LAFCO
Local Agency Formation Commission of Santa Clara County

SPECIAL LAFCO MEETING
AGENDA

Wednesday, September 10, 2008
1:15 PM

PLEASE NOTE CHANGE IN MEETING LOCATION

Isaac Newton Senter Auditorium
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: hhttp://www.santaclara.lafco.ca.gov/sclafcopolicies_annex&reorg_home.html

1. **ROLL CALL**

2. **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.

3. **APPROVE MINUTES OF JUNE 4, 2008 AND JULY 2, 2008 MEETINGS**

ITEMS FOR COMMISSION DISCUSSION / ACTION

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4. **OPTIONS FOR REVENUE NEUTRALITY TERMS FOR THE PROPOSED INCORPORATION OF THE TOWN OF SAN MARTIN**

   Possible Action: Accept report and provide staff with direction.

5. **UPDATE ON (a) PAYMENT OF LAFCO STAFF COSTS, (b) COMPLIANCE WITH DISCLOSURE REQUIREMENTS, AND (c) PROPOSED SCHEDULE FOR THE SAN MARTIN INCORPORATION PROCESS**

   Additional Documents:

   1. Staff Report

   Possible Action: Accept report and provide staff with direction.

6. **COMMISSIONERS' REPORTS**

7. **EXECUTIVE OFFICER'S REPORT**

8. **NEWSPAPER ARTICLES / NEWSLETTERS**

9. **ADJOURN**

   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.

In compliance with the Americans with Disabilities Act, those requiring accommodation for this meeting should notify the LAFCO Clerk 24 hours prior to the meeting at (408) 299-6415, or at TDD (408) 993-8272, indicating that message is for the LAFCO Clerk.

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.

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Pete Constant, Chairperson
Local Agency Formation Commission

ATTEST:

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Emmanuel Abello, LAFCO Clerk

LOCAL AGENCY FORMATION COMMISSION OF
SANTA CLARA COUNTY
MINUTES
WEDNESDAY, JULY 2, 2008

1. ROLL CALL

The Local Agency Formation Commission (LAFCO) of Santa Clara County convenes this 2nd day of July 2008 at 1:15 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; and Mala Subramanian, 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

Brian Schmidt, Committee for Green Foothills (CGF), informs that the CGF led a tour of farms in South Santa Clara County and visited, among other places, an orchard in Morgan Hill, the Mission Organics Home Ranch and the Thomas Kruse Winery. He notes that participants saw the importance of farmland, bought local products and made a commitment to support local agriculture and signed a letter requesting the County and city governments to do the same. The letter also calls upon LAFCO to stop ignoring its obligations to protect farmlands from the effects of sprawl. He states that CGF found that LAFCO neglected to follow its obligation to protect the farmlands when it allowed expansion of Morgan Hill last year and labeled it "infill." He states that CGF passed a resolution of no confidence in LAFCO a first in CGF's 46-year history. He informs that the resolution was sent to LAFCO commissioners, staff, and the proponents of San Martin incorporation.

4. APPROVE MINUTES OF JUNE 4, 2008 MEETINGS

Commissioner Wilson informs that the Commission did not have a chance to review the minutes. On motion of Commissioner Wilson, seconded by Commissioner Howe, it is unanimously ordered that approval of the minutes of the June 4, 2008 meeting be deferred to the next meeting.

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

The Chairperson requests the staff report. Ms. Palacherla states that upon the direction of the Commission at the June 4, 2008 meeting, LAFCO Counsel has prepared an analysis of the revenue neutrality issue and requests Ms. Subramanian to make a presentation.

Ms. Subramanian briefly describes her June 25, 2008 memorandum outlining the options for the Commission in considering revenue neutrality. Ms. Palacherla then continues by providing a summary of the revisions to the CFA Tables 1 and 3. She also directs attention to the supplemental staff report dated July 2, 2008 which includes further revisions to Tables 1 and 3. She then explains the changes and notes that the responses from the CFA Consultant to the proponents' most recent comments on the CFA are included in the report.

In response to an inquiry by Commissioner Wilson, Ms. Palacherla informs that the numbers being used in the CFA are based on the FY06-07 data and the figures for FY07-08 will not be available until August or September 2008.

The Chairperson opens the public comment period for this item and informs that one speaker representing the County and another representing the proponents will each be given five minutes to speak, and all others will be given three minutes.

Sylvia Gallegos, Deputy County Executive, County of Santa Clara, recommends that the Commission accept the finding of the LAFCO Executive Officer that the incorporation is not fiscally feasible. She requests the Commission to consider the fiscal impact to the County as illustrated in Table 3, and advises that the ongoing deficit is approximately $69,000 even if the two funds are combined. She then indicates that the County is opposed to the proposed incorporation unless the General Fund is made whole through mitigation payments. She states that the purpose of revenue neutrality is to protect the County's General Fund, as was indicated in her last address to the Commission. She then expresses objection to LAFCO counsel's position to use the savings in the Roads Fund to offset the shortfall to the General Fund because revenue neutrality should be determined by separately considering the General Fund and Road Fund. She states that this is consistent with the guidelines issued by the State Office of Planning and Research and LAFCO policies.

Miguel Marquez, Assistant County Counsel, County of Santa Clara, continues to address the Commission on behalf of the County by expressing agreement with LAFCO Counsel's position that the statutory scheme prohibits the Commission from approving the incorporation unless revenue and costs are substantially equal. He informs that the statutory scheme defines what is to be included in the revenue neutrality calculation, quotes the specific provision of the CKH Act, and states that the statute requires only the use of unrestricted General Fund in the revenue neutrality calculation, and explicitly excludes the restricted funds. He expresses disagreement with LAFCO Counsel on whether the Commission has the discretion to disregard the mechanical calculation of revenue neutrality required by statute. He notes that while the statutory scheme gives the Commission the discretion to include terms and conditions, that discretion must be exercised in a manner that complies with all the statutory requirements, including the use of mechanical calculation. Responding to the LAFCO Counsel's reference to the legislative intent underlying the statutory scheme, he informs that courts only look at legislative intent when the language in the statute is ambiguous and subject to more than one interpretation. He informs that doing so exceeds the Commission's discretion and could be challenged in court. Finally, he notes that the County should be held harmless in this incorporation, and trading of restricted and unrestricted monies would harm the County.

