

**SPECIAL REORGANIZATION OF THE SAN FERNANDO VALLEY**  
**EXECUTIVE OFFICER'S SUPPLEMENTAL REPORT**

TO THE

LOCAL AGENCY FORMATION COMMISSION  
FOR LOS ANGELES COUNTY

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## **INTRODUCTION**

### **Purpose**

Pursuant to the Cortese-Knox Local Government Reorganization Act of 1985 (the “Cortese-Knox Act”)<sup>1</sup> the executive officer of a local agency formation commission is required to review each application for a change of organization or reorganization filed with the commission and prepare a report to the commission, including his recommendations on the application.<sup>2</sup> The objective of this Executive Officer’s Supplemental Report is to provide the Local Agency Formation Commission for Los Angeles County (the “Commission”) with its Executive Officer’s final recommendations regarding the application and proposal for special reorganization of the San Fernando Valley area of the City of Los Angeles (“Valley Special Reorganization”).<sup>3</sup>

### **Context**

The Executive Officer’s Supplemental Report updates the Executive Officer’s Report dated April 24, 2002. The Commission has held three public hearings subsequent to the release of that report. On May 15, 2002, the City of Los Angeles submitted a response to the Executive Officer’s Report and the draft resolution and the Applicant submitted fourteen requested changes to the resolution.

This Supplemental Report is based on studies, negotiations and proposals that have been conducted in this process. This input includes, but is not limited to, the Comprehensive Fiscal Analysis (“CFA”) and supplemental report prepared by the Commission’s consultant, the State Controller’s review of the CFA, comments at public hearings, the “terms and conditions” round of negotiations between the City of Los Angeles and the Valley Special Reorganization applicant (the “Applicant”) held during the last quarter of 2001, the revenue neutrality negotiations between the Applicant and the City of Los Angeles held during the first part of this year, the written proposals of those parties, and the recommendations of the Commission’s Subcommittee on Findings, Terms and Conditions (the “Subcommittee”), which held multiple hearings and adopted recommendations on findings, terms and conditions for consideration by the Commission. All of the above submissions, reports and proposals, and all other written submissions which have been provided by the parties and interested third parties, and all recordings, transcripts and minutes of all meetings and hearings are incorporated in this Supplemental Report by reference for consideration by the Commission.

### **Caveats**

This Supplemental Report includes analysis and recommendations on fiscal findings and terms and conditions for the Commission to consider as it makes its determinations with respect to the Valley

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<sup>1</sup> Former California Government Code section 56000, *et seq.* The Cortese-Knox Act was amended by the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (the “Hertzberg Act”), which became effective January 1, 2001. The proposal for special reorganization of the San Fernando Valley area of the City of Los Angeles was accepted for filing prior to the Hertzberg Act’s effective date, and therefore, pursuant to the provisions of the Hertzberg Act it is being processed under the prior law, and all references herein are to the former Government Code sections of the Cortese-Knox Act.

<sup>2</sup> Government Code section 56833.

<sup>3</sup> Pursuant to Government Code section 56075.5, a “special reorganization” means a reorganization that includes the detachment of territory from a city or city and county and the incorporation of that entire detached territory as a city. The Valley Special Reorganization, therefore, consists of a detachment of the San Fernando Valley territory from the City of Los Angeles and incorporation of that area as an independent city.

Special Reorganization. The decision whether or not to approve or disapprove the proposal, with or without amendment, wholly, partially or conditionally, 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.

## ***FISCAL FINDINGS***

This Report sets forth adjusted and updated fiscal calculations of current revenues and expenditures and fiscal projections for the new city's first three years of incorporation. These fiscal estimates differ from those presented in the Executive Officer's Report in five ways:

- 1) The fiscal calculations are based upon the actual City of Los Angeles revenues and expenditures in the base year (fiscal year 2000-01) which were recently released in the Mayor's proposed fiscal year 2002-03 budget. Previously, the CFA and the Executive Officer had calculated the fiscal findings based upon the adopted budget for the base year rather than the actual figures, which were unavailable.
- 2) The City of Los Angeles allocation of the County's Public Safety Augmentation Fund (Government Code section 30051, *et seq.*) has been allocated on the basis of property tax share. The CFA and the Executive Officer's Report did not allocate this revenue source to the new city. The City of Los Angeles receives an allocation of the County's Public Safety Augmentation Fund which consists of a State 0.5 % sales tax allocated to local governments as replacement revenue for the diversion of property taxes from cities to schools in the 1993-94 State Budget. This revenue source generated approximately \$10.9 million in the San Fernando Valley in the base year.
- 3) The City of Los Angeles allocation of tobacco settlement revenues has been allocated on the basis of general fund proportionate share. The CFA and the Executive Officer's Report did not allocate this revenue source to the new city. This revenue source generated approximately \$3.0 million in the San Fernando Valley in the base year.
- 4) Special purpose fund appropriations have been reassessed to ensure that revenues and appropriations in each fund are allocated in a consistent manner. These final calculations use the same allocation factors for revenue received in a particular special fund, as are used for the appropriations made from that fund.
- 5) Transition costs have been updated based upon the most recent information supplied by the City of Los Angeles to the State Controller in its request for review of the Hollywood Comprehensive Fiscal Analysis. This information provided greater detail on the estimated transition costs applicable to any of the proposed cities.

### **REVENUE NEUTRALITY FINDING**

The Executive Officer finds that the current revenues generated in the San Fernando Valley that would accrue to the new city are \$1.14 billion based on actual base year revenues, and \$1.07 billion based on budgeted base year revenues. For purposes of the revenue neutrality test, revenues reflect the documentary transfer tax that would accrue to the new city.

By comparison, the Executive Officer finds that the current expenditures for services that would be assumed by the new city are \$1.05 billion based on actual base year expenditures, and \$1.01 billion based on budgeted base year expenditures. For purposes of the revenue neutrality test, expenditures exclude the Van Nuys Airport subsidy as this cost is currently borne by the Department of Airports, a proprietary department, and does not post to the City's budget. For the purposes of the revenue neutrality test, the budget surplus has been allocated based on general fund proportionate share to the new city as an expenditure item.

The Executive Officer concludes that the proposed special reorganization is not revenue neutral, as current revenues exceed current expenditures by \$98 million based on actuals and by \$66 million based on budgeted fiscal information. By comparison, the CFA found that for purposes of the revenue neutrality test, revenues exceed expenditures by \$34.9 million.

### **FISCAL IMPACT ON THE CITY OF LOS ANGELES**

In assessing the fiscal impact on the remaining City of Los Angeles, Government Code section 56845 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 Executive Officer finds that current revenues that would accrue to the new city exceed current expenditures that would be assumed by the new city by approximately \$98 million. The Executive Officer has recommended that the fiscal mitigation payment include an additional \$30 million to compensate the City of Los Angeles for its loss of documentary transfer tax revenues generated in the San Fernando Valley.

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 56845(a) defines the expenditure component of the revenue neutrality calculation as “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”. 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) the San Fernando Valley were no longer part of the City, and b) the San Fernando Valley was not relying on the City of Los Angeles for contract service.

