Commission's adoption of the Resolution, and that the City had access to the same financial data. Further, in the month subsequent to adoption of the Resolution, the City has not raised any specific challenges to the Executive Officer's final fiscal allocations or to the underlying actual financial data. This factual foundation is not associated with any specific proposal or critique of the Executive Officer's financial calculations affecting the finding of the proposed city's fiscal viability.

#### *Controller Review*

The City has complained that the Executive Officer's Report and its fiscal allocations should have been subject to State Controller review. The City alleges that the Executive Officer's allocations are based on a governmental model entirely different from that used in the CFA due to the adoption of the City's proposal to shorten the transition period from three years to twelve months. Second, the City asserts that the switch from budgetary to actual data warrants an independent review.

The Executive Officer's fiscal allocations do not constitute abandonment of the conceptual model in the CFA. The CFA assumed that the proposed city would rely on the City of Los Angeles for services on a contractual basis throughout the three-year planning horizon. The Executive Officer's allocations are predicated on the same assumption. Although the Applicant had proposed a three-year transition period during which the City of Los Angeles would be obligated to provide all services to the new city, the City of Los Angeles proposed that the transition period be limited to a twelve-month period. The Executive Officer, the Subcommittee, and the Commission accepted the City's proposal to limit the transition period, based on the City's argument that the transition period would be fraught with conflict due to the lack of a contract between the parties at that time for service. The City expressed concerns in the negotiation sessions with the San Fernando Valley Applicant as to whether the parties would have adequate time to negotiate service contracts during the transition period to cover the years following the transition period. Clearly the City anticipates that it would provide services to the proposed city after the transition period under service contracts. While the City may not be required by the Resolution to provide all services to the proposed city after the transition period, it is reasonable to assume that the new city and the City of Los Angeles will enter into negotiated agreements for the continued provision of most if not all municipal services for the foreseeable future. Thus, both the CFA and the Executive Officer based the

financial calculations on the assumption that the City would be providing services to the new city during the three-year planning horizon.

The switch from budgetary to actual data as the financial basis for the financial calculations does not constitute a substantive change in the financial allocation methodology. The change in the financial basis simply involved data entry of the City's actual financial data for the base year, and simple multiplication of the revenue and cost allocation percentage factors by the appropriate financial data. The accuracy of the underlying data was repeatedly checked by LAFCO's consultants against the data published by the City of Los Angeles. In fact, LAFCO's consultants identified several errors in the City's own data as a result of its own thorough review of the actual financial data, called these errors to the attention of the City, and made appropriate revisions to the actual financial data. LAFCO's consultants remained in contact with the State Controller throughout the process of revising the financial basis of the calculations. Furthermore, LAFCO retained a municipal audit and accounting firm to review the financial allocations in all reports released by the Executive Officer. LAFCO has a high degree of confidence in the accuracy of the change in the financial basis. This change constitutes a data change, rather than a methodological change, and is not sufficiently substantive to warrant reissuance of the CFA.

### **Conclusion**

The Executive Officer concludes that the only factual basis for reconsideration of the fiscal viability finding relates to the fiscal mitigation payment. If the Commission decides to amend the Resolution to increase the fiscal mitigation payment as proposed by the City of Los Angeles, the Commission must also amend its finding on fiscal viability. If the Commission does not amend the Resolution to increase the fiscal mitigation payment, there is no reason to amend the Commission's finding of fiscal viability.

### **Executive Officer's Recommendation**

The Executive Officer recommends in the next section that the Commission deny the City's request for reconsideration of the fiscal mitigation payment. If so, based on the above, the Executive Officer recommends that the Commission deny the City's first request for reconsideration related to the fiscal viability finding.

### **SECOND REQUEST: FISCAL IMPACT ON THE CITY OF LOS ANGELES**

The City of Los Angeles requests that the Commission reconsider its finding that the \$21 million fiscal mitigation payment to be made by the proposed city to the City of Los Angeles adequately mitigates the negative fiscal effect of special reorganization on the City of Los Angeles. Specifically the City of Los Angeles proposes that the Commission find that the negative fiscal effect on the City of Los Angeles is \$73 million. Based upon the City's calculation of the negative fiscal effect, the City proposes that the Commission find that the proposed city would not be financially viable and that the Commission reject the special reorganization proposal.

The City also proposes that the fiscal mitigation payment be made over a twenty-five year term rather than a twenty-year term, and that the Resolution language phasing out the fiscal mitigation payment at a five percent annual rate be removed.

The City presented new information related to this request in the form of a letter from the City of Los Angeles City Administrative Officer and two reports produced by the City's fiscal consultant Hamilton, Rabinovitz and Alschuler, Inc. ("HR&A"). The July 2, 2002 letter from the City of Los Angeles City Administrative Officer raises several new issues regarding service impacts on the

remaining City of Los Angeles following Hollywood Special Reorganization. The first report updates the memo previously released by HR&A on May 31, 2002, by extending the firm's job position-level review of the job positions allegedly required by the City of Los Angeles after special reorganization in order to maintain current service levels in the remaining area of the City of Los Angeles.<sup>19</sup> The second report is a critique of a statement made in the Executive Officer's original report<sup>20</sup> that "both the City of Los Angeles and the proposed Hollywood city would be more likely to deliver services more cheaply than to lose economies of scale by being separated into smaller cities."<sup>21</sup>

## **Background**

In assessing the fiscal impact on the remaining City of Los Angeles, Government Code section 56815 requires the comparison of current revenues that would accrue to the new city and current expenditures for services that the new city would assume. The Code grants the Commission the discretion to determine the fiscal mitigation payment amount that would adequately mitigate the negative fiscal effect on the City of Los Angeles. Although the Commission has the discretion to determine a mitigation payment that adequately mitigates the negative fiscal impact on the City of Los Angeles, the Commission is neither required nor directed by the Government Code to include "stranded costs" in the mitigation payment.

The Government Code Section 56815(b) defines the expenditure component of the revenue neutrality calculation as "expenditures, including direct and indirect expenditures, currently made by the local agency transferring the affected territory for those services that will be assumed by the local agency receiving the affected territory."