At the request of Commissioner Gage, Ms. Subramanian advises that the Commission has the authority to use the County's Road Fund savings to offset all, a portion of, or none of the General Fund shortfall.

Richard Van't Rood, SMNA Spokesperson, directs attention to the staff report and states that other road costs like street sweeping, trash removal, signage and drainage costs to the County is $452,569; however, the proposed San Martin budget allots $526,252 for this expenditure. He then proposes that if road related maintenance is contracted with the County, San Martin would have savings to pay for mitigation as indicated on Table 3. He adds that the projected expenditure in the first year is overstated by approximately $300,000 to $500,000 and better applies to much larger towns of 60,000 to 70,000 people. He informs that the proponents will submit a letter relating to this matter. He then continues by stating that LAFCO has the discretion to use all or none of the Road Fund savings to offset the General Fund shortfall; however, the cooperation of the County will be required.

Maureen Peterson, a resident of San Martin, expresses concern on how the projected revenues are going to be realized and requests staff to provide the list of businesses by category indicating how the projected revenues will be realized. She informs that unlike the CFA, the IFA clearly indicated development and even illustrated where retail businesses, town hall and other developments would be located. She informs that if there in an average of two working adults on every parcel, there will be roughly 3,600 taxpayers in about 1,800 parcels. She comments that without expansion, the present population base could not sustain San Martin, and informs that the citizens oppose urban development. She then states that she will provide more details in an email to the Commissioners.

Kenneth Peterson, a resident of San Martin, informs that his family moved from San Jose because San Martin is quiet and peaceful and wants to keep the community that way. He informs that he is raising vegetables and farm animals. He then expresses the opinion that the whole reason for incorporating is to build up San Martin.

Lynne Bonino, a resident of San Martin, states that the incorporation is ill-timed because the current economic situation is the worst since the Great Depression and that the new town will only be established with a debt of over $1 million to the County. If FY2008-09 figures are used, that debt could be even larger because of reduced revenues and increased costs. She notes that it is risky to project that the revenues will keep pace with inflation, and discusses how the town's projected Road Fund deficit would absorb the General Fund surplus over the years. She then refers to a statement in the CFA that financial feasibility is based on how the new city should be able to maintain pre-incorporation level of services. She notes that San Martin's traffic enforcement service is not included in the budget projections in the CFA. In addition, the CFA lists a number of items that are not funded such as storm water management, plan and permit compliance, and maintenance of several rail routes, among others. She then inquires how these costs would be funded. She informs that the County currently has assigned a special deputy sheriff for agricultural problems and expresses concern that the escalating cost of food products would mean substantial law enforcement cost for the town. She then quotes a statement in the CFA that San Martin "may not be able to receive the same level of services currently provided by the County because of the city's smaller scale of operation and limited revenue base," and states that San Martin may not be financially feasible particularly if the CFA takes into account the present state of the economy and the unfunded services.

Larry Warren, a resident of San Martin, proposes that revenues and expenditures be provided in spreadsheets with best case and worst case scenarios. He comments that FY08 figures will not be available until August 2008,however, projections can be used for the CFA. He observes that the CFA does not show the worst case scenario because it does not take into account the actual reduced revenues and spiraling costs. As an example, a mere 10 percent reduction in tax revenue would amount to $84,000 in the first two years. He then questions the $274,000 revenues from planning and building fees because it has been assumed that there would be little or no building activity. He also questions whether it is reasonable to assume $42,000 in fines and penalties during the first year of incorporation. He then questions the reduction in FY2009-10 road maintenance allocation since the cost should actually increase.

Judith Comprechio, SMNA member, requests that the opponents for incorporation prepare tables illustrating their revenues and cost projections to enable the proponents to review these figures.

The Chairperson calls on Jenny Van't Rood, Sylvia Hamilton and Betsy Siemens to address the Commission and all waive their time to speak. The Chairperson determines that there are no more members of the public who would like to speak on the item.

In response to an inquiry by Commissioner Howe, Ms. Palacherla informs that the CFA is based on FY07 data and that the FY08 data would not be available until August or September 2008. Using the FY08 data would entail additional consultant cost and may require revision of the contract with EPS. In response to a follow-up question by Commissioner Howe, Ms. Palacherla indicates that the Certificate of Filing was issued on June 30, 2008, the law only requires that the CFA use the data from the prior fiscal year.

Commissioner Howe moves to accept the report and request the County of Santa Clara and the proponents to reopen revenue neutrality negotiations with a professional facilitator and focus on the road vs. general funds to make the County whole.

In response to an inquiry by Commissioner Wilson, Ms. Palacherla advises that the staff report includes a statement to the effect that even if LAFCO applies the entire Road Fund benefits to reduce the impact to the County's General Fund, the new town would still be unable to pay the reduced mitigation payments resulting in an incorporation proposal that would not be fiscally feasible. This also applies to the revised tables, as there will be years when the town will be unable to make the mitigation payments.

Commissioner Gage seconds the motion.

Commissioner Alvarado informs that she was supportive of the incorporation at the start of the process; however, as the Commission got deeper into the process, she doubts the fiscal feasibility of the town. Initially, the significant road improvements in the area made the revenue neutrality uncertain and recently, there is an issue on the use of restricted Road Fund to cover the General Fund shortfall. She states that she is convinced that there is not enough leeway to support uncertainties because of events that the Commission cannot foresee such as the deteriorating economy. As a LAFCO Commissioner, she states that her obligation is to ensure that the process is fair, transparent and accurate so the voters would have enough information to make the right decision. She states that it would be irresponsible for the Commission to go forward with the incorporation because a deficit of $70,000 or even a surplus of $200,000 will not make a viable city. She states that while she is not arguing with the legal opinion, she expresses the opinion that State law and LAFCO policies do not give LAFCO the discretion to figure out which figures work in favor of one side or the other. She adds that there are many pieces to the puzzle that are unclear to her, including the refusal by the proponents to fulfill LAFCO's disclosure requirements. She then informs that she is voting against the motion.