### **CFA Approach**

The Comprehensive Fiscal Analysis apportioned field staff like front-line fire fighters, street cleaners, refuse collectors, police patrol officers, and librarians to the respective area based on the geographic area served by that particular worker. The CFA authors reviewed budget documents, organizational charts and other city records. In addition, the CFA authors interviewed City department managers about workload indicators, service levels, and the impact of special reorganization on their operations. The City department managers had difficulty identifying cost savings if one-third of the current City were to become independent. Despite repeated requests by the CFA authors, City representatives did not provide workload indicators useful in determining its employees’ workload attributable to servicing the San Fernando Valley. The interviews yielded little insight on the staffing requirements for a hypothetical post-secession City of Los Angeles. The CFA proceeded by allocating administrative staff based on the proportion of field staff serving the San Fernando Valley.

For purposes of illustration, the CFA approach is demonstrated through its allocation of the Police Department. Based upon organizational charts of the Police Department, the CFA identified 2,062 staff assigned to Valley police stations of a total 7,486 citywide staff assigned to police stations.<sup>4</sup>

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<sup>4</sup> The CFA methodology allocated budgeted and authorized positions as reflected in City of Los Angeles organizational charts. Similarly, the City of Los Angeles consultant’s stranded cost report focused on budgeted positions.

Thus, the CFA found the 28 percent of field staff were serving the San Fernando Valley. The CFA then allocated 28 percent of the Police Department's personnel, emergency dispatch, specialized policing units, crime lab and other centralized personnel costs to the San Fernando Valley.

### **City of Los Angeles Approach**

The City of Los Angeles argued that the CFA had overstated the cost savings that would be realized by the post-secession City of Los Angeles by over \$200 million.

The City views its centralized operations as requiring a minimum level of staffing with associated costs that could not be divided or reduced if the City were to become two-thirds of its current size.<sup>5</sup> In particular, the City views its accounting, payroll, human resources, purchasing, contracting, and computer system maintenance functions to be staffed at minimum levels and difficult to divide or reduce if the scope of the City's field operations were reduced by special reorganization. The City argues that the workloads for such functions does not disappear if the Valley departs because the workload is dependent "upon the performance of a specific function" rather than population, geography or the size of the City.<sup>6</sup> The City recommended that the best method of assessing the negative fiscal impact on the City is to look at current service levels. If the workload is not affected by the departure of the Valley, the City reasons that budget cuts in those areas would result in a decrease in service to the remaining City of Los Angeles.<sup>7</sup> The City concludes that "if service levels are decreased from their existing levels (and all other conditions are assumed to be fixed), then one can reasonably assume a negative fiscal impact from the departure of the Valley." (*ibid.*, page 2, emphasis added)

The logical thread of the City's argument assumes that:

- 1) The City's administrative units are currently staffed at minimum levels;
- 2) The workload of the City's administrative functions is unaffected by the size of the City, i.e. the number of criminals, fires, potholes, library card holders, garbage bins, taxpayers or City employees providing direct service to the public;
- 3) A secession-related reduction in the City's budget for administrative functions would reduce service levels in the remaining City of Los Angeles; and
- 4) The post-secession City of Los Angeles would be organizationally identical to the existing City of Los Angeles. In other words, the post-secession City of Los Angeles would not reorganize its units, branches, bureaus and departments, would not streamline its job classifications, would not rewrite job descriptions, and would not rely more heavily on outside specialists.

The second assumption—that the workload of administrative functions is dependent on the performance of a specific function—is tautological. The notion that the City's administrative workload is unrelated to the size of the City is inconsistent with the budgets of other cities, as discussed in the Executive Officer's Report. The City's fiscal consultant has acknowledged that if the City were 30 percent smaller, its leaders would allocate the same percent of resources to central

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<sup>5</sup> Fujioka, William T. *City Response to LAFCO Regarding Valley Secession Proposal and Initial Fiscal Analysis*. City of Los Angeles Office of Administrative and Research Services, June 13, 2001, page 4.

<sup>6</sup> *Ibid.* page 5

<sup>7</sup> *Ibid.* page 3

senior management as is currently devoted to such overhead costs.<sup>8</sup> In other words, the City's fiscal consultant believes that such administrative costs would shrink in proportion to the reduction in the size of the City's budget.

The third assumption would require the City to draw a connection between the activities of centralized staff and service levels provided to the taxpayers. If the City were to draw a connection between the activities of administrative staff and service levels, the City would then invalidate the second assumption. If payroll clerks are busy cutting paychecks for refuse collectors, if human resources specialists are busy recruiting to fill vacant police officer positions, if purchasing clerks are busy buying park sprinklers or if computer maintenance staff are busy keeping the local library computers running, then these administrative staff are providing municipal services to the public. If administrative workers are providing directly or indirectly services to the public, then their workload is clearly driven by the volume of the public's needs, which is in turn driven by the size of the city.

The fourth assumption is not credible. Even the City's fiscal consultant envisions the post-secession City of Los Angeles undergoing a reorganization involving unprecedented employee turnover, re-training of employees and managers as well as changes in employee and managerial assignments.<sup>9</sup> The elected officials of the City of Los Angeles would undoubtedly reorganize the various units, branches, departments and worker assignments to achieve service cost efficiencies. For example, a post-secession City of Los Angeles could economize on service costs by deploying specialists to assist the various small departments, rather than constraining specialists to serve a narrow function within a small department or unit. Another example is that the City could economize on supervisory costs by consolidating compatible units or departments.

The CFA authors rejected the City of Los Angeles allegations because the City failed to produce empirical evidence on the workloads and the factors driving the workloads of City staff. The State Controller found the City of Los Angeles argument about cost savings irrelevant because Government Code Section 56815 "validates the CFA's methodology to base mitigation payments solely on the difference between current revenue and current expenditures."<sup>10</sup> The Executive Officer rejected the City's "stranded cost" argument after finding that other cities manage to keep their expenditures in line with the size of the population being served.

### **Revised City Approach**

In response, the City of Los Angeles retained a consulting firm to conduct an "independent" estimate of the "stranded costs". In a one-month period, the City provided its consultant with interview access to representatives of each individual unit of the largest City departments and with "objective" workload data documenting the need for a particular level of staffing, and the consultant produced a fiscal analysis report. Generally, the consultant found that the post-secession City of Los Angeles could reduce its field staff engaged in direct service provision, but could make only limited 10-15 percent reductions in administrative and centralized support staff without affecting service levels. The City's consultant concluded that the fiscal mitigation payment should be at least \$98 million higher than the CFA estimate.

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<sup>8</sup> Hamilton, Rabinovitz & Alschuler, Inc. *The Division of Service Cost Burdens Following Separation of the San Fernando Valley from the City of Los Angeles: An Independent Appraisal*. Los Angeles, May 13, 2002, page 15.

<sup>9</sup> Hamilton, Rabinovitz & Alschuler, Inc. *The Division of Service Cost Burdens Following Separation of the San Fernando Valley from the City of Los Angeles: An Independent Appraisal*. Los Angeles, May 13, 2002, page 7.

