

**SPECIAL REORGANIZATION OF THE SAN FERNANDO VALLEY AND
HOLLYWOOD: COMBINED EFFECTS**

EXECUTIVE OFFICER'S SUPPLEMENTAL REPORT

TO THE

LOCAL AGENCY FORMATION COMMISSION
FOR LOS ANGELES COUNTY

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This report has been prepared pursuant to inquiries by Commissioners Miscikowski, Proo and Burke regarding the combined effects of the San Fernando Valley and Hollywood special reorganizations.

The City of Los Angeles has expressed concern about “the combined effects of two or all three of the proposals being adopted simultaneously. Of particular uncertainty is the impact multiple secessions might have on the remaining city.”¹ Although Commissioner Burke asked the City of Los Angeles to provide analysis of the combined effect of special reorganization at the April 24, 2002 Commission meeting, neither the City’s subsequent nor previous correspondence has provided any analysis of this issue. The City has not advanced any hypothesis as to why the combined fiscal effects would exceed the sum of the individual reorganization effects, nor has the City argued that such would be the case.²

Nonetheless, the Executive Officer has identified two areas—transition costs and economies of scale—in which the combined effect might theoretically differ from the sum of the individual effects as assessed in the Executive Officer’s Reports on San Fernando Valley and Hollywood special reorganization.

Transition Costs

Combined transition costs could be higher or lower than the sum of individual transition costs depending on how the LAFCO resolution allocates such costs and the extent to which the transition tasks for Hollywood duplicate transition tasks that must be performed for the San Fernando Valley. There are two types of cost-sharing arrangement for transition costs:

- 1) **All Cities’ Costs:** The draft resolution requires the City and the new cities to share certain transition costs in proportion to assessed value, this cost-sharing requirement applies to about \$700,000 in expenses for the special reorganization election and the cost of redistricting the City of Los Angeles. For the special reorganization election, this manner of apportionment is required by Government Code section 57150(e). The City’s share of these costs would be 95% if only the Hollywood special reorganization is approved, and 60% if both the San Fernando Valley and Hollywood reorganizations are approved. That is reflective, however, of the size of the remaining City of Los Angeles after special reorganization since the costs are apportioned based upon assessed value, and therefore, multiple reorganizations do not have any real cumulative impact on the City’s share of these costs.
- 2) **New Cities’ Costs:** The resolution requires the new cities to bear other transition costs, such as bond validation, revenue collection, photocopying records, computer reprogramming and transferring deeds. In certain cases, such activities would be less expensive if the tasks performed for the San Fernando Valley are of equal use for Hollywood. Given that the resolution does not require the City of Los Angeles to share in

¹ Fujioka, William T. *Draft Resolution of Determination and LAFCO Executive Officer Report regarding the Valley Special Reorganization*, dated April 19, 2002, May 14, 2002, page 6.

² The City’s fiscal consultant has argued that stranded costs for centralized service staffing “as a result of multiple secessions would certainly be different from, and very possibly appreciably higher than, those stranded by a single secession.” (Emphasis added.) The Executive Officer notes that this point does not address the question of the combined effect exceeding the sum of the effects of each proposal. See Hamilton, Rabinovitz & Alschuler, Inc. Revenue Neutrality Issues Related to the Proposed Hollywood Secession. Report to the City of Los Angeles City Administrative Officer, May 31, 2002, page 5.

such costs, there would be no fiscal effect on the City from either or both of the special reorganizations.

The Executive Officer concludes that combined transition costs would be no greater than the sum of the transition costs associated with the San Fernando Valley and Hollywood. The City of Los Angeles' share of transition costs in the event of multiple special reorganizations would be no greater than the sum of the parts.

Economies of Scale

The combined effects of Hollywood and San Fernando Valley special reorganization could be higher or lower than the sum of the individual effects depending on whether or not the City of Los Angeles would lose economies or diseconomies of scale. In this context, "economies of scale" represent lower costs for municipal services due to cost savings attributable to the large size of the City, whereas "diseconomies of scale" represent higher costs for municipal services due to cost inefficiencies attributable to the large size of the City.