Commissioner Wilson informs that she opposes the motion because it is inconsistent. The staff report is clear that even with the revisions, the incorporation proposal is infeasible; thus, there is no reason for revenue neutrality negotiation.

Commissioner Gage comments that he has been relatively neutral throughout this process in order to allow San Martin residents to explore what they want to do with their community. However, he expresses concern that San Martin may not be solvent in the out years. He states that since there is not much reserves, a little incident could wipe out the town. However, since the legal opinion provides some discretion, he states that he would like to have the opportunity to work through that. He also states that if no agreement is reached, then it is up to LAFCO to decide and he cannot support the incorporation if the County cannot be held revenue neutral. He then states that he would support the motion to explore every aspect.

Commissioner Howe informs that the purpose of the motion is to reopen the revenue neutrality negotiation, in good faith, possibly with a facilitator. The Chairperson expresses agreement with reopening the negotiations and allowing the proponents and the County to work with a facilitator to find common ground. He then requests staff to maintain the reserve fund at 10 percent to further close the gap and questions if the

General Plan costs have been addressed. In response to that, Ms. Palacherla advises that this issue has been addressed in the consultant's memorandum included in the staff report. In response to a follow-up inquiry by the Chairperson, Ms. Palacherla advises that some costs are not based on the size of the town, rather on the type of the change, the process and the community. She states that the current figure for the General Plan is very reasonable .

Ms. Gallegos informs that the County would be willing to renegotiate under the conditions set by the Board of Supervisors that revenue neutrality payments are made to make the County General Fund whole. She indicates that she has no authority to enter into negotiations otherwise; and, the Board of Supervisors would have to authorize staff when it reconvenes in August 2008.

At the request of the Chairperson, Commissioner Howe amends the motion to convey a request to the Board of Supervisors to enter into revenue neutrality negotiations with the proponents. Commissioner Gage expresses agreement.

Ms. Palacherla informs that the next Board of Supervisors meeting will be on August 12, 2008 and advises that the October 1, 2008 deadline may not be met if the revenue neutrality negotiations are reopened thereafter. The Chairperson expresses the desire for the County to give this matter its full attention.

Mr. Van't Rood informs that the proponents would like to discuss road costs for the town which may result in revisions to the tables 1 and 3 and help with the revenue neutrality discussions. He then requests that the motion be amended to remove from the staff report a statement that the incorporation is not feasible because it is premature and tables could be revised. The Chairperson indicates that the proponents may work with staff to provide necessary information to facilitate the revenue neutrality negotiations because this is an evolving process. In response to Mr. Van't Rood's reiteration of his request to amend the motion to remove the statement regarding feasibility from the staff report, the Chairperson informs that the Commission cannot change the staff report and its acceptance does not indicate whether or not it is accurate or that the CFA is final.

The Chairperson calls the question. It is ordered on a vote of 3-2, with Commissioners Alvarado and Wilson voting against, that staff report be accepted, and that the Board of Supervisors be requested to enter into revenue neutrality negotiations with the proponents with the support of a professional facilitator.

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

The Chairperson requests the staff report. Ms. Palacherla advises that the CKH Act and LAFCO policies require the disclosure of contributions and expenditures related to LAFCO applications. The proponents have indicated that disclosure is not required until the matter is a ballot measure. LAFCO Counsel in her response letter has stated that disclosure is required. She adds that LAFCO's responsibility for disclosure is likely to be shifted to FPPC by January 1, 2009 if legislation to that effect is successful. In the meantime, LAFCO is using the FPPC disclosure forms which use the definition for an election as included in the LAFCO policies and the proponents are requested to use those forms.

Relating to LAFCO staff costs, as of March 2008, the proponents owe LAFCO approximately $86,000, and staff time invoices for May and June will be provided soon. In May 2008, about $21,000 in legal cost has been incurred. She then directs attention to LAFCO Counsel's memorandum in the staff report relating to the options if the proponents are unable to pay LAFCO prior to the public hearing.

Commissioner Gage comments that the Commission has operated on the premise of fairness and that the Fee Agreement must be honored whether or not the incorporation is successful because LAFCO must be paid for the staff work.

The Chairperson opens the public comment period for this item.

Mr. Van't Rood informs that these disclosure requirements may not apply to the San Martin incorporation proposal because the application was filed prior to the policies. He states that he was informed by the Fair Political Practices Commission (FPPC) hotline that FPPC did not have jurisdiction over this. He comments that FPPC forms create ambiguity and confusion for LAFCO's disclosures. He states that the proponents will provide either a spreadsheet or a letter to the Commission as an initial disclosure.

In response to an inquiry by Commissioner Gage, Mr. Van't Rood informs that he would comply with the disclosure requirements by July 11, 2008. Commissioner Gage expresses agreement.

Margaret Wolford, a resident of San Martin, questions the proponents' refusal to comply with the disclosure requirement. She informs that she received a mail from the proponents and that should be disclosed because it indicated that SMNA is funding the application process and is for the incorporation. She then expresses agreement with Commissioner Alvarado that the present economic situation is not the right time for incorporation.

The Chairperson expresses agreement with Ms. Wolford that disclosures should make the process transparent and asks if staff could revise the disclosure forms to eliminate confusion. In response to an inquiry by the Chairperson, Ms. Palacherla informs that the proponents and opponents are subject to the disclosure policy.

Commissioner Alvarado states that the most important characteristic of a public agency is transparency, and disclosure holds decision makers accountable and enables the public to understand where the financial influence is coming from. She states that she does not know who the other proponents are except for a few people who consistently attend the LAFCO meetings. She expresses concern regarding Mr. Van't Rood's letter to staff and states that policy makers must know about the financial influence, where it is coming from, what kind of resources, and how the expenses have been paid for.

