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Carolyn Emery
Executive Officer

Scott Smith
General Counsel

MEETING DATE: March 13, 2024

TO: Local Agency Formation Commission
of Orange County

FROM: Executive Officer
Policy Analyst II

SUBJECT: Policy and Procedural Guidelines for Processing
Incorporation Applications and Implementing
Revenue Neutrality Provisions

BACKGROUND

Periodically, the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (CKH Act) is modified, requiring the Commission to amend an agency’s respective policy. This report includes recommended amendments to the “Policy and Procedural Guidelines for Processing Incorporation Applications and Implementing Revenue Neutrality Provisions” to align with current State law and local policy. The policy was originally adopted by the Commission in 1990, and in 1998, state provisions involving revenue neutrality for proposed incorporations were appended to the policy. For ease of review, proposed amendments to the policy are indicated in redline format in Attachment 1 and are summarized in the table below.

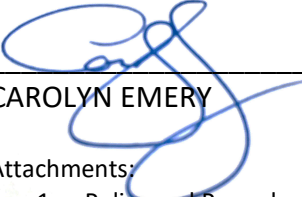
PROPOSED POLICY AMENDMENTS		
SECTION	PAGE	AMENDMENT SUMMARY
Section I: Prefiling Meeting	1	Updated language that outlines prefiling requirements for incorporation proponents.
Section VI: Public Hearing Process	9	Updated language to align with current state law.
Section VII: Request for Reconsideration	9	Updated language to align with current state law.

RECOMMENDED ACTION

Staff recommends the Commission:

1. Adopt the Policy and Procedural Guidelines for Processing Incorporation Applications and Implementing Revenue Neutrality Provisions, as amended.

Respectfully Submitted,



CAROLYN EMERY



GAVIN CENTENO

Attachments:

1. Policy and Procedural Guidelines for Processing Incorporation Applications and Implementing Revenue Neutrality Provisions (Redline)
2. Policy and Procedural Guidelines for Processing Incorporation Applications and Implementing Revenue Neutrality Provisions (As Amended)

Policy and Procedural Guidelines for Processing Incorporation Applications and Implementing Revenue Neutrality Provisions

I. PRE-FILING ~~MEETING ADVISORY TEAM CONSULTATION~~

Prior to initiating an incorporation proposal, the ~~Commission shall make available to the~~ incorporation proponents ~~shall participate in a pre-filing meeting with OC LAFCO staff a team of independent experts in municipal finance and/or city management to provide receive~~ an overview of ~~the incorporation process, associated costs and relative laws, city government, laws, and current regional and statewide financial trends affecting cities and their long-term fiscal viability.~~ The ~~advisory team consultation- pre-filing meeting~~ will be at no cost to the ~~applicant or OC LAFCO proponents.~~

II. FILING MATERIALS

Prior to initiation and filing of any documents, a meeting with the incorporation applicants and OC LAFCO staff to discuss the incorporation process, required documents and schedule of payment of all fees and other costs associated with the proposed incorporation is highly advised.

Required filing materials include:

- A. Resolution of Application, Landowner Petition, or Registered Voter Petition
- B. Completed Justification of Proposal Questionnaire
- C. Boundary Map
- D. Filing Fee
- E. Preliminary Feasibility Analysis

After receipt of above filing materials, OC LAFCO staff will review for completeness and initiate the development of a Comprehensive Fiscal Analysis (CFA) and related CEQA documents.

III. CONTENTS OF THE COMPREHENSIVE FISCAL ANALYSIS

At a minimum, the Comprehensive Fiscal Analysis must contain the following information:

- A. The costs to the proposed city of providing public services and facilities during the ten (10) fiscal years following incorporation.
- B. The revenues of the proposed city during the ten (10) fiscal years following incorporation.
- C. The effects on costs and revenues of any affected local agency during the ten (10) fiscal years following incorporation.
- D. An analysis, consistent with Government Code Section 56815, ensuring that the revenues currently received by the local agency transferring the affected territory, that but for the operation of this section, would accrue to the local agency receiving the affected territory are substantially equal to the expenditures, including direct and indirect expenditures, currently made by the local agency transferring the affected territory for those services that will be assumed by the local agency receiving the affected territory unless the Commission finds either that the county and all of the subject agencies agree to the proposed transfer or that the negative fiscal effect has been adequately mitigated by tax sharing agreements, lump-sum payments, payments over a fixed period of time, or any other terms and conditions pursuant to Government Code Section 56886.
- E. Any other information and analysis needed to make the following findings:
 - Proposal is consistent with the intent of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000.
 - Proposal is consistent with the spheres of influence of all affected local agencies.
 - The proposed city is expected to receive revenues sufficient to provide public services and facilities and a reasonable reserve during the ten (10) fiscal years following incorporation. The definition of reasonable reserve will be subject to the specific conditions associated with the proposed incorporation proposal.

IV. REVIEW OF FILING MATERIALS

A. Petition

If the proposal is filed by registered voter petition, OC LAFCO will submit the petitions to the Registrar of Voters for verification. This process can take from a few weeks to months depending on the workload at the Registrar's Office and the number of

signatures to verify. The Registrar will charge OC LAFCO a verification fee for each signature that is submitted to them. OC LAFCO will recover this charge from the incorporation applicant. If the Registrar determines that there are an insufficient number of valid signatures, the incorporation applicants have an additional 15 days to acquire the sufficient number of valid signatures.

In addition, the petition will be verified by OC LAFCO staff to ensure consistency with Section 56700 of the California Government Code.

B. Resolution

If the proposal is filed by resolution, OC LAFCO staff will review the resolution to ensure it is in accordance with the relevant sections of the California Government Code.

C. Justification of Proposal Questionnaire

OC LAFCO staff will review the questionnaire for accuracy and completeness. All affected local agencies and interested parties will also review the questionnaire for potential impacts. The results of this review will be included within the OC LAFCO staff report to the Commission.

D. Boundary Map

OC LAFCO staff, affected local agencies, and interested parties will review the boundary map to determine consistency with existing local agencies and to ensure that the boundaries are logical and reasonable.

A more detailed map and legal description meeting the requirements of the Orange County Surveyor's Office and the State Board of Equalization will need to be completed prior to the incorporation proposal being set for election.

E. Comprehensive Fiscal Analysis

Upon receipt of the Comprehensive Fiscal Analysis (CFA), OC LAFCO staff will publish a legal notice setting a thirty (30) day review period for the CFA. This legal notice will be published at least fifteen (15) days prior to the commencement of the thirty-day review period in accordance with Section 56153 of the California Government Code and mailed to all affected local agencies and any persons requesting special notice who has filed a written request for special notice with the Executive Officer.

Prior to the conclusion of the thirty-day review period, OC LAFCO staff will issue a preliminary analysis of the CFA, specifying portions of the CFA which OC LAFCO staff believes are inaccurate, without sufficient documentation, or otherwise lacking reliability. During the thirty-day review period, any person can request that the State

Controller's Office review the CFA in accordance with Section 56801 of the California Government Code. The request must be accompanied by a deposit, in the amount to be determined by the Executive Officer, to cover the costs of the Controller's review. The request for the Controller's review should specify the portion or portions of the CFA to be reviewed and a brief explanation of why the review is being requested. This information will assist the Controller in completing a timely review of the CFA and help to reduce the costs of the review to the requesting party. No requests for Controller's review will be accepted after 5:00 p.m. on the final day of the thirty-day review period.

F. California Environmental Quality Act (CEQA)

OC LAFCO staff will review the incorporation proposal in regard to the requirements of CEQA. Depending on the specific circumstances of each incorporation proposal, either a Negative Declaration or an Environmental Impact Report (EIR) will be prepared.

The applicants will be responsible for all costs of preparing the required environmental review documents under CEQA in accordance with OC LAFCO's Schedule of Filing and Processing Fees.

V. REVENUE NEUTRALITY

The provisions of Government Code Section 56815 declare the intent of the Legislature that the incorporation of new cities results in a similar exchange of both revenue and responsibility for service delivery among the county, the proposed city and other subject agencies and as a result minimize the long term negative fiscal effects incorporations have on counties.