The question is whether or not the City could lose economies of scale and related efficiencies if its size were reduced by the combined special reorganizations. In considering this question, it is important to distinguish between the straightforward short-term fiscal effects and long-term efficiency-related fiscal effects.

- 1) **Current-cost fiscal effects** are the subject of the CFA, and are clearly identifiable based on the current cost of servicing the different geographic areas of the City. In the short term, the new cities are expected to contract with the City of Los Angeles for services, and each city is expected to bear its share of service costs based on current practices. So long as the new cities continue to use City of Los Angeles contract services, the current-cost fiscal effects are the only relevant fiscal effects. These short-term and relatively straightforward effects are the fiscal effects contemplated by the Cortese-Knox Act. The current-cost fiscal effects are not relevant to the question of whether or not the City would lose cost efficiencies due to simultaneous departure of the San Fernando Valley and Hollywood, because the City of Los Angeles can only lose economies of scale if the new cities discontinue service contracts. Otherwise, the current scale of City operations would continue to be the same.
- 2) **Efficiency-related fiscal effects** of special reorganization are based on the future cost of servicing the different special reorganization areas. In the long term, the new cities will deliver services in the most efficient manner, if that is what their constituents are demanding. In a rational world, the new cities will establish direct services or contract with the other service providers if that means they can more effectively and efficiently deliver services to their constituents, and will continue to rely on the City of Los Angeles for contract service if that is the more efficient option. In a rational world, the City of Los Angeles will "right-size" and reorganize in the long term to effectively and efficiently deliver services to their smaller constituent base. These efficiency-related long-term fiscal effects differ from current-cost fiscal effects in being determined by the future adaptability, creativity and political priorities of each of these affected cities.

Theoretically, there are two possible scenarios that would cause the combined effect of San Fernando Valley and Hollywood reorganization to differ significantly from the sum of the effects of each proposal. These involve the City losing economies of scale thereby facing higher costs, and the City losing diseconomies of scale thereby achieving lower costs.

The City of Los Angeles could lose economies of scale if both cities were to discontinue relying on the City of Los Angeles for those contract services that the City most efficiently provides. Clearly if there are service areas in which the City of Los Angeles offers efficiencies due to economies of scale, the new cities would have incentives to continue contracting with the City of Los Angeles for service.

Although the bond rating agencies have expressed general concern about the potential loss of economies of scale, they have merely assumed the existence of such economies of scale and failed to provide meaningful examples.³ The City has provided some examples of economies of scale:

- 1) The City has argued that it would lose managerial efficiencies relating to “span-of-control,” or in other words would need to keep most of its supervisors and managers even after the size of the City’s non-supervisory workforce is reduced by one-third. However, the City’s own arguments contradict the notion that the City currently has supervisory cost efficiencies related to the size of the City, because the City indicated that the workload of these supervisors is unrelated to the size of the City. Further, the City has acknowledged that its analysis of this issue assumes that the remaining City of Los Angeles would be organizationally identical to the current City of Los Angeles.
- 2) The City has provided in a submittal received by LAFCO today additional examples including payroll, police computer dispatch, base station radio support and the asphalt plant supporting street resurfacing.⁴

The City did not provide LAFCO with workload data useful in establishing the extent of economies and diseconomies of scale at the City. Interviews conducted by the CFA authors indicate that the City’s department representatives lack workload data for supervisory workers with alleged “span-of-control” efficiencies, in addition to lacking a clear understanding of the connection between workload and post-reorganization staffing levels. The City’s fiscal consultant apparently received and analyzed such data in addition to conducting “marathon” interviews with multiple senior personnel from each agency within the span of a one-month engagement,⁵. However, the reports produced by this consultant do not share any of the “objective” workload data or interview content with readers.