Commissioner Wilson moves to accept the staff report, and direct staff to revise the forms to meet the CKH Act disclosure criteria, and to work with LAFCO Counsel if necessary. Commissioner Gage seconds the motion.

In response to an inquiry by the Chairperson, Commissioner Wilson indicates that her motion includes direction to staff to modify the FPPC disclosure form in a way that complies with statutory disclosure requirements. In response to an inquiry by Commissioner Howe, Ms. Subramanian informs that a spreadsheet from the proponents would be made available to the Commission and would later be transferred to the modified FPPC form. In response to an inquiry by Commissioner Howe, Ms. Palacherla advises that disclosures could be made available on the LAFCO website. Upon the request of Commissioner Howe, Commissioner Wilson amends the motion to include direction to staff to post disclosures relating to the proposed incorporation on the LAFCO website. Commissioners Wilson and Gage express agreement.

The Chairperson calls the question. It is unanimously ordered on a vote of 5-0 that the staff report be accepted, staff be directed to revise the FPPC forms in a way that meets the CKH Act disclosure criteria and work with the LAFCO Counsel if necessary, and to post any disclosure on the LAFCO website.

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

The Chairperson requests the report. Ms. Palacherla directs attention to her staff report stating that the public hearing is scheduled for October 1, 2008 and this timeframe includes an allowance for potential revenue neutrality negotiations during the period from July 2 to August 18, 2008 and the consideration of a potential agreement by the Board of Supervisors on August 26, 2008. She then discusses possible adjustments to the schedule.

In response to the comment by Commissioner Gage, Ms. Palacherla advises that the Board may consider at its August 12, 2008 meeting the reopening of revenue neutrality negotiations for a period of 30 to 40 days. Commissioner Gage expresses agreement. In response to an inquiry by Commissioner Wilson, Ms. Palacherla advises that LAFCO policy allows 90 days for revenue neutrality negotiations; however, there is no policy for the duration of a second round of negotiations. Commissioner Wilson proposes that negotiations be shortened to 20 days because the two parties would only need to resolve specific issues. Commissioner Gage indicates that 10 days would be enough time for revenue neutrality negotiations.

Commissioner Howe informs that he would not be available on November 12 and proposes that the meeting be scheduled to November 10. He also adds that he would not be available from November 11 to 17, 2008. Ms. Palacherla advises that staff would work with the Commissioners on the schedule. In response to an inquiry by the Chairperson, Ms. Palacherla advises that there is no need to have a meeting before October 1 because the Board of Supervisors will not meet until August 12, 2008 and that there are no applications to LAFCO for the August meeting.

On motion of Commissioner Wilson, seconded by Commissioner Gage, it is unanimously ordered on a vote of 5-0 that the schedule be revised to allow a 10-day revenue neutrality negotiation period on August 12, 2008, and that staff be directed to find an alternate date for the proposed November 12 meeting to enable Commissioner Howe to participate.

The Chairperson calls on Brian Schmidt who has requested to speak on the item.

Brian Schmidt, Committee for Green Foothills, quotes a statement made by the LAFCO Counsel regarding CEQA that "keeping in mind the low bar for fair argument standard, we believe that inclusion in the record of the information discussed above (environmental impacts), there is probably substantial evidence to support preparation of either an MND or EIR." He states that the LAFCO Counsel then states that it is up to the Commission to determine whether or not physical impacts would exist. The reason why it is relevant to the schedule is because the record for this item is not closed and more evidence could likely be submitted to LAFCO. He then proposes that the Commission reconsider the issue of whether a Negative Declaration is sufficient either in an open discussion or a closed session.

At the request of Commissioner Wilson, Ms. Palacherla advises that the deadline for payment of LAFCO fees will be before September 1, 2008 which is 30 days before the October 1, 2008 hearing. She adds that the first disclosure will be required on August 22, 2008, which is 40 days prior to the LAFCO public hearing. She then indicates that staff will provide the staff time invoices in a timely manner to the proponents.

8. COMMISSIONERS' REPORTS

Commissioner Wilson requests that commissioners address the vote of no confidence made by the Committee for Green Foothills and echoes the concerns raised by the organization. She informs that she takes her duty as a LAFCO commissioner seriously in upholding CKH Act and the policies that the Commission has established over several decades. Commissioner Alvarado informs that she too takes the LAFCO role very seriously and with a great sense of responsibility.

The Chairperson informs that this issue is not on the agenda and should be properly noticed for discussion, if desired.

9. EXECUTIVE OFFICER'S REPORT

There is no report from the Executive Officer.

10. NEWSPAPER ARTICLES / NEWSLETTERS

There are no newspaper articles.

11. ADJOURN

The Chairperson announces that the LAFCO meeting scheduled for August 6, 2008 is cancelled..

On order of the Chairperson, there being no objection, the meeting is adjourned at 4:01 p.m. to the next regular meeting to be 'held on Wednesday, October 1, 2008 at 1:15 p.m. in the Chambers of the Board of Supervisors, County Government Center, 70 West Hedding Street, San Jose, California.

Pete Constant, Chairperson
Local Agency Formation Commission

ATTEST:

Emmanuel Abello, LAFCO Clerk

LAFCO
Local Agency Formation Commission of Santa Clara County

ITEM NO. 4

LAFCO Meeting Date: September 10, 2008

TO: LAFCO

FROM: Neelima Palacherla, Executive Officer
Dunia Noel, Analyst

SUBJECT: **Options for Revenue Neutrality Terms: Proposed Incorporation of the Town of San Martin**
Agenda Item # 4

STAFF RECOMMENDATION

Consider the report and the options for revenue neutrality mitigation payments to the County and provide direction to staff.

REVISED CFA TABLES 1 and 3 DATED July 23, 2008

Please see Attachment A for CFA Tables 1 & 3 dated July 23, 2008.