<sup>10</sup> Connell, Kathleen. *California State Controller's Review of the Proposed San Fernando Valley Special Reorganization Comprehensive Fiscal Analysis*. Sacramento: California State Controller, April 2002, page 26.

The City of Los Angeles consultant's report provided tables indicating which City employees would be needed to sustain current service levels in a post-secession City of Los Angeles, and a brief summary of the general methodology used to derive the estimates.<sup>11</sup> The consultant's report does not share any of the particulars relating to the interviews of City staff, does not share any of the objective workload data documenting the need for post-secession staffing levels, and does not provide a rationale for its City staff allocations. The consultant's report lacks documentation on the derivation of the post-secession cost estimates.

The City's consultant has separately analyzed each unit in the major City departments, an approach that restricts the flexibility of reorganizing or "rightsizing" city government. Where there were fewer than three employees in a particular job title, the consultant has typically assumed that all of those staff are critical to maintaining City service levels. Thus, most of the centralized supervisory positions were assumed to be critical to maintaining City service levels. Where there are a significant number of staff with the same job title in a particular unit, the City's consultant has defined a greater than proportionate share as necessary to maintain City service levels.

The accompanying table demonstrates the difference between the CFA allocation and the City consultant's allocation of staff to the remaining City of Los Angeles in the case of the crime lab. While the CFA provides a rationale for apportioning staff costs based on the proportion of patrol officers stationed in the Valley, the City's consultant does not explain why a post-secession City of Los Angeles would need more photographers, typists or chemists to maintain service levels.

In the General Services department, the CFA allocated 24 percent of costs to the San Fernando Valley using explicit allocation factors. For example, the CFA allocated building maintenance costs based on the percent of City buildings located in the San Fernando Valley. By comparison, the City's consultant indicated that the City could eliminate only 17 percent of its positions in this department, but provides no details or explanation as to why additional positions were deemed necessary after secession.

The City's latest report does not provide evidence or adequate analysis substantiating the City's claim of stranded costs.

The Executive Officer concludes that the recent report reflects the opinions of the City's consultant without the benefit of concrete evidence of stranded costs. Furthermore, the Executive Officer notes that if indeed there are high fixed costs that the City would face if the Valley were independent, then the Valley would have strong financial incentives to contract with the City of Los Angeles for centralized services. In absence of compelling evidence,

	<b>CFA</b>	<b>City Consultant</b>
<b>Total</b>	<b>182</b>	<b>219</b>
Captain	1	1
Secretary	1	1
Forensic print specialists	56	66
Criminalists	45	50
Photographers	28	33
Typists	15	18
Police officers	13	18
Surveillance specialists	6	7
Chemists	2	3
Polygraph examiner	3	4
Management analysts	3	4
Document examiner	3	4
Lab technicians	3	4
Drafting technician	1	1
Composite artist	1	1
Storekeeper	1	1
Student workers	2	3

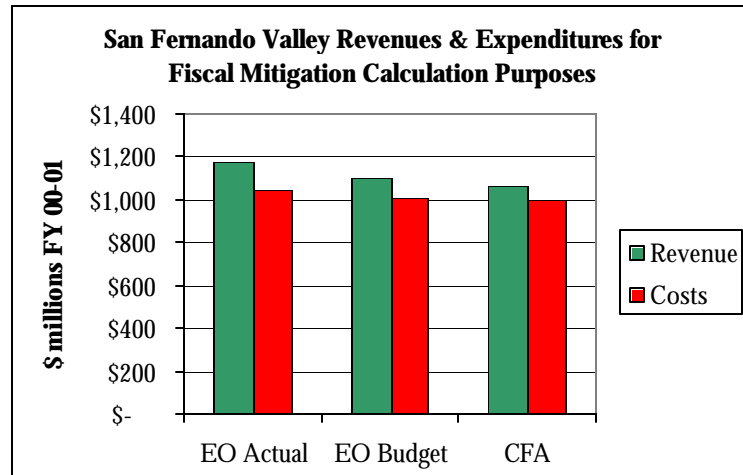
<sup>11</sup> Hamilton, 2002.

the Executive Officer recommends that the City's stranded cost estimates be disregarded in the fixing of the fiscal mitigation payment and that the commission determine that the \$128 million mitigation payment adequately mitigates the negative fiscal effect of the proposed special reorganization on the City of Los Angeles.

## Fiscal Mitigation Payment Amount

For purposes of calculating the fiscal mitigation payment, the Executive Officer recommends inclusion of the documentary transfer tax so that the negative fiscal impact on the City of Los Angeles reflects the effect of this reduced revenue stream. This approach diverges from the recommendations of the State Controller, who found that the negative fiscal impact on the City of Los Angeles should be calculated based on the revenue neutrality test and should not include lost documentary transfer taxes.

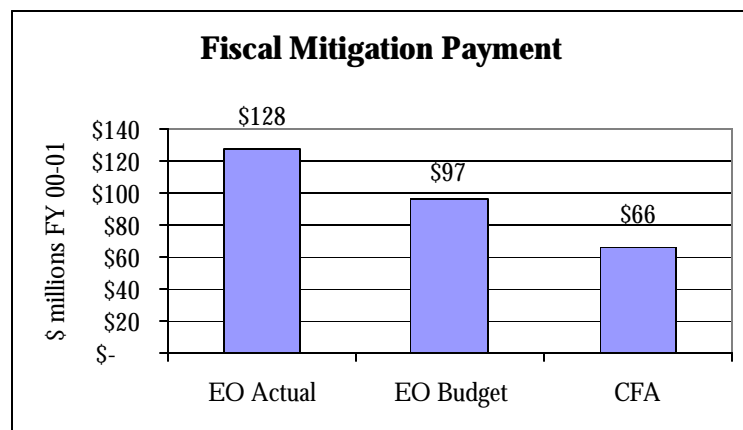
In calculating the fiscal mitigation payment, the Executive Officer has followed Government Code section 56845, which focuses on the current expenditures for services that will be assumed by the transferring territory rather than the budget cutbacks that the City of Los Angeles anticipates making after 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. This issue is discussed in greater length in the previous section of this report.



Based on the above, the Executive Officer finds that the negative fiscal impact on the City of Los Angeles had special reorganization occurred in the base year would have been \$128 million. This represents an increase of \$31 million over the Executive Officer's estimate of the fiscal mitigation payment based on budgeted revenues and expenditures. Further, the Executive Officer's estimate of the fiscal mitigation payment based on budgeted numbers is \$31 million higher than the CFA estimate. The difference is primarily due to the fact that the Executive Officer allocated a share of the Public Safety Augmentation Fund and reserve fund transfers, whereas the CFA did not allocate these revenues to the new city.

## Conclusion

Based on the above, the Executive Officer recommends that the Commission find that the Valley Special Reorganization would have an annual negative fiscal effect on the City of Los Angeles of \$128 million that should be mitigated.<sup>12</sup>



<sup>12</sup> Pursuant to Government Code section 56845(c), if current revenues and current expenditures are not substantially equal, the Commission may only approve a proposal if it finds that: (1) the county and all other subject agencies

## **FISCAL VIABILITY FINDING**

The Executive Officer has recalculated the fiscal estimates based on actual City revenues and expenditures in the base year for purposes of evaluating the fiscal viability finding. Further, the Executive Officer has updated other fiscal estimates that affect the fiscal viability finding as detailed below.