Nonetheless, the City has criticized the Executive Officer for failing to examine “the hard data submitted by the City”⁶, and has criticized the Executive Officer for failing to refer to workload analysis specific to the City to prove that economies of scale would appear to be less relevant than diseconomies of scale.⁷ The City of Los Angeles has never provided concrete examples of economies of scale, objective workload data or a logical argument establishing economies of scale.

³ Doppelt, Amy S. “Two May be Less than One: The Impact of Secession on Los Angeles’ Credit Quality”, *Fitch Ratings*, May 16, 2002. Hoffman, Eric and Ken Kurtz. “What if the San Fernando Valley Secedes from Los Angeles?” Moody’s Investors Service: Municipal Credit Research, June 2001. These articles raise concerns about foregone economies of scale in the case of the San Fernando Valley special reorganization, but provide no examples or evidence of current economies of scale at the City of Los Angeles.

⁴ Fujioka, William T. *Los Angeles County LAFCO Hollywood Proposal for Special Reorganization; Executive Officer’s Report dated May 29, 2002, May 31, 2002, page 5.*

⁵ See 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*, May 13, 2002; Hamilton, Rabinovitz & Alschuler, Inc. *Revenue Neutrality Issues Related to the Proposed Hollywood Secession*. Report to the City of Los Angeles City Administrative Officer, May 31, 2002, page 3.

⁶ Fujioka, May 14, 2002, page 12.

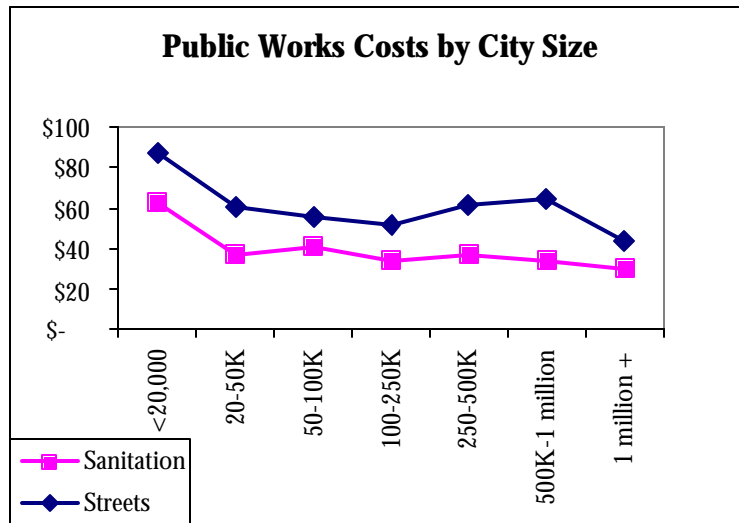
⁷ Baxter Culver Government Affairs. Review of Executive Officer’s Report, Special Reorganization of the San Fernando Valley, Report to the City of Los Angeles City Administrative Officer, May 2, 2002.

The City has only provided opinions of department managers and City consultants as to the budget cutbacks that the remaining City could undertake if it were to remain organizationally identical to the current City.⁸

The Executive Officer has reviewed academic research by economists and public policy experts on this topic, as well as data on the service costs of American cities.⁹ The Executive Officer has found evidence of economies of scale in public utility service such as wastewater, water and electric service. Special reorganization is not expected to affect economies of scale in public utility services provided by the City of Los Angeles, because the resolution requires the new cities to extend a franchise to the City of Los Angeles for utility service.

In addition, the Executive Officer has found evidence of economies of scale in street maintenance and repair. A Government Finance Officers Association database on American cities indicates that per capita public works costs tend to be lower at larger cities than at smaller cities.

If the City of Los Angeles is like other large American cities in offering economies of scale in street services, that would most likely mean that contracting for service with the City of Los Angeles would be the



least expensive service alternative for the new cities. In the evaluation of service costs in the Harbor special reorganization area, the Executive Officer found that the City of Los Angeles public works costs were less expensive than the preliminary estimate made by the County of Los Angeles Public Works Department.¹⁰ If the new cities' least expensive option is to contract for service with the City of Los Angeles, it is reasonable to assume that all cities will have financial incentives to pursue such an arrangement. To the extent that the new cities contract for service with the City of Los Angeles, all three affected cities would continue to reap the cost savings associated with any economies of scale.