In calculating the fiscal mitigation payment, the Executive Officer has followed Government Code section 56815, which focuses on the current expenditures for services that will be assumed by the transferring territory rather than the budget cutbacks that the City of Los Angeles anticipates making after special reorganization. On this issue, the Executive Officer concurs with the State Controller, who found that the City of Los Angeles' "stranded costs" are not relevant to the calculation of the fiscal mitigation payment. The Executive Officer found that current revenues that would accrue to the new city exceed current expenditures that would be assumed by the new city by approximately \$17.9 million. The Executive Officer recommended that the fiscal mitigation payment include an additional \$3.6 million to compensate the City of Los Angeles for its loss of documentary transfer tax revenues generated in the Special Reorganization Area. In accordance with this recommendation, the Commission adopted a \$21.5 million fiscal mitigation payment in the Resolution.

By comparison, the City of Los Angeles has argued that the expenditure component of the fiscal mitigation payment should be based on the savings that the City of Los Angeles would realize if: (a) Hollywood were no longer part of the City, and (b) Hollywood was not relying on the City of Los Angeles for contract service. The City of Los Angeles estimates that the fiscal mitigation payment should be \$73 million.

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<sup>19</sup> Hamilton, Rabinovitz & Alschuler, Inc., *The Division of Service Cost Burdens Following Separation of the Hollywood Area from the City of Los Angeles: Final Report of an Independent Appraisal*, Report to the City of Los Angeles, July 3, 2002.

<sup>20</sup> Larry J. Calemine, *Special Reorganization of Hollywood Executive Officer's Report*, May 28, 2002, p. 23.

<sup>21</sup> Hamilton, Rabinovitz & Alschuler, Inc., *Assessment of the 'Diseconomy of Scale' Argument Advanced by the Executive Officer of the Local Agency Formation Commission*, Report to the City of Los Angeles City Attorney, June 20, 2002.

## **Service Impacts on the City of Los Angeles**

The City of Los Angeles City Administrative Officer submitted a letter dated July 2, 2002 that raises four areas in which Hollywood Special Reorganization might have negative service effects on the remaining City of Los Angeles, which the City alleges was not considered by LAFCO prior to adoption of the Resolution.

- 1) Street Lighting:** The City points out that its Public Works Bureau of Street Lighting headquarters are located within the Hollywood Special Reorganization Area at 4550 Santa Monica Boulevard, and indicates that Hollywood Special Reorganization would require the City to relocate this facility. The City's concern is that this would involve a significant one-time transition cost that would not be reimbursed by the new city. The Executive Officer notes that although there have been slight boundary changes to the Hollywood Special Reorganization Area, this area has always been included in the proposed new city, and therefore, the City should have been aware of that this facility is located within the proposed new city and would be subject to transfer unless the City of Los Angeles requested otherwise. In both the San Fernando Valley and Hollywood resolutions, the Commission has accommodated the City's requests to retain identified regional assets. Here, however, the City has never raised the issue of the Bureau of Street Lighting headquarters and does not provide the Commission with any reason as to why this issue could not have been presented previously. As such, pursuant to Government Code section 56895(a) this is not a proper ground for reconsideration and the Executive Officer recommends that the Commission deny the City's request for mitigation.<sup>22</sup>
- 2) Police Service:** The City expressed concern that an area northwest of the proposed Hollywood city would become geographically isolated if Hollywood detaches and does not rely on the City of Los Angeles for contract police service. This issue was discussed prior to the adoption of the Resolution along with the discussion of impacts on fire service. As with fire service, the Executive Officer was willing to recommend to the Commission that the City retain the police department facilities in the Special Reorganization Area as a means to encourage contracting for those services between the City and the new city and to ensure continued service coverage to potentially impacted areas in the remaining City. The City did not pursue this option with respect to police services. It is expected that the City will have to redeploy and reconfigure its resources if special reorganization occurs and if the new city no longer contracts for these services at some point in the future. As the City points out, there are a number of options available to the City to deal with this situation, including contracting for services with other public agencies. The City however, does not raise any new or different facts that could not have been presented previously, and therefore, pursuant to Government Code section 56895(a) this is not a proper ground for reconsideration.
- 3) Fire Service:** The City expressed concern that it would require new fire station facilities to properly service the areas north and west of Hollywood. The City alleges that if Hollywood were to discontinue fire service contracts with the City of Los Angeles, there would be negative effects on response times as well as uncompensated capital construction costs for replacement fire station facilities. The Executive Officer notes that the Hollywood Resolution did not transfer ownership of fire stations to the new city in order to

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<sup>22</sup> Although the City's request to modify the Commission's findings regarding impacts on the City of Los Angeles should be rejected, we are proposing that this regionally serving facility should have been identified as such and excluded from transfer. The Executive Officer will separately recommend a technical correction to the Resolution to correct this matter pursuant to Government Code section 56883.

accommodate these very concerns, that the proposed city would likely rely on the City of Los Angeles for fire service on a long-term basis, and that the City of Los Angeles could finance capital construction costs, if necessary, by selling its existing Hollywood facilities to the new city upon the transfer of such service responsibilities.

- 4) **Streets and Public Works:** The City expressed concern about the complexity of street-related service issues for major thoroughfares half of which would be located in the proposed city due to the fact that many boundaries run down street centerlines. The Executive Officer notes that the City of Los Angeles currently shares public works responsibilities for major thoroughfares with Culver City (Venice and La Cienega Boulevards), Santa Monica (Centinela Avenue), Beverly Hills (Robertson Boulevard) and other cities with which it shares borders. Further, the Executive Officer notes that regional governance structures like the Metropolitan Transportation Authority and the Southern California Association of Governments oversee the allocation of transportation funding which the new city would require in order to make significant alterations in these shared major thoroughfares. The Executive Officer once again notes that the general boundaries of the Special Reorganization Area have been known for some time.
- 5) **Mount Lee:** In addition to the alleged service impacts identified by the City of Los Angeles City Administrative Officer, the City's consultant has alleged that the City would be required to relocate its Mount Lee central radio communication facility outside the Hollywood boundaries. The Commission has accommodated the City's request to maintain ownership of the Mount Lee facility, and as noted by the "there is no single site in the remaining City that provides the same physical advantages of Mount Lee."<sup>23</sup>

The City's concerns on these matters reflect a worst-case scenario in which Hollywood no longer relies on the City for contract service, and the parties are unable to resolve issues. The City's arguments regarding the need to relocate City facilities seem disingenuous, given that the Commission considered and accommodated those facility-related issues the City properly raised prior to adoption of the Resolution. The Executive Officer concludes that none of the service issues raised by the City warrant alteration in the fiscal mitigation payment or the terms and conditions in the Resolution.