### **State Subventions**

The State allocates vehicle license fees and gas tax to local government on the basis of population and, in the case of new cities, on the basis of triple the number of registered voters. The Urban Research Division has estimated that there were 582,388 registered voters in the special reorganization area in March 2001. Based on this figure, the population estimate used for purposes of allocating state subventions would be 29 percent higher than the estimated population based on 2000 Census data. Because the current revenues generated in the San Fernando Valley are simply based on population, the actual distribution of state subventions to the new city would be more favorable.

The Executive Officer estimates that the new city would receive \$92.3 million in vehicle license fees based on fiscal year 2000-01 actual revenues, of which \$18.9 million reflects new revenues for the San Fernando Valley. Similarly, the new city would receive \$56.5 million in gas taxes based on fiscal year 2000-01 actual revenues, of which \$12.2 million reflects new revenues.

### **Documentary Transfer Tax**

As reported previously in the Executive Officer's Report and the CFA supplemental report, the San Fernando Valley would not be authorized to levy a documentary transfer tax at the City of Los Angeles current rate of \$2.25 per \$500 in property sales, and instead would have only half of the County's tax rate of \$.55 per \$500 in property sales. The new city's revenues would be \$30 million lower than current revenues generated in the territory due to this reduction in the documentary transfer tax rate.

### **Transition Costs**

For purposes of fiscal viability computations, the Executive Officer has used the most recently provided transition costs. The City informed the State Controller in its request for review of the Hollywood CFA that it estimated that one-time transition costs associated with redistricting were \$500,000, with bond validation were \$20,000, and with revenue collection were \$95,000 during the transition year. The State Controller had previously found that the City's annual contract administration costs would be approximately 0.3 percent of the service contract cost.<sup>13</sup>

The City estimated that its incremental election costs associated with holding two elections after redistricting the city council boundaries would be approximately \$274,000; however, the Executive Officer recommends that this cost be borne by the City of Los Angeles. In addition, the City estimated that its on-time contract administration costs would include a \$16 million Information Technology Agency contract negotiation expense. However, this cost estimate was deemed unreasonable by the State Controller, and the Executive Officer has not included that cost estimate in the fiscal viability calculations.

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agree, or (2) the negative fiscal effect of the incorporation is adequately mitigated by tax sharing agreements, a lump sum payment over a fixed period of time or other terms and conditions imposed by the Commission.

<sup>13</sup> California State Controller, *California State Controller's Review of the Proposed San Fernando Valley Special Reorganization Comprehensive Fiscal Analysis*, April 2002.

The Executive Officer estimates that the new city would pay approximately \$250,000 annually to reimburse the costs of the third party fiscal agent. This expense of the new city has been included in the fiscal viability calculations.

### **Debt Payments**

The fiscal viability calculations include debt payments by the new city to the City of Los Angeles for debt issued as of the election date. The resolution requires the new city to pay a proportionate share of lease obligation debt, Convention Center lease obligation debt, judgment obligation bonds, sanitation equipment revenue debt, parking revenue bonds, tort liability and workers' compensation claims.<sup>14</sup> Further, property owners in the San Fernando Valley would continue to bear liability for general obligation bonds, Proposition K debt, and special assessment debt that is included in the property tax bill. These debt payments made by Valley property owners would be remitted directly to the City of Los Angeles for use in defeasing the debt.

### **Reserve Fund and Fund Balances**

The Executive Officer's fiscal viability estimates include a transfer of a general fund proportionate share of the City of Los Angeles' emergency reserve fund. Although the resolution provides for a portion of the special purpose fund balances to be allocated to the new city, the fiscal viability computations assume that no such fund balances would transfer and do not reflect additional funding available to the new city through the transfer of such balances.

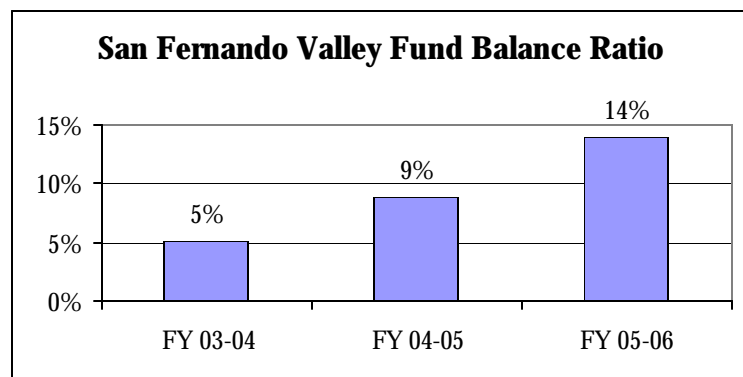
### **Van Nuys Airport Subsidy**

The City of Los Angeles Department of Airports subsidized the Van Nuys Airport at a net cost of \$3.4 million in the base year. This cost is currently an expenditure of a proprietary department and is not included in the City of Los Angeles budget. However, if the Van Nuys Airport were transferred to the new city, the new city would have to subsidize the airport from general fund revenues. Whether or not the Van Nuys airport would actually transfer to the new city is unknown because such a transfer would require the approval of the Federal Aviation Administration. Nonetheless, the Executive Officer has included the airport subsidy as a cost of the new city.

### **New City's Reserves**

The Executive Officer estimates that the expected cash balance of the new city would be 14 percent of general fund revenues by the end of new city's third year.

In order to approve a special reorganization, the Commission must find that the proposed city would generate "reasonable reserves" during its first three years. The Government Finance Officers Association recommends a minimum unreserved fund balance of "no less than 5 to 15 percent of regular



<sup>14</sup> In the fiscal viability appendix table, the sanitation equipment revenue debt payment is included in the cost of purchased services. The resolution requires the new city to make payments on this debt regardless of whether the new city relies on the City of Los Angeles for refuse collection service.

general fund operating revenues, or of no less than one to two months of regular general fund operating expenditures”.<sup>15</sup>

In its request for the Controller’s review, the City expressed concerns about the adequacy of the proposed city’s reserves in its first year. Further, the City questioned the CFA estimate of an eventual 2 percent reserve. The City’s opinion is that “the CFA has assumed a level of fiscal stability in the proposed new city greater than in the existing City of Los Angeles without having a basis for doing so.”<sup>16</sup> The Controller concluded that “no authoritative basis exists upon which a ‘sufficient’ level of reserve can be determined.”<sup>17</sup> However, the Controller asserted that the CFA estimates of the Valley city’s projected reserves are considerably lower than were Los Angeles and San Diego’s undesignated reserves in fiscal year 1998-99. Further, the Controller indicated that undesignated reserves tend to fluctuate significantly from year to year, and that projections of reserve levels are unreliable.