The Public Hearing Draft Comprehensive Fiscal Analysis (CFA) and Plan for Services for the proposed incorporation of San Martin was released on March 7, 2008 for a 30 day public review period. LAFCO held a hearing on May 7 to accept public testimony on the Draft CFA and at that meeting, LAFCO directed staff to review comments and make any necessary revisions to the document. Since then, the tables in the CFA have been revised in response to comments and/or new information.

The current revisions to these tables are in response to new information provided by the County and in response to comments from the proponents. These revised tables were provided to the commissioners, incorporation proponents and the County and have been made available on the LAFCO website. Table 1 includes the 10-year budget projections for the new city and Table 3 depicts the fiscal impacts to the County upon incorporation. All the data in these tables is compiled in accordance with the Cortese Knox Hertzberg (CKH) Act, OPR's Incorporation Guidelines and Santa Clara LAFCO policies.

FINANCIAL FEASIBILITY FINDING

One of the key findings that the Commission must make prior to approving an incorporation proposal relates to financial feasibility of the new city specifically *"that the proposed city is expected to receive revenues sufficient to provide public services and facilities and a reasonable reserve during the three fiscal years following incorporation."*

The CFA is the basis for LAFCO's determination of feasibility and Table 1 summarizes the information necessary for LAFCO to assess financial feasibility of the new Town.

Table 1 shows that the estimated General Fund surplus for the 10 year period following incorporation averages approximately $800,000 annually without including the first year of incorporation. The first year ends with a General Fund shortfall of $72,000. This shortfall may be dealt with by spreading a portion of the transition year costs over the following five years. The General Fund surplus in the remaining years is used to cover the road maintenance costs.

Estimated Road Funds over that same period result in an average annual deficit of approximately $700,000 except for the first year that sees a $264,476 surplus as that year's costs for road maintenance are spread over a five year period. Despite using the General Fund to cover the Road Fund shortfalls, two of the first ten years result in deficits - Year 4 reflects an overall deficit of $30,744 and Year 6 reflects a deficit of $8,491. These deficits are likely underestimated as they do not include the payment of the General Fund's first year shortfall of $72,000. The combined surplus for General Fund and Road Fund in the remaining years ranges from approximately $20,000 to $200,000.

A 10% annual contingency is included in both the General Fund and Road Fund and another 10% reserve fund is maintained as of the first year. This analysis does not yet include any revenue neutrality mitigation payments to the County.

Financial feasibility of the proposed incorporation of San Martin will be determined **after** revenue neutrality mitigation payments are established.

REVENUE NEUTRALITY FINDING

LAFCO must also make a revenue neutrality finding that the cost of services to be transferred to the new Town are "substantially equal" to the amount of revenue transferred. Specifically Government Code §56815 states the Commission must find that the following two quantities are substantially equal:

(1) Revenues currently received by the local agency transferring the affected territory that, but for the operation of this section, would accrue to the local agency receiving the affected territory.

(2) Expenditures, including direct and indirect expenditures, currently made by the local agency transferring the affected territory for those services that will be assumed by the local agency receiving the affected territory.

Alternatively the Commission may approve an incorporation if it finds either of the following:

(1) The county and all of the subject agencies agree to the proposed transfer.

(2) The negative fiscal effect has been adequately mitigated by tax sharing agreements, lump-sum payments, payments over a fixed period of time, or any other terms and conditions pursuant to Section 56886.

As seen in Table 3, the County would experience a loss of $872,240 annually to its General Fund and would realize a $1,552,912[1] benefit to its road fund based on the Fiscal Year 2006-2007 data.

Since County and the proponents have been unable to reach agreement on how to make this a revenue neutral proposal, LAFCO must establish terms and conditions in order to make the revenue neutrality finding. There is no standard model for achieving revenue neutrality and LAFCO has board authority to impose terms and conditions as indicated in LAFCO Legal Counsel's memo dated June 25, 2008.

REVENUE NEUTRALITY CALCULATIONS

Issues raised regarding the tabulation of the fiscal impacts of the San Martin incorporation on the County include:

1. County has stated that the County's road expenses in San Martin for FY 06-07 are unusually high ($1,552,912) - approximately 50% higher than an estimated average year costs (approximately $800,000) and therefore not representative of the typical annual expenditures in the area. These higher costs were due to the significant amount of road maintenance completed

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[1] Please see Issue #1 under "Revenue Neutrality Calculations" section regarding County's typical annual road expenditures in San Martin.

in the area in that particular year as a result of availability of funds. The proponents agree that the costs are high however; the two parties were unable to agree on a typical year costs.

State law requires the CFA to be based on the County's costs and revenues for the most recent fiscal year for which data is available prior to issuance of the Certificate of Filing. Since the Certificate of Filing was issued in June 2008, the CFA uses the FY 06-07 costs without any adjustments in Table 3.

Per LAFCO Counsel, the Commission has the discretion to consider this information and make adjustments in recognition of an average year's costs at the time of establishing the terms for revenue neutrality.

2. The proponent's position is that the Road Costs in Table 3 should not be separated from the General Fund expenses. LAFCO Counsel has reviewed this issue and confirmed that the expenditures in the two categories should be evaluated separately. Please see Attachment B for correspondence from proponents regarding this issue and Attachment C for LAFCO Counsel's response.

REVENUE NEUTRALITY MITIGATION OPTIONS

Option #1: County's Proposal

In its proposal, the County is seeking full recovery of the $872,240 annual loss to its General Fund for a period of 10 years and is allowing the payment to be spread over a 25 year period. This results in annual payments of $500,771 for 25 years after including interest and inflation factors. See Attachment D for County's letter dated August 20, 2008, in response to the proponents' proposal.

Discussion: The Town would not be fiscally feasible under this option as it will be unable to make the $500,000 annual payments since the annual surplus available in the Town's forecasted budget only averages approximately $100,000 annually in the first 10 years. Additionally, the Town may not have sufficient resources to make even the $100,000 payments in first few years (Years 2 through 6) of the incorporation due to small / no surpluses during those years.