### **Multiple Special Reorganization**

The City of Los Angeles City Administrative Officer expressed concern about the Executive Officer's conclusion that "combined transition costs would be no greater than the sum of the transition costs associated with the San Fernando Valley and Hollywood."<sup>24</sup> The City charged that the Executive Officer's conclusion "is without substance" and indicated that "We think it unlikely that the simultaneous combined transition cost (and associated workload) would be the same as each secession happening separately."<sup>25</sup>

The City did not present any clear hypothesis or any data regarding the effect of multiple special reorganizations. The City has not proposed any specific modifications to the fiscal mitigation

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<sup>23</sup> Hamilton, Rabinovitz & Alschuler, Inc., *The Division of Service Cost Burdens Following Separation of the Hollywood Area from the City of Los Angeles: Final Report of an Independent Appraisal*, Report to the City of Los Angeles, July 3, 2002, page 31.

<sup>24</sup> Larry J. Calemine, Executive Officer, *Special Reorganization of the San Fernando Valley and Hollywood: Combined Effects. Executive Officer's Supplemental Report*, June 3, 2002.

<sup>25</sup> William T. Fujioka. Letter addressed to Larry Calemine, Executive Officer, dated July 2, 2002, page 9.

payment or to the terms and conditions in the Resolution related to the City's concerns regarding the effect of multiple special reorganizations.

The Executive Officer concludes that this issue does not warrant reconsideration of the fiscal mitigation payment or other terms and conditions.

## Fiscal Mitigation

In its memo dated May 31, 2002, HR&A rejected the cost allocation methodology used in the Hollywood CFA and Executive Officer's Report, but did not provide alternative estimates of the fiscal impact of Hollywood Special Reorganization on the City of Los Angeles. Subsequent to adoption of the Hollywood Resolution, HR&A reviewed nearly all of the City's budgetary departments, and estimated that the City of Los Angeles could reduce its expenditures by \$64 million after Hollywood detaches and no longer relies on the City for contract services.<sup>26</sup> The HR&A analysis is premised on the City remaining organizationally identical to its configuration in the base year, and does not contemplate reorganization of the City in accordance with its reduced size.

Given that the fiscal mitigation payment is based on actuals rather than budgetary figures, the Executive Officer converted the HR&A calculations to an actual financial basis. Based on these corrections, a fiscal mitigation payment consistent with the HR&A analysis would be \$44 million

<b>Stranded Cost Estimates by City Department</b>		
<b>Department</b>	<b>Stranded Costs</b>	
	<b>(1)</b>	<b>% Stranded (2)</b>
<b>Comparable Expenses (4)</b>	44,099,776	40.03%
Police	15,941,090	40.02%
Fire	8,314,769	59.56%
General Services	4,605,619	49.03%
Transportation	3,421,767	44.39%
Recreation & Parks	3,391,381	67.55%
City Attorney	1,634,575	44.24%
Information Technology Agency	1,491,292	40.03%
Personnel	936,182	53.05%
Bureau of Engineering	763,297	41.19%
Planning	695,047	80.93%
Los Angeles Housing Department	581,603	39.54%
Community Development	541,166	36.06%
Bureau of Street Services	468,351	11.36%
Animal Services	424,894	72.53%
City Clerk	349,354	44.21%
Bureau of Street Lighting	284,970	54.66%
Council	235,525	24.45%
Finance	216,756	28.13%
Controller	146,243	30.13%
Building & Safety	109,056	3.99%
Mayor	97,466	20.31%
Neighborhood Empowerment	28,760	38.25%
City Administrative Office	26,611	6.21%
Cultural Affairs	10,123	1.88%
Aging	(29,732)	-56.96%
Library	(238,956)	-11.04%
Bureau of Sanitation	(506,915)	-14.75%
Notes:		
(1) Stranded costs are the difference between the cost savings that HR&A estimates the City of Los Angeles would experience and the cost allocations made by the Executive Officer for the final boundaries. Stranded costs have been converted to an actual financial basis.		
(2) The percent of costs stranded are the stranded costs divided by the costs allocated to the Hollywood by the Executive Officer.		

<sup>26</sup> The HR&A analysis does not assess the pension departments, Zoo, El Pueblo monument and Convention Center. The HR&A analysis of the Public Works department is based on the budgetary categories for this department effective in fiscal year 2001-02, with the implementation of the Public Works Director's office and reorganization of the Accounting and Management and Employee Services bureaus.

higher than the fiscal mitigation payment adopted by the Commission.

The HR&A assessment implies that 40 percent of the costs allocated by the Executive Officer to the Special Reorganization Area could not be translated into cost savings for the remaining City of Los Angeles without reducing service levels. By comparison, HR&A found that approximately 20 percent of costs that had been allocated by the Executive Officer to the San Fernando Valley Special Reorganization Area could not be translated into cost savings.

HR&A found that the remaining City of Los Angeles could save more than had been projected in the CFA for the Library, Bureau of Sanitation, Public Works Board, Human Relations Commission, and Aging departments. In the remaining City departments, HR&A found that the remaining City of Los Angeles could not reduce staffing and associated costs by the degree that had been estimated in the CFA (and, by extension, the Executive Officer's reports).

In addition to presenting final estimates of stranded costs, the HR&A report also provided additional discussion regarding the allocations made in the CFA and Executive Officer's reports. Specifically, HR&A criticized LAFCO for allocating central service workers at the branch/unit level as opposed to allocating workers at the detailed position level.

HR&A used the crime lab example presented in the Executive Officer's Report to illustrate the differences between the LAFCO and HR&A cost allocation methodologies. The HR&A discussion in this section relates to the San Fernando Valley rather than Hollywood. As this is one of only two instances in the HR&A report where any workload data underlying the allocations (albeit for a different Special Reorganization Area) are cited, the example is instructive. HR&A found that 27 percent of all requests for crime lab photographer services came from the San Fernando Valley. But only two of the crime lab's 38 photographers handled virtually all of the Valley's photography requests. HR&A reports that the Police Department contends that it could only spare the two photographers stationed in the Valley.