Indeed, the City of Los Angeles general fund reserves have fluctuated significantly over the last several years. The City entered fiscal year 1997-98 without any undesignated reserves; in fact, the City’s financial statements reported slightly negative reserves as of June 1997.<sup>18</sup> By the end of fiscal year 2000-01, which is the base year for purposes of the CFA, the City’s reserves were \$159 million or 5.4 percent of annual general fund revenues.<sup>19</sup> However, the City has apparently depleted a good portion of that reserve in the current fiscal year due to unanticipated revenue shortfalls, and is currently attempting to maintain a \$60 million emergency reserve.<sup>20</sup> This represents 1.9 percent of general fund revenues. If the City uses all or part of the \$60 million reserve fund to balance its budget this year, the reserves available in fiscal year 2002-03 may be lower than 2 percent.

In her review of the Hollywood CFA, the Controller took issue with construing the proposed city’s cash balance to be the proposed city’s reserves. Specifically, the Controller argued that the reserves should be defined as the cash balance before factoring in any loans or budget cutbacks that the proposed city might undertake. In essence, the Controller is defining reserves under a strict accounting approach in which the fund balance is the difference between the assets and liabilities of the proposed city.

The Controller’s accounting approach to the definition of reserves is impractical for evaluation of the proposed cities for three reasons. First, the CFA was conducted on the basis of the City of Los Angeles budget, due to the greater programmatic detail provided in the budget as opposed to the City’s financial statements. Second, the Controller’s approach to defining reserves would require financial statements on the new cities, which are not expected to be available until after the City of Los Angeles has produced financial statements for activity ending on the special reorganization effective date. Third, the Controller’s approach would require a valuation of assets transferred to the proposed city which is not available.

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<sup>15</sup> Government Finance Officers Association. “Governmental Accounting Focus: New Recommendations from GFOA”, *GAAFR Review*, Vol. 19, No. 2, February 2002.

<sup>16</sup> Letter from City of Los Angeles Mayor James K. Hahn to LAFCO Executive Officer Larry Calemine. “Request by the City of Los Angeles for the State Controller’s Review of the Comprehensive Fiscal Analysis for the Proposed Special Reorganization for the San Fernando Valley”, February 11, 2002.

<sup>17</sup> California State Controller, *California State Controller’s Review of the Proposed San Fernando Valley Special Reorganization Comprehensive Fiscal Analysis*, April 2002.

<sup>18</sup> City of Los Angeles, Office of the Controller. *Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 1997*, December 22, 1997.

<sup>19</sup> City of Los Angeles, Office of the Controller. *Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2001*, January 18, 2002.

<sup>20</sup> City of Los Angeles, Office of the Controller, *Estimate of Revenue for Fiscal Year 2002-03*, March 1, 2002.

The year-end cash balance reflected in the Executive Officer's fiscal viability calculations reflects the overall budget surplus of the proposed city. As such, it includes both general and special purpose funds. For the most part, the Executive Officer's fiscal estimates have assumed that appropriations from special purpose funds are allocated to the proposed city in proportion to the special purpose revenues allocated to the new city. Thus, the year-end balance primarily reflects a general fund balance. Given that future debt payments have been budgeted in the fiscal viability calculations, the year-end balance approximates the undesignated, unreserved general fund balance that is reflected in the "reasonable" reserve ratios discussed above.

### **Conclusion**

The Executive Officer concludes that the proposed city's cash balance would meet the Government Finance Officers Association standard for reasonable reserves. The Executive Officer finds that the proposed city is expected to generate reasonable reserves and to be financially viable.

## **FISCAL MITIGATION TERMS**

The City proposed that the mitigation amount be \$305 million, subsequently revised by the City's consultant to be no lower than \$165 million.<sup>21</sup> The Executive Officer finds that the mitigation payment should be \$128 million, and based on the actual City revenues and expenditures in the special reorganization base year. The mitigation amount reflects the fiscal effect on the City of Los Angeles based on current revenues and expenditures. Although the Commission is not legally required to do so, the Executive Officer recommends that the fiscal mitigation payment include the City's full loss in documentary transfer tax revenues currently generated in the Valley.<sup>22</sup>

The Applicant has proposed a mitigation payment made over a twenty-year term.<sup>23</sup> The City of Los Angeles has proposed a mitigation payment made on a monthly basis over a period of 25 years.<sup>24</sup>

The Executive Officer recommends that the mitigation payment should be \$128 million and structured as a twenty-year payment with a gradual phase-out. This approach is based in part on the Elk Grove mitigation payment that was structured to gradually reduce the County's reliance on the mitigation payment.<sup>25</sup> Under the recommended approach, the mitigation payment would be discounted by five percent annually beginning in the first full fiscal year following incorporation. This five percent phase-out rate is less than the City of Los Angeles' staff attrition rate (7 percent), implying that the City of Los Angeles could adjust to the financial effect of the Valley's departure without laying off City workers. By the year 2022, the Valley would make its final payment, which would be only 5 percent of the inflation-adjusted estimate in the CFA.

For purposes of making provisional monthly fiscal mitigation payments, the new city should use the California Department of Finance forecasts of the Consumer Price Index for the Los Angeles area. Once the actual inflation data are available, the new city should adjust its next payment for any overpayment or underpayment made due to differences between the forecast and the actual inflation.

Given that the Subcommittee previously adopted a staff recommendation that all such revenues be remitted to the third party fiscal agent, the mitigation payment would be taken out of the new city's property taxes by that fiscal agent and remitted to the City of Los Angeles.

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<sup>21</sup> Hamilton, Rabinovitz & Alschuler, Inc. *The Division of Service Cost Burdens Following Separation of the San Fernando Valley from the City of Los Angeles: An Independent Appraisal*. A report commissioned by the City of Los Angeles. May 13, 2002.

<sup>22</sup> The State Controller recommended that the new city be required to pay fiscal mitigation based on revenues that would accrue to the new city. That approach would reduce the mitigation amount by

<sup>23</sup> Valley VOTE, *Recommended Terms and Conditions*, March 6, 2002.

<sup>24</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>25</sup> Elk Grove initially paid Sacramento County 90 percent of its property tax revenues, with the share declining by 5 percent every five years, and in the 19th year being phased out at a rate of 10 percent annually.

## ***TRANSITION PERIOD***

### **EFFECTIVE DATE**

The Commission must establish an effective date for the proposed city within nine months of the election approving the special reorganization.<sup>26</sup> The City of Los Angeles had proposed July 1, 2003, whereas the Applicant proposed that the new city incorporate on December 16, 2002 or January 1, 2003. In the draft resolution, the effective date is established as the July 1 after the election.