Option #2: Proponents' "Below Cost Road Maintenance" Proposal

Under this option, the proponents are proposing that the Town contract with the County for the County to maintain roads in San Martin for the cost of its average Road Fund revenues ($215,000). This would allow the Town to pay $735,000 from its surplus General Funds for a 10 year period to the County as revenue neutrality payments to mitigate the negative impacts to the County's General Fund. See Attachment E, the letter from the proponents dated August 15, 2008 to the County with a description of this option.

Discussion: This option is only feasible if the County agrees to provide road maintenance services under contract to the Town for the lower cost. The County has stated (see Attachment D) that it is only willing to provide road maintenance services equal to the $215,000 provided by the Town (Town's annual road costs are estimated to be approximately $800,000) and has rejected this option. LAFCO legal counsel does not believe that LAFCO has the ability to establish such a condition without consent from the parties.

Option #3: Proponents' "All Surplus to County" Proposal

Alternately, the proponents are proposing that the town would pay all its 10 year cumulative surplus of $1,059,000 to the County. This amounts to approximately $100,000 per year for the 10 year period. Additionally, the proponents suggest that since the shortfall to the County's General Fund is less than four hundredth percentage of its total budget, there is not "unusual financial detriment" to the County and LAFCO can find the incorporation revenue neutral under this option. See Attachment E for proponent's letter describing this option.

Discussion: Although the amount is a small percentage of the County's total revenue, the County has stated (see Attachment D) that the impact to the County is substantial as a shortage of funds could result in cuts to many countywide services.

Additionally, LAFCO Counsel does not believe that the courts would find such a proposal to meet the "substantially equal" criteria for revenue neutrality that is required in the CKH Act. See Attachment C for analysis.

Option #4: "Road Fund Credit" Proposal

This option requires that LAFCO consider that a portion of the General Fund loss to the County is offset by the benefit that the County realizes to its Road Fund and that therefore a correspondingly smaller mitigation payment is sufficient to make the incorporation proposal revenue neutral. See LAFCO legal counsel analysis dated June 25, 2008 which states that LAFCO has broad discretion in making the revenue neutrality finding and that LAFCO may consider benefits to the County Road Funds as an offset to the County's General Fund impacts.

The total impact to the County's General Fund over a 10 year period is $8,720,000. In the attached analysis (See Attachment F) that EPS has prepared, approximately 25% of the General Fund impact ($2,159,272) is mitigated by revenue neutrality mitigation payments - resulting in annual payments of $180,000 from Years 7 through 25 (the Town would be unable to make such payments in the first few years). The remaining amount of $6,560,727 impact is offset by the County's benefit to its Road Fund (approximately $8,000,000) under the assumption that a General Fund dollar is likely more valuable (in this case, it amounts to approximately 20% more) than a Road Fund dollar since General Funds are unrestricted and can be used to fund any service, not just roads.

Discussion: This option would allow the Town to be fiscally feasible when mitigation payments are not required in the first 6 years of incorporation but extended over the following 19 years and 75% of the General Fund loss is offset by savings to the Road Fund. The County has stated previously that it wants full mitigation of its General Fund loss and is opposed to the use of Road Fund benefits to offset losses to its General Funds as Road Funds are restricted funds and cannot be used to provide the services that the General Fund could otherwise provide. This is the maximum mitigation that the Town can pay to the County while providing the current level of services and maintaining adequate reserves.

Other potential options include:

New Tax for San Martin

The Commission could consider an option which includes approving the incorporation subject to the approval of a new tax such as a parcel tax or a utility user's tax in order to address the shortfall in the Town's revenue for making revenue neutrality mitigation payments. However, the proponents have indicated that they would withdraw support for an incorporation that includes a new tax for achieving revenue neutrality. Therefore this option has not been pursued further.

Alternative Boundaries for the Proposed Incorporation

At the June 4, 2008 LAFCO meeting, the commission was presented with boundary alternatives for the incorporation area and the corresponding fiscal impact analysis (Tables 1 and 3) for each of the alternatives. The Commission at that meeting took a preliminary decision on the boundaries for the incorporation. Since that decision, staff has not updated the fiscal analysis for the alternative boundaries.

Next Steps

Based on direction provided by the Commission, staff will prepare terms and conditions for revenue neutrality mitigation payments to be included in the Executive Officer Report for the October 1st LAFCO public hearing on the proposed San Martin incorporation. The CFA will also be revised accordingly.

7/23/08 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	$0	$705,773	$724,107	$742,968	$762,367	$782,320	$802,841	$823,945	$845,646	$867,960
Sales Tax	$419,443	$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
VLF (AB1602)	$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)	*revenues retained by County during Transition Year are credited to city repayment for Transition Year services.*									
Investment Earnings	$31,765	$60,657	$60,373	$60,094	$59,821	$59,555	$60,040	$60,537	$61,046	$61,567
Total	$1,620,038	$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	($21,020)	($2,686)	$1,444	($10,083)	$2,286	$236	$2,305	$255	$2,324
LAFCO	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249	$1,249
Repayment of Transition Yr Cnty Services (1)	($61,566)	$0	$0	$0	$0	$0	$0	$0	$0	$0
Total	$1,692,001	$2,318,562	$2,307,355	$2,327,364	$2,204,923	$2,242,441	$2,242,983	$2,270,410	$2,271,162	$2,298,801
General Fund Operating Surplus (Deficit)	($71,963)	$774,957	$771,643	$737,416	$845,955	$794,866	$819,056	$816,967	$842,176	$841,138
Reserve Fund Balance	$233,596	$212,576	$209,890	$211,334	$201,251	$203,537	$203,773	$206,078	$206,333	$208,657
% of Expenditures (exc. conting, reserves)	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
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		$310,050	$313,150	$316,282	$319,445	$322,639	$325,865	$329,124	$332,415	$335,740
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)		$370,644	$372,497	$374,360	$376,232	$378,113	$380,003	$381,903	$383,813	$385,732
Contingency (10%)		$73,170	$73,691	$74,216	$74,745	$75,279	$75,816	$76,358	$76,905	$77,456
Repayment of Transition Yr Cnty Services	$0	$180,928	$180,928	$180,928	$180,928	$180,928				
Total	$0	$985,800	$991,529	$997,304	$1,003,126	$1,008,994	$833,981	$839,943	$845,953	$852,011
Road Fund Operating Surplus (Deficit)	$264,476	($733,446)	($750,742)	($768,160)	($785,698)	($803,357)	($627,021)	($631,648)	($636,312)	($641,013)
TOTAL, All Funds	$192,513	$41,511	$20,901	($30,744)	$60,257	($8,491)	$192,035	$185,319	$205,864	$200,125
Cumulative Surplus (Deficit)	$192,513	$234,024	$254,925	$224,181	$284,438	$275,947	$467,982	$653,301	$859,165	$1,059,290