Uncertainties likely to arise in the interpretation of Government Code Section 56845 may act to impede incorporation of viable cities and/or invite inter-jurisdictional disputes following incorporation. The purpose of this policy is to establish incorporation guidelines that provide a framework for the development of terms and conditions related to the balancing of revenues and service responsibilities, otherwise known as "revenue neutrality," and to:

- Institute a process for analysis and mitigation of the fiscal impacts of incorporation on the county that results in stable, predictable financial outcomes for both the county and the new city.
- Define the terms and budget items to be negotiated under revenue neutrality requirements of Government Code Section 56815.
- Mitigate potential fiscal losses to the county without making incorporation impossible for local communities ready for self-governance or precluding an adequate fiscal base for new cities.

- Specify how participants in the incorporation process can develop proposed terms and conditions of incorporation that will meet revenue neutrality criteria and the standards of this commission in making the findings required by Government Code Sections 56815 and 56375 for approval of incorporations.

It is the policy of this Commission that implementation of revenue neutrality provisions of Government Code Section 56815 shall ensure adequate protection of the financial stability of the county and other affected agencies while at the same time permitting the incorporation of communities demonstrating the necessary resources and capacities for self-governance. The legislative mandates for achieving revenue neutrality shall be implemented through a rational and predictable process for gathering information, determining the appropriate content of revenue neutrality agreements and providing for the revision of those agreements.

Figure 1 illustrates the portions of the incorporation process involving the development of revenue neutrality actions that must be taken by the Commission. Incorporation proponents are required to submit a preliminary fiscal analysis (PFA) for evaluation by OC LAFCO staff. The PFA is augmented by OC LAFCO staff as necessary with county revenue and departmental cost data, the calculation of the property tax allocation and analysis of fiscal and service level assumptions. The PFA is used as a starting point for the comprehensive fiscal analysis prepared by the Executive Officer or her designee. OC LAFCO staff convenes a revenue neutrality negotiating committee composed of representatives of the county, other affected agencies and the chief petitioners for the incorporation when the first draft of the comprehensive fiscal analysis is available. OC LAFCO staff will attend meetings of this committee in order to facilitate discussions and compliance with this policy.

The revenue neutrality committee will have an initial period of 45 days to negotiate an agreement to meet the requirements of Government Code Section 56815. At the conclusion of negotiations or the end of the 45-day negotiating period, OC LAFCO Executive Officer will certify that an agreement has been reached or has not been reached. If any agreement is reached, ratification by resolution of the County Board of Supervisors and by letter of the incorporation committee is returned to OC LAFCO staff for inclusion in the comprehensive fiscal analysis, staff report and recommendations.

If the negotiating parties do not reach an agreement, the status of the negotiations will be referred to the Commission for workshop discussion of outstanding issues at the first available meeting as determined by the Executive Officer. If revenue neutrality issues are not resolved during the course of the workshop, the Commission will direct the negotiating committee to resume negotiations for an additional 45-day period.

If no agreement is reached by the revenue neutrality committee and ratified by the County Board of Supervisors and the incorporation committee after two negotiating periods, OC LAFCO staff will draft proposed terms and conditions for use in the comprehensive fiscal analysis and for recommendation to the Commission at its public hearing.

Revenue neutrality agreements should adhere to the standards for content described in this policy. Such agreements should include a description of methodologies and assumptions leading up to the terms of the agreement. Revenue neutrality agreements should also provide for a process of adjustment after incorporation in order to account for unforeseen economic or legislative events significantly affecting the flow of local revenue.

A. Content and Analytical Standards:

The provisions of revenue neutrality agreements negotiated pursuant to this policy shall adhere to the following standards:

1. Revenue neutrality agreements shall be based on county costs and revenues for the most recent prior year for which data are available. Only identifiable and recurring revenues and expenditures should be evaluated for purposes of determining revenue neutrality. Anticipated or projected revenue growth should not be included.
2. Expenditures for services transferred to a new city should be evaluated on a “net cost” basis. Services funded on a full cost recovery basis (such as building inspection) are by definition revenue neutral and should not be included in the analysis.
3. Costs of capital improvements are not recurring costs and should not be included.
4. Countywide costs for regional services and administrative functions, which are required to support county governance of both incorporated and unincorporated areas, should not be included in defining services transferred to the new city.
5. Inflationary factors should not be included in the analysis of revenue neutrality provisions unless the resulting agreement provides for annual adjustment for mitigation payments based on actual data.
6. Restricted and unrestricted revenues should be evaluated separately. An agency may pay a portion of its annual revenue neutrality payment with restricted funds if both agencies agree, and a legal exchange mechanism can be created.