#### Pros:

- 1) There will be an additional six months of time for the new city to recruit a city manager and department heads, to conduct strategic planning and budgeting, and to prepare the ordinances of the new city.
- 2) The City of Los Angeles will be obligated to provide transition period services without service contracts for a twelve-month period rather than an eighteen-month period, reducing the City's exposure to a service obligation that is not defined by contract.
- 3) The City of Los Angeles will be able to redistrict and conduct city council elections between the special reorganization election and the effective date. If the effective date were January 1, the City of Los Angeles council members representing the special reorganization area would remain on the Council until March 2003.
- 4) The July 1 effective date will better accommodate the allocation of a share of the City's reserve funds to the new city. The City of Los Angeles predicts that it will not have reserves available for allocation to the proposed city on January 1, as the City is likely to be in a negative cash-flow position at that time of year.<sup>27</sup>
- 5) The City of Los Angeles will be unencumbered by special reorganization when it issues and reimburses its fiscal year 2002-03 tax and revenue anticipation notes. The City of Los Angeles and the new city may separately issue and reimburse short-term debt in fiscal year 2003-04 and thereafter.
- 6) The July 1 effective date simplifies special reorganization from an accounting standpoint. There will be no need for the City to close its books in the middle of the fiscal year. The July 1 effective date eliminates the need for a property tax transfer from the City of Los Angeles to the new city, and eliminates the need for a business tax revenue offset to be computed and applied to the transition period service payment.

#### Cons:

- 1) A July 1 effective date gives the City of Los Angeles an eight-month window during which it may make policy decisions affecting the San Fernando Valley without accountability, whereas a January effective date limits that window to two months.
- 2) The new city would not be a legal entity, and would be unable to defend itself against a legal challenge by the City of Los Angeles between the election and the effective date.

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<sup>26</sup> Government Code section 57202.

<sup>27</sup> City of Los Angeles. *Attachment: Fiscal Comments and Questions on the Valley Secession Draft Resolution of Determination and the LAFCO Executive Director's [sic] Report on Valley Secession Dated April 19, 2002, May 15, 2002.*

- 3) The new city would not exist as a legal entity, which would limit its ability to conduct negotiations with the City of Los Angeles between the election and the effective date.

The Executive Officer has evaluated the Applicant's concerns regarding a July 1 effective date, and continues to recommend a July 1 effective date. A January 1 effective date would have a negative fiscal impact on the proposed city by creating additional accounting transition costs, require the apportionment and crediting of revenue sources that would continue to flow to the City of Los Angeles, and create cash flow issues that are avoided by a July 1 effective date. The draft resolution has been structured to avoid long-term impacts of City of Los Angeles decisions, such as the issuance of debt, after the election date. Potential legal challenges prior to the effective date would likely be directed to the Commission's decision and defended by Legal Counsel.

### **TRANSITION PERIOD LENGTH**

Although the Government Code provides that the transition period end at the end of the fiscal year during which incorporation takes place, the Commission has discretion over the length of the transition period. The City of Los Angeles has proposed that the transition period be no longer than one year, whereas the Applicant proposes that the transition period be eighteen to thirty months in length. The draft resolution establishes a twelve month transition period, from July 1 to June 30 of the following year.

The City of Los Angeles proposed that the transition period be limited in length to reduce the length of what the City predicts will be a contentious period. The City is concerned about potential conflict arising from a service obligation which is not defined by contract.

The Applicant proposed a longer transition period to provide an appropriate interval for the assessment, planning, research, recruitment, negotiation and transition necessary to establish the new city. The Applicant foresees negotiating service contracts, setting up departments, recruiting personnel and adopting a new city charter during the transition period.

The Executive Officer recommends that the transition period end date coincide with the end of the fiscal year. Further, the Executive Officer concurs with the City of Los Angeles that the transition period will be a time of uncertainty and potential conflict over service scope and payment, and thus seeks to limit that period of time. However, the Executive Officer considers the nineteen-month period between the election and the end of the transition period to be adequate time to accommodate negotiation of service contracts and the establishment of the new city.

The Executive Officer continues to recommend a twelve-month transition period that commences on the July 1 after the election and ends on the following June 30.

### **TRANSITION PERIOD SERVICE SCOPE**

The draft resolution requires that the City of Los Angeles continue to provide all currently-provided services to the new city during the transition period. Although the Executive Officer's report recommended that the activities of the City's Department of Neighborhood Empowerment be outside the scope of transition period service, the Applicant subsequently proposed that the Department of Neighborhood Empowerment be included within the scope of transition period service requirements.<sup>28</sup> The City of Los Angeles has asked for clarification of the transition period service scope. The transition period service scope now includes all services currently provided.

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<sup>28</sup> Valley Vote, *San Fernando Valley Special Reorganization Applicant Requests*, May 15, 2002.

The Executive Officer recommends that the transition period service scope include all services currently provided to the San Fernando Valley special reorganization area.

### **TRANSITION COST CONTROLS**

The draft resolution includes a provision that imposes transition cost controls on the City of Los Angeles. The provision provides that the City of Los Angeles shall not be entitled to reimbursement for transition costs in excess of \$100,000 without the prior consent of the new cities.

The City of Los Angeles has argued that such consultation infringes upon the home rule authority of the City and will create unnecessary disputes. Further, “the City of Los Angeles has been forthright in identifying known transition costs at this time.”<sup>29</sup> While the City has identified categories of transition costs, the City has not identified all costs and certain estimates have been questioned.

For instance, the City Information Technology Agency’s \$16 million estimate of computer-related transition costs. The State Controller reviewed the estimate, found inadequate justification, and concluded that “the estimate of the potential costs of the Information Technology Department seems unreasonable.”<sup>30</sup>

Upon further analysis, the Executive Officer has expanded the scope of reimbursable transition costs to include copying records and data, costs related to employee transfers, , recording deeds for property transfers, street easement quitclaim processing, accounting costs, information technology and computer reprogramming, and other similar one-time costs related to the special reorganization. However, given that there may be unknown costs involved and given the fact that the new cities will have to bear the burden of these costs, it is reasonable to require the City of Los Angeles to inform and obtain the concurrence of the new cities with respect to these costs. .

The Executive Officer continues to recommend that the transition cost control provision be included in the resolution.

### **TRANSITION SERVICE COST PAYMENT**

Consistent with Government Code section 57384 the draft resolution provides that the new city shall reimburse the City of Los Angeles for the total actual direct and indirect costs of transition period services, except that the definition of “net costs” should not exclude cost to be paid from special funds that have been transferred to the new city. Transition period service costs area also offset by any revenues generated in the new city during the transition period that are retained by the City of Los Angeles, including first quarter sales tax. The City of Los Angeles has asked for clarification of the sales tax revenue offset for the first quarter of the transition period. The Board of Equalization has informed the Executive Officer that it will be unable to process the new city’s application in a one-day period, and that the new city’s sales tax allocation in the first quarter of the transition period will be remitted to the City of Los Angeles. Thus, the City of Los Angeles will be directly receiving the new city’s sales tax payment in the first quarter of the transition period. The sales tax offset is designed to ensure that sales tax revenues generated in the San Fernando Valley after the effective date are credited toward transition period service costs.

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<sup>29</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>30</sup> California State Controller, *California State Controller’s Review of the Proposed San Fernando Valley Special Reorganization Comprehensive Fiscal Analysis*, April 2002.

### **BUDGETED GRANT FUNDS**

The draft resolution requires the City of Los Angeles to allocate budgeted grant funds to the new city during the transition period. The Executive Officer has reviewed the budgeted entitlement grants, and determined that the granting agencies are not likely to allocate funds directly to the new city during the transition period. Thus, the Executive Officer has recommended that in lieu of a direct allocation by the granting agencies or any other legal prohibitions or requirements, these grant funds be allocated to the new city during this interim period.

