LAFCO
Local Agency Formation Commission of Santa Clara County

PLEASE NOTE THAT THE MEETING WILL BE HELD AT THE BOARD CHAMBERS and not in the Sheriff's Auditorium as announced at the last meeting.

SPECIAL LAFCO MEETING AGENDA

Wednesday, July 2, 2008
1:15 PM

Board of Supervisors' Chambers
70 West Hedding Street, First Floor
San Jose, CA 95110

CHAIRPERSON: Pete Constant • VICE-CHAIRPERSON: Susan Vicklund-Wilson
COMMISSIONERS: Blanca Alvarado, Don Gage, John Howe
ALTERNATES: Sam Liccardo, Pete McHugh, Al Pinheiro, Terry Trumbull

The items marked with an asterisk (*) are included on the Consent Agenda and will be taken in one motion. At the beginning of the meeting, anyone who wants to discuss a consent item should make a request to remove that item from the Consent Agenda.

Disclosure Requirements

1. **Disclosure of Campaign Contributions**

   If you wish to participate in the following proceedings, you are prohibited from making a campaign contribution of more than $250 to any commissioner or alternate. This prohibition begins on the date you begin to actively support or oppose an application before LAFCO and continues until three months after a final decision is rendered by LAFCO. No commissioner or alternate may solicit or accept a campaign contribution of more than $250 from you or your agent during this period if the commissioner or alternate knows, or has reason to know, that you will participate in the proceedings.

   If you or your agent have made a contribution of more than $250 to any commissioner or alternate during the twelve (12) months preceding the decision, that commissioner or alternate must disqualify himself or herself from the decision. However, disqualification is not required if the commissioner or alternate returns the campaign contribution within thirty (30) days of learning both about the contribution and the fact that you are a participant in the proceedings. For disclosure forms and additional information see: http://www.santaclara.lafco.ca.gov/annexations&Reorg/PartyDisclForm.pdf

2. **Lobbying Disclosure**

   Any person or group lobbying the Commission or the Executive Officer in regard to an application before LAFCO must file a declaration prior to the hearing on the LAFCO application or at the time of the hearing if that is the initial contact. Any lobbyist speaking at the LAFCO hearing must so identify themselves as lobbyists and identify on the record the name of the person or entity making payment to them. For disclosure forms and additional information see: http://www.santaclara.lafco.ca.gov/annexations&Reorg/LobbyDisclForm.pdf

3. **Disclosure of Political Expenditures and Contributions Regarding LAFCO Proceedings**

   If the proponents or opponents of a LAFCO proposal spend $1,000 with respect to that proposal, they must report their contributions of $100 or more and all of their expenditures under the rules of the Political Reform Act for local initiative measures to the LAFCO office. For additional information and for disclosure forms see: http://www.santaclara.lafco.ca.gov/sclafcopolicies_annex&reorg_home.html

1. **ROLL CALL**

2. **CLOSED SESSION**

Conference with Legal Counsel - Anticipated Litigation. Significant exposure to litigation pursuant to Government Code § 54956.9 (1 case)

2:15 PM Time Certain

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3. **PUBLIC PRESENTATIONS**

This portion of the meeting is reserved for persons desiring to address the Commission on any matter not on this agenda. Speakers are limited to THREE minutes. All statements that require a response will be referred to staff for reply in writing.

4. **APPROVE MINUTES OF JUNE 4, 2008 MEETING**

ITEMS FOR COMMISSION DISCUSSION / ACTION

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5. **COMPREHENSIVE FISCAL ANALYSIS AND REVENUE NEUTRALITY ANALYSIS FOR THE PROPOSED INCORPORATION OF THE TOWN OF SAN MARTIN**

Additional Documents
1. Supplemental Staff Report
2. Comment Letters

Possible Action: Accept report and provide direction to staff.

6. **UPDATE ON DISCLOSURE REQUIREMENTS AND PAYMENT OF LAFCO STAFF COSTS FOR THE PROPOSED INCORPORATION OF THE TOWN OF SAN MARTIN**

Possible Action: Accept report and provide direction to staff.

7. **UPDATE ON SCHEDULE FOR THE PROPOSED INCORPORATION OF THE TOWN OF SAN MARTIN**

Possible Action: Accept report and provide direction to staff.

8. **COMMISSIONERS' REPORTS**

9. **EXECUTIVE OFFICER'S REPORT**

10. **NEWSPAPER ARTICLES / NEWSLETTERS**

11. **ADJOURN**

Cancel the next scheduled regular LAFCO meeting on August 6, 2008 and adjourn to the regular LAFCO meeting on Wednesday, October 1, 2008, at 1:15 PM in the **Board of Supervisors' Chambers, 70 West Hedding Street, First Floor, San Jose, CA 95110.**

Any disclosable public records related to an open session item on the agenda and distributed to all or a majority of the Commission less than 72 hours prior to that meeting are available for public inspection at the LAFCO Office at the address listed at the bottom of the first page of the agenda during normal business hours.

ITEM NO. 4

LOCAL AGENCY FORMATION COMMISSION OF
SANTA CLARA COUNTY
MINUTES
WEDNESDAY, JUNE 4, 2008

1. ROLL CALL

The Local Agency Formation Commission (LAFCO) of Santa Clara County convenes this 4th day of June 2008 at 1:16 p.m. in the Chambers of the Board of Supervisors, County Government Center, 70 West Hedding Street, San Jose, California, with the following members present: Chairperson Pete Constant, Vice Chairperson Susan Vicklund-Wilson, and Commissioners Blanca Alvarado, Don Gage and John Howe. Alternate Commissioners Al Pinheiro and Terry Trumbull are also present.

The LAFCO staff in attendance includes Neelima Palacherla, LAFCO Executive Officer; Dunia Noel, LAFCO Analyst; and, Mala Subramanian and Scott Smith, LAFCO counsel for the San Martin Incorporation proposal.

The meeting is called to order by Chairperson Constant and the following proceedings are had, to wit:

2. CLOSED SESSION

On order of the Chairperson, there being no objection, the Commission adjourns to Closed Session at 1:18 p.m. to discuss one item of significant exposure to litigation per Government Code §54956.9.

The Commission reconvenes at 2:15 p.m.

3. PUBLIC PRESENTATIONS

There are no public presentations.

4. APPROVE MINUTES OF APRIL 16, 2008 AND MAY 7, 2008 MEETINGS

On motion of Commissioner Howe, seconded by Commissioner Gage, it is unanimously ordered on a vote of 5-0 that the minutes of April 16, 2008 and May 7, 2008 meetings be approved, as submitted.

5. ENVIRONMENTAL / CEQA REVIEW FOR THE SAN MARTIN INCORPORATION PROPOSAL

The Chairperson requests the staff report. Scott Smith, LAFCO Counsel, advises the Commission to consider the counsel's memorandum included in the staff report, as well as the oral and written testimony provided at the meeting, in order to determine whether the proposal has foreseeable physical environmental impacts. He directs attention to the section of the memorandum discussing the inconsistencies of the proposed incorporation boundaries with long-standing policies of LAFCO, the County and the cities. He advises that the Commission, in its role as a fact-finder, must consider whether the inconsistencies will result in physical impacts and, based on that finding, consider the alternatives and the CEQA action. He then briefly discusses each of the possible options, namely, a negative declaration, a mitigated negative declaration, an environmental impact report, or a modification of proposal boundary with a negative declaration.

The Chairperson opens the public comment period for this item.

Michelle Beasley, South Bay Field Representative, Greenbelt Alliance, expresses concern that the expansive boundaries of San Martin will have regional implications, specifically on the existing boundaries of Gilroy and Morgan Hill. She states that the Commission's role is more important than ever because of climate change, rising fuel costs, and rapidly disappearing farmlands. She states that a negative declaration is insufficient because Greenbelt Alliance is convinced that San Martin would grow in a sprawling pattern in order to survive. The future town would face development pressure because it is strategically located along Caltrain and U.S. Highway 101, and since the Bay Area population is projected to grow by 1.7 million in 2030.

Chairperson informs that Richard Van'tRood, SMNA spokesperson, be allowed to speak for five minutes because seven individuals have deferred their time to him.

Mr. Van'tRood informs that, in addition to the four possible CEQA actions outlined by Mr. Smith, the court has determined in the Carmel Valley case that incorporation is not a project under CEQA. He then informs that the proposal's inconsistencies arise from LAFCO's urban service area (USA) and agricultural mitigation policies, and the South County Joint Area Plan. With regard to USA boundary, he states that USA policies were put in place some years ago to stop urban sprawl from the rampant annexations by the cities. He notes that establishing an urban service area (USA) would create an impression that the town is being incorporated for the purpose of development. He suggests that the USA boundary may be established if the town chooses to do so after it incorporates and states that the preference of the proponents is to have no USA boundary because the community is a rural residential area.

With regard to agricultural mitigation policies, he informs that the language of the policies is not mandatory and states that these are intended for annexations that result in the loss of prime agricultural lands rather than an incorporation of a town. He states that San Martin had lost a lot of agricultural lands over the years under the County. He then indicates that the policies' timing and fulfillment of mitigation are applicable to annexation projects so it does not apply to incorporation. With regard to South County Joint Area Plan, he indicates that the County General Plan would be adopted after the town incorporates, and any change would require an environmental review. He states that the Area Plan mandates South County jurisdictions to come up with a new agreement once San Martin is incorporated. He then comments that none of these policy issues create an environmental impact. He states that every town should have its own unique character and that decision will be made by people who live in the community.

In response to an inquiry by the Chairperson, Ms. Subramanian advises that the Carmel Valley case, which was litigated by their firm, had a different set of facts and was in a completely different situation than the San Martin incorporation proposal. In response to a follow-up inquiry by the Chairperson, Ms. Subramanian informs that Monterey LAFCO determined that an EIR would be required; however, the court found that there was no substantial evidence in the record to justify an EIR. She states that with regard to the San Martin incorporation, is documentation, including memos and policy considerations, which would allow the Commission to make a decision to require an EIR. At the request of the Chairperson, Ms. Subramanian states that the court did make a determination that incorporation is not a project but also said that if it was a project, there was no substantial evidence in the record for an EIR. With regard to the comment that agricultural mitigation policies apply only to annexation, Ms. Subramanian indicates that the argument to that is a concern that once the land is within the boundary of the proposed town, a General Plan amendment could potentially change the land use from agricultural to commercial and housing. The intent behind the policies is to avoid that, and concerns and facts in annexation and incorporation are similar.

Dave Piccardo, a resident of San Martin, directs attention to SMNA's April 10, 2008 letter requesting that the phrase "rural agricultural and residential area" under the Present Land Use/Zoning/General Plan Use section, be revised to read "rural residential and agricultural area." He informs that this means SMNA is placing more emphasis on residential rather than agricultural use.

Commissioner Gage inquires how annexation is different from incorporation from the standpoint of CEQA and how this affects this incorporation process. In response to this, Mr. Scott advises that looking at land use, even in the absence of policies or with policies that relate to annexation and not incorporation, the Commission is in charge of determining the likelihood that physical consequences might result from that change in organization, whether it is annexation or incorporation. He adds that while the proponents argue that the policies have been written from the point of view of an annexation, he expresses the opinion that the plain text of policies in the General Plan or Master Plan apply to either scenarios when considered in connection with LAFCO's SOI determinations. He informs that LAFCO policies make no distinction between annexation and incorporation. Further, he informs that upon incorporation, the town will adopt the County's Zoning Ordinance which will be in place for 120 days, while a General Plan may be adopted within 36 months. At the request of Commissioner Gage, Mr. Smith advises that the town should start with the General Plan process right away. In response to another inquiry by Commissioner Gage, Mr. Smith cites the Bozung vs. Ventura LAFCO case where LAFCO approved the annexation of Thousand Oaks with a Negative Declaration that did not reflect the evidence on how the annexation is going to open the flood gates of urban development. In the case of San Martin, he comments that it is difficult to determine what is going to happen once the town council is occupied by those who may or many not be the proponents of the incorporation.

In response to an inquiry by Commissioner Wilson, Ms. Palacherla advises that while it may not be the intent of the proponents to provide new services after the incorporation, the new town will have the authority to decide what services and development should be allowed within its boundary. Consistent with that of the 15 cities in the County, San Martin should have a USA, Commissioner Wilson inquires about the potential environmental impact of not having unincorporated buffers. Mr. Smith advises that arguments could be made that by not moving the line, physical impacts would not have happened based on the documental from the 1970s before the policies were in place. He then states that the Commission should determine whether that is likely to occur in this case. Commissioner Wilson informs that she have been on LAFCO for over a decade and has seen for a fact the development pressure and its domino effect in South County which is real and not speculative. In response to a further inquiry by Commissioner Wilson, Mr. Smith indicates that the consultant has raised environmental impacts in the discussion of the policies in the introductory section of the draft IS/ND. The Commission may conclude that the discussion of the likelihood of physical impacts be recast as a discussion about impacts in the appropriate sections of agricultural lands and growth inducement, among others.

The Chairperson comments that it is foreseeable to say that without the incorporation, development will continue to occur in San Martin because of actions and decisions by the County; however, it is speculative to say that the future town, being incorporated to maintain the rural community, would cave in to development pressures. He states that in the Bozung case, there was a real and credible evidence of development pressures that are not present in San Martin.

Commissioner Alvarado comments that nobody can determine the future of San Martin; therefore, LAFCO has to do due diligence to be able to tell the voters and residents in the community whether or not there is evidence that a town will be able to support itself. Since there is no guarantee that after 36 months, the General Plan will reaffirm the rural community of San Martin, especially when pressure mounts for city services that would have to be funded by the residents themselves. The Commission has an obligation to give voters the confidence to decide whether or not to proceed with the incorporation. She then discusses how urban sprawl caused the enactment of State law and local policies that are meant to manage growth in an orderly fashion. The boundaries being proposed by staff and the original initial study are in keeping with these policies. She informs that the exclusion of area 4, 5 and 7 is the most practical way and the best alternative at this time.

Commissioner Alvarado then moves to accept the staff report, adopt the original Initial Study and Negative Declaration with a modified boundary. In response to Ms. Palacherla, Commissioner Alvarado states that the motion excludes areas 4, 5 and 7. Upon the suggestion of Mr. Smith, Commissioner Alvarado clarifies that the motion directs staff to revise the Negative Declaration as necessary, in view of exclusion of areas 4, 5 and 7.

Commissioner Wilson seconds the motion.

In response to Commissioner Alvarado, the Chairperson indicates that the Commission is unable to determine the physical impacts of the proposed boundaries unless it speculates. He informs that the job of the Commission is to look at what is foreseeable given the available information because the Commission will fail to fulfill its role if its decision is based on speculation.