HR&A points out that the workload data do not reflect the "time consuming" work done by the in-house photographers physically stationed in the crime lab. By implication, the Police Department believes that all photographers physically stationed in the crime lab are conducting work associated with crimes committed outside the Valley or are conducting work that bears no relationship to where crimes are committed. HR&A proceeded to identify three of the centrally located junior photographers as expendable after special reorganization. Overall, HR&A indicated that the remaining city would require all five of the crime lab's senior photographers, and 20 of 23 Photographers III (presumably the centrally located staff photographers). In sum, HR&A categorized only 13 percent of photographers as expendable following Valley Special Reorganization, whereas the Police Department viewed only 5 percent of the photographers as expendable. HR&A then indicates that "there is no real world basis whatever for further increasing the estimate by another five—to a total of 10 photographer positions eliminated—as the LAFCO contractor has done."<sup>27</sup> What HR&A fails to describe is the nature of the work conducted by the photographers located centrally, and the basis for determining that the work of these individuals had such a disproportionately low relationship with police service in the Valley Special Reorganization Area. The reader is left with the impression that crime lab management mistakenly confuse the location of workers with the geographic area being served by workers, and have difficulty identifying the factors driving the workloads of centrally located staff. As HR&A revealed no workload data

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<sup>27</sup> Hamilton, July 3, 2002, page 28.

for the centrally located staff, the reader is left with the impression that the mistaken perceptions of the crime lab management are determining the allocations of such centrally located staff.

HR&A assures its readers in the 29-page summary of its research that:

[R]eams of workload data had been collected by HR&A with respect to many agencies, units and functions, and that all of this could and would be shared with LAFCO representatives if they were only willing to take the time to review it. It was obviously impractical within the time provided for the HR&A review to print all the underlying workload data and/or summaries of the many hours of detailed discussions held with senior representatives of City agencies. LAFCO staff were [sic] well aware of this, and of the standing invitation to them to review and discuss the underlying data in any level of detail.<sup>28</sup>

The HR&A detailed position allocation tables in Appendix Volumes I and II constituted 431 pages. Similar to the HR&A report on the San Fernando Valley, the HR&A final report on Hollywood does not reveal workload data, departmental interview content or HR&A rationales used as a basis for the position allocations for City departments. The voluminous appendix tables listing the position allocations do not include any text explaining the reason for the particular allocation at the position level or the level of the organizational unit. Without any documentation, the voluminous material does not constitute professional research that can be assessed by independent experts. In a response to HR&A analysis of the San Fernando Valley, the Executive Officer had indicated that the lack of documentation, workload information or some rationale for each allocation prevented the Executive Officer from viewing the research as anything more than the consultant's opinions.

#### *Inconsistency with San Fernando Valley Findings*

The HR&A report gives little explanation as to why it found that the proportion of costs that would be stranded by the Hollywood Special Reorganization (40 percent) is twice as high as the proportion that would be stranded by the San Fernando Valley Special Reorganization (20 percent). HR&A argues that the "likelihood of any change in the size of central governmental organs or in the number of senior management personnel declines with the scale of change in city size."<sup>29</sup> HR&A reasons that the effect on the City of Los Angeles of a relatively small area like Hollywood detaching is "not so large as to be likely to have so significant an impact on the workload of major central systems and managerial ranks that it would be reasonable to expect major reductions in positions or non-personal expenditures in parts of the City workforce who are not posted in Hollywood and/or providing services directly to that area."<sup>30</sup> Further, HR&A does state that Hollywood, unlike the San Fernando Valley, does not constitute a discrete service area, and that identifying City of Los Angeles cost savings requires "more painstaking analysis than is the case vis-à-vis the Valley."<sup>31</sup>

The HR&A report clearly indicates that the HR&A employee allocations were more unlikely to treat central service workers as expendable than were the HR&A employee allocations in the case of the San Fernando Valley. The reader of the HR&A report is left with the impression that the City of Los Angeles views the Hollywood Special Reorganization as too inconsequential to merit reductions in central service staffing. Further, the reader is left with the impression that HR&A had great difficulty identifying the factors driving the workloads of centrally located employees, given that

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<sup>28</sup> Hamilton, July 3, 2002, page 24.

<sup>29</sup> Hamilton, July 3, 2002, page 15.

<sup>30</sup> Hamilton, July 3, 2002, page 15.

<sup>31</sup> Hamilton, July 3, 2002, page 3.

HR&A's allocations of such workers was inconsistent in the Hollywood and San Fernando Valley reports.

### *Conclusion*

As previously stated in the Executive Officer's report, the HR&A approach differs substantially from the approach outlined in the Government Code and followed in the CFA and the Executive Officer's Reports. The HR&A report is premised entirely on the City's perception of its ability to cut costs after special reorganization and after the proposed city no longer relies on the City for services. This notion runs counter to the Government Code, which directs that the cost allocations associated with revenue neutrality be based on current expenditures associated with serving the geographic area. Further, the City's theories about stranded costs are not persuasive as has previously been explained in the Executive Officer's Report.

Without objective workload data connecting the activities of central service workers with output, the CFA approach was the most reasonable and objective approach to allocating central service workers on the basis of the location of field workers directly serving the public. The State Controller provided an independent review of the CFA, and concluded that the CFA cost allocations were reasonable and accurate. The lack of documentation and the crime lab photographer example in the HR&A report do not contradict and arguably validate PFM's conclusion from its interviews of City departmental representatives that there is a dearth of workload data associated with City of Los Angeles central service workers and that City representatives had difficulty identifying the factors driving the workloads of such workers.

Further, the Hollywood HR&A report implies that the proportion of costs stranded by the Hollywood Special Reorganization would be twice as high as in the case of the San Fernando Valley Special Reorganization. However, the HR&A report fails to provide an explanation as to why foregone economies of scale would somehow be proportionally doubled in size in the event of Hollywood Special Reorganization. The Executive Officer views this inconsistency as a strong indicator that HR&A's interviews and other data sources did not shed light on the factors driving the workloads of centrally located employees.

Given the lack of documentation for the HR&A calculation of the fiscal mitigation payment, the Executive Officer views the HR&A report as an unverifiable piece of research that is inconsistent with HR&A's previous research.

### **Diseconomies of Scale**

The City commissioned HR&A to produce a second report that purports to refute "a theory advanced relatively recently by the Executive Officer that the City of Los Angeles would benefit financially from downsizing (claimed economies of smaller scale)."<sup>32</sup> The Executive Officer notes that this statement was made in the San Fernando Valley Executive Officer's Report and was not made in the Hollywood Executive Officer's Report. The HR&A report was accompanied by evidence of economies of scale experienced in the City's purchasing of supplies such as uniforms.