The City of Los Angeles has asked for clarification of the provision allowing the City to transfer funds directly to the fiscal agent or to credit the grant funds toward the transition period service cost. The provision requires the City of Los Angeles to transfer the appropriate share of budgeted grant funds directly to the third party fiscal agent, or to deduct the appropriate share of budgeted grant funds from the transition service cost invoice. This provision would allow the City to deduct the Housing and Urban Development (“HUD”) grant administration allocation from the Community Development Department’s cost of administering grants in the San Fernando Valley during the transition period.

The City argued that HUD grant apportionments be determined by HUD formula rather than the proportion of low and moderate income households in the San Fernando Valley. The Executive Officer notes that at least 70 percent of HUD grant funds are required to benefit the low and moderate income population, and that any HUD directives on transition period grant allocations would, by the terms of the draft resolution, supercede the resolution.

The Applicant proposed that the new city begin applying for grants in 2004, and that the City of Los Angeles provide grant administration services through the end of calendar year 2004. The Executive Officer notes that the new city could receive HUD grants directly as early as April 2004, if it were to begin applying for grant funds soon after the effective date. Further, the resolution does not prevent the new city from contracting with the City of Los Angeles for grant administration services after the transition period.

The Applicant argued that the provision should include competitive grants as well as entitlement grants. The Executive Officer notes that the new city may appeal directly to granting agencies as to the appropriateness of a requirement that competitive grant funds be expended in the San Fernando Valley during the transition period.

The Executive Officer continues to recommend that the City of Los Angeles be required to allocate directly or through a credit towards the transition period service payment a proportionate share of budgeted entitlement grant funds unless and until the granting agencies direct otherwise.

### **OFF-BUDGET GRANT FUNDS**

Most entitlement grant funds received by the City are excluded from the City’s budget, because they are essentially pass-through funds allocated to non-profit social service providers. The draft resolution does not require the City of Los Angeles to transfer off-budget grant funds to the new city, but does require that the City of Los Angeles continue to provide social services through grant funds in the new city unless instructed otherwise by the granting agency.

The City of Los Angeles did not express opposition to this provision.

The Applicant expressed concern that the provision should include both competitive and entitlement grants. The resolution provision is not limited to entitlement grants, and requires the

City of Los Angeles to continue to provide grant funding to social service providers in the San Fernando Valley throughout the transition period.

The Applicant expressed concern that the provision should extend through the end of calendar year 2004 instead of sunseting on June 30, 2004. The Executive Officer notes that the new city could apply for HUD entitlement grants for receipt in April 2004. The resolution does not prevent the new city from requesting grant allocation extensions from the granting agency directly, in the event that the granting agency is unable to allocate funds to the new city by the end of the transition period.

The Executive Officer continues to recommend that the City of Los Angeles be required to maintain off-budget grant funding for social service providers located in the San Fernando Valley throughout the transition period. Any transition period grant allocation instructions by the granting agency would, by the terms of the draft resolution, supercede the resolution.

### **FISCAL AGENT PAYMENT PRIORITIES**

The resolution includes a provision that establishes the payment priority scheme to be followed by the third party fiscal agent. This provision establishes as first priority the new city's payments to the City of Los Angeles for outstanding debt, as second priority the new city's payments to creditors for the new city's direct debts, as third priority the fiscal mitigation payment, as fourth priority the new city's payment of transition period services, as fifth priority the new city's transition cost payments, and as sixth priority the new city's operating costs. The first priority is required to ensure that the rights of City of Los Angeles bondholders are not impaired, and that the credit rating of the City of Los Angeles is not impaired. The second priority is required to ensure that the new city may issue debt such as tax and revenue anticipation notes with adequate assurances that bond-holders will be repaid.

The City of Los Angeles has asked that transition costs be ranked above transition period service costs in the payment priority scheme. The Executive Officer has accommodated this request. In addition, the City of Los Angeles has proposed that payments for any debt issued by the new city be reduced to the last priority of payment. The Executive Officer recommends against this proposal as it would limit the new city's ability to issue short-term debt that might reasonably be used by the new city to make its debt payments, fiscal mitigation payment or transition period service payment. The Executive Officer considers the new city's access to creditors to be critical to accommodate the cash flow needs of both cities.

The Applicant's bond counsel requested that the new city's debt payments be given equal priority as its debt payments to the City of Los Angeles. The Executive Officer rejects this proposal and continues to recommend that debt payments to the City of Los Angeles be ranked top priority in order to provide the strongest protection possible to existing bond-holders and the City's credit rating.

In conclusion, the Executive Officer has revised his recommendation to accommodate the City of Los Angeles request that transition costs be ranked at a higher payment priority level than transition period service costs.

### **ADVANCE PAYMENTS**

The resolution includes a provision that prevents the City of Los Angeles from demanding advance payments for the City's debt, as the City had originally proposed to do. The provision would require

the City of Los Angeles to credit the new city for interest on payments made more than one week in advance.

The City of Los Angeles has proposed that it should be allowed to require advance payments from the new city if the new city does not pay in a timely manner. The Executive Officer notes that the resolution authorizes the City of Los Angeles to reduce service levels in the new city if the new city is more than 30 days late in making a transition period service payment. There is no risk of late payments for City of Los Angeles debt as those payments receive top priority in the payment scheme.

The City of Los Angeles has asked that reasonable interest expenses be more specifically defined based upon the City of Los Angeles general pool investment yield. The Executive Officer has accommodated this proposal.

The Executive Officer continues to recommend that advance payments require compensation for lost interest.

## ***EMPLOYEES***

The resolution includes two provisions relating to employees. With respect to employee transfers, both the City of Los Angeles and the new city are required to comply with the provisions of Government Code section 56844.2. This requires the parties to honor collective bargaining agreements, and existing retirement benefits, and to meet and confer with the unions representing any transferred employees. More specifically the statute requires the following:

- b. All public employees to which Chapter 10 (commencing with Section 3500) of Division 4 of Title 1 applies shall continue to be deemed public employees of the original local agency or of the newly incorporated local agency for all the purposes of that chapter, including, but not limited to, the continuation and application of any collective bargaining agreement that applies to these employees, and all representational and collective bargaining rights under that chapter.
- c. Any existing collective bargaining agreement shall remain in effect and be fully binding on the original local agency or on the newly incorporated local agency, and on the employee organizations that are parties to the agreement for the balance of the term of the agreement, and until a subsequent agreement has been established.
- d. Any existing retiree benefits, including, but not limited to, health, dental, and vision care benefits, shall not be diminished.
- e. Notwithstanding any other provision of law, an employee organization that has been recognized as the exclusive representative of local agency public employees affected by a special reorganization shall retain exclusive representation of the unit employees of the original local agency, or of the newly incorporated local agency.

The City of Los Angeles has proposed that the new city pay for accrued vacation and sick leave of transferred employees. The Executive Officer notes that it is unnecessary to “cash out” the compensated time off of transferred employees. In order to accommodate this need, the new city shall accept responsibility and liability for accrued vacation, sick leave and other compensated time-off for City of Los Angeles employees who transfer to the new city as part of a transfer in service responsibility from the City of Los Angeles to the new city.