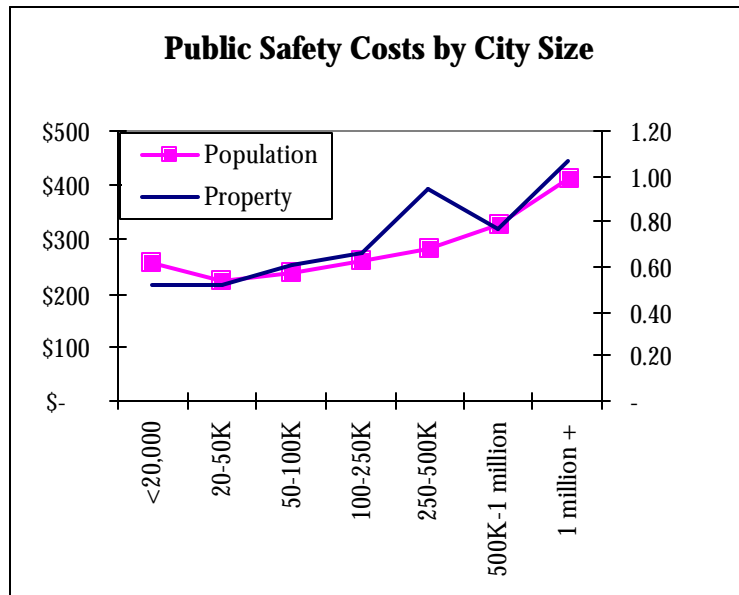
The Executive Officer has examined other areas of municipal service, and found more evidence indicating diseconomies of scale than economies of scale in public safety and general government service. The academic and empirical evidence indicate that large cities tend to spend more per capita on public safety than do smaller cities. The preponderance of academic research by economists and public policy experts on this topic indicates that diseconomies of scale are more prevalent in local government than are economies of scale.

⁸ Local Agency Formation Commission for Los Angeles County. *Special Reorganization of the San Fernando Valley Executive Officer's Supplemental Report*. May 20, 2002.

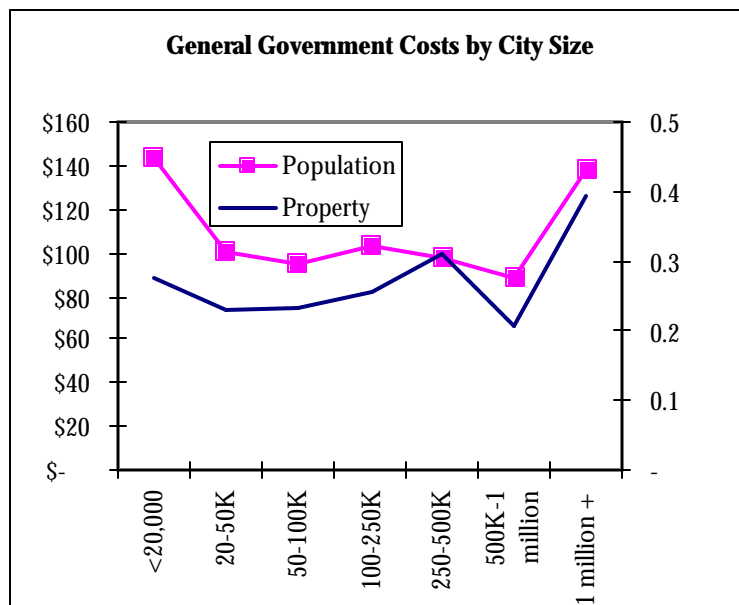
⁹ Local Agency Formation Commission for Los Angeles County. *Special Reorganization of Hollywood Executive Officer's Report*, May 28, 2002. Local Agency Formation Commission for Los Angeles County. *Special Reorganization of the San Fernando Valley Executive Officer's Supplemental Report*. May 20, 2002. Local Agency Formation Commission for Los Angeles County. *Special Reorganization of the San Fernando Valley Executive Officer's Report*. April 24, 2002.

