Agenda Item No. 7.

SACRAMENTO LOCAL AGENCY FORMATION COMMISSION
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October 1, 2003

TO: Sacramento Local Agency Formation Commission

FROM: Peter Brundage, Executive Officer

RE: **Policy Discussion Paper:**
Tax Sharing Agreement Process for City Annexations and Special District Detachments per Revenue and Taxation Code

RECOMMENDATION

Encourage cities and County of Sacramento to include special districts as part of their property tax sharing negotiation process in annexation/ reorganization proposals in which special districts are affected.

PURPOSE

1. The purpose of this paper is to define the legal requirements and process of negotiated Property Tax Agreements and to advise the Commission of LAFCo's role in this process.

2. Advise the Commission that the County of Sacramento and City of Sacramento intend to work with specific special districts which are likely to be impacted by future annexation/ reorganization proposals.

DISCUSSION

This paper provides a basic description of the property tax sharing agreement process. In order for a city to annex property, the city and county must enter into a property tax agreement. This ***agreement apportions property tax from the county to the city based upon the fiscal impact to the respective jurisdictions related to the simultaneous transfer of service responsibility.***

The negotiation process between the city and county is set forth in the Revenue and Taxation Code. LAFCo is not a party to this process. Nor is LAFCo required to participate in this process. Nor does LAFCo have any legal authority to participate in this process. However, LAFCo cannot determine the annexation application complete until an agreement has been reached between these entities.

The county is not required by the Revenue and Taxation Code to reach a property tax agreement. If an agreement cannot be reached, the annexation/ reorganization proposal cannot proceed.

LAFCo does not have the authority to:

(1) Impose the requirement that an agreement between two taxing entities be achieved;

(2) Impose terms or conditions on any property tax sharing agreement;

(3) Impose a requirement that the county negotiate on behalf of special districts except as provided by statute.

Therefore, LAFCo encourages the County of Sacramento and cities within the county to include special districts in the negotiation process when developing property tax sharing agreements that propose annexation/ reorganization in which special districts are affected.

Legal Analysis: *The role of the County to negotiate property tax agreements.*

The county is required to negotiate on behalf of special districts. The Revenue and Taxation Code provides the following process:

> "In the event that a jurisdictional change would affect the service area or service responsibility of one or more special districts, the board of supervisors of the county or counties in which the districts are *located shall, on behalf of the district or districts, negotiate any exchange of property tax revenues. Prior to entering into negotiations on behalf of a district for the exchange of property tax revenue, the board shall consult with the affected district. The consultation shall include, at a minimum, notification to each member and executive officer of the district board of the pending consultation and provision of adequate opportunity to comment on the negotiation.*
>
> Notwithstanding any other provision of law, the executive officer shall not issue a certificate of filing pursuant to Section 56658 of the Government Code until the local agencies included in the property tax revenue exchange negotiation, within the 60-day negotiation period, present resolutions adopted by each county and city whereby each county and city agrees to accept the exchange of property tax revenues.

> In the event that the Commission modifies the proposal or its resolution of determination, any local agency whose service area or service responsibility would be altered by the proposed jurisdictional change may request, and the executive officer shall grant, 15 days for the affected agencies, pursuant to paragraph (4) to renegotiate an exchange of property tax revenues. Notwithstanding the time period specified in paragraph (4), if the resolutions required pursuant to paragraph (6) are not presented to the executive officer within the 15 day period, all proceedings of the jurisdictional change shall automatically be terminated."[1]

The following scenarios describe the most typical type of detachments that occur as part of a reorganization process as the result of a city annexation proposal.

Scenario 1

A city proposes to annex unincorporated property.
No detachment from a special district is proposed.

In this case, the city and county reach an agreement. There is no impact to any special district. Property tax negotiations impact only two parties: the city and county.

Analysis

The county is not required to enter into a property tax agreement, however, the Revenue and Taxation Code provides for an arbitration process. This process cannot impose an agreement on either party. If the city and county enter into a property tax agreement, there is no effect to a special district because no detachment will occur.

Scenario 2

A city proposes to reorganize unincorporated territory.
The proposal annexes territory to the city and detaches territory from one or more special districts located in the unincorporated territory
to which the special district may or may not currently be providing services.
The effect of the detachment is that the special district no longer receives property tax revenue nor will it provide service (currently or at a future time)
to the detached territory.

From a special district point of view, the issue is whether or not the territory to be detached is (1) undeveloped, thus unserved, territory or (2) developed, and served at the time of detachment, territory. The financial aspects and service delivery impacts under each type of detachment may be very different. LAFCo's responsibility is to evaluate both the financial and service delivery impacts; not to negotiate agreements.

Special districts have four primary concerns related to detachments:

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1 Revenue and Taxation Code, Sections 93 and 99.

1. Loss of property tax revenue base.
2. Loss of future revenue growth.
3. Cumulative impact of revenue loss.
4. Impacts affecting district ability to provide service.

These are valid concerns that must be analyzed for each type of proposal. However, LAFCo must weigh these issues in the context of a number of other issues: open space, agricultural lands, logical service boundaries, growth, population trends, affordable housing, water availability, and the overall efficiency and effectiveness of municipal service delivery.