### *Background*

The San Fernando Valley Executive Officer's Report explained the connection between economies of scale and stranded costs as follows:

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<sup>32</sup> Frederick N. Merkin, City of Los Angeles Office of the City Attorney, *Request for Reconsideration of and Amendments to the Resolution Making Determinations for the Proposed Secession of the San Fernando Valley*, dated June 20, 2002, , p. 8.

A critical question in evaluating the City's claim regarding stranded costs is whether or not there are economies of scale in local government. By economies of scale, we mean greater cost efficiencies due to large size. That is, as a city grows, these fixed costs can be shared by a larger and larger population base, which results in a lower per capita cost. Or, as Los Angeles alleges, if the city shrinks these same costs must be borne by a smaller population base and the cost per capita rises. If local government costs tend to be relatively lower at large cities than at smaller cities, that would support the City's stranded cost argument by indicating that large cities are able to provide services more cheaply because their fixed costs are spread among a larger revenue base. If municipal costs tend to be proportional to the size of a city, that would mean that the costs tend to vary with the size of the city and that the City of Los Angeles should be able to adjust to its smaller size by reducing costs. If municipal costs tend to be relatively higher at large cities than at smaller cities, that would indicate that the City should be able to reduce its expenditures on more than a proportionate basis if the size of the City is reduced.<sup>33</sup>

The Hollywood Executive Officer's Report presented evidence from a Government Finance Officers Association database on 1,500 American cities that larger cities tend to have higher per capita costs for public safety and general administration than do smaller cities. Further, the Executive Officer found evidence that larger cities tend to have proportionately lower costs for street services, municipal water and sewage services than do smaller cities providing these services. Based on the budgets of San Diego and San Jose, the Executive Officer found that the budgets for City Attorney and City Clerk departments tend to be proportional to population.

The Executive Officer's Reports rejected the City's stranded cost argument for several reasons. First, the Government Code neither requires nor directs the Commission to consider the effects of foregone economies or diseconomies of scale in calculating the fiscal mitigation amount needed to mitigate the negative fiscal effect of a special reorganization. Second, the City's argument for large stranded costs in central services was inconsistent in that it alleged that there was no connection between the activities of stranded central service workers and the size of the city, but that there is a connection between the activities of stranded central service workers and service levels affecting the public.<sup>34</sup> Third, the City's argument for large stranded costs in central services is not persuasive in that it is premised on the notion that the City of Los Angeles would not reorganize after losing the 5 percent share of population currently located in the Special Reorganization Area, and would remain organizationally identical to its current structure. Fourth, LAFCO's consultant concluded from its interviews of City department representatives that the City lacks workload indicators useful for tracing the connection between the activities of central service workers and service levels. Fifth, the City consultant's study lacked documentation of workload data or interviews that would allow the work to be viewed as more than the consultant's opinions. Sixth, the data and research on economies of scale indicate that diseconomies of scale are more prevalent in local government than are economies of scale, as public safety constitutes the majority of city government costs and costs proportionately more in larger cities.

#### *City Report Analysis*

The HR&A report focuses on one of many reasons why the Executive Officer rejected the City's stranded cost argument in the case of the San Fernando Valley, but none of the reasons stated in the

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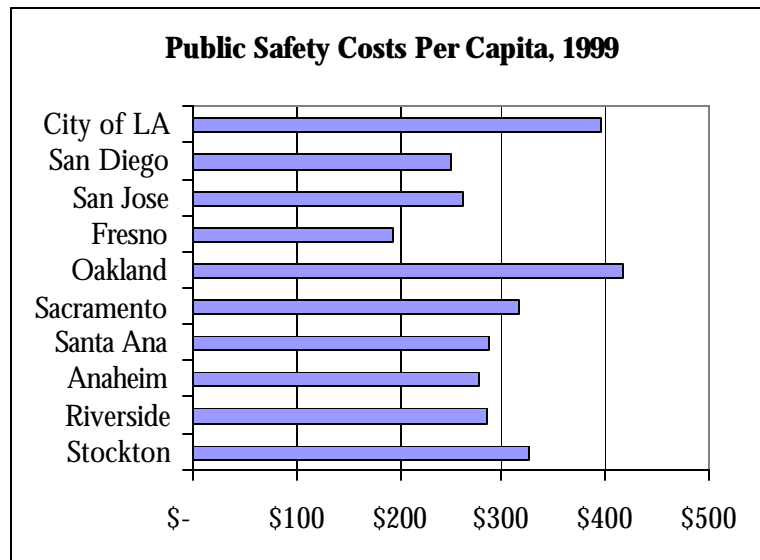
<sup>33</sup> Larry J. Calemine, *Special Reorganization of the San Fernando Valley Executive Officer's Report*, April 24, 2002, page 22.

<sup>34</sup> Larry J. Calemine, *Special Reorganization of Hollywood Executive Officer's Report*, May 28, 2002, pp. 13-14.

Hollywood Executive Officer's Report. The new information raised by the HR&A diseconomies report include some additional information on the academic literature cited in the San Fernando Valley Executive Officer's Report. Additionally, the HR&A report contends that only studies of scale economies in Los Angeles city government would be acceptable evidence that Los Angeles currently experiences greater diseconomies of scale than it does economies of scale.

The HR&A report correctly points out that most of the academic research on economies of scale in local government is focused on police department costs. This is hardly surprising, given that policing costs are the single largest cost category faced by urban governments, with fire safety and street maintenance being the second and third most important local costs. The HR&A report rejects academic literature that is not focused solely on the case of Los Angeles, and cites an academic study that was not found in the Executive Officer's search of the academic literature: a 1975 article that found evidence of economies of scale in the Los Angeles Police Department in the 1956-1970 period.

Given the HR&A emphasis on Los Angeles data, the Executive Officer compared public safety costs of large California cities in the Government Finance Officers Association database to determine whether Los Angeles experiences lower costs than other large California cities. Los Angeles is second only to Oakland in its per capita public safety costs, and otherwise has higher per capita costs than other large California cities. In order to control for cost of living differences within California, the Executive Officer found that Los Angeles public safety costs as a percent of assessed property value in the city ranks fourth among these ten cities. There is not a clear relationship between public safety costs and city size among large California cities, but there is certainly no clear evidence that Los Angeles manages to economize compared with other large California cities.