B. Permissible Types of Terms and Conditions

Terms and conditions for implementation of revenue neutrality may include provisions for tax sharing agreements, lump-sum payments, payments over a fixed period of time, modification of incorporation boundaries or any other terms and conditions permitted under Government Code Section 56815.

C. Duration of Fiscal Impact Mitigation

The term of mitigation payments may be either ongoing or limited to a specific number

of years. Ongoing revenue neutrality agreements may provide for the permanent sharing of revenues between the new city and affected agencies. Agreements that limit revenue neutrality payments should establish the term of payments in the following steps:

1. Determine the annual net revenue loss to the County and other affected agencies resulting from the proposed incorporation.
2. Determine a lump sum sufficient to yield in interest funds equal to the annual net revenue loss to the County and other affected agencies.
3. The duration of mitigation payments will be calculated using the annual mitigation payment amount and inflation and discount rates established by negotiation.

D. Method of Annual Payment

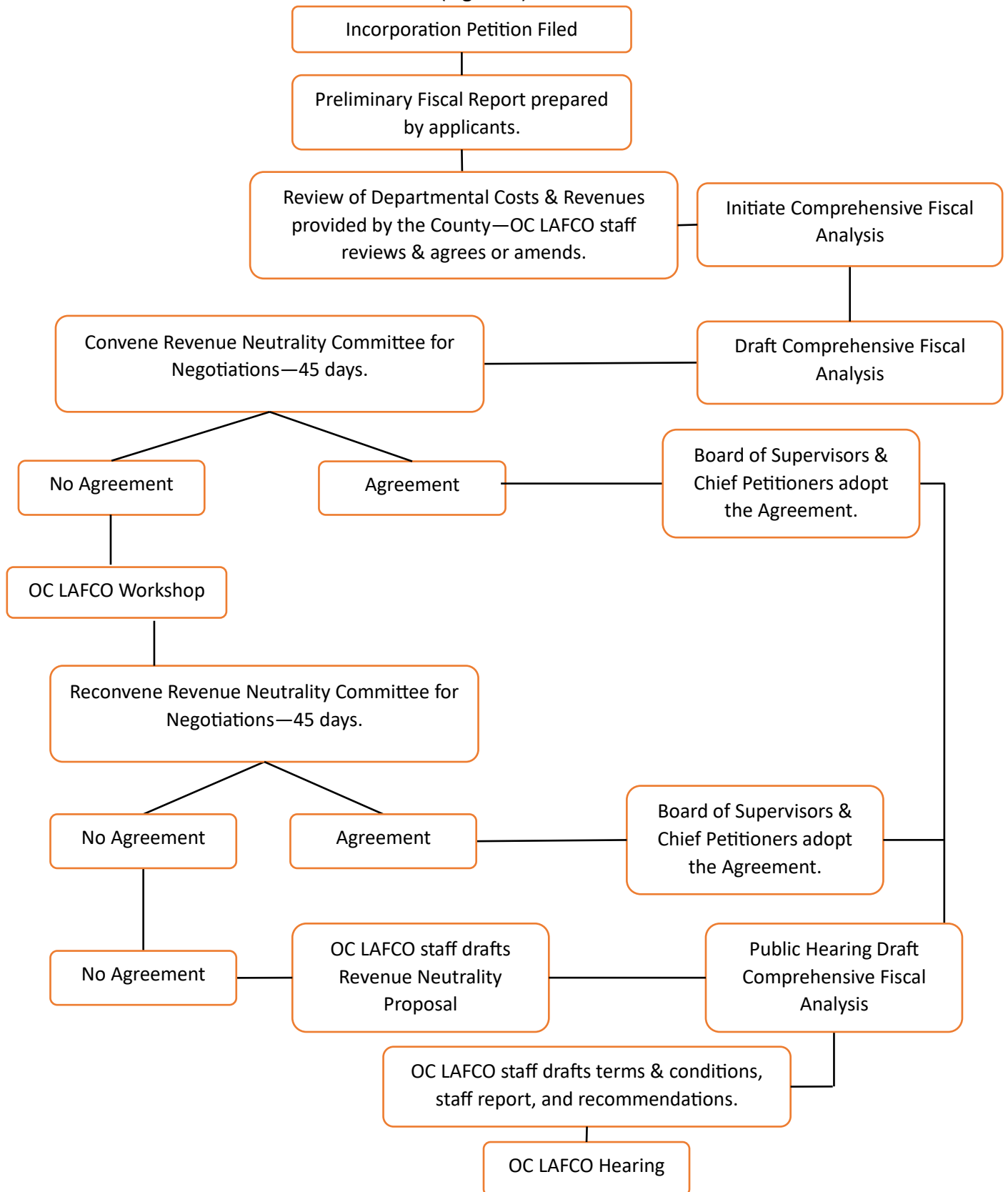
In instances in which revenue neutrality requires tax sharing or mitigation payments to the county, payment should be affected as directly from the revenue source as permitted by State law.