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

ITEM NO. 4
ATTACHMENT A

7/23/08

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)	$1,502,235	Based on FY07 costs, noted as atypical (higher) of recent average road maintenance expenditures.
Other Road Costs (traffic engineering, signal maint.)	$120,000	Excludes cost-recovery development engineering
Subtotal	$1,622,235	
Net County Road Fund Surplus or (Deficit)	**$1,552,912**	
Total General Fund and Road Fund Surplus or (Deficit)	**$680,672**	(5)

(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 of FY07 expenditures. These costs are higher than the County's estimated average expenditures in the San Martin area and are above the estimate of average annual road maintenance costs that the new city is likely to incur.

(5) Legal requirements restrict the transfer of certain Road Fund revenues to the General Fund. Legal counsel has indicated that LAFCO may consider the two funds in total when determining revenue neutrality impacts.

Palacherla, Neelima

From: richard vantrood [rvantrood@mindspring.com]
Sent: Monday, August 18, 2008 8:24 PM
To: Scott Smith
Cc: Palacherla, Neelima; Noel, Dunia
Subject: follow up

Hi Scott,

To follow up with our previous conversation, I do not believe LAFCO has discretion to exclude the road maintenance expense from the revenue neutrality calculation. The concept of analyzing restricted and unrestricted revenues separately is in the policies not the statutes. The policy speaks to restricted revenues only, not expenses. The policy makes sense because the restricted revenues do not transfer to the new town and are therefore not part of the revenue neutrality calculation, strictly speaking. I think this, by its terms, means that the LAFCO commission can consider the losses to the county road revenue (here about $70,000 per year) and the gains to the town road revenue (here about $200,000 annually) in its deliberations when determining revenue neutrality. I think the road maintenance expense should not fall under a separate category from other expenses that transfer to the new town. As such, if the road maintenance expense is correctly included in the expenses side of the revenue neutrality calculation, the revenue neutrality calculation comes in about even. In that case, the commission would not have discretion to exclude the road maintenance expense from the revenue neutrality calculation. Given this analysis, we still object for the record to the presentation of the revenue neutrality calculation in table 3 as noted in Bill Ross' opinion.

The county takes the position that the guidelines are absolutely binding on the commission and that they must be strictly followed. This is contrary to my understanding of policies. Policies such as the ones at issue here are intended as guidelines, not law. Furthermore, the county takes the position that the policy of separating restricted revenue from general revenue and analyzing them separately is derived from the auditor's ratio in 56810. I do not see any connection there. 56810 creates a formula for calculating the auditors ratio. There is no analysis involved in the 56810 calculation. It is a mechanical calculation. The LAFCO policy is not. The LAFCO policy suggests an analysis of restricted and unrestricted revenues in order to provide a mechanism for the new city to pay revenue neutrality with restricted funds. The policy in no way suggests a mechanical calculation for revenue neutrality. I think it needs to be clear to the commission that the policies are guidelines and should be treated as such.

Please feel free to call to further discuss these concepts.

Rick

SMNA, Incorporation Committee Chair, Attorney.

LAW OFFICES OF
BEST BEST & KRIEGER
LLP

ITEM NO. 4
ATTACHMENT C

MEMORANDUM

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

FROM: Malathy Subramanian
Scott Smith

DATE WRITTEN: September 2, 2008

MEETING DATE: September 10, 2008

RE: San Martin Incorporation – Follow Up Issues Regarding Revenue Neutrality

Background

The San Martin Neighborhood Alliance ("Proponents") and the County of Santa Clara ("County") have each submitted proposals regarding possible revenue neutrality payments pursuant to the Cortese-Knox-Hertzberg Local Reorganization Act of 2000 (Government Code section 56600 *et seq.*, the "Act")[1] for the proposed incorporation of the Town of San Martin ("Town"). We understand the parties have failed to reach agreement on terms for revenue neutrality.

The Proponents believe that the road expenditures should be combined with the other general fund expenditures and that LAFCO's fiscal review should include the full spectrum of revenue and expenditures for all services. They also believe that LAFCO could determine that the revenues and expenditures to be transferred to the Town are "substantially equal" for purposes of revenue neutrality and authorize a reduced revenue neutrality payment or no payment to the County. You have asked us to provide you with our legal opinion regarding these issues.

Analysis

I. Revenue Neutrality

A. Expenditures and Revenues

The Act requires that any incorporation proposal result in a similar exchange of both revenue and responsibility for service delivery among the county, 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 statute is not meant to favor either the County or the new city.

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 <u>services</u> 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) emphasis added.)[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 Proponents believe that subsection 56810(j) means that once the ad valorem calculation is made pursuant to Section 56810, that same ad valorem calculation should transfer to the Revenue Neutrality ledger. The County believes that subsection 56810(j) means that all calculations in the Revenue Neutrality ledger should be made pursuant to the 56810 formula. The County's reading of subsection (j) means that (i) the Town accepts the transfer of road maintenance responsibilities, (ii) the Town receives no "credit" in the revenue neutrality calculation for assuming that responsibility, and (iii) the County reaps a windfall by retaining the road maintenance funds currently committed to road maintenance in San Martin.