*Conclusion*

It is unclear why this report has any bearing on the fiscal mitigation payment adopted by the Commission, as that payment was calculated on the statutory basis of current expenditures in the Special Reorganization Area. The HR&A report is focused on one of many reasons why the Executive Officer rejected the City's stranded cost argument in the case of the San Fernando Valley rather than Hollywood as has already been explained.

The HR&A report does not produce any evidence that negates the majority of academic studies which have found diseconomies of scale in local government public safety. Further, the HR&A study does not provide empirical evidence that the City of Los Angeles experiences greater economies of scale than it does diseconomies of scale. The HR&A report focuses on criticizing the notion that diseconomies of scale are more prevalent in municipal government than are economies

of scale, but does not convince the reader that the opposite is the case, i.e. that economies of scale are more prevalent. Given the higher costs of City of Los Angeles services compared with other California cities, it is difficult to make a convincing case that the City would on net lose economies of scale due to special reorganization.

The HR&A report does not produce strong evidence of the predominance of economies of scale at the City of Los Angeles. Given that HR&A's July 3 report indicates that two-fifths of the costs allocated to the Hollywood Special Reorganization Area are stranded costs, the HR&A report would have needed to produce very strong evidence of large economies of scale at the City in order to justify the fiscal mitigation payment proposed by the City.

As has been pointed out previously, if the City is correct in that it experiences economies of scale that other large cities do not appear to experience, then the new city will have financial incentives to contract with the City of Los Angeles for service. As the City has pointed out, financial incentives may not necessarily motivate the new city to contract for service with the City of Los Angeles if other more political factors outweigh these financial incentives.

### **Modifications to Mitigation Payment Structure**

The City proposes that the term of the mitigation payment be 25 years, rather than the 20 years provided in the Resolution. In addition, the City proposes that the five percent annual phase-out of the mitigation payment be removed, as that phase-out "inflicts fiscal harm on the remaining City, increasing as each year goes by."<sup>35</sup>

As the Executive Officer pointed out in his original report on this matter, the fiscal mitigation payment term has been set at a 10-year to 25-year length in other California incorporations.<sup>36</sup> Orange County has established a 14-year mitigation payment term in three incorporations; Sacramento County has established a 25-year term in two incorporations. The Goleta incorporation included a ten-year component to the fiscal mitigation payment, as well as a component that will exist in perpetuity. The City's proposal for a 25-year term with no phase-out would be more generous than the Sacramento County LAFCO has been towards its two most recent incorporations.

The Executive Officer recommended a 20-year term with a 5 percent annual phase-out rate. That approach appears reasonable compared with the approach used in other California incorporations. Further, the five percent annual phase-out rate is less than the City's 7 percent employee attrition rate, implying that the City could manage its own reorganization without laying off City workers. The City has not advanced any rationale as to why the City would require 25 years to adjust to the departure of Hollywood, and how the City would make that adjustment if the mitigation payment is not phased out over time.

### **Executive Officer's Recommendation**

Based on the above, the Commission should reject the City's second request for reconsideration.

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<sup>35</sup> Frederick N. Merkin, City of Los Angeles Office of the City Attorney, *Request for Reconsideration of and Amendments to the Resolution Making Determinations for the Proposed Secession of the San Fernando Valley*, dated June 20, 2002, , p. 12.

<sup>36</sup> Larry J. Calemine, *Special Reorganization of Hollywood Executive Officer's Report*, May 28, 2002, p. 40.

### **THIRD REQUEST: APPROVAL OF THE HOLLYWOOD SPECIAL REORGANIZATION**

The City of Los Angeles requests that the Commission modify Recital H of its Resolution, which approved the Hollywood Special Reorganization, subject to the conditions set forth thereafter. The City's requested modification is to have the Commission *disapprove* the Hollywood Special Reorganization.

The City's request notes that on May 31, 2002, the City Council adopted a resolution that called on the Commission to disapprove the resolution on the Hollywood Special Reorganization. Thus, the City had already made its position on the special reorganization known to the Commission prior to the Commission's adoption of its Resolution approving the special reorganization. With the exception of the new reports which accompany the City's request for reconsideration, and which have already been addressed, the City's third request is not based upon any new or different information or law.

As in its past submittals, the City makes much of the Executive Officer's use of the term "compelling evidence" in previous reports by the Executive Officer to this Commission discussing the issue of stranded costs. The City seems to assert that the Executive Officer has injected an evidentiary standard into the proceedings that has no basis in the Hertzberg Act. The City's assertion is misplaced.

Government Code section 56665 provides that: "The executive officer shall review each application which is filed with the executive officer and shall prepare a report, including his or her recommendations, on the application." In making his recommendations to the Commission regarding the stranded costs issue raised by the City, the Executive Officer reviewed all reports provided up to that time by the City, and reviewed all research and analysis prepared by staff, and based thereon found that the evidence submitted by the City was not compelling and recommended that it be disregarded. The terms "persuasive" or "convincing" could have readily been substituted for "compelling." Rather than setting up a new legal standard, the Executive Officer was giving his opinion regarding the quality of the evidence submitted by the City to support its contention that stranded costs would exist after special reorganization and the City should be compensated for those costs.

The City also contends that a greater demand has been placed upon it than the Applicant in this regard. It should be noted, however, that the issue of stranded costs was raised by the City, and is a part of the City's argument for a legal interpretation of the revenue neutrality statute that is contrary to the interpretation provided by Legal Counsel and confirmed by the State Controller.<sup>37</sup> As such, the burden should be upon the City to provide persuasive evidence to the Commission. The City also has the information most readily available to it to support its position. With regard to the Applicant, numerous positions supported by the Applicant, including the boundary of the new city and the division of certain assets, were not recommended by the Executive Officer because the Applicant's arguments and evidence were also not considered "compelling" by the Executive Officer, although that term may not have been used. Thus, it cannot be said that the Executive Officer did not treat the parties and their concerns equitably in his recommendations.

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<sup>37</sup> Government Code section 56845; County of Los Angeles, Office of the County Counsel, *Revenue Neutrality*, July 19, 2000; California State Controller, *California State Controller's Review of the Proposed Hollywood Special Reorganization Comprehensive Fiscal Analysis*, May 9, 2002, pp. 20-21.