E. Effective Date of Incorporation

The effective date of incorporation should be considered in revenue neutrality agreements. The effective date should be set to establish adequate initial account balances for the new city as it assumes service responsibilities but should not otherwise conflict with the intent of fiscal neutrality.

**REVENUE NEUTRALITY NEGOTIATIONS &
FISCAL ANALYSIS PROCESS**

(Figure 1)



VI. PUBLIC HEARING PROCESS

The incorporation proposal will be considered by OC LAFCO at a minimum of one but most likely several public hearings. These hearings will address the various factors required to be considered in Government Code Section 56720, the Comprehensive Fiscal Analysis, the OC LAFCO staff report, the Controller's review (if appropriate), and any other relevant information.

~~If the incorporation proposal is approved, the approving resolution will be transmitted to the County Board of Supervisors who will conduct the "protest hearing." If the incorporation proposal is approved, the Commission shall order the incorporation subject to the confirmation of the voters within the affected territory. A protest proceeding shall not be conducted.~~

If the incorporation proposal is disapproved, no new proposal which is the same or substantially the same may be filed for one year. Although, the Commission may waive this waiting period.

VII. REQUEST FOR RECONSIDERATION

Within thirty (30) days following the adoption of the OC LAFCO resolution either approving or disapproving the proposal, ~~or prior to the County Board of Supervisors conducting the protest hearing, whichever occurs first,~~ any interested party can file a written request with the Commission to reconsider ~~their~~ its action. Such a request requires the payment of a fee as determined by the OC LAFCO Schedule of Filing and Processing Fees in effect at that time. Upon receipt of a timely request, OC LAFCO will hold a legally noticed (at least 21 days prior to the hearing) public hearing on the reconsideration request. At the reconsideration hearing, OC LAFCO may approve, deny, or continue the reconsideration request.

Originally Adopted: 1990 (Incorporation Processing)
1998 (Revenue Neutrality)

Last Reviewed: ~~3/8/2023~~ 3/13/2024

Last Revised: ~~2/8/2012~~ 3/13/2024

Policy and Procedural Guidelines for Processing Incorporation Applications and Implementing Revenue Neutrality Provisions

I. PRE-FILING MEETING

Prior to initiating an incorporation proposal, the incorporation proponents shall participate in a pre-filing meeting with OC LAFCO staff to receive an overview of the incorporation process, associated costs and relative laws. The pre-filing meeting will be at no cost to the proponents.

II. FILING MATERIALS

Prior to initiation and filing of any documents, a meeting with the incorporation applicants and OC LAFCO staff to discuss the incorporation process, required documents and schedule of payment of all fees and other costs associated with the proposed incorporation is highly advised.