Ms. Palacherla explains the potential impacts of policy inconsistencies by reading an excerpt from the County's Open Space and Urban Development Policies, "…the scattered pattern of urban development unnecessarily destroyed the economic productivity of much of the County's prime agricultural lands, and further this development idled substantial amounts of land that were not needed for urban purposes. Between 1962 and 1967, for example, 7,400 acres of agricultural land were developed for residential use, but an even larger amount, 9,200 acres, became vacant urban land."

In response to the inquiry by the Chairperson, Mr. Van't Rood indicates that the proponents oppose the exclusion of areas 4, 5, and 7 because these areas are not substantially different from the rest of San Martin, it does not make sense to cut up San

Martin to create an artificial buffer, and it is inappropriate to create a land use distinction by removing parts of the San Martin boundary.

Commissioner Wilson, stating that there are places in Gilroy and Morgan Hill that look exactly like San Martin, inquires whether those too should be included in San Martin. She comments that Morgan Hill and the County letters discuss the impact if areas 4, 5 and 7 are not removed. She then expresses her support for the motion. She continues by stating that not deleting areas 4, 5 and 7 will have a real, and not speculative impact on San Martin, Gilroy, Morgan Hill and the County.

In response to an inquiry by the Chairperson, Mr. Smith informs that cities in Southern California tend to buffer themselves from development that the counties initiate; however, Santa Clara County has a long standing tradition of not providing services in unincorporated areas. In response to a follow-up inquiry by the Chairperson, Mr. Smith indicates that in accordance to CKH Act, the Commission may find that the boundaries could have buffers inside or outside the city limits, or on both sides of the city limits. He indicates, however, that the policies are a little different.

Commissioner Howe comments that it is speculative to say who would do what in the future, and expresses more confidence in the future San Martin town council because its members have local accountability rather than the County Board of Supervisors. He then informs that he is voting against the motion.

The Chairperson calls the question.

The motion fails on a vote of 2-3, with Chairperson Constant, and Commissioners Gage and Howe voting against.

Commissioner Gage moves to include in the proposed boundary areas 4, 5 and 7. At the request of the Chairperson, Mr. Smith advises that the Commission may direct staff to prepare the final CEQA document based on the findings and deliberations at this meeting. Commissioner Gage indicates that his motion includes adoption of the Negative Declaration.

Commissioner Howe seconds the motion.

The Chairperson acknowledges Alternate Commissioner Pinheiro, stating that he may participate in the discussion but may not vote or make a motion. Alternate Commissioner Pinheiro informs that the City of Gilroy has requested staff to include a portion of Masten/Fitzgerald Road in its SOI because many city residents use it. Commissioner Gage indicates that Gilroy is planning to widen that road as part of its General Plan. In this regard, Commissioner Wilson states that the need to amend Gilroy's SOI boundary is already a physical impact of the incorporation. Ms. Palacherla advises that staff has informed Gilroy staff that the SOI amendment is a separate application under a separate process with specific requirements and fees, and Gilroy had withdrawn that request. At the request of the Chairperson, Commissioner Gage indicates that the Gilroy SOI amendment is not part of the motion.

Commissioner Alvarado expresses opposition to the motion, stating that the County Planning Office requested that appropriate environmental analysis be made considering its potential impact on countywide growth management policies. She informs that this is the position of the County which she would maintain whenever this subject comes up. She then questions the adoption of a Negative Declaration in the midst of the huge environmental impacts and states that the residents of San Martin will bear the consequences.

The Chairperson comments that he has read and reviewed all documents and opines that many impacts stated are only on paper and are not supported by evidence.

Mr. Smith recommends that the motion include direction for staff to prepare the Negative Declaration based on comments and findings at this meeting <u>and to bring it back for deliberation as the process continues</u>. The Chairperson notes that this is included in the motion, and Commissioners Gage and Howe express agreement.

The Chairperson calls the question.

It is ordered on a vote of 3-2, with Commissioners Alvarado and Wilson opposed, that staff be directed to retain areas 4, 5 and 7 in the incorporation boundary and proceed with the Negative Declaration based on the comments and findings at this meeting and bring it back for deliberation as the process continues.

6. COMPREHENSIVE FISCAL ANALYSIS (CFA) FOR THE SAN MARTIN INCORPORATION PROPOSAL

The Chairperson requests the staff report. Ms. Palacherla reports that staff revised the CFA after the May 7, 2008 pubic hearing with new information relating to election costs and the repayment to the County of the transition year costs. She then walks through the revised table showing the new city's revenues and expenditures for different boundaries. She then indicates that there is a concern that financial feasibility of San Martin is very marginal even without including any mitigation payments to the County.

The Chairperson opens the public comments period for this item.

Susan Glasser, a resident of San Martin, speaks against the incorporation because a sewer system is needed to attract businesses and building a new system is difficult under the present economic situation. She then inquires about the cost of a sewer plant, its funding, where it would be built, and whether an EIR has been done.

Lucy Walsh and Maureen Peterson, both residents of San Martin, indicate that they are giving their time to Larry Warren. Mr. Warren, also a resident of San Martin, comments that the CFA does not reflect the reduced tax assessments, collapse of real estate market, reduced property values, and reduced gas consumption. He then informs that the use of unrealistic road paving and maintenance cost, as well as the unfunded items, will result in deficits that will be passed on as increased fees and assessments to the residents.

Margaret Wolford, a resident of San Martin, informs that the town will be bankrupt before it is incorporated and the residents will end up paying more taxes because the city's tax base will not generate enough revenues under the present economic situation.

David Piccardo, a resident of San Martin and a certified public accountant, informs that his comments on the draft CFA included in his letter dated May 28, 2008, have not been included in the revised CFA. He informs that the CFA has many unrealistic assumptions, such as the pricing of road maintenance; investment earnings and the unexplained decrease in insurance cost in the fifth year of incorporation. Commissioner Gage informs that the Counsel has been directed to review the CFA and a revised version will be available within 30 days. In response to an inquiry by Mr. Piccardo, Commissioner

Gage indicates that LAFCO counsel is currently reviewing the CFA, and Mr. Piccardo suggests that the law firm hire an accountant.

Richard Van'tRood, SMNA spokesperson, responding to a statement that San Martin is marginally feasible, informs that all new towns are marginally feasible because all surpluses are given to the counties as mitigation payments. He states that the CFA is a reliable document because all the assumptions are conservative. He then questions the inclusion of the $300,000 allocated for updating the General Plan. He informs that the deferred payment of $1 million for road maintenance payments in the first five years is excessive because the total road maintenance budget is only about $800,000.

Commissioner Howe moves to accept the staff report with direction to staff and counsel to come back with a legal analysis on the CFA at the July 2, 2008 meeting, and that public input from this meeting be considered in revising the CFA.

In response to an inquiry by Commissioner Gage, Ms. Subramanian advises that reopening of revenue neutrality negotiations has not been discussed and that the Counsel intends to come back with a legal analysis on July 2, 2008. Commissioner Gage seconds the motion. Commissioner Howe proposes that if there is a difference in opinion between staff and counsel, that the information be included and so delineated on the report. In response to an inquiry by Commissioner Wilson, Ms. Subramanian advises that she will submit the legal analysis at the next meeting and the Commission may provide appropriate direction to staff.

The Chairperson then sums up the motion and calls the question.

It is unanimously ordered on a vote of 5-0 that the staff report be accepted, that counsel be directed to come back with legal analysis on revenue neutrality at the July 2, 2008 meeting, and the public input provided at this meeting be considered.

7. UPDATE ON PAYMENT OF LAFCO STAFF COSTS FOR THE PROPOSED INCORPORATION OF THE TOWN OF SAN MARTIN

Chairperson requests the staff report. Ms. Palacherla directs attention to staff's letter to the proponents regarding the payment of LAFCO staff fees and the response received from the proponents.

In response to an inquiry by Commissioner Wilson, Ms. Palacherla advises that other than payments for CFA and CEQA consultants, LAFCO has not received any payment from the proponents and has no information about the fundraising events. Commissioner Gage comments that there is a need to follow the contract and to find out whether there is an assurance that LAFCO would be compensated at the end of the process. The Chairperson inquires whether there have been discussions between staff and SMNA regarding fundraising.

In response to a request by Commissioner Alvarado, Ms. Subramanian indicates that she will provide information at the July 2, 2008 meeting on the options for the Commission in the event that SMNA fails to pay prior to the public hearing, including the option to hold off the pubic hearing until the fees are paid. The Chairperson indicates that there is no violation of the contract at this time.

On motion of Commissioner Howe, seconded by Commissioner Gage, it is unanimously ordered that report be accepted, that staff be directed to send a letter to the proponents inquiring about their plans to pay and the schedule of their fundraising events, and the counsel be directed to submit a written opinion relating to options for the Commission in the event that the proponents are unable to pay the LAFCO staff cost.

8. UPDATE ON SCHEDULE FOR THE PROPOSED INCORPORATION OF THE TOWN OF SAN MARTIN

The Chairperson requests the staff report. Ms. Palacherla states that the incorporation timeline is dependent upon the Counsel's legal opinion on revenue neutrality. She notes that the incorporation would be on schedule for the April 2009 elections if the hearings are held in September and October 2008.

On motion of Commissioner Gage, seconded by Commissioner Constant, it is unanimously ordered on a 5-0 vote that the schedule for the proposed incorporation of the Town of San Martin be deferred to the July 2, 2008 meeting.

Commissioner Gage leaves at 3:49 p.m.
Ms. Subramanian and Mr. Smith, LAFCO counsel for San Martin incorporation, leave at 3:50 p.m., and Ms. Kathy Kretchmer, LAFCO Counsel, arrives at 3:50 p.m.

9. FINAL LAFCO BUDGET FOR FISCAL YEAR 2008-2009

This being the time and place set to consider the Final LAFCO Budget for Fiscal Year 2008-2009, the Chairperson declares the public hearing open.

The Chairperson requests the staff report. Ms. Palacherla informs that minor changes to the preliminary budget have been recommended by the budget subcommittee relating to cost allocated for County Counsel and revenues from interest, resulting in a net drop in operating expenses. The County Controller will send invoices to the cities based on the most recent Cities Annual Report.

The Chairperson expresses appreciation to Commissioners Gage and Howe for their participation on the budget subcommittee.

The Chairperson determines that there are no members of the public who would like to speak on the item and declares that the public hearing be closed.

On motion of Commissioner Wilson, seconded by Commissioner Alvarado, it is unanimously ordered on a 4-0 vote, with Commissioner Gage absent, that the Final LAFCO Budget for FY 2008-09 be adopted, find that the Final Budget is adequate to allow the Commission to fulfill its statutory responsibilities, authorize staff to transmit the final budget adopted by the Commission, including the estimated agency costs, to each of the cities, County and Cities Association, and direct the County Auditor-Controller to apportion LAFCO costs to the cities and County using the most recent edition of Cities Annual Report published by the Controller, and collect payments pursuant to Government Code §56381.

10. PROPOSED REVISION TO LAFCO FEE SCHEDULE

This being the time and place set to consider the proposed revision to the LAFCO Fee Schedule, the Chairperson declares the public hearing open.

The Chairperson requests the staff report. Ms. Palacherla reports that the budget subcommittee directed staff to review the fee schedule to ensure cost recovery. She directs attention to the staff report indicating the increases in staff costs, calculation of costs, and fees increases. She likewise informs that LAFCO has waived about $60,000 in processing fees for island annexations during the last two years.

The Chairperson comments that the Commission should ensure full cost-recovery. In response to an inquiry by Commissioner Wilson, Ms. Palacherla informs that the cities, the County and stakeholders have been noticed and staff did not receive any comments. In response to an inquiry by Commissioner Alvarado, Ms. Palacherla advises that the bulk of island annexations are in San Jose, Morgan Hill and Los Altos. The Chairperson informs that there will be more island annexations in San Jose.

The Chairperson determines that are no members of the public who wish to speak on the item and declares the public hearing closed.

On motion of Commissioner Alvarado, seconded by Commissioner Wilson, it is unanimously ordered on a 4-0 vote, with Commissioner Gage absent, that Resolution 2008-03 be adopted, revising the LAFCO fee schedule.

11. AMENDMENT TO AGREEMENT BETWEEN LAFCO AND COUNTY OF SANTA CLARA FOR LEGAL SERVICES FOR FISCAL YEAR 2009

The Chairperson requests the staff report. Ms. Palacherla advises that staff has requested amendment to the Legal Services Agreement between LAFCO and the Office of the County Counsel and will issue an RFP for legal services in the next few months.

On motion of Commissioner Alvarado, seconded by Commissioner Howe, it is unanimously ordered on 4-0 vote, with Commissioner Gage absent, that the First Amendment to Legal Services Agreement between LAFCO and the Office of County Counsel, relating to providing legal services for Fiscal Year 2008-09, be approved.

12. COMMISSIONERS' REPORTS

There are no Commissioners' reports.

13. EXECUTIVE OFFICER'S REPORT

13.1 CALAFCO ANNUAL CONFERENCE IN UNIVERSAL CITY ON SEPTEMBER 2-5, 2008

Ms. Palacherla requests the Commission to authorize attendance of commissioners and staff at the 2008 CALAFCO Annual Conference in Universal City on September 2-5, 2008, and authorize travel expenses to be funded by the LAFCO budget.

In response to an inquiry by Commissioner Alvarado, Commissioner Wilson informs that this year's theme is "The future of California is our business," and that the program lists the topics and activities during the Conference.

Commissioner Wilson moves to authorize attendance of commissioners and staff at the conference with travel expenses to be paid from the LAFCO budget. Commissioner Alvarado seconds the motion. Commissioner Howe comments that there is a policy on attendance.

In response to an inquiry by the Chairperson, Ms. Palacherla advises that CALAFCO's "Agriculture and Open Space Mitigation Policy, Practices and Definitions" course in Sacramento on July 11, 2008 is designed for staff and commissioners, and that no authorization is required from the Commission.

The Chairperson calls the question.

It is unanimously ordered on a vote of 4-0, with Commissioner Gage absent, that commissioners and staff be authorized to attend the 2008 CALAFCO Annual Conference on September 2-5, 2008, and travel expenses be authorized to be paid from the LAFCO budget.

14. WRITTEN CORRESPONDENCE

The Chairperson notes the receipt of a letter from City of Santa Clara notifying LAFCO of its intention to extend dark fiber lines outside of the City of Santa Clara boundaries and seeking advise on whether LAFCO approval is required.

15. NEWSPAPER ARTICLES

The Chairperson acknowledges receipt of the June 2008 issue of CALAFCO newsletter, The Sphere.