The Commission had both the recommendations of the Executive Officer and the reports and positions of the parties before it when it made its determinations. Government Code section 56107 provides that:

All determinations made by a commission under, and pursuant to, this division shall be final and conclusive in the absence of fraud or prejudicial abuse of discretion. . . . Prejudicial abuse of discretion is established if the court finds that the determination or decision is not supported by substantial evidence in light of the whole record.

The whole record includes evidence that both supports and opposes many of the determinations made by the Commission. The Commission is charged with making its determinations based upon the evidence before it. The Executive Officer contends that the determinations made by the Commission and reflected in the Resolution are supported by substantial evidence.

**Executive Officer's Recommendation**

Based on the above, the Commission should reject the City's third request for reconsideration.

## ***REQUESTS SEEKING MODIFICATIONS TO THE RESOLUTION***

### **FOURTH REQUEST: REGULATION OF UTILITY SERVICE RATES**

The City of Los Angeles requests the deletion of condition 20(d) of the Resolution, which requires rate parity amongst customers of the same class in the City of Los Angeles and the new city. The City requests replacement of that condition with a condition previously submitted which subjects the City to the common law reasonableness standard for setting utility rates, which would permit the City to differentiate between customers of the same class in the City of Los Angeles and the new city.

The City has consistently voiced its objections to the concept of rate parity, and provides no new or different information or law in its request. This issue has previously been addressed in the City report and letter cited in the City's request and in the Executive Officer's Report and an opinion of Legal Counsel.<sup>38</sup>

First and foremost, it should be noted that the intention and effect of condition 20(d) is not to set rates. The condition does not set rates, it merely provides for rate parity between customers of the same class in the City of Los Angeles and the new city.

It should also be noted that the Commission's alternative courses of action with respect to the utilities were to: (1) divide the assets or (2) provide the new city with an undivided ownership interest. In lieu of these more drastic measures the Commission's actions permit the City of Los Angeles to retain full ownership rights in the utilities, protect the City's customer base, secure the City's outstanding financial obligations, and preserve the City's ongoing revenue transfers from the Department of Water and Power to the City's general fund.<sup>39</sup> In return, condition 20(d) provides the captive customers of the new city with the modest protection of rate parity.

Condition 20(d) must be considered in conjunction with the obligations placed upon the new city with respect to utility services. Pursuant to conditions 20(a) and (b), the new city is required to enter into franchise or service agreements with the City of Los Angeles for utility services at least until the latest maturity date of the bonded indebtedness for the respective utility. It is because of the fact that the new city is required to remain tied in this manner to the City of Los Angeles for an extended period of time, that condition 20(d) has been imposed.

The protection provided to the customers of the new city pursuant to condition 20(d) is incidental to the continuation of utility services as set forth in condition 20. Although there has been no case law interpreting the relevant provisions of the Hertzberg Act, Legal Counsel has advised that the provisions of condition 20 are within the Commission's authority as set forth in Government Code section 56886(r), (t), and (v).<sup>40</sup>

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<sup>38</sup> Larry J. Calemine, *Special Reorganization of Hollywood Executive Officer's Report*, May 28, 2002, pp. 64-66; County of Los Angeles, Office of the County Counsel, *Commission Authority to Set Terms and Conditions Regarding Public Utilities*, February 7, 2002.

<sup>39</sup> The City of Los Angeles requires the Department of Water and Power to transfer seven percent of its water revenue and seven percent of its power revenue to the City's general fund. The customers in the new city will continue to contribute to the City of Los Angeles general fund in this manner, even though they will no longer be residents of the City.

<sup>40</sup> County of Los Angeles, Office of the County Counsel, *Commission Authority to Set Terms and Conditions Regarding Public Utilities*, February 7, 2002.

## **Executive Officer's Recommendation**

Based on the above, the Commission should deny the City's fourth request for reconsideration.

### **FIFTH REQUEST: PROPOSITION K**

The City of Los Angeles requests the deletion of condition 29, which provides for the detachment of the Special Reorganization Area from Landscape and Lighting District No. 96-1 (Proposition K) (the "District") and the formation of a new district in the Special Reorganization Area, consistent with Proposition K. The City requests the modification of condition 30 to serve in place of condition 29. Condition 30 provides an alternative to condition 29 if condition 29 were found unlawful. Condition 30 would keep the District intact.

Condition 29 is based upon the proposed term and condition for addressing Proposition K the City submitted in April, 2002.<sup>41</sup> The applicants and the City at that time appeared to be in agreement on the treatment of the District. The City's proposal contemplated the detachment of the Special Reorganization Area from the District and the formation of a new district consistent with Proposition K. The only substantive difference between condition 29 and the condition proposed by the City in April is that the City's proposed condition required the insertion of specific monetary allocations in the condition. Staff ultimately revised this condition to allocate Proposition K resources and obligations based upon the share of assessments paid in fiscal year 2000-01, because the City did not provide the specific monetary allocations.<sup>42</sup>

On May 20, 2002, two days before the scheduled Commission hearing on the San Fernando Valley resolution, the City provided an alternative to its earlier proposed condition. The alternative keeps the District intact, but permits the new city some discretion in the use of local Proposition K funds.<sup>43</sup> The proposed condition was contrary to the earlier consensus of the parties; however, it was incorporated as condition 30, the alternative condition in both the Hollywood and San Fernando Valley resolutions.

The City does not put forth any legal argument as to why condition 30 should be preferred over condition 29. Legal Counsel has reservations regarding the legality of keeping the District intact for the following reasons: (1) the terms of Proposition K require its boundaries to be coterminous with the boundaries of the City of Los Angeles;<sup>44</sup> and (2) the Landscape and Lighting Act of 1972 appears to require the exclusion of territory from an assessment district when that territory is included within a city by incorporation.<sup>45</sup>

On the other hand, Government Code section 56886(u) clearly provides the Commission with the discretion to transfer authority and responsibility among any cities, counties, or districts for the administration of improvement districts, section 56886(e) provides the Commission with discretion to form new improvement districts, and section 56886(t) provides the authority for the extension or continuation of any previously authorized tax or assessment. Government Code section 56125

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<sup>41</sup> City of Los Angeles, *Special Reorganization of the San Fernando Valley, Harbor, and Hollywood—Objections to Recommendations of the LAFCO Subcommittee on Terms and Conditions*, April 2, 2002.

<sup>42</sup> The City provided the data presumably necessary to formulate such allocations on May 20, 2002, two days before the Commission hearing on the Valley Special Reorganization, along with a new proposed condition that kept the District intact. See fn. 39.