¹⁰ Local Agency Formation Commission for Los Angeles County. *Special Reorganization of the Harbor Area Executive Officer's Report*. May 15, 2002.

If the City of Los Angeles is like other large American cities, it pays relatively more per capita for public safety than do smaller cities. That would most likely mean that the new cities would eventually seek less expensive alternatives to public safety service than contracting for service with the City of Los Angeles. In fact, the Executive Officer found that Los Angeles County Sheriff and Fire would be less expensive service providers in the Harbor Area than the City of Los Angeles. If the new cities are able to save further by providing public safety services directly, it would be reasonable to assume that the new cities would establish their own public safety departments eventually. The evidence indicates that the new cities would most likely achieve some cost savings by discontinuing City of Los Angeles public safety service.



Through employee transfers, natural labor market dynamics or layoffs, the City is expected to reduce its public safety operations in proportion to the reduced size of the service area. In an assessment of the City's arguments regarding increased "stranded" costs in public safety due to special reorganization, the Executive Officer has previously concluded that the City's argument is illogical and inconsistent with evidence that other cities manage to keep costs proportional to city size.¹¹ The Executive Officer concludes that the City could reduce its public safety costs in proportion to the reduction in city size. Whether or not the City will reduce inefficiencies in public safety is unknown.



The Executive Officer concludes that where the City offers cost efficiencies due to economies of scale, the new cities will have incentives to contract for service with the City of Los Angeles to continue to reap those cost savings. In services with existing economies of scale, the affected cities

¹¹ Local Agency Formation Commission for Los Angeles County. *Special Reorganization of the San Fernando Valley Executive Officer's Supplemental Report*. May 20, 2002. Local Agency Formation Commission for Los Angeles County. *Special Reorganization of the San Fernando Valley Executive Officer's Report*. April 24, 2002.

are expected to continue to collaborate in order to provide services most efficiently to their constituents. In services with existing diseconomies of scale, the new cities are expected to eventually seek cost savings through alternative service arrangements. Whether or not the City of Los Angeles will reorganize to achieve efficiencies in such services will be at the sole discretion of the City of Los Angeles, and is therefore, unknown at this time. As there are existing diseconomies of scale, the City would not be losing economies of scale, however, it is conceivable that they could exacerbate existing diseconomies of scale depending upon how the reorganization of the City of Los Angeles is managed.

Conclusion

The City of Los Angeles has not stated that the combined effects of special reorganization would exceed the sum of the individual effects, nor has it provided any rationale why such would be the case. Further, the City has failed to provide LAFCO with objective workload data, and has advanced arguments about stranded costs that are inconsistent with the notion that there are truly economies of scale at the City.

The Executive Officer concludes that:

- 1) The combined transition costs faced by the City of Los Angeles if both the San Fernando Valley and Hollywood special reorganizations are approved would be no greater than the sum of the transition costs associated with each of the proposals.
- 2) The combined fiscal effect of San Fernando Valley and Hollywood special reorganizations on the City of Los Angeles is not substantially different from the sum of the fiscal effects of each proposal so long as the new cities are contracting with the City of Los Angeles for service. If there are economies of scale offered by the City, the new cities and the City would have financial incentives to continue to reap cost savings associated with economies of scale in municipal services through a contract-for-service approach with the City of Los Angeles.
- 3) The new cities would have financial incentives to discontinue service contracts with the City of Los Angeles for municipal services where existing cost inefficiencies relate to the size of the City (i.e. diseconomies of scale). The City of Los Angeles would have financial incentives to reorganize municipal services for which there are existing cost inefficiencies related to the size of the City.