16. PENDING APPLICATION / UPCOMING PROJECTS

The Chairperson announces that the Executive Officer will conduct a protest proceeding for West Valley Sanitation District Annexation 2008-01 (Canon Drive) on June 19, 2008 at 9:30 a.m. in Room 157 at 70 West Hedding Street, San Jose.

The Chairperson likewise announces that the Commission has received a Notice of Intent to Circulate a Petition for the Formation of Greater San Jose Healthcare District.

17. ADJOURN

The Chairperson announces a special LAFCO meeting on Wednesday, July 2, 2008 at 1:15 p.m. in the Sheriff's Auditorium, Sheriff's Office, 55 Younger Avenue, San Jose, California. He requests staff to notify the proponents and all stakeholders about the change in the venue.

On order of the Chairperson, there being no objection, the meeting is adjourned at 4:01 p.m.

____
Pete Constant, Chairperson
Local Agency Formation Commission

ATTEST:

____
Emmanuel Abello, LAFCO Clerk

LAFCO
Local Agency Formation Commission of Santa Clara County

LAFCO Meeting Date: July, 2, 2008

TO: LAFCO

FROM: Neelima Palacherla, Executive Officer
Dunia Noel, Analyst

SUBJECT: **Comprehensive Fiscal Analysis and Revenue Neutrality Analysis for the Proposed Incorporation of the Town of San Martin**
Agenda Item # 5

STAFF RECOMMENDATION

Consider the report and provide direction to staff.

REVISED TABLE 3 DATED JUNE 25, 2008

Table 3 in the CFA has been revised to more accurately reflect the road maintenance expenditures transferred to the new Town. This amount is being reduced from $1,502,235 to $751,118 in accordance with information provided by the County in its April 8, 2008 staff report to the County Board of Supervisors. See attachment A for the revised Table 3 dated June 25, 2008.

LAFCO COUNSEL'S REVENUE NEUTRALITY ANALYSIS

Attached is the independent analysis provided by LAFCO Counsel on revenue neutrality. The memo describes the discretion that LAFCO has with regard to imposing terms and conditions to establish revenue neutrality. See Attachment B.

FINANCIAL FEASIBILITY OF THE PROPOSED TOWN OF SAN MARTIN

Based on the revenue neutrality analysis prepared by LAFCO Counsel, EPS conducted some preliminary analysis to evaluate the impacts of potential revenue neutrality payments on the feasibility of the new city. The memo (see Attachment C) indicates that even if LAFCO applied the County's entire road fund benefit to reduce the negative impacts to the County's general fund, the new town would not have the ability to make this reduced mitigation payment, resulting in an incorporation proposal that would not be fiscally feasible.

70 West Hedding Street ▪ 11th Floor, East Wing ▪ San José, CA 95110 ▪ (408) 299-5127 ▪ (408) 295-1613 Fax ▪ www.santaclara.lafco.ca.gov

RESPONSES TO WRITTEN COMMENTS ON THE COMPREHENSIVE FISCAL ANALYSIS

LAFCO has received several comments / questions regarding the Comprehensive Fiscal Analysis (CFA). The following is staff's response to various written comments/ questions.Also, attached (Attachment D) is a memo from Economic Planning Systems with responses to questions concerning the assumptions and the methodology used in the CFA.

1. **Will property taxes increase if we incorporate?**

   No, property taxes will not increase due to the incorporation. Proposition 13 determines the conditions under which a property may be reassessed for property tax purposes, and incorporation is not one of them. California state law (including Proposition 13 and Proposition 218) prohibits any tax increase without the approval of the voters.

2. **Can other taxes increase if we incorporate?**

   Incorporation does not in itself raise taxes. First, any issue that raises taxes must go to the voters. Voters must then decide, usually by a 2/3 vote (per Proposition 218), to approve the issue.

3. **Who will get to vote in the incorporation election?**

   Only registered voters within the boundaries of the proposed incorporation are eligible to vote in the incorporation election and also vote on city council members.

4. **How will the city council be selected?**

   As part of the incorporation election, registered voters in the proposed incorporation area will vote on the incorporation and also vote on city council members. If you are interested in running for the new city council, please contact the Santa Clara County Registrar of Voters for information about filing as a candidate.

5. **Will sewer service be provided after incorporation?**

   The incorporation application does not include provision of sewer service. However upon incorporation, the city council and community will decide if, when, and how sewer service will be provided and funded in the City.

6. Why does the IFA differ from the CFA?

*The Initial Fiscal Analysis (IFA) is intended to provide a preliminary evaluation of the financial feasibility of incorporation and to enable the proponents/community to appraise the potential for incorporation before spending additional time and resources on the incorporation efforts. The San Martin Neighborhood Alliance (SMNA) retained Economic Planning Systems (EPS), to prepare an IFA which was released in July 2003. Even though LAFCO policies require that an IFA be prepared, the IFA is **not** prepared under the direction of LAFCO and LAFCO is **not** involved in the development of the data, methodology or assumptions used in the IFA. LAFCO staff reviewed the IFA and in its October 4, 2004 letter to SMNA requested a reexamination of the issues establishing fiscal feasibility.*

*In February 2007, SMNA submitted a petition/ application to LAFCO for the incorporation of the Town of San Martin. LAFCO retained EPS to prepare the Comprehensive Fiscal Analysis (CFA), the preparation of which is a legal responsibility of LAFCO. The purpose of the CFA is to analyze the new city's fiscal feasibility, evaluate the fiscal impacts of incorporation on affected agencies and provide a basis for findings that LAFCO is required to make before approving the incorporation. The CFA for the Proposed Incorporation of San Martin was prepared under direction of LAFCO pursuant to LAFCO's Incorporation Policies, the State Office of Planning and Research's Incorporation Guidelines, and the State law. The CFA is based on data provided by the County and other affected public agencies. It is extremely important to understand that the CFA **does not** rely on data or assumptions that were included in the IFA. LAFCO's decision on the incorporation will be based on the financial feasibility conclusions included in the CFA and will **not** be based on the IFA.*

7. Have the data and assumptions within the CFA been reviewed by an independent party?

The CFA was prepared by Economic Planning Systems under the direction of LAFCO staff and based on the Cortese Knox Hertzberg Act, State Guidelines, LAFCO Policies, and the consultant's professional knowledge and experience. The CFA has been reviewed by LAFCO staff, the proponents, County staff, and the public. State law allows for any interested person or agency to request a review of the CFA by the Office of the State Controller at their own cost.

8. How will the incorporation affect lands that are under a Williamson Act Contract?

Pursuant to Government Code section 56754, the new city must succeed to the rights, duties and powers of the County in administering any Williamson Act contracts within the city's boundaries. In other words, Williamson Act contracts held by the County for lands located within the proposed city boundaries will transfer to the new city upon incorporation.

9. How can I ensure that my voice is heard?

There are several ways. LAFCO accepts comments on the proposed incorporation by mail and by email and accepts public testimony at LAFCO meetings and hearings.

10. What is the schedule for the proposed San Martin Incorporation?

The schedule for the proposed San Martin Incorporation continues to evolve. Please see staff report on the incorporation schedule and please continue to consult the LAFCO website (www.santaclara.lafco.ca.gov) for the latest information concerning the schedule for this project.

11. Is this plan to incorporate realistic as stated in LAFCO's own rules?

Government Code §56720 states that the Commission shall not approve or conditionally approve an incorporation proposal, unless the commission finds, among others things, that the proposed city is expected to receive revenues sufficient to provide pubic services and facilities and maintain a reasonable reserve during the three fiscal years following incorporation. The OPR Guidelines and Santa Clara LAFCO policies recommend and require that LAFCO evaluate the new city's long term financial feasibility and therefore the CFA includes a 10 year projection of the new city's expenditures and revenues. Financial feasibility is based on the ability of the new city to maintain pre-incorporation service levels.

12. If the Town of San Martin cannot "make it" on its' own, what happens then? Does the County of Santa Clara get to "pick up the pieces" and have to bail us out?

LAFCO's role in the incorporation process is to ensure that the new city will be fiscally feasible in the long-term. Upon incorporation, the new city and the community will be responsible for maintaining the fiscal health of the city. It is highly unlikely that the new city will be able to rely on other jurisdictions for *financial support in such unstable economic times. It is therefore imperative that LAFCO evaluate this proposal carefully and only approve the incorporation if it can find that it could be fiscally viable.*

13. What and where is the village "core"?

Page II-2 of the County of Santa Clara's San Martin Integrated Design Plan refers to the "village core" as being located around the intersection of San Martin Avenue and Monterey Road. Therefore, this term is meant to be general and informal.

14. If the village "core" is to be the present downtown area, from where will the funds come to "redevelop" this area? How many businesses will be put out of business for redevelopment?

Neither the CFA nor the CEQA document references any plans for redevelopment of the village "core." The project as submitted by the proponents includes very little new development (approximately 7 new single-family homes a year are projected). The city council will decide if, when, and how redevelopment of the village "core" or development within the town will occur.

15. Where can I find a list of names of the businesses that are located within the incorporation boundary for the proposed Town of San Martin? Where can I find information on the amount of income that is expected from such businesses?

The County Controller's Office developed a listing of individual businesses located in the incorporation area based on addresses provided by EPS. The total sales tax generated from these businesses in the incorporation area was calculated by a private consultant, HDL Inc. retained by the County. The information on sales tax from individual businesses is confidential information. The total sales tax information is as follows:

16. Did LAFCO's contract for the preparation of a comprehensive fiscal analysis for the proposed incorporation of the Town of San Martin go through an open bid process?

Yes. LAFCO issued a Request for Professional Services (RFP) for the preparation of the CFA for the proposed incorporation of the Town of San Martin. Four consulting firms submitted proposals and all four firms were interviewed by

LAFCO's interview panel. Economic Planning Systems was awarded the contract based on the results of the interview process.

17. Is it true that SMNA will be using the Lion's Club Hall & grounds for city offices?

The location of the new city's offices will be decided by the city council and by the community after incorporation.

18. Where is the "right to farm" mentioned in the CFA? What will happen to all the farmers who count on their occupation to make a living?

The "right to farm" is not mentioned in the CFA. The County of Santa Clara has a Right to Farm Ordinance. Government Code Section 57376 requires the new city to immediately adopt an ordinance providing that all Santa Clara County ordinances (including the County's Right to Farm Ordinance) shall continue as the new city's ordinances for 120 days or until superseded by ordinances adopted by the new city.

ATTACHMENTS

Attachment A:	Revised Table 3 dated June 25, 2008
Attachment B:	LAFCO Counsel's Revenue Neutrality Analysis dated June 25, 2008
Attachment C:	EPS Memo on Impact of Revenue Neutrality on City Feasibility dated June 26, 2008.
Attachment D:	EPS Response to Questions on San Martin CFA dated June 25, 2008

June 25, 2008

Table 3
Change in Revenues and Expenses to Santa Clara County
San Martin Incorporation Analysis, EPS #17060 **Proponents' Proposed Boundary**

Item	Amount	Notes
General Fund Revenues and Expenditures (FY07) (1)		
Revenues Transferred to the City		
Property Taxes	$599,522	estimated transfer amount FY 07
Transient Occupancy Tax	$221,557	
Sales Tax	$838,885	includes estimated 12% unallocated
Real Property Transfer Tax	$2,335	50% of FY 07 amount ($.55/$1,000 value)
Franchise Fees	$253,621	including solid waste, PG&E, cable, water
AB 939 Fees	$10,237	
Subtotal	$1,926,157	
Expenditures for Service Responsibilities Transferred to the City (1)		
Animal Control	$278,447	
Land Use Planning, Inspection, Enforcement	$151,056	
Clean Water	$3,186	
Waste Management	$129,205	
Sheriff	$483,933	
Subtotal	$1,045,827	
Other (revenue increases) (2)		
Property Tax Administration Fees	$8,090	Based on first year of city
Booking Fees	$0	Not paid by cities, per State budget
Net County Surplus or (Deficit)	**($872,240)**	
County Road Fund		
Revenue Reductions (3)		
Gas Tax: Highway User Tax 2106c	$27,491	based on 7.7% reduction in unincorp. a.v.
Gas Tax: Highway User Tax 2105a [2]	$208	based on reduction in County maintained miles
Grants	$89,414	Cnty avg/collector times 27 collector miles
Traffic Congestion Relief: 2182a [1] (B)	$41,624	based on reduction in County maintained miles
Subtotal	$158,737	
Expenditure Reductions		
Road Maintenance (4)	$751,118	
Other Road Costs (traffic engineering, signal maint.)	$120,000	Excludes cost-recovery development engineering
Subtotal	$871,118	
Net County Road Fund Surplus or (Deficit)	**$712,381**	
Total General Fund and Road Fund Surplus or (Deficit)	**($159,859)** *	

* Note: legal requirements restrict the transfer of certain Road Fund revenues to directly offset General Fund service cost impacts.

(1) Costs shown in this table represent FY07 County costs for those service responsibilities to be transferred to the new city. Future city costs shown in Table 1 will not necessarily correspond to these FY07 County costs since the specific future services, staffing, facilities, contracts and manner of service provision will differ for the future city. For example, the future city will need to provide traffic enforcement, which currently is not a County responsibility.

(2) The County will realize new revenues (e.g., property tax administration charges) for services currently provided without compensation.

(3) County road revenues are not significantly affected, as they largely depend on Countywide population and registered vehicles, and are not influenced by a change in unincorporated vs. incorporated population or road miles.

(4) Road maintenance expenditures are based on County estimates (County staff report dated April 8, 2008). The estimates represent a 50% reduction compared to prior years due to higher expenditures in prior years to improve road conditions.

LAW OFFICES OF
BEST BEST & KRIEGER
LLP

ITEM NO. 5
ATTACHMENT B

CONFIDENTIAL
ATTORNEY-CLIENT PRIVILEGE
ATTORNEY WORK PRODUCT

MEMORANDUM

TO:	Chair Constant Members of the Commission Neelima Palacherla, Executive Officer
FROM:	Malathy Subramanian Scott Smith
DATE WRITTEN:	June 25, 2008
MEETING DATE:	July 2, 2008
RE:	San Martin Incorporation – Revenue Neutrality Analysis

Background

The San Martin Neighborhood Alliance ("Proponents") and the County of Santa Clara ("County") have submitted different interpretations of the revenue neutrality provisions of the Cortese-Knox-Hertzberg Local Reorganization Act of 2000 (Government Code section 56600 *et seq.*, the "Act") [1] for the proposed Town of San Martin ("Town"), specifically as they relate to certain expenditures transferred from the County and assumed by the Town, which are paid for from restricted road revenues. You have asked us to provide you with our legal opinion regarding this issue.