<sup>43</sup> Letter from James K. Hahn, Mayor, to the Executive Officer of LAFCO, dated May 20, 2002.

<sup>44</sup> Referendum Ordinance K, approved by the voters of the City of Los Angeles, November, 1996, section 4.

<sup>45</sup> Streets and Highways Code section 22613 provides that:

(a) Whenever any territory of an assessment district is included within a city by annexation or incorporation . . . that territory is thereby excluded from the assessment district.

provides that the Commission need not comply with the principal act when formation of a new improvement district is pursuant to a reorganization. Based thereon, the detachment and formation of a new district in the Special Reorganization Area is the more legally defensible condition.

The City also objects to the use of assessment ratios from fiscal year 2000-01 in condition 30, claiming potential unfairness in predicating the allocations based on a single year. The City's modifications would remove any benchmark for the pro rata allocations between the cities, and would leave these decisions to the discretion of the City of Los Angeles City Council. The treatment of the Proposition K allocations is consistent with the other allocations contained in the Resolution. All allocations are based upon proportionate shares derived from a single fiscal year, typically 2000-01, unless otherwise indicated.

### **Executive Officer's Recommendation**

Based on the above, the Commission should deny the City's fifth request for reconsideration.

### **SIXTH REQUEST: SEVERABILITY**

The City of Los Angeles requests the deletion of condition 36, which provides that the terms and conditions of the Resolution are severable from the remainder of the Resolution.

The City has asserted that severability clauses are unlawful and unfair to voters. The case law cited by the City contradicts that assertion. Not one of the cases cited by the City finds a severability clause unlawful. The three post-election cases cited by the City utilize severability clauses to preserve the valid portions of the legislative act or initiative at issue.<sup>46</sup> The three pre-election cases cited by the City found that the severability clauses were of no consequence because the measures were unconstitutional or beyond the power of the voters to enact.<sup>47</sup>

The cases are all consistent on one point—the courts determine severability.

In the case of post-election review, the inclusion of a severability clause in a measure or statute does not mean that any provision can be automatically severed. As set forth in *Calfarm Insurance*:

'Although not conclusive, a severability clause normally calls for sustaining the valid part of the enactment, especially when the invalid part is mechanically severable. . . . Such a clause plus the ability to mechanically sever the invalid part while normally allowing severability, does not conclusively dictate it. The final determination depends on whether the remainder . . . is complete in itself and would have been adopted by the legislative body had the latter foreseen the partial invalidity of the statute . . . or constitutes a completely operative expression of the legislative intent . . . [and is not] so connected with the rest of the statute as to be inseparable.'<sup>48</sup>

The courts determine whether or not a provision is severable based upon three criteria: the invalid provision must be grammatically, functionally and volitionally separable.<sup>49</sup> Accordingly, if any condition of the Resolution is invalidated after approval by the voters, the courts will determine

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<sup>46</sup> *Calfarm Insurance Co., v. Deukmejian*, 48 Cal.3d 805, 258 Cal.Rptr. 161 (1989); *Gerken v. Fair Political Practices Com.*, 6 Cal.4th 707, 25 Cal.Rptr.2d 449 (1993); and *People's Advocate, Inc. v. Superior Court*, 181 Cal.App.3d 316, 226 Cal.Rptr. 640 (1986).

<sup>47</sup> *City and County of San Francisco v. Patterson*, 202 Cal.App.3d 95, 248 Cal.Rptr. 290 (1988); *Citizens for Responsible Behavior v. Superior Court*, 1 Cal.App.4th 1013, 2 Cal.Rptr.2d 648 (1991); and *City of San Diego v. Dunkl*, 86 Cal.App.4th 384, 103 Cal. Rptr.2d 269 (2001).

<sup>48</sup> *Calfarm*, 48 Cal.3d at 821 (quoting *Santa Barbara Sch. Dist. v. Superior Court*, 13 Cal.3d 315, 331 (1975)).

<sup>49</sup> *Id.*

whether or not the condition is severable. The effect of condition 36 is merely to place the issue of severability before the courts.

In cases of pre-election review, the courts will only take action on a matter when it is substantively unconstitutional or beyond the power of the voters to enact, and under those circumstances the courts generally ignore severability clauses:

‘In a pre-election opinion . . . it would constitute a deception on the voters for a court to permit a measure to remain on the ballot knowing that most if its provisions, including those provisions which are most likely to excite the interest and attention of the voters, are invalid.’<sup>50</sup>

Therefore, the three pre-election cases do not support the City’s request to delete the severability clauses. Those cases demonstrate that a severability clause will have no effect if a court determines that a measure cannot be placed on the ballot if it is unconstitutional or beyond the power of the voters to enact.

The Executive Officer recommends preserving the severability clause because in the case of a pre-election challenge to the Resolution they would be of no consequence, and in a post-election challenge they would permit the court to address the issue.

#### **Executive Officer’s Recommendation**

Based on the above, the Commission should deny the City’s sixth request for reconsideration.

#### **SEVENTH REQUEST: AT-LARGE CITY COUNCIL MEMBERS**

The City requests that the Commission not proceed with the at-large city council member elections, as provided for in condition 4 of the Resolution, until it assures itself that an at-large election would not violate the Voting Rights Act of 1965 or the Equal Protection Clause of the Fourteenth Amendment. In response to the City’s request and objections raised by the Mexican American Legal Defense and Education Fund and the California Latino Redistricting Coalition, Legal Counsel has prepared the attached Report on Objections to At-Large Election System, based upon a separate electoral analysis prepared by Stephen P. Klein, Ph.D., also attached. Based upon Legal Counsel’s review of the applicable law in light of Dr. Klein’s electoral analysis, Legal Counsel has concluded that an at-large election system for the proposed new city would not violate the Voting Rights Act of 1965 or the Equal Protection Clause of the Fourteenth Amendment. Legal Counsel has prepared appropriate determinations for the Commission’s review and consideration which are attached.

#### **Executive Officer’s Recommendation**

Based upon the attached reports, the Commission should deny the City’s seventh request for reconsideration and adopt the attached determinations prepared by Legal Counsel in support of that decision.

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<sup>50</sup> *Patterson*, 202 Cal.App.3d at 106 (quoting *American Federation of Labor v. Eu*, 36 Cal.3d 687, 716 (1984)).