The City of Los Angeles has noted that the resolution does not provide a solution to mitigate fiscal harm to sworn Police and Fire employees who are not vested in the pension system. The Executive Officer notes that the City of Los Angeles has the power to prevent fiscal harm to unvested police officers and firefighters by amending its charter to allow the new city to participate in the City of Los Angeles Fire & Police Pension Fund.

The Applicant proposed that the resolution require reciprocity between the pension systems of the City of Los Angeles and the new city for any transferred police and fire personnel. The Applicant has argued that the Commission is authorized by law to specify such a requirement in the resolution.

The Executive Officer continues to recommend that the City of Los Angeles be allowed to resolve the pension portability problem for police officers and fire fighters, and recommends against the Commission imposing a term and condition on this matter.

The Applicant proposed that the Commission impose the City of Los Angeles civil service system upon the new city for any employees who transfer from the City of Los Angeles to the new city.

The Executive Officer considers this policy decision to be an appropriate decision of the elected officials of the new city.

## **ASSETS**

With respect to assets, the Commission has received differing legal opinions regarding the Commission's authority to transfer assets. The legal opinion of the County of Los Angeles Office of the County Counsel ("County Counsel"), the Commission's legal advisor, concluded that the Commission could only transfer proprietary assets of the City of Los Angeles subject to the payment of compensation or consent of the City, but could transfer assets held subject to a public trust without compensation.<sup>31</sup> The legal opinion of the California Legislative Counsel ("Legislative Counsel") concluded that the Commission has the discretion to allocate assets either with or without compensation.<sup>32</sup>

To the extent that these opinions conflict with respect to the manner in which the Commission may handle the transfer of assets, staff provided dual recommendations for the Subcommittee's consideration. Where there was no conflict in the legal opinions or where, because of other considerations, staff recommended a particular course of action, only one recommendation was provided to the Subcommittee.

### **LEGAL OPINIONS**

The County Counsel's legal opinion concluded that the Commission was not authorized to transfer proprietary property of the City of Los Angeles to a Valley city without compensation or the consent of the existing city. The County Counsel concluded, however, that assets held pursuant to a public trust, such as pueblo lands, roads, highways, donated parks and donated libraries, may be transferred without compensation.

The Legislative Counsel's legal opinion concluded that the Commission has the discretion to order a transfer of assets from the City of Los Angeles to a proposed new city as a condition of approving a special reorganization, with or without compensation. The Legislative Counsel believes that it was the intent of the Legislature to leave the decision as to whether or not to require compensation to the Commission, and did not identify any constitutional restrictions on the Commission's authority to transfer assets without compensation.

### **TRUST ACCOUNT FUNDS & LIQUID ASSETS**

The City of Los Angeles requested that fund balances available for transfer be defined as the fund balance net of reversions, required re-appropriations, outstanding loans and encumbrances. The draft resolution allocates fund balances net of outstanding loans, encumbrances and re-appropriations required for capital improvements.

### **LOCAL SERVICE-RELATED ASSETS**

The City of Los Angeles objects to the transfer of assets without compensation from the new city. The Executive Officer notes that the City of Los Angeles engaged in negotiations with the Applicant regarding which specific facilities would transfer to the new city, and provided a list of transferable facilities to the Executive Officer.

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<sup>31</sup> County of Los Angeles, Office of the County Counsel, *Authority to Require the Transfer of Assets as Terms and Conditions of the Proposed Special Reorganizations*, November 21, 2001.

<sup>32</sup> California Legislative Counsel Opinion No. 128, *Special Reorganizations: Division of Assets*, January 8, 2002.

## ***ENTERPRISES***

### **UTILITIES**

#### **Utility Rates**

The City of Los Angeles continues to object to a resolution provision that prevents the City of Los Angeles from charging higher utility rates to San Fernando Valley customers than it would charge equivalent customers in the remaining City of Los Angeles. This provision does not involve utility rate-setting on the part of LAFCO and does not prevent the City from recouping its costs of providing utility service.

The City of Los Angeles objects to the resolution provision and alleges that it would require ratepayers in the remaining City to subsidize ratepayers in the Valley through payment of a DWP franchise fee in the Valley. The Executive Officer acknowledges that if the Valley imposes a franchise fee on utility usage, that would limit the City of Los Angeles "Power Revenue Transfer" fee imposed on Valley ratepayers to no more than two percent less than the corresponding fee charged to ratepayers in the remaining City of Los Angeles. The Executive Officer does not concur with the City's conclusion that ratepayers in the remaining City would subsidize Valley ratepayers. In fact, the provision does not prevent the City from continuing to impose "Power Revenue Transfer" charges on Valley ratepayers, thus Valley ratepayers would be effectively subsidizing the City of Los Angeles general fund.

## ***LIABILITIES***

### **GENERAL FUND LEASE OBLIGATIONS AND CERTIFICATES OF PARTICIPATION**

The Convention Center bonded indebtedness is a lease obligation debt that is paid partly by Convention Center operating revenues and partly by the City of Los Angeles general fund. The draft resolution provides for the City of Los Angeles to continue to own and operate the Convention Center; thus, the City of Los Angeles will control the Center's revenue stream.

The City of Los Angeles alleges that the draft resolution inaccurately apportions bonded indebtedness relating to the Convention Center, and alleges that Convention Center operating revenues do not pay for debt service. The Executive Officer encourages the City to review the Mayor's proposed fiscal year 2003-04 budget in which the lease obligation to the Convention Center exceeds the general fund source of funds for each of four fiscal years reflected on pages 58-59.

Although the Executive Officer's report and draft resolution had already provided that the new city only bear obligation for the general fund component of Convention Center debt, the provision has been further clarified.

## **MISCELLANEOUS PROVISIONS**

### **PROPOSITION K ASSESSMENT DISTRICT**

#### **AUDIT RIGHTS**

The City of Los Angeles requested reciprocal audit rights of the new city and its fiscal agent. The draft resolution accommodates this request.

#### **PROVISIONAL APPROPRIATIONS LIMIT**

The Executive Officer has calculated the provisional appropriations limit of the new city as \$1.350 billion. This provisional limit is based upon the new city's projected revenues of \$1.173 billion in the base year, as well as inflation and population growth that is expected to occur between the base year and fiscal year 2004-05. The California Department of Finance has forecast 4.7 percent population growth in Los Angeles County will occur between year 2000 and 2005.<sup>33</sup> Given that the San Fernando Valley population estimate is based on 2000 Census data, this forecast adjusts for population growth through fiscal year 2004-05. Based on a combination of empirical data from the U.S. Bureau of Labor Statistics and inflation forecasts issued by the California Department of Finance, inflation between January 2001 and January 2005 is estimated at 10 percent. Given that the base year is fiscal year 2000-01, this inflation figure adjusts for inflation between the base year and the middle of fiscal year 2004-05.

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<sup>33</sup> State of California, Department of Finance, *Interim County Population Projections*. Sacramento, California, June 2001