Analysis

The Act requires that any incorporation proposal result in a similar exchange of both revenue and responsibility for service delivery among the county and the proposed city, and other subject agencies. This is known as "revenue neutrality," and the Commission may not approve an incorporation proposal unless it finds that the revenues currently received by the County that transfer to the proposed Town are substantially equal to the direct and indirect costs of the services transferred. (Section 56815(b) "Revenue Neutrality Statute".)

The Commission may approve an incorporation if its finds: (1) that the County and all of the subject agencies agree to the proposed transfer; or (2) that the negative fiscal effect has been adequately mitigated by tax sharing agreements, lump-sum payment, payments over a fixed period of time, or any other terms and conditions pursuant to Section 56886. (Section 56815(c).)

As part of the process for determining the property tax revenue to be exchanged among agencies affected by incorporation, the Commission is required to determine the County's total net cost during the prior fiscal year of providing those services the Town will assume as part of the incorporation. (Subsection 56810(c)(2).) The "total net costs" means the total direct and indirect costs that were

[1] All references are to the Government Code, unless otherwise specified.

funded by general purpose revenues of the County and excludes any portion of the total cost that was funded by restricted funds such as:
(a) revenue, which by statute, is required to be used for a specific purpose;
(b) revenue from fees, charges, or assessments which are levied to specifically offset the cost of particular services and do not exceed the cost reasonably borne in providing these services; and
(c) revenue received from the federal government which is required to be used for a specific purpose. (Section 56810(c)(2).)[2]

The total net cost calculation is incorporated in the revenue neutrality calculations as specified in Subsection 56810(j), which provides: "The calculations and procedures specified in this section shall be made prior to and shall be incorporated into the calculations specified in Section 56815."

The Office of Planning and Research has published incorporation guidelines ("Guidelines") to assist incorporation proponents and provide direction to affected agencies through this process. The Guidelines are advisory to LAFCOs in the review of incorporation proposals, and are not binding as regulations. (Section 56815.2.) The Guidelines provide that restricted and unrestricted revenues should be evaluated separately for purposes of calculating revenue neutrality. (Guidelines page 44.) The Guidelines also provide that an agency may make a portion of its annual revenue neutrality payment with restricted funds if both agencies agree and a legally enforceable mechanism for payment is utilized. (Id.)

In addition, Santa Clara LAFCO has adopted its own incorporation policies ("Incorporation Policies"), which provide that "fiscal impacts to restricted and unrestricted revenues should be evaluated separately". The Incorporation Policies also provide that an agency may make a portion of its annual revenue neutrality payment with restricted funds if both agencies agree to this arrangement and it is legally enforceable.

As indicated above, Subsection 56810(j) specifies that the calculations and procedures used under the remainder of Section 56810 (to determine the real property tax exchange) should be used for the revenue neutrality calculation. However, the Act, the Guidelines, and the Incorporation Policies do not specify whether a positive fiscal impact remaining in a County restricted fund should be considered to offset a negative fiscal impact on the County's general fund in measuring revenue neutrality.

Background and Statutory Construction of Revenue Neutrality

The Guidelines provide this background for the Revenue Neutrality Statute:

> After Proposition 13, local agencies could no longer alter the property tax rate to compensate for lost revenue when a new city incorporated and started receiving sales and other tax revenue. Other communities in the unincorporated area who [sic] had relied on the county to provide municipal level services found their revenue sources reduced. Counties facing revenue losses due to the incorporation were forced to reduce services simply because there were no practical alternatives such as raising additional revenue. The revenue neutrality law was an attempt to

[2] These funds are referred to as "restricted funds".

> make the tax allocation more equitable by requiring LAFCO to ensure that counties and districts are held harmless from new incorporations. Counties have dual responsibilities for services. The County is the provider of law enforcement services in the unincorporated area. It often provides fire protection as well. Additionally, it is the county that provides for the rest of the criminal justice system to all county residents--- services such as the District Attorney, correctional facilities, probation, and Public Defender. These services are provided regardless of where people live and are funded by the same revenue stream that previously could be diverted to an incorporating city. Revenue neutrality has generally removed the financial incentive for communities to incorporate as counties do not lose more revenues over and above the costs associated with services to be transferred. However, counties may still have strong financial incentive to facilitate incorporations especially if there is strong citizen sentiment to create the new city, the county's financial base is assured, and the county may avoid the long-term costs of providing municipal level services to rapidly developing communities.

Statutory construction provides that courts "do not construe statutes in isolation, but rather read every statute with reference to the entire scheme of law of which it is part so that the whole may be harmonized and retain effectiveness." (*People v. Thomas* (1992) 4 Cal.4th 206, 210 [internal quotations and citations omitted].) "Words must be construed in context, and statutes must be harmonized, both internally and with each other, to the extent possible. Interpretive constructions which render some words surplusage, defy common sense, or lead to mischief or absurdity are to be avoided." (*California Manufacturers Association v. Public Utilities Commission* (1979) 24 Cal.3d 836, 844.) It is a cardinal rule of statutory construction that in attempting to ascertain the legislative intention effect should be given, whenever possible, to the statute as a whole and to every word and clause thereof, leaving no part of the provision useless or deprived of meaning." (*Gay Law Students Assn. v. Pacific Tel. & Tel. Co.* (1979) 24 Cal.3d 458, 478 [emphasis added]; see also *City and County of San Francisco v. Farrel* (1982) 32 Cal.3d 47, 54; *Dyna-Med, Inc. v. Fair Employment & Housing Com.* (1987) 43 Cal.3d 1379, 1387.)

Here, the County and Proponents have been unable to agree to the formula for calculating revenue neutrality or to terms for a negotiated revenue neutrality agreement. The Commission's first concern is to calculate the relationship between the revenues and the costs of services transferred to the Town. Its second concern is to determine how much latitude it has in imposing terms and conditions under Section 56886 to find the revenue neutrality balance met. Any terms and conditions that mitigate negative fiscal effects of an incorporation must be included in the Commission's resolution making determinations. (Section 56815(e).)

The application of Section 56810's ad valorem formula to determine revenue neutrality – without looking beyond that formula – leads to the conclusion that the incorporation will result in a negative impact on the County's general fund. This occurs because the County uses only restricted funds to fund road maintenance services.[3] Since this is the case, Subsection 56810(j) requires that the 56810 ad valorem formula exclude the entire cost of road maintenance from the Town's side of the revenue

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[3] This conclusion is based on the County's written statements regarding sources of funds.

neutrality calculation. This results in (1) not enough road funds transferred to the Town to cover road expenses; and (2) the Town not getting "credit" in the revenue neutrality formula for the road maintenance services assumed from the County. This situation is probably unusual in that the County does not currently use any general funds for road maintenance.[4] In assuming this expenditure, the Town will need to use general fund money to cover it, as the Gas Tax revenue it will receive is inadequate to fund it.

The Revenue Neutrality Statute, as noted above, was created to make sure that Counties were "held harmless" for incorporations. While the incorporation will cause a decrease in general fund revenues to the County, it will also cause an increase to the County's road fund due to the decrease in County miles to maintain. The County currently does not use general fund money to supplement the road fund and does not anticipate doing so in the future.[5] Thus, the application of Section 56810's formula to the road maintenance issue results in more than simply holding the County harmless under Section 56815; it results in a windfall to the County as it transfers a significant responsibility, while maintaining the restricted funds formerly used to cover it.

Terms and Conditions

The Commission has broad discretion to impose terms and conditions under Section 56886 to further the purposes of the Act, so long as none of the terms and conditions directly regulates land use, property development, or subdivision requirements. In addition, the Incorporation Policies provide that the Commission "will make findings and/or impose conditions/mitigations to equalize the transfers of revenue and service."

Under Section 56886(v), the Commission can provide for any other matters necessary or incidental to any of the specified terms and conditions. The Commission will be designating the Town as the successor to the County pursuant to Section 56886(m), which will include that the Town will succeed to all of the duties and obligations of the County. This includes, among other things, road maintenance.

The Revenue Neutrality Statute incorporates by reference Section 56866. Harmonization of these sections with Section 56810 and the Incorporation Policies indicate that the Commission may impose terms and conditions to make its revenue neutrality finding. In other words, the Commission may look beyond the mechanical calculation of Section 56810 to makes its finding under Section 56815. Because the County and the Proponents cannot come to agreement on a revenue neutrality agreement, the Commission can impose mitigation payments to address the negative fiscal effects of the incorporation on the County.

If the Town incorporates, the Town will be responsible for road maintenance after the transition year. After the transition year, the County will receive a reoccurring benefit to its road funds in an amount of $606,524 per year that will not be transferred to the Town, and the County will no longer provide road

[4] The County has used general fund money in the past 10 years for road-related purposes years during FY2001 to FY2003.

[5] The County has indicated that is highly unlikely given its current general fund deficit that general fund revenue could be made available for roads in the foreseeable future. However, they have also indicated that they cannot guarantee that general funds will not be used in the future to address road maintenance in the County. The County's Five Year Expenditure Plan, currently has a total difference between available resources and unconstrained needs of $358 million.

maintenance services to Town roads that were once County maintained roads.[6] While this benefit to the road fund cannot be used for general services, it does assist the County in providing a much needed service for the benefit of the County as a whole. In the future, the County may not need to utilize general funds to compensate for any deficiencies in the road fund because of this benefit. Although the Town will assume this service, it will not receive credit for this service under the revenue neutrality calculation, unless some portion of the road maintenance is considered to offset the general fund revenues the County is losing.

The purpose of the Revenue Neutrality Statute is to hold the County harmless for losses in revenue that do not equal the cost of providing services to the proposed city. In this case, the County will lose general fund revenues, but will have little change in restricted road funds compared with the decrease in road maintenance services that will be assumed by the Town. The effect on the County is much less when the Commission considers the costs of road maintenance as it is transferred without the revenues formerly used to fund it. The legislative intent of the Revenue Neutrality Statute and the Statute's reference to terms and conditions suggest that the Commission may look beyond Section 56810's mechanical calculation to make a revenue neutrality calculation. Specifically, the Commission could require the Town to make revenue neutrality payments to the County for the associated loss to the County general fund from the incorporation, but offset a portion of these payments based upon the benefit to the County's road fund. This would still hold the County harmless from the incorporation, but not provide the County a windfall from the incorporation, i.e., the minimal impact on the restricted road fund without the cost of providing road maintenance in San Martin.

The Commission has broad authority to impose terms and conditions on the incorporation proposal. Terms and conditions relating to the transfer of services or funds could take this discrepancy/windfall into account and mitigate or offset a portion of the Town's revenue neutrality payment. The Commission could require the Town to make revenue neutrality payments in the full amount to the County for its general fund loss or provide that the payment is offset by a portion of the savings[7] to the County's road funds.

This would allow the County to be held harmless from the incorporation, in keeping with the intent of revenue neutrality, and also avoid the County receiving a windfall from the incorporation. It would allow the Commission to review the negative impacts on the County's general fund, but to also consider the minimal impact on the County's road fund and the decrease in County miles that must be maintained.

<u>Revenue Neutrality Negotiations</u>

This discrepancy can also be accounted for by the parties, should they choose to re-engage in revenue neutrality discussions. Our understanding is that the parties have considered the County unable to transfer any of the road fund windfall to the Town. In fact, the County may provide aid for maintenance of city streets from the County general fund, the road fund, the proceeds of any county bond issue for road maintenance, or any other fund available for such purposes. (Streets and Highway

[6] The County estimates that the annual cost of traffic engineering, signal maintenance, and road maintenance is $871,000. The Town will receive $264,476 in Gas Tax Revenues in Fiscal Year 2009-2010, which the County will no longer receive.
[7] As the road fund is a restricted fund and cannot be used for general purposes, the Commission may decide to consider only a portion of the savings to the road fund to offset the revenue neutrality payments to address the loss to the general fund.

Code § 1680 et seq.) Should the County agree to providing aid to maintain the Town's roads, using road fund revenues as permitted under this statute, the Town could in exchange make its revenue neutrality payment to the County in full, which would be part of the County's general fund and could be used by the County for any purpose.

Transition Year Costs

Section 57384 requires the County to provide services to the Town for the remainder of the fiscal year during which the incorporation became effective or until the Council requests discontinuance of the services, whichever occurs first. The County must furnish these services without additional charge to the Town, unless the County requests reimbursement for the net costs of services provided ("Transition Year Costs").

The Commission is required to impose on the Town this condition of payment to the County for transition year costs as a term and condition. The transition year "net cost of services" are also calculated pursuant to Section 56810, i.e., the total direct and indirect expense to the County of providing services, as determined pursuant to paragraph (2) of subdivision (c) of Section 56810, adjusted by any subsequent change in the California Consumer Price Index, less any revenues which the County retains that were generated from the formerly unincorporated territory during the period of time the services are furnished. Therefore, since the County has already indicated that it did not spend general funds for maintenance of County roads in Fiscal Year 2006-2007, these costs should not be charged to the Town for repayment as Transition Year Costs. The County is required to provide the transition services for the remainder of the fiscal year during which the incorporation became effective or until the Town council requests discontinuance of the services, whichever occurs first.

To the extent that the County provides a full year of transition services, the costs of these services would be borne from the County's road restricted funds. Therefore, should the effective date of the incorporation include almost a full year of service, the Commission could provide that the Town is not required to pay the Transition Costs currently associated with roads. The Commission has the authority to set the effective date of the incorporation and could consider this issue as part of its decision to set the date. Alternatively, the County and the Town or the Commission can take this into account in determining revenue neutrality.

Depending on what position the Commission takes for purposes of revenue neutrality will likely effect how much the Town should pay the County for Transition Year Costs associated with roads. If the Commission does not offset any benefit to the County's road fund against the loss to its general fund for purposes of determining revenue neutrality, the Commission should not impose on the Town a repayment to the County of Transition Year Costs associated with roads. Likewise, if the Commission offsets the entirety of the benefit to the County's road fund against the loss to its general fund, the Town should pay the County for all of its costs associated with road maintenance provided in the Transition Year to avoid a windfall to the Town.

Conclusion

The purpose of the Revenue Neutrality Statute is to hold the County harmless for losses in revenue that do not equal the cost of providing services to the proposed city. In this case, under a mechanical application of the Section 56810 formula to revenue neutrality, the calculation would result in a general fund loss to the County, but also little change to its road fund and a decrease in maintenance obligations assumed by the Town. The legislative intent of the Revenue Neutrality Statute does not suggest that the Commission must ignore this windfall. Rather, the Commission has latitude to (1) impose terms and conditions and to exclude all, none, or a portion of Transition Year Costs funded by restricted funds; and (2) to offset the windfall in whole, in part, or not at all against revenue neutrality payments to the County for the associated loss to the County general fund from the incorporation. In so doing, the Commission could also consider the County's inability to use this "windfall" to pay for other essential services it may need to provide. In other words, unrestricted funds lost to the Town are probably more valuable to the County to the extent they can be used to fund any service, not just roads.