Required filing materials include:

- A.** Resolution of Application, Landowner Petition, or Registered Voter Petition
- B.** Completed Justification of Proposal Questionnaire
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- C. The effects on costs and revenues of any affected local agency during the ten (10) fiscal years following incorporation.
- D. An analysis, consistent with Government Code Section 56815, ensuring that the revenues currently received by the local agency transferring the affected territory, that but for the operation of this section, would accrue to the local agency receiving the affected territory are substantially equal to the expenditures, including direct and indirect expenditures, currently made by the local agency transferring the affected territory for those services that will be assumed by the local agency receiving the affected territory unless the Commission finds either that the county and all of the subject agencies agree to the proposed transfer or that the negative fiscal effect has been adequately mitigated by tax sharing agreements, lump-sum payments, payments over a fixed period of time, or any other terms and conditions pursuant to Government Code Section 56886.
- E. Any other information and analysis needed to make the following findings:
 - Proposal is consistent with the intent of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000.
 - Proposal is consistent with the spheres of influence of all affected local agencies.
 - The proposed city is expected to receive revenues sufficient to provide public services and facilities and a reasonable reserve during the ten (10) fiscal years following incorporation. The definition of reasonable reserve will be subject to the specific conditions associated with the proposed incorporation proposal.

IV. REVIEW OF FILING MATERIALS

A. Petition

If the proposal is filed by registered voter petition, OC LAFCO will submit the petitions to the Registrar of Voters for verification. This process can take from a few weeks to months depending on the workload at the Registrar's Office and the number of signatures to verify. The Registrar will charge OC LAFCO a verification fee for each signature that is submitted to them. OC LAFCO will recover this charge from the incorporation applicant. If the Registrar determines that there are an insufficient

number of valid signatures, the incorporation applicants have an additional 15 days to acquire the sufficient number of valid signatures.

In addition, the petition will be verified by OC LAFCO staff to ensure consistency with Section 56700 of the California Government Code.

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request for the Controller’s review should specify the portion or portions of the CFA to be reviewed and a brief explanation of why the review is being requested. This information will assist the Controller in completing a timely review of the CFA and help to reduce the costs of the review to the requesting party. No requests for Controller’s review will be accepted after 5:00 p.m. on the final day of the thirty-day review period.

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OC LAFCO staff will review the incorporation proposal in regard to the requirements of CEQA. Depending on the specific circumstances of each incorporation proposal, either a Negative Declaration or an Environmental Impact Report (EIR) will be prepared.

The applicants will be responsible for all costs of preparing the required environmental review documents under CEQA in accordance with OC LAFCO’s Schedule of Filing and Processing Fees.

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- Institute a process for analysis and mitigation of the fiscal impacts of incorporation on the county that results in stable, predictable financial outcomes for both the county and the new city.
- Define the terms and budget items to be negotiated under revenue neutrality requirements of Government Code Section 56815.
- Mitigate potential fiscal losses to the county without making incorporation impossible for local communities ready for self-governance or precluding an adequate fiscal base for new cities.
- Specify how participants in the incorporation process can develop proposed terms and conditions of incorporation that will meet revenue neutrality criteria and the standards of this commission in making the findings required by Government Code

Sections 56815 and 56375 for approval of incorporations.

It is the policy of this Commission that implementation of revenue neutrality provisions of Government Code Section 56815 shall ensure adequate protection of the financial stability of the county and other affected agencies while at the same time permitting the incorporation of communities demonstrating the necessary resources and capacities for self-governance. The legislative mandates for achieving revenue neutrality shall be implemented through a rational and predictable process for gathering information, determining the appropriate content of revenue neutrality agreements and providing for the revision of those agreements.

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The revenue neutrality committee will have an initial period of 45 days to negotiate an agreement to meet the requirements of Government Code Section 56815. At the conclusion of negotiations or the end of the 45-day negotiating period, OC LAFCO Executive Officer will certify that an agreement has been reached or has not been reached. If any agreement is reached, ratification by resolution of the County Board of Supervisors and by letter of the incorporation committee is returned to OC LAFCO staff for inclusion in the comprehensive fiscal analysis, staff report and recommendations.