Scenario 2 is far more complex and controversial than Scenario 1. However, again, LAFCo should not be directly involved in a property tax exchange process. **LAFCo has no legal authority to negotiate anything on behalf of the county, any city, any special district, or any other local governmental entity. If the transfer of revenue and services cannot be agreed upon by all parties, LAFCo may mitigate financial impacts by amending boundaries, requiring the assumption of bonds or debts, or other similar adjustments; LAFCo may deny the proposal; or LAFCo may request the parties continue to resolve their differences.**

Fiscal and Service Impacts Analysis Under Scenario No. 2

Situation 1: ***Impact on detaching special districts for annexation of undeveloped unincorporated areas.***

In this case, the general theory, or assumption, is that the transfer of property tax is entirely offset by the transfer of service responsibility. As a result, this transfer, in most instances, may be considered revenue neutral.

Typically, on undeveloped property, special districts receive minimal revenue and provide no, or minimal, municipal services. After a special district is detached, it no longer has any service responsibility.

a. Loss of Property Tax Base: Minimal impact in terms of shift in property tax revenue. LAFCo would analyze the revenue and service impact to the district before and after detachment

b. Loss of Future Revenue Growth: In theory, the future revenue should be spent on services to the area that is proposed to be detached. Since the district no longer provides services, it does not need the revenue because it does not have service responsibility.

c. Cumulative Impacts: Cumulative impact is the sum of all previous redirection of both revenue and service responsibility of a district. Thus, LAFCo, when it evaluates how a proposed detachment impacts the ability of a district to provide services to the remaining district, it automatically factors in previous impacts that have occurred.

An analysis of previous detachments factors in the cumulative impact of previous LAFCo actions. The impacts of each detachment evaluate the probable changes to the district as a whole and its ability to function and operate. The following simple description illustrates that cumulative impacts are factored in the analysis.

Assume that a district serves 100 acres. A one-acre detachment may have certain impacts to the remaining 99 acre district. The second one-acre detachment may have different or similar impacts. The second detachment evaluates the proposal on its impact to 99 acres, not the original 100-acre district. In essence, the analysis of the second proposal takes into account the cumulative impact of previous detachments and/or annexations because it examines the impact on the 99 acre district. The incremental change, or net change, includes the previous impacts.

While this methodology factors in previous changes, it does not provide a summary of the total change. The impact of the proposed detachment is compared to existing conditions and is relative to only the current situation. Nonetheless, it provides a means to evaluate the impacts.

Situation 2: ***Transfer of developed unincorporated areas and concurrent detachment of special districts.***

This situation is likely to result in negative impacts to the district if there is a significant loss of revenue to the district. This situation may be more difficult to resolve because the long term viability of a special district may be at stake if the parties cannot reach an agreement. The Natomas Panhandle may be an example of this situation. Again, it is in the best interest of cities, the County, and special districts to try and resolve these financial impacts in the development of a property tax sharing agreement prior to submitting a proposal to LAFCo.

Impacts to Special Districts

The concerns raised by special districts are valid; impacts must be fully analyzed for each annexation/ reorganization proposal. Because detachment has different levels of financial and service impacts, it is impossible to develop standards that define what is and is not significant.

LAFCo Responsibility

Based on the financial issues and service delivery impacts, as well as other regional impacts, the Commission can approve, modify or deny a proposal.

In addition, the Commission, from time to time, has not taken action on a proposal, requesting that entities negotiate a property transfer phase-out agreement to mitigate financial issues because the Commission believed the financial impacts were significant.

[Note: Upon annexation the county auditor is required to transfer property tax allocations to the annexing entity. The auditor cannot phase this out over time, therefore, the entities must reach an agreement whereby they agree to phase-out property tax revenue over a period of time.]

The Commission must evaluate and weigh a significant number of issues during its deliberations over proposals. Many times the Commission must find the balance between competing interests and issues. Any change in governmental reorganization implies changes to the status quo and are never easy. Annexations and detachments relative to property tax revenue may have significant impacts on special districts.

Future reorganizations (annexations/ detachments) by the City of Sacramento and City of Folsom will likely impact special districts to a great extent. For this reason, the cities and county should adequately evaluate special district financial impacts during their negotiation process and address special district issues and concerns.

City and County Responsibility

If LAFCo cannot make a finding that revenue loss is equal to service loss and the detachment will not have a significant negative impact on the special district, LAFCo may significantly modify or deny the proposal. The cities and county have several alternatives to mitigate special district revenue loss:

1. Property tax phase-out over a fixed period of time.
2. Annexation of the territory without detachment of special district.
3. Consolidate or merge special districts with the proposal city.

Therefore, LAFCo encourages cities and the county to work in good faith with special districts when the city and county commence negotiations for an annexation/ detachment process. To the degree that impacts to special districts can be minimized prior to the LAFCo public hearing, the proposal may be able to be processed with less delay and with fewer mitigation terms and conditions.

LAFCo must evaluate the loss of property tax revenue to a special district in the context of the district's viability before and after the proposed detachment. LAFCo must examine whether or not a special district should be dissolved and reorganized or consolidated with another special district. These are complex in that an analysis must often make assumptions concerning future growth within the remaining territory of a special district: whether or not the property tax base is growing, if so at what rate; whether or not the cumulative affect of the detachment creates a loss so great as to impact the district's capacity to serve the remainder of its district.

PB:Maf
(Tax Sharing Agreement)