Economic &
Planning Systems
Real Estate Economics
Regional Economics
Public Finance
Land Use Policy

MEMORANDUM

To: Neelima Palacherla, Santa Clara LAFCO

From: Richard Berkson

Subject: San Martin CFA – Impact of Revenue Neutrality on City Feasibility; EPS #17020

Date: June 26, 2008

As you requested, we have reviewed the San Martin Incorporation revenue neutrality analysis prepared by Best Best & Krieger (BB&K) and its implications for cityhood feasibility. Our conclusions are based on the city budget table (CFA Table 1) dated 6/3/08, and the change in revenues and expenses to Santa Clara County (CFA Table 3) dated 6/25/08.

The BB&K analysis indicates that LAFCO has the discretion to impose a revenue neutrality payment on the new city that provides credit for some portion of the benefit to the County Road Fund against negative County General Fund impacts. For purposes of analysis, we have reviewed the implications of a mitigation payment that credits the entire County Road Fund surplus against the County General Fund shortfall; BB&K indicates that LAFCO may credit none, some or the entire Road Fund surplus.

The County Road Fund surplus is estimated at $712,000 annually as a result of transferring service responsibilities and costs to the new city that significantly exceed Road Fund revenue reductions to the County. The $712,000 is based on County estimates (County staff report dated April 8, 2008) which indicated that future road maintenance expenditures were anticipated to be approximately 50 percent lower than in prior years due to additional expenditures in prior years to improve San Martin road conditions.

After crediting the County Road Fund surplus to the County General Fund shortfall of ($872,000), the resulting annual negative impact on the County equals ($160,000). It is important to note that the County Road Fund expenditures are funded by revenues that are restricted to road-related purposes; although the surplus revenues cannot be used to mitigate negative impacts on General Fund services, they would result in road-related benefits to other County residents.

The additional revenue neutrality payments would worsen the annual shortfalls shown in the city budget in years two through six; the total annual shortfalls would range from ($190,000) to ($245,000). In years seven through ten, the city would still fall short of meeting the mitigation obligation by about ($15,000) to ($25,000).

According to the BB&K analysis, LAFCO could choose to not require the city to repay the County for transition year road-related costs, because they are not funded by County general revenues, and because the County Road Fund surplus could fund the transition year services. However, BB&K noted that if repayment of these transition costs is not required, LAFCO could not also credit County Road Fund benefits against County General Fund impacts in the transition year. Therefore, the city would experience a shortfall of ($657,000) in the transition year due to a mitigation obligation in the transition year of ($872,000). In subsequent years two through six, the city's annual shortfall would range from ($20,000) to ($40,000), with the exception of a positive $10,000 in the fifth year. Years seven through ten would still fall short of meeting the mitigation obligation by about ($15,000) to ($25,000).

The preceding findings show negative fiscal results for the city in nearly all years, assuming full credit of the County Road Fund surplus against the County General Fund shortfalls. The potential city shortfalls after year six are only slightly negative. While cost savings in future years may be possible, other factors such as a protracted economic and real estate downturn could worsen the projections shown.

June 25, 2008

Table 3
Change in Revenues and Expenses to Santa Clara County
San Martin Incorporation Analysis, EPS #17060 **Proponents' Proposed Boundary**

Item	Amount	Notes
General Fund Revenues and Expenditures (FY07) (1)		
Revenues Transferred to the City		
Property Taxes	$599,522	estimated transfer amount FY 07
Transient Occupancy Tax	$221,557	
Sales Tax	$838,885	includes estimated 12% unallocated
Real Property Transfer Tax	$2,335	50% of FY 07 amount ($.55/$1,000 value)
Franchise Fees	$253,621	including solid waste, PG&E, cable, water
AB 939 Fees	$10,237	
Subtotal	$1,926,157	
Expenditures for Service Responsibilities Transferred to the City (1)		
Animal Control	$278,447	
Land Use Planning, Inspection, Enforcement	$151,056	
Clean Water	$3,186	
Waste Management	$129,205	
Sheriff	$483,933	
Subtotal	$1,045,827	
Other (revenue increases) (2)		
Property Tax Administration Fees	$8,090	Based on first year of city
Booking Fees	$0	Not paid by cities, per State budget
Net County Surplus or (Deficit)	**($872,240)**	
County Road Fund		
Revenue Reductions (3)		
Gas Tax: Highway User Tax 2106c	$27,491	based on 7.7% reduction in unincorp. a.v.
Gas Tax: Highway User Tax 2105a [2]	$208	based on reduction in County maintained miles
Grants	$89,414	Cnty avg/collector times 27 collector miles
Traffic Congestion Relief: 2182a [1] (B)	$41,624	based on reduction in County maintained miles
Subtotal	$158,737	
Expenditure Reductions		
Road Maintenance (4)	$751,118	
Other Road Costs (traffic engineering, signal maint.)	$120,000	Excludes cost-recovery development engineering
Subtotal	$871,118	
Net County Road Fund Surplus or (Deficit)	**$712,381**	
Total General Fund and Road Fund Surplus or (Deficit)	**($159,859)** *	

* Note: legal requirements restrict the transfer of certain Road Fund revenues to directly offset General Fund service cost impacts.

(1) Costs shown in this table represent FY07 County costs for those service responsibilities to be transferred to the new city. Future city costs shown in Table 1 will not necessarily correspond to these FY07 County costs since the specific future services, staffing, facilities, contracts and manner of service provision will differ for the future city. For example, the future city will need to provide traffic enforcement, which currently is not a County responsibility.

(2) The County will realize new revenues (e.g., property tax administration charges) for services currently provided without compensation.

(3) County road revenues are not significantly affected, as they largely depend on Countywide population and registered vehicles, and are not influenced by a change in unincorporated vs. incorporated population or road miles.

(4) Road maintenance expenditures are based on County estimates (County staff report dated April 8, 2008). The estimates represent a 50% reduction compared to prior years due to higher expenditures in prior years to improve road conditions.

6/3/08 DOES NOT INCLUDE REVENUE NEUTRALITY MITIGATION

Table 1
Summary of Revenues and Expenses (All Figures in Constant $'s)
San Martin Incorporation Analysis, EPS #17060 Full Transition Year 12 months Proponents' Proposed Boundary

Item	Fiscal Year 2009-10 1	2010-11 2	2011-12 3	2012-13 4	2013-14 5	2014-15 6	2015-16 7	2016-17 8	2017-18 9	2018-19 10
A. GENERAL FUND OPERATIONS										
General Fund Revenues										
Property Taxes	$687,951	$705,773	$724,107	$742,968	$762,367	$782,320	$802,841	$823,945	$845,646	$867,960
Sales Tax	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885
Transient Occupancy Tax	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557
Real Property Transfer Tax	$5,305	$5,436	$5,571	$5,708	$5,849	$5,993	$6,141	$6,292	$6,447	$6,605
Franchise Fees	$289,670	$289,873	$290,075	$290,277	$290,479	$290,681	$290,883	$291,086	$291,288	$291,490
Planning and Building Fees	$0	$274,742	$276,116	$277,496	$278,884	$280,278	$281,679	$283,088	$284,503	$285,926
Public Works/Eng. Fees	$0	$89,020	$89,465	$89,913	$90,362	$90,814	$91,268	$91,724	$92,183	$92,644
Fines, Penalties, Misc.	$42,813	$32,684	$32,793	$32,901	$33,009	$33,117	$33,225	$33,333	$33,441	$33,549
State Motor Vehicle License Fees	$62,172	$62,377	$62,583	$62,788	$62,994	$63,200	$63,405	$63,611	$63,816	$64,022
Property Tax/VLF Swap	$547,312	$512,513	$477,474	$442,193	$406,670	$370,907	$372,113	$373,320	$374,526	$375,733
Revenue Credits (transition yr, rec'd by County)	$5,000									
Investment Earnings	$53,913	$60,657	$60,373	$60,094	$59,821	$59,555	$60,040	$60,537	$61,046	$61,567
Total	$2,754,579	$3,093,519	$3,078,998	$3,064,780	$3,050,878	$3,037,308	$3,062,039	$3,087,377	$3,113,339	$3,139,939
General Fund Expenses										
Legislative	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500
Elections	$200,000	$10,000	$0	$10,000	$0	$10,000	$0	$10,000	$0	$10,000
City Manager and City Clerk	$281,225	$328,659	$330,289	$331,927	$333,573	$335,227	$336,890	$338,561	$340,240	$341,928
City Attorney	$250,000	$76,131	$76,511	$76,894	$77,278	$77,665	$78,053	$78,443	$78,836	$79,230
Administrative Services	$166,050	$222,507	$223,620	$224,738	$225,861	$226,991	$228,126	$229,266	$230,413	$231,565
Police	$0	$588,661	$594,598	$600,594	$606,650	$612,767	$618,944	$625,184	$631,485	$637,850
Animal Control	$0	$74,811	$75,185	$75,561	$75,939	$76,319	$76,700	$77,084	$77,469	$77,856
Planning and Building	$137,672	$443,032	$444,635	$446,246	$347,864	$349,491	$351,126	$352,769	$354,421	$356,080
Public Works Administration	$74,250	$178,040	$178,931	$179,825	$180,724	$181,628	$182,536	$183,449	$184,366	$185,288
Non-Departmental										
Office Rent/Supplies	$109,000	$112,500	$84,500	$76,500	$76,500	$76,500	$76,500	$76,500	$76,500	$76,500
Insurance	$37,431	$61,915	$61,133	$61,554	$58,617	$59,283	$59,351	$60,023	$60,097	$60,774
Contingency (10%)	$233,596	$212,576	$209,890	$211,334	$201,251	$203,537	$203,773	$206,078	$206,333	$208,657
Reserve Fund Contribution	$233,596	$0	$0	$0	$0	$0	$0	$0	$0	$0
LAFCO	$1,279	$1,279	$1,279	$1,279	$1,279	$1,279	$1,279	$1,279	$1,279	$1,279
Repayment of Transition Yr Cnty Services (1)	$1,050,827	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total	$2,804,425	$2,339,612	$2,310,070	$2,325,950	$2,215,036	$2,240,185	$2,242,778	$2,268,135	$2,270,938	$2,296,507
General Fund Operating Surplus (Deficit)	($49,846)	$753,907	$768,928	$738,829	$835,842	$797,123	$819,261	$819,242	$842,401	$843,432
Reserve Fund Balance	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596
% of Expenditures (exc. conting, reserves)	10.0%	11.0%	11.1%	11.1%	11.6%	11.5%	11.5%	11.3%	11.3%	11.2%
B. ROAD FUND OPERATIONS										
Road Fund Revenues										
Gas Taxes	$200,789	$188,455	$176,036	$163,531	$150,940	$138,264	$138,692	$139,119	$139,547	$139,975
Prop 42 Funds	$63,687	$63,899	$64,751	$65,614	$66,488	$67,373	$68,268	$69,175	$70,094	$71,023
Total	$264,476	$252,354	$240,787	$229,145	$217,428	$205,637	$206,960	$208,295	$209,641	$210,998
Road Fund Expenditures										
Pavement Maintenance		$211,049	$213,160	$215,292	$217,444	$219,619	$221,815	$224,033	$226,274	$228,536
Signal Maintenance, Traffic Engineering		$51,008	$51,263	$51,519	$51,776	$52,035	$52,296	$52,557	$52,820	$53,084
Other Costs (sweeping, trash removal, signs, drainage)		$523,833	$526,452	$529,084	$531,730	$534,388	$537,060	$539,746	$542,444	$545,157
Contingency (10%)		$78,589	$79,087	$79,589	$80,095	$80,604	$81,117	$81,634	$82,154	$82,678
Repayment of Transition Yr Cnty Services	$0	$201,206	$201,206	$201,206	$201,206	$201,206				
Total	$0	$1,065,685	$1,071,168	$1,076,691	$1,082,252	$1,087,853	$892,288	$897,970	$903,692	$909,455
Road Fund Operating Surplus (Deficit)	$264,476	($813,331)	($830,382)	($847,546)	($864,824)	($882,216)	($685,328)	($689,675)	($694,051)	($698,457)
TOTAL, All Funds	$214,631	($59,424)	($61,454)	($108,716)	($28,982)	($85,094)	$133,933	$129,568	$148,350	$144,976
Cumulative Surplus (Deficit)	$214,631	$155,207	$93,753	($14,964)	($43,946)	($129,040)	$4,893	$134,461	$282,811	$427,787

(1) Repayment cost accounts for animal services, planning and land use, code enforcement, public works, and sheriff department services the County is obligated to provide for the remainder of the first fiscal year.

ITEM NO. 5
ATTACHMENT D

Economic &
Planning Systems

Real Estate Economics
Regional Economics
Public Finance
Land Use Policy

MEMORANDUM

To: Neelima Palacherla, Santa Clara LAFCO

From: Richard Berkson

Subject: Response to Questions on the San Martin CFA; EPS 17060

Date: June 25, 2008

As you requested, we have prepared responses to questions you forwarded to us regarding the San Martin CFA (March 2008). The questions are repeated below, followed by our response.

1. *"Do the projected expenses in the CFA account for the rising costs of oil and petroleum based products?"*

   Response: In the first full year of the new city, the estimated pavement maintenance costs are increased by 16 percent (including inflation) above the costs estimated in the CFA based on 2007 costs; the cost in the first full year for pavement maintenance is shown as $211,000 (2007$$).

   Over the past five years, the costs of road construction have increased approximately 10 percent annually as a result of increasing demand for construction materials ("Highway Construction Producer Prices", ARTBA, March 2008). Although construction demand is slackening, oil and fuel prices, which comprise a significant portion of the maintenance cost, continue to increase.

   The CFA includes a 10 percent annual contingency in the Road Fund, and a 10 percent annual contingency in the General Fund, totaling approximately $290,000 annually, a portion of which may be required to the extent that pavement maintenance costs continue to escalate at a rate greater than the future annual 4 percent (including inflation) assumed in the CFA.