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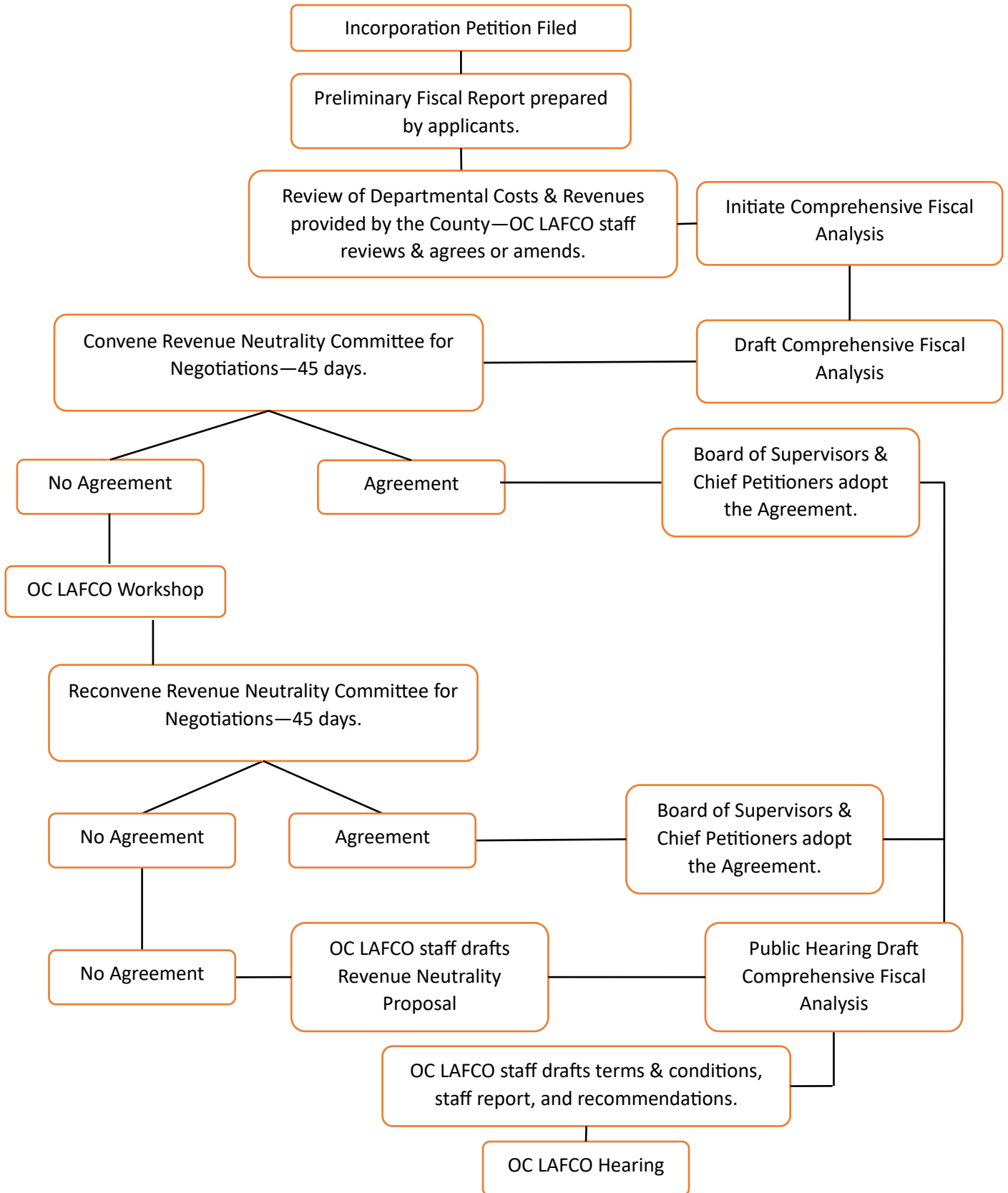
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REVENUE NEUTRALITY NEGOTIATIONS & FISCAL ANALYSIS PROCESS

(Figure 1)



VI. PUBLIC HEARING PROCESS

The incorporation proposal will be considered by OC LAFCO at a minimum of one but most likely several public hearings. These hearings will address the various factors required to be considered in Government Code Section 56720, the Comprehensive Fiscal Analysis, the OC LAFCO staff report, the Controller's review (if appropriate), and any other relevant information.

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