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2. *"Does the CFA account for the drop in property values and therefore a drop in assessments and a corresponding reduction in property taxes collected by the jurisdiction"*

   Response: The estimated growth in assessed value in the CFA through FY09 approximates the adopted final County FY09 budget property tax compared to FY07, which is a change of about 15% (including inflation). From FY08 to FY09, the County budget assumed a 6.5% growth, which is slightly greater than the 5.7% growth assumed in the CFA (including inflation) for the San Martin area. The CFA adds another 5.7% growth (including inflation) to arrive at the FY10 estimate of transferred property tax. This growth rate is assumed into the future to estimate property tax growth.

   If no net assessed value growth occurs in San Martin from FY09 to FY10 (e.g., as a result of re-assessments), property taxes transferred to the new city would be about $25,000 less, or 4 percent lower than estimated. This reduction would represent a decline in total projected revenues of about 1 percent.

3. *"Are the assumptions made in the CFA concerning Investment Earnings realistic and not drastically inflated?"*

   Response: Investment earnings represent about 2 percent of total revenues. This is believed to represent a reasonable estimate. The actual earnings will depend on future interest rates that can be obtained by public entities, as well as the flow of revenues and expenditures and average balances maintained by the new city including reserve balances.

4. *"Why does the CFA project that the cost of Liability Insurance for the city will decline to $60,774 over the subsequent nine years when in my experience litigation and insurance costs have steadily risen over the past years?"*

   The projections are shown in terms of dollars with constant 2007 purchasing power. Because the insurance cost has been estimated as a percent of expenditures, the projected amount, BEFORE inflation, is shown to vary slightly in 2007 terms. Expenditures are assumed to grow at the rate of inflation (or greater, as noted for many of the salary costs); therefore, after 9 years, insurance expenditures are likely to grow by about 27 percent after accounting for inflation.

5. *"In the Planning and Building category of the CFA, why is there such a large one time drop in year five expenses, with a significantly reduced amount then carried forward, while revenue remains at the same general level throughout Table 1?"*

   Response: The CFA assumes that the new city will choose to develop its own General Plan, after initially adopting the County's plan. Costs for plan development are assumed at $100,000 annually, ending prior to the fifth year.

6. *"Do the expense categories for City Manager and City Clerk, Administrative Services, Planning, Building, Public Works and Other Costs take into consideration actual growth of wages and benefits for any future city employees?"*

   Response: The CFA assumes staff salary increases averaging ½ percent plus inflation every year.

7. *"Given that the Road Fund Expenditures are more than 25% of the entire city budget, why doesn't the CFA include adjustments for the current cost of materials, most notably oil based or aggregate materials and the increasing costs to transport heavy/bulky items such as gravel, asphalt and base rock?"*

   Response: Please refer to the response to Question #1, above.

LAFCO
Local Agency Formation Commission of Santa Clara County

Additional Staff Report Item #5

LAFCO Meeting Date: July, 2, 2008

TO: LAFCO

FROM: Neelima Palacherla, Executive Officer

SUBJECT: **Comprehensive Fiscal Analysis and Revenue Neutrality Analysis for the Proposed Incorporation of the Town of San Martin**
Agenda Item # 5

Additional Revisions to Table 3 and Table 1

Following the release of the staff report for the July 2nd LAFCO meeting, proponents raised questions regarding the information used to revise Table 3. Specifically, they questioned why the County Road Maintenance funds were reduced by 50%. Staff and consultant have researched and obtained documentation from the County on this issue and prepared additional revisions to both Tables 1 and 3 which are attached and dated July 2, 2008.

ATTACHMENTS

Attachment A1: Revised Table 1 dated July 2, 2008

Attachment B1: Revised Table 3 dated July 2, 2008

Attachment C1: EPS Memo Responding to Proponents' Questions and Comments on the CFA Tables.

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Attachment A1

7/2/08 DOES NOT INCLUDE REVENUE NEUTRALITY MITIGATION

Table 1
Summary of Revenues and Expenses (All Figures in Constant $'s)
San Martin Incorporation Analysis, EPS #17060 Full Transition Year 12 months Proponents' Proposed Boundary

	Fiscal Year									
Item	2009-10 1	2010-11 2	2011-12 3	2012-13 4	2013-14 5	2014-15 6	2015-16 7	2016-17 8	2017-18 9	2018-19 10
A. GENERAL FUND OPERATIONS										
General Fund Revenues										
Property Taxes	$687,951	$705,773	$724,107	$742,968	$762,367	$782,320	$802,841	$823,945	$845,646	$867,960
Sales Tax	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885	$838,885
Transient Occupancy Tax	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557	$221,557
Real Property Transfer Tax	$5,305	$5,436	$5,571	$5,708	$5,849	$5,993	$6,141	$6,292	$6,447	$6,605
Franchise Fees	$289,670	$289,873	$290,075	$290,277	$290,479	$290,681	$290,883	$291,086	$291,288	$291,490
Planning and Building Fees	$0	$274,742	$276,116	$277,496	$278,884	$280,278	$281,679	$283,088	$284,503	$285,926
Public Works/Eng. Fees	$0	$89,020	$89,465	$89,913	$90,362	$90,814	$91,268	$91,724	$92,183	$92,644
Fines, Penalties, Misc.	$42,813	$32,684	$32,793	$32,901	$33,009	$33,117	$33,225	$33,333	$33,441	$33,549
State Motor Vehicle License Fees	$62,172	$62,377	$62,583	$62,788	$62,994	$63,200	$63,405	$63,611	$63,816	$64,022
Property Tax/VLF Swap	$547,312	$512,513	$477,474	$442,193	$406,670	$370,907	$372,113	$373,320	$374,526	$375,733
Revenue Credits (transition yr, rec'd by County)	$5,000									
Investment Earnings	$53,913	$60,657	$60,373	$60,094	$59,821	$59,555	$60,040	$60,537	$61,046	$61,567
Total	$2,754,579	$3,093,519	$3,078,998	$3,064,780	$3,050,878	$3,037,308	$3,062,039	$3,087,377	$3,113,339	$3,139,939
General Fund Expenses										
Legislative	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500	$29,500
Elections	$200,000	$10,000	$0	$10,000	$0	$10,000	$0	$10,000	$0	$10,000
City Manager and City Clerk	$281,225	$328,659	$330,289	$331,927	$333,573	$335,227	$336,890	$338,561	$340,240	$341,928
City Attorney	$250,000	$76,131	$76,511	$76,894	$77,278	$77,665	$78,053	$78,443	$78,836	$79,230
Administrative Services	$166,050	$222,507	$223,620	$224,738	$225,861	$226,991	$228,126	$229,266	$230,413	$231,565
Police	$0	$588,661	$594,598	$600,594	$606,650	$612,767	$618,944	$625,184	$631,485	$637,850
Animal Control	$0	$74,811	$75,185	$75,561	$75,939	$76,319	$76,700	$77,084	$77,469	$77,856
Planning and Building	$137,672	$443,032	$444,635	$446,246	$347,864	$349,491	$351,126	$352,769	$354,421	$356,080
Public Works Administration	$74,250	$178,040	$178,931	$179,825	$180,724	$181,628	$182,536	$183,449	$184,366	$185,288
Non-Departmental										
Office Rent/Supplies	$109,000	$112,500	$84,500	$76,500	$76,500	$76,500	$76,500	$76,500	$76,500	$76,500
Insurance	$37,431	$61,915	$61,133	$61,554	$58,617	$59,283	$59,351	$60,023	$60,097	$60,774
Contingency (10%)	$233,596	$212,576	$209,890	$211,334	$201,251	$203,537	$203,773	$206,078	$206,333	$208,657
Reserve Fund Contribution	$233,596	$0	$0	$0	$0	$0	$0	$0	$0	$0
LAFCO	$1,267	$1,267	$1,267	$1,267	$1,267	$1,267	$1,267	$1,267	$1,267	$1,267
Repayment of Transition Yr Cnty Services (1)	$1,050,827	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total	$2,804,414	$2,339,600	$2,310,059	$2,325,939	$2,215,025	$2,240,174	$2,242,766	$2,268,124	$2,270,926	$2,296,495
General Fund Operating Surplus (Deficit)	($49,834)	$753,919	$768,939	$738,841	$835,853	$797,134	$819,273	$819,254	$842,413	$843,444
Reserve Fund Balance	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596	$233,596
% of Expenditures (exc. conting, reserves)	10.0%	11.0%	11.1%	11.1%	11.6%	11.5%	11.5%	11.3%	11.3%	11.2%
B. ROAD FUND OPERATIONS										
Road Fund Revenues										
Gas Taxes	$200,789	$188,455	$176,036	$163,531	$150,940	$138,264	$138,692	$139,119	$139,547	$139,975
Prop 42 Funds	$63,687	$63,899	$64,751	$65,614	$66,488	$67,373	$68,268	$69,175	$70,094	$71,023
Total	$264,476	$252,354	$240,787	$229,145	$217,428	$205,637	$206,960	$208,295	$209,641	$210,998
Road Fund Expenditures										
Pavement Maintenance		$211,049	$213,160	$215,292	$217,444	$219,619	$221,815	$224,033	$226,274	$228,536
Signal Maintenance, Traffic Engineering		$51,008	$51,263	$51,519	$51,776	$52,035	$52,296	$52,557	$52,820	$53,084
Other Costs (sweeping, trash removal, signs, drainage)		$523,833	$526,452	$529,084	$531,730	$534,388	$537,060	$539,746	$542,444	$545,157
Contingency (10%)		$78,589	$79,087	$79,589	$80,095	$80,604	$81,117	$81,634	$82,154	$82,678
Repayment of Transition Yr Cnty Services	$0	$170,921	$170,921	$170,921	$170,921	$170,921				
Total	$0	$1,035,400	$1,040,884	$1,046,406	$1,051,967	$1,057,568	$892,288	$897,970	$903,692	$909,455
Road Fund Operating Surplus (Deficit)	$264,476	($783,047)	($800,097)	($817,261)	($834,539)	($851,932)	($685,328)	($689,675)	($694,051)	($698,457)
TOTAL, All Funds	$214,642	($29,128)	($31,158)	($78,420)	$1,314	($54,798)	$133,945	$129,579	$148,362	$144,987
Cumulative Surplus (Deficit)	$214,642	$185,514	$154,356	$75,936	$77,250	$22,453	$156,397	$285,976	$434,338	$579,325

(1) Repayment cost accounts for animal services, planning and land use, code enforcement, public works, and sheriff department services the County is obligated to provide for the remainder of the first fiscal year.

Attachment B1

7/2/08

Table 3
Change in Revenues and Expenses to Santa Clara County
San Martin Incorporation Analysis, EPS #17060 **Proponents' Proposed Boundary**

Item	Amount	Notes
General Fund Revenues and Expenditures (FY07) (1)		
Revenues Transferred to the City		
Property Taxes	$599,522	estimated transfer amount FY 07
Transient Occupancy Tax	$221,557	
Sales Tax	$838,885	includes estimated 12% unallocated
Real Property Transfer Tax	$2,335	50% of FY 07 amount ($.55/$1,000 value)
Franchise Fees	$253,621	including solid waste, PG&E, cable, water
AB 939 Fees	$10,237	
Subtotal	$1,926,157	
Expenditures for Service Responsibilities Transferred to the City (1)		
Animal Control	$278,447	
Land Use Planning, Inspection, Enforcement	$151,056	
Clean Water	$3,186	
Waste Management	$129,205	
Sheriff	$483,933	
Subtotal	$1,045,827	
Other (revenue increases) (2)		
Property Tax Administration Fees	$8,090	Based on first year of city
Booking Fees	$0	Not paid by cities, per State budget
Net County Surplus or (Deficit)	**($872,240)**	
County Road Fund		
Revenue Reductions (3)		
Gas Tax: Highway User Tax 2106c	$27,491	based on 7.7% reduction in unincorp. a.v.
Gas Tax: Highway User Tax 2105a [2]	$208	based on reduction in County maintained miles
Grants		no reduction assumed
Traffic Congestion Relief: 2182a [1] (B)	$41,624	based on reduction in County maintained miles
Subtotal	$69,323	
Expenditure Reductions		
Road Maintenance (4)	$752,569	
Other Road Costs (traffic engineering, signal maint.)	$120,000	Excludes cost-recovery development engineering
Subtotal	$872,569	
Net County Road Fund Surplus or (Deficit)	**$803,246**	
Total General Fund and Road Fund Surplus or (Deficit)	**($68,994)** *	

* Note: legal requirements restrict the transfer of certain Road Fund revenues to directly offset General Fund service cost impacts.

(1) Costs shown in this table represent FY07 County costs for those service responsibilities to be transferred to the new city. Future city costs shown in Table 1 will not necessarily correspond to these FY07 County costs since the specific future services, staffing, facilities, contracts and manner of service provision will differ for the future city. For example, the future city will need to provide traffic enforcement, which currently is not a County responsibility.

(2) The County will realize new revenues (e.g., property tax administration charges) for services currently provided without compensation.

(3) County road revenues are not significantly affected, as they largely depend on Countywide population and registered vehicles, and are not influenced by a change in unincorporated vs. incorporated population or road miles.

(4) Road maintenance expenditures are based on County estimates, including pavement maintenance at $300,000 (Ron Jackson, 7/1/08), which is a reduction compared to prior years due to higher expenditures in prior years to improve road conditions. Includes costs due to injunction against "roundup" spraying.

Attachment C1

Economic &
Planning Systems
Real Estate Economics
Regional Economics
Public Finance
Land Use Policy

MEMORANDUM

To: Neelima Palacherla, Santa Clara LAFCO

From: Richard Berkson

Subject: Additional Response to Questions on the San Martin CFA; EPS 17060

Date: July 2, 2008

As you requested, we have prepared responses to additional questions raised by the Proponents today regarding the EPS memorandum (June 26, 2008) with revised San Martin CFA tables distributed for the LAFCO hearing (July 2, 2008).

The questions are stated below, followed by our response.

1. *Why are grant revenues shown as a revenue reduction to the County in Table 3, but are not included in the city budget forecast in Table 1?*

   Response: While the new city may apply for, and qualify for grant funds for roads, the grants are excluded from the Table 1 city forecast at the direction of LAFCO policy to not base city feasibility on uncertain, periodic revenues such as grants.

   The grants were included in the County revenue reductions based on historical information. However, after further discussions with County staff (Ron Jackson, 7/1/08), it was concluded that a significant reduction in grants revenues were not anticipated by the County as a result of the incorporation. A revised **Table 3** excluded the loss of grants to the County is attached to this memorandum.

2. *Why were the County road maintenance expenditures in Table 3 dated June 25, 2008 reduced from $1,502,235 to $750,000?*

   Response: The County's Road Fund expenditures for FY07 were exceptionally high due to the periodic nature and efficiencies gained performing road maintenance on roads within the same area, in the same time period, and due to the major reconstruction work performed to bring San Martin roads up to an acceptable standard. Significant federal funds were also available in FY07 for pavement maintenance; certain San Martin roads met the criteria for funding. Further information provided by the County (Ron Jackson, 7/1/08) has been used to revise **Table 3**, attached.

The revised numbers are based on information which indicated that pavement maintenance for a representative year would be significantly lower than FY07. Specifically, average expenditures for pavement maintenance are estimated to be approximately $300,000 annually compared to $1,045,000 reported for FY07; the FY07 costs include the category of "pavement maintenance" as well as a portion of other cost categories incurred in the process of re-paving and reconstructing roads. Weed abatement costs are assumed to unchanged, although future costs will depend on the cost and use of alternative spraying methods, and/or the lifting of the current court injunction restricting the use of "roundup" weed spray. Other road related costs, other than pavement management, total approximately $452,569 (Ron Jackson, 7/1/08, including current spray costs). Pavement maintenance and other costs total $752,569 which would be added to the $120,000 annual costs estimated for FY07 for traffic engineering and signal maintenance, for a total of $872,569.

In **Table 1**, the city projections were revised to reflect a lower repayment to the County for transition year road services based on the changes noted above to County costs. It is assumed that the city would not be subject to the costs associated with spraying, and therefore the transition year costs are lower than the current County estimates.

3. *The city's $300,000 for General Plan costs are too high.*

   Response: Although the new city initially will adopt the County's General Plan, every new city formed in California has chosen to modify and adopt its own plan over the subsequent several years. Discussions with consultants indicate that these costs are $300,000 at a minimum and may be higher depending on environmental documentation, extent of changes, public participation and analysis.

4. *Election costs are too high.*

   Response: The election costs are based on estimates provided by the County Registrar of Voters (4/08) for a special election based on the election issue, elections for 5 council members, and based on the number of estimated voters.

5. *Why did the sheriff cost in the Table 3 (March 5, 2008) change, but the corresponding costs in Table 1 did not change?*

Response: The County clarified its contract cost estimates to indicate that they included allowable indirect charges, and therefore the additional indirect charges added in Table B-4 were eliminated to avoid double-counting. The costs in Table 3 are linked to Table B-4; therefore, the costs in Table 3 changed, but the original contract costs in Table 1 did not change as a result of the correction.

6. *The City Attorney cost is too high for a small city, and a lawyer could be hired full-time for the costs shown.*

Response: The cost estimates assume that a law firm is contracted to provided legal services; the first year of the city will require a substantial effort to create and adopt ordinances, negotiate contracts with service providers, and deal with transition issues including leases and employee contracts. Many of these issues apply to all new cities, whether large or small. While it may be possible to find a lawyer at a lower cost, it is assumed that the services of an experienced municipal law firm will be required.

7. *The City Manager and Clerk costs are too high.*

Response: The current city forecast assumes a full year during the city's initial transition year. The prior analysis assumed a partial transition year due to the timing of the incorporation, which has been delayed. One full-time city manager is shown, and 0.5 city clerk position. A city manager will be required for the full year, and may be required to start in advance of city formation to plan for the transition and to begin the hiring process.

Item #5

Palacherla, Neelima

From: Gallegos, Sylvia
Sent: Wednesday, July 02, 2008 12:19 PM
To: Palacherla, Neelima
Cc: Kutras, Pete; Graves, Gary
Subject: COUNTY OF SANTA CLARA'S COMMENTS RE: SAN MARTIN INCORPORATION

Hi, Neelima:

Please share the following communication with the LAFCO Members:

The County of Santa Clara has reviewed the July 2 LAFCO meeting staff report and outside counsel's review of the Comprehensive Fiscal Analysis (CFA) report.

The County urges LAFCO to accept its executive officer's finding that the incorporation is not fiscally feasible.

We also request the LAFCO Members to consider Table 3, which depicts the proposed incorporation's impact on the County of Santa Clara. Table 3 clearly shows that even when the impact on the County's General Fund and Road Fund are taken together, the County would experience a negative ongoing deficit of $160,000 from the incorporation. In other words, there are not enough savings in the Road Fund to mitigate the ongoing loss in the General Fund-----a revenue neutrality approach, I would add, that we oppose.

LAFCO's outside counsel is suggesting that savings in the County's Road Fund could be used to offset the ongoing shortfall in our General Fund.

As the County has stated previously, the purpose of revenue neutrality is to protect a county's general fund. Road Fund revenues are restricted to roads-related purposes and cannot be used to mitigate losses in our General Fund. Our General Fund budget shortfalls since 2003 have been such that we have had to find $1 billion in budget solutions. The FY09 deficit that we had to solve was $179 million, and we expect to hold October hearings to address the State budget impact, which we estimate could be $75 million to the County. The point is that it is urgent that our General Fund be protected.

Our revenue neutrality position conforms with the State OPR guidelines on incorporations and the LAFCO of Santa Clara County's own incorporation policies.

The County urges LAFCO to consider these points in its deliberations.

Thank you. Sylvia

Sylvia M. Gallegos | Deputy County Executive
Office of the County Executive| Eleventh Floor – East Wing
70 West Hedding Street | San Jose, California 95110
(408) 299-5107 p | (408) 295-1613 f

To proceed with incorporation in what many are calling the most difficult financial situation since the great depression is pure folly. It makes about as much sense as selling homes to marginal buyers hoping for good times down the road.

A reserve fund balance for 2009-10 is obtained by starting the new city with a debt of over one million to the county for repayment of transition year costs. The debt could be even larger if 2008-09 revenues continue below projections and costs are above projections which is highly probable.
To make matters worse the projections assume that revenues will keep pace with inflation across all years of the plan. This is a very risky assumption at this point.

Even projecting unrealistic road maintenance costs there are large road fund deficits that require a large surplus in the general funds. The odds of a large surplus occurring in 2009-10 are small at best and it is certainly risky to project good times in later years without seeing a turn around first. Our governments have dug a very deep fiscal hole and who knows how long it will take to resolve it. Further if one takes a realistic look at road maintenance costs and considers unfunded items the picture is even worse and there will be deficits of several hundred thousand and larger across the plan.

Even the present CFA projections which do not take into account the fact that costs are outpacing revenues show a bottom line deficit in 3 of the 6 first years.

We should learn from the sub-prime debt overload mess that now exists instead of going blindly down the same path.

REVENUE NEUTRALITY & MAINTENACE OF SERVICE LEVELS

In response to written comments, the statement is made "Financial feasibility is based on the ability of the new city to maintain pre-incorporation service levels." Today San Martin has traffic enforcement which is certainly a critical service. The CFA points out that traffic enforcement funds are not included in the budget projections. This may not be a service provided by the county but it is provided today to San Martin and therefore should be maintained at the pre-incorporation level. How much will this cost and why isn't it included in the budget.

The CFA also lists a number of requirements not funded or listed in the cost projections including development of a Storm Water Management Plan, NPDES Permit Compliance, Maintenance of several trail routes located within road right of ways . How much will they cost and why aren't they included in projected budget costs: The CFA also lists the requirement for a fully equipped Type 3 Wildland Fire Engine. Who will pay for this:

Today there is a special deputy sheriff for agricultural problems, an area that will become a larger problem with the escalating costs of food products. The projected budget for law enforcement will cover approximately 1 person, 12 hrs.per day which in itself is not adequate. This doesn't allow funds for the special deputy sheriff which would mean a service reduction.

The CFA states that the city of San Martin, and I quote, "may not be able to provide the same level of services currently provided by the County because of the City's smaller scale of operations and limited revenue base." In other words, the CFA is effectively questioning the financial feasibility without even considering the present economy or the unfunded services already discussed.

CFA ANALYSIS

EPS has made several iterations of the projected revenues & costs data sheet in an attempt to show financial feasibility of San Martin Incorporation. My question is why hasn't the same level of effort been made to show the true picture as it exists today on revenues and costs. Spread sheets are a wonderful tool and it is not difficult to construct a probable case, best case and worst case as is frequently done in industry. What I see in this CFA analysis is closer to a best case than a probable case that would take in to account the actual reduced revenues & spiraling costs.

Let's look at the first couple of years of the plan. If tax revenues are down 10% there goes approx. $84,000, if 15% it's $125,000. If transient occupancy is down 10% there goes another $22,000. Diesel sales are down 11% from May 07 to May 08. If that continues into 2009, that's another $21,000, etc. etc. If there is very little building activity , which is certainly the probable case, how reasonable is it to project $274,000 for planning and building fees.

On the cost side of the ledger there is a 10% contingency which is intended for the unexpected. If one uses actual cost increases instead of gimmicked government inflation numbers that contain things like hedonic pricing, substitution of lower cost items, and geometric computation of the CPI, the actual increase over the past year is 11.5% not 4%. This would not only consume the entire contingency but also leave it in deficit without funding any unexpected or unfunded items.

To go a step further, the budget should show known required items that are not funded in the CFA analysis, like traffic control. Also, some items need to be sanity checked. Is it reasonable to expect $42,000 in fines & penalties during the first year of a new city. The road maintenance is another area which requires a much closer look and I'll say more about this because it is such a large item in the budget.

Larry Hansen

7/2/08

ROAD MAINTENANCE COSTS

The answer in the memo, Item No. 5, regarding road costs leads one to conclude that there is a 16% increase in road maintenance funds for 2009-10 over the 2007 fy costs. Lets look at what the facts are:

.Santa Clara County costs for San Martin road maintenance in FY 2007 was approx. $27,500 per centerline mile. The projected cost for 2009-10 is $3,836. I don't know how one turns a 700% reduction into a 16% increase.

.The supposed rationale for the huge reduction is that the road are in such great shape that minimum maintenance will be required for 10 years. The projection, in fact, is that 2018-19 will only cost $17,000 total more than 2009-10. That's a 0.8% increase per year. With a 100% increase in oil in one year how does that make sense?

.Santa Clara County road maintenance costs for the entire county in FY 2007 averaged between $30,000 and $35,000. Since this is more than San Martin then all the roads must be in great shape and we should see a county budget that is also less than $4,000 per centerline mile instead of more than $30,000 as projected. Our nearest neighbor, Morgan Hill, projects a cost per year for the next 5 years of $35,000 per centerline mile. It's obvious that the projected San Martin maintenance costs are not realistic and that an independent input is required.

.Sanity testing the San Martin projection by an estimate from a major road maintenance/construction company gives a minimum maintenance number of over $12,000.per centerline mile This would result in a bottom line Deficit for an incorporated San Martin of some $400,000 in 2009-10 and even larger deficits for subsequent years, like over $700,000 in 2014-15. Even if all contingency funds were available, which obviously won't be the case, there would still be large deficits.

Local control is very appealing, but not if it means financial disaster.

LAFCO
Local Agency Formation Commission of Santa Clara County

ITEM NO. 6

LAFCO Meeting Date: July, 2, 2008

TO: LAFCO

FROM: Neelima Palacherla, Executive Officer

SUBJECT: **Update on Disclosure Requirements and Fee Payments for the Proposed Incorporation of the Town of San Martin**
Agenda Item # 6

STAFF RECOMMENDATION

Accept report and provide direction to staff.

BACKGROUND

In its letter dated June 11, 2008 to SMNA, staff requested information on SMNA's fundraising events and also informed SMNA of LAFCO's requirements regarding disclosure of contributions and expenditures. SMNA responded in its letter dated June 20, 2008 with some information on their scheduled fundraisers and noted that the disclosure requirements would not apply to the incorporation proposal until the issue is placed on the ballot. LAFCO Counsel's response explains that the disclosure requirements do apply to the incorporation proposal. See Attachment A for the correspondence between staff and the proponents, and the response from Counsel.

UPDATE ON STAFF COSTS

As of the end of March 2008, LAFCO staff costs for the incorporation proposal amounted to $86,148.33. A cost of 21,127.62 has been incurred on the incorporation proposal in the month of May for legal services provided by Best Best and Krieger. Invoices for LAFCO staff time in the months of April, May and June will be provided soon to the proponents.

LAFCO

Local Agency Formation Commission of Santa Clara County

June 11, 2008

San Martin Neighborhood Alliance (SMNA)
Attn.: Richard van't Rood and Sylvia Hamilton
PO Box 886, San Martin, CA 95046

RE: Request for Information regarding SMNA's Fundraising Events for the Incorporation Proposal and Compliance with Disclosure Requirements

Dear Rick and Sylvia:

Please provide information on the schedule of your fundraising events, the estimated amounts to be raised, the amount that would be paid to LAFCO, and the specific dates by which payments would be made to LAFCO. This information was requested by the Commission at its April 16th LAFCO meeting, and again at the June 4th LAFCO meeting. This request for information was also made in staff's letter to SMNA dated May 16, 2008.

Additionally, I would like to inform you that the CKH Act and LAFCO policies (adopted in December 2007) require disclosure of contributions and expenditures relating to LAFCO reorganization proposals. The San Martin Incorporation Proposal is subject to those requirements. Once the proponents or the opponents of a LAFCO reorganization proposal spend $1,000 with respect to that proposal, they must report their contributions of $100 or more and all of their expenditures **to LAFCO** under the rules of the Political Reform Act (PRA) for local initiative measures. An "election" date for purposes of compliance with the PRA is defined as the LAFCO hearing date on the proposal. Since the public hearing date for the incorporation proposal has not been scheduled, a date must be set to serve as the date of the "election" for purposes of pre-election filings. That date is set as August 6, 2008. The LAFCO policies on Disclosure of Contributions and Expenditures and the forms are attached and are also available on the LAFCO web site.

Please respond by June 20th to allow enough time for further discussion if necessary, and/or to include information in the packet for the July 2nd LAFCO meeting. I'm available to answer any questions you may have or to discuss this issue further. Thank you.

Sincerely,

NPalacherla

Neelima Palacherla
LAFCO Executive Officer

cc: LAFCO Commissioners

Palacherla, Neelima

From: richard vantrood [rvantrood@mindspring.com]

Sent: Friday, June 20, 2008 11:05 PM

To: Palacherla, Neelima

Cc: Sylvia Hamilton; Constant, Pete; Susan Wilson; Don Gage; JH2@aol.com; Blanca Alvarado; TerryT1011@aol.com; al.pinheiro@ci.gilroy.ca.us; sam.liccardo@sanjoseca.gov; McHugh, Peter

Subject: Re: Fundraising Information and Disclosure Requiremets

Dear Neelima,

In response to your letter regarding campaign contributions, we offer the following:

We have plans for two fundraisers in addition to our ongoing fundraising efforts. One in August (Happy Days Car Show) and one in September (Autumn Moon). Proceeds from these fundraisers is used for SMNA's non-profit public purposes which is to educate the public on various issues affecting the community. You are welcome to check our web site for dates and times. Maybe you would consider coming to these events.

We cannot give you an estimate of the revenues of the fundraisers as it varies from year to year and the amount that may be applied to the incorporation proposal has not been decided. If the intention of your letter is to determine whether SMNA can comply with the terms of the agreement, please rest assured that we have the ability to raise sufficient funds and fully intend to comply with all the terms of the agreement with LAFCO. As the agreement does not require us to disclose our sources of revenue or provide you with any details of our fundraising efforts, we decline to do so at this time.

With respect to the disclosure documents you provided, we do not believe these are required at this stage of the process. SMNA has not has not taken a position on any ballot initiative or endorsed any candidate for public office. To date, its activities have included obtaining comment from the public related to various land use proposals affecting the community and conveying the position of those members of the public to various government agencies processing the applications, gathering information on issues of public importance and providing that information to the members of the community, and sponsoring various social gatherings to enhance community spirit. Therefore, none of the contributions made to SMNA to date constitute "contributions" under Government Code Section 82015.

Specifically, with respect to the incorporation, SMNA is the proponent of the incorporation application. It has agreed to fund the processing of the application which is by definition, not a "Contribution" under Section 82015 because the payments are made to a governmental agency for a governmental or legislative purpose and are not "for or against" the proposal or for political purposes. Similarly, it is not an "expenditure for political purposes" under Government Code Section 56700.1. Also, the payments cannot be construed as advocating a position on a ballot initiative because there is no ballot initiative until LAFCO determines the language of the initiative. Indeed, While SMNA is generally in support of incorporation for San Martin, SMNA does not know whether it will support or oppose the initiative if it is ever approved by LAFCO. As for the inclusion of requirements in Santa Clara County LAFCO policies, we believe these are policies, not law, and do not modify the requirements of the Government Code. To the extent these purport to change the meaning of the government code, we believe they are not enforceable. The policies purport to change the meaning of the government code in two important respects related to the meaning of "measure" and "election." We believe that a "measure" or "ballot measure" is not an application for reorganization. You can call it anything you want but it does not change what it is. Second, an "election" is not a LAFCO meeting. We have had several public meetings before the LAFCO commission. None of those are "elections." This one is not any different.

To underscore our position, you could say that LAFCO is loaning the money for the application fees until the time of the public hearing. Since a loan is considered a contribution, LAFCO would need to disclose all the taxpayers who contributed to the general fund of the county and cities who fund the LAFCO budget. Of course such a position would be an absurdity. Stated simply, the processing of the application is a governmental action that is not for or against the incorporation.

Even having said that, you have a record of all payments made by SMNA, Inc. to LAFCO. We have not made any expenditures for political purposes as defined by the code. With respect to the incorporation, other than the payments made to LAFCO, we have only made payments to our consultants for legal opinions which do not constitute payments for political purposes as they were payments to help us understand and interpret the information provided by LAFCO consultants. We have not paid for advertising or distribution of information urging citizens to vote for or against incorporation. Therefore, we believe no disclosures are required at this time.

Richard van't Rood

Palacherla, Neelima wrote:

> Hi Rick, Sylvia:
> Please se attached letter to SMNA requesting information on its fundraising activities and disclosure of contributions. Neelima.
>
> **Neelima Palacherla**
> **Executive Officer**
> **LAFCO of Santa Clara County**
> **www.santaclara.lafco.ca.gov**
>
> **70 West Hedding Street**
> **San Jose, CA 95110**
> **Ph: (408) 299-5127 Fax: (408) 295-1613**
> **neelima.palacherla@ceo.sccgov.org**

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ATTORNEYS AT LAW

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Walnut Creek, CA 94596
Phone: (925) 977-3300
Fax: (925) 977-1870
bbklaw.com

June 26, 2008

VIA U.S. MAIL

San Martin Neighborhood Alliance
Attn: Richard van't Rood and Sylvia Hamilton
P.O. Box 886
San Martin, California 95046

Re: Disclosure Requirements

Dear Mr. van't Rood and Ms. Hamilton:

This letter is in your response to your correspondence dated June 20, 2008 regarding disclosure requirements. As you were previously informed by Ms. Palacherla, in her letter to you dated June 11, 2008, the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 ("Act") and LAFCO policies require the disclosure of contributions and expenditures relating to a reorganization proposal. The San Martin incorporation proposal is subject to this requirement.

You have indicated that these disclosure documents are not required at this stage in the process because the San Martin Neighborhood Alliance ("SMNA") has not taken a position on any ballot initiative or endorsed any candidate for public office. Please note, the requirements of the Act are separate and distinct from the requirements of the Political Reform Act.

The Act provides that "a commission may require, through the adoption of written policies and procedures, the disclosure of contributions, as defined in Section 82015, expenditures, as defined in Section 82025, and independent expenditures, as defined in Section 82031, made in support of or opposition to a proposal . . . Disclosure pursuant a requirement under the authority provided in this section shall be in addition to any disclosure required by the Political Reform Act. . . ." (Section 56100.1[1].)

The legislative history of Section 56100.1 provides as follows:

> The Political Reform Act requires ballot measure committees to disclose and report their contributions and expenditures. A local ballot initiative becomes a "measure" when the proponents start circulating petitions. When an initiative becomes a measure, a committee must begin reporting contributions and expenditures once it receives contributions of $1,000 or

[1] All references are to the Government Code unless otherwise noted.

> more. A committee must report its contributions and expenditures even if they took place before the initiative became a measure. In its 1976 Fontana opinion, the Fair Political Practices Commission said that a petition for city incorporation was not a local initiative under the PRA. An incorporation proposal does not become a "measure" until local officials place the proposal on the ballot. . . . The Legislature amended LAFCO law to require that contributions and expenditures for political purposes on boundary changes that have been submitted to LAFCO must be disclosed and reported as if they were local initiative measures."

Following the Political Reform Act deadlines for when reports and disclosures must be filed, Government Code section 84200.8 provides that a preelection statement must be filed as follows: (a) for the period ending 45 days before the election, the statement shall be filed no later than 40 days before the election; and (b) for the period ending 17 days before the election, the statement shall be filed no later than 12 days before the election.

The Commission's policies have defined "election" as used in the Political Reform Act to mean the date of the originally scheduled commission hearing on a proposal for a change of organization. In the event the originally scheduled hearing date for the proposal for organization is rescheduled or continued to a later date, the obligation to file continues and reports shall be filed on or before the 10th day of each month following the original hearing date with respect to contributions and expenditures received in the previous calendar month up to and including the third calendar month following final action by the Commission on the proposal.

Your letter indicates that SNMA is in support of the incorporation, as the correct date for consideration is the public hearing and not an election on the proposed incorporation, SMNA must disclose all contributions, expenditures, and independent expenditures in a timely manner as noted above.

All reports and disclosures shall be filed with the Commission's Executive Officer, Ms. Palacherla and are in addition to any other requirements that may be otherwise applicable under the Political Reform Act. The Commission looks forward to receiving the reports and disclosures from SMNA in the near future.

Very truly yours,

Malathy Subramanian

Malathy Subramanian
of Best Best & Krieger LLP

cc: Chair Constant and LAFCO Commissioners
Neelima Palacherla, Executive Officer

ORANGE\MSUBRAMANIAN\48258.1

LAW OFFICES OF
BEST BEST & KRIEGER
LLP

ITEM NO. 6
ATTACHMENT B

MEMORANDUM

TO: Chair Constant
Members of the Commission
Neelima Palacherla, Executive Officer

FROM: Malathy Subramanian
Scott Smith

DATE WRITTEN: June 26, 2008

MEETING DATE: July 2, 2008

RE: San Martin Incorporation – Options Should Proponents Fail to Pay Application Costs and Expenses

Background

The San Martin Neighborhood Alliance ("Proponents") entered into an agreement with LAFCO regarding the payment of costs and expenses related to its incorporation application ("Agreement"). Under the Agreement, the Proponents are responsible for all costs and expenses for processing and reviewing the incorporation proposal. This is also consistent with LAFCO's Incorporation Policies. The costs and expenses are payable regardless of whether the application is withdrawn, denied, or otherwise terminated prior to completion. The Proponents are to pay each consultant in advance of each task to be preformed by the consultant and shall pay staff costs and expenses 30 days prior to the date first set for the first public hearing. You have asked for an opinion on LAFCO's options in the event the Proponents do not comply with its payment obligations under the Agreement.

Analysis

LAFCO can take any of the following actions if the Proponents do not comply with the Agreement:

Suspend the Process

In the event LAFCO does not receive payment for staff costs and expenses within 30 days prior to the date first set for the first public hearing, it can suspend the process, including suspension of the public hearing on the application as provided for in Section 5(c) of the Agreement. Section 7 provides that LAFCO will not incur liability for any suspension of the process or inaction on the application due to late or nonpayment of fees by the Proponents.

Negotiate with Proponents

LAFCO could negotiate with the Proponents to receive payment with or without interest, over a longer defined period of time, while still suspending the process. Likewise, LAFCO could negotiate with the Proponents to receive payment with or without interest, over a longer defined period of time, and continue the process, providing for suspension if payments are not timely made.

Initiate Litigation Against the Proponents

In the event LAFCO does not receive payment for staff costs after suspending the process, LAFCO could initiate litigation against the Proponents to obtain payment for all costs and expenses that have been incurred by LAFCO to process the application.

Conclusion

Once the hearing date is set for the first public hearing on the application, the Proponents must make payment for all staff costs and expenses 30 days prior to the hearing date. If LAFCO does not receive timely payment for all staff costs and expenses associated with the application, it may suspend the process, including continuing the hearing until LAFCO receives payment in full. LAFCO may also consider negotiating with the Proponents to receive payments at a later specified date, with payments accruing interest. Lastly, LAFCO may choose to sue the Proponents to recover staff costs and expenses incurred.

LAFCO

Local Agency Formation Commission of Santa Clara County

ITEM NO. 7

LAFCO Meeting Date: July, 2, 2008

TO: LAFCO

FROM: Neelima Palacherla, Executive Officer

SUBJECT: Update on the Schedule for the Proposed Incorporation of the Town of San Martin
Agenda Item# 7

STAFF RECOMMENDATION

Consider the proposed revised incorporation schedule and provide direction to staff.

REVISED SCHEDULE FOR SAN MARTIN INCORPORATION PROPOSAL

The following is an outline of the proposed schedule for the San Martin incorporation proposal.

CFA / Revenue Neutrality Related Dates

At the May 7, 2008 LAFCO meeting, LAFCO directed its Counsel to review the analyses submitted by the County and the proponents and prepare an independent analysis for LAFCO with respect to the revenue neutrality issues surrounding the incorporation of San Martin. Agenda Item # 5 includes LAFCO Counsel's revenue neutrality analysis. The proposed schedule allows for a 45-day period should the proponents and the County choose to reopen the revenue neutrality negotiations. LAFCO staff will follow up with the proponents and the County as to their intent regarding negotiations.

1	July 2, 2008	LAFCO Meeting to discuss San Martin Incorporation Proposal including LAFCO Counsel's Analysis of Revenue Neutrality Issues and Next Steps
2	July 2 to August 18, 2008	45-day period: Negotiations between Proponents and County on Revenue Neutrality
3	August 26 2008	County BoS considers Agreement, If no Agreement reached between Proponents and County at end of Negotiations Period, LAFCO Imposes Terms for Revenue Neutrality

LAFCO Public Hearings: Final Approval

The proposed schedule for the San Martin incorporation assumes that the public hearing on the incorporation issue will occur on the regular scheduled LAFCO meeting on October 1, 2008 with one informational workshop on the incorporation to be held in San Martin in late September.

1	Before June 30, 2008	Proponents Complete Filing Requirements and LAFCO issues Certificate of Filing
2	Before September 1, 2008	Proponents pay LAFCO Fees
3	September 10, 2008	Issue Public Hearing Notice for October 1, 2008 LAFCO Hearing on Incorporation Proposal
4	September 10, 2008	Issue EO Staff Report with Analysis, Recommendations and Findings
5	September 2008	Hold an Informational Workshop in San Martin
6	October 1, 2008	LAFCO Public Hearing on Incorporation Proposal: LAFCO Adopts Findings, Terms and Conditions. Set Date for Reconsideration Hearing.
7	October 2, 2008	Final LAFCO Resolution sent to Proponents and Affected Agencies
8	October 31, 2008	Last Day to Request Reconsideration of LAFCO Resolution adopted on October 1, 2008
9	Following LAFCO Approval	Prepare Final Boundary Map and Legal Description
10	November 12, 2008	Potential Meeting Date for LAFCO Reconsideration Hearing (To confirm availability with Commissioners)

Election Related Dates

An incorporation issue can be put on the ballot at a regular or a special election. A regular election is one for which a specific date is established by the Elections Code. In 2009, established election dates include those in March, June or November. Special election dates may be possible in April or May of 2009. If the VLF legislation does not pass, then there remains the option of holding a special election in April or May of 2009 to ensure an effective date prior to June 30, 2009. The proposed schedule for the San Martin incorporation assumes a June 2, 2009 election date.

1	November 14, 2008	Deadline for submittal of Final LAFCO Approval Documents to County for BoS November 18 Meeting
2	November 18, 2008	BoS' Scheduled Meeting Adopt Resolution Calling Election and Determine whether Candidates will be Charged for Candidates' Statement to be sent to Each Voter or whether County will Absorb Costs
3	E-120 February 2, 2009	Last Possible Date for BoS to Call Election.
4	November 19, 2008	EO to Submit Impartial Analysis to LAFCO (within 5 days of BoS calling election)
5	December 3, 2008	Scheduled LAFCO Meeting: LAFCO Hearing to Approve Impartial Analysis
6	E-113 to 88 February 6 to March 6, 2009	City Council Candidates may be Nominated for Elections by Voters Signing a Nomination Paper
7	E-83 March 11, 2009	Deadline to Submit Arguments For or Against the Measure
8	E-76 March 18, 2009	Deadline for LAFCO to Submit Impartial Analysis to Registrar of Voters
9	E-0 June 2, 2009	Election Day
10	E+28 June 30, 2009	Registrar Certifies Election Results to the BoS, BoS Declares Results of Election

LAFCO Finalization Dates

The incorporation becomes effective when LAFCO records the Certificate of Completion.

1	Following certification of election results	LAFCO Records Certificate of Completion / Termination and LAFCO Forwards the Finalization Documents to SBE and other Affected Agencies and County Departments
2	August 1, 2009 or later	Effective Date of Incorporation