The incorporation guidelines ("Guidelines"), published by the Office of Planning and Research, provide that restricted and unrestricted revenues (and the costs of services currently funded with them) should be evaluated separately for purposes of calculating revenue neutrality. (Guidelines page 44.)

Santa Clara LAFCO incorporation policies ("Incorporation Policies") provide that "fiscal impacts to restricted and unrestricted revenues should be evaluated separately". The Incorporation Policies are broader than the Guidelines in that they do not reference only restricted and unrestricted revenues, but the fiscal impacts to restricted and unrestricted revenues.

As indicated above, Subsection 56810(j) specifies that the calculations and procedures specified in Section 56810 should be incorporated into the revenue neutrality calculation. We believe that this means that the calculations and procedures to be incorporated are not just the base property tax allocation cost, but also the calculations for revenues and services to be transferred as noted in Section 56810(c). Furthermore, the Incorporation Policies provide for a separate evaluation of fiscal impacts to restricted and unrestricted revenue. Therefore, the expenditures associated with restricted revenues should not be combined with the other general fund expenditures.

While the statute is clear on its face as to what calculations and procedures are to be incorporated into the revenue neutrality calculations, the Act, the Guidelines, and the Incorporation Policies do not specify whether a positive fiscal impact remaining in a County restricted fund should also be considered to offset a negative fiscal impact on the County's general fund in measuring revenue neutrality. The Act authorizes the Commission to consider mitigation of the negative fiscal effect of incorporation and any terms and conditions that mitigate negative fiscal effects of incorporation must be included in the Commission's resolution making determinations. (Section 56815(e).)

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

As noted in our previous memorandum, the Commission has the ability to consider and to "offset" the benefit the County receives from the transfer of road services to the Town without the corresponding transfer of revenues to provide those services. To do this, LAFCO would compare the loss attributable to the County's general fund to the windfall in its road fund and find that retention of the San Martin portion of the road fund – decoupled from the previously corresponding service responsibility – mitigates or partially mitigates the negative fiscal effect of the incorporation. This would allow neither the County nor the Proponents to benefit from the incorporation.

The County has informed LAFCO that it believes the Act leaves no room for LAFCO's consideration of these broader fiscal ramifications. The County's position is that the revenue neutrality formula is unambiguous on its face and leaves no opportunity for consideration in the broader context of the Act or the Revenue Neutrality Statute's original legislative intent. Our position is that LAFCO may look to this broader context. (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].)) 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, although the Commission cannot combine the expenditures associated with restricted revenues with the general fund expenditures, the Commission may look beyond the mechanical calculation of Section 56810 to makes its finding under Section 56815.

B. Substantially Equal

The Commission cannot approve the incorporation proposal, unless it finds that the revenues currently received by the County that will accrue to the Town are substantially equal to the expenditures, including direct and indirect expenditures, currently made by the County that will be assumed by the Town. Notwithstanding this, the Commission may approve an incorporation proposal so long as the negative fiscal effect has been adequately mitigated by tax sharing agreements, lump-sum payments, payments over a fixed period of time, or any other terms and conditions pursuant to Section 56886.

The Proponents believe that the Commission could determine that the revenues and expenditures to be transferred to the Town are substantially equal for purposes of revenue neutrality and authorize a reduced revenue neutrality payment or no such payment to the County. As the basis for this argument they cite Board of Supervisors v. Local Agency Formation Commission (1992) 3 Cal.4th 903 for the proposition that LAFCO was within its discretion to find revenue neutrality for the Citrus Heights incorporation with a 1% detriment to the County's total revenue. However, this case precedes the revenue neutrality statute that currently is in effect, which was enacted in 1992, while this incorporation was considered by LAFCO in 1986.

We are not aware of any cases that address the substantially equal provision of the current revenue neutrality statute as most incorporation have had tax sharing agreements between the parties to address the issue. The County is expected to lose $870,000 to its general fund, without considering an offset based upon the transfer of road services. The County has indicated that this loss will have a significant impact due to budgetary constraints it is facing. For the Town, this amount would prove to be a significant gain to its general fund. We do not believe this amount could be considered substantially equal by a court considering that the incorporation is not to benefit either the County or the proposed Town.

Conclusion

The Revenue Neutrality Statute provides that the calculations and procedures of Section 56810 apply not only to the base ad valorem calculation, but also the calculations for revenues and services to be transferred as noted in Section 56810(c). Therefore, the expenditures associated with restricted revenues should not be combined with the other general fund expenditures. However, LAFCO can find that the transfer of the road services to the Town and the retention of the San Martin portion of the road fund by the County mitigates or partially mitigates the negative financial effect of the incorporation.

The $870,000 deficit to the County's general fund on its own[3], will make it difficult for the Commission to find that the revenues and expenditures to be transferred to the Town are substantially equal.

[3] This does not take into consideration an offset based upon the transfer of road services.

County of Santa Clara

Office of the County Executive

County Government Center, East Wing
70 West Hedding Street
San Jose, California 95110
(408) 299-5105

ITEM NO. 4
ATTACHMENT D

August 20, 2008

Dear San Martin Incorporation Proponents:

We are in receipt of your August 15, 2008 revenue neutrality proposal. We appreciate your efforts to find a mutually beneficial outcome, and we have strived as well to support the incorporation effort while ensuring that vital health and human services can be safeguarded through the protection of our General Fund.

To that end, the County has from the outset endeavored to identify possible means by which the proposed town could make the County's General Fund whole. To obtain a sense of the size of the total mitigation payment the County could seek, we made a calculation based upon a ten year mitigation term. This calculation yielded a total mitigation payment amount of $10.3 million.

It was a supportive gesture by the County to limit the total mitigation payment amount to a 10-year term when other counties receive payments based on much longer terms, as high as twenty five years. If the County of Santa Clara had sought a longer term that falls within the range sought by other counties, it would have generated a total mitigation amount that would have been well beyond what the town could possibly be capable of paying. Furthermore, while the County capped the total payment to a 10-year term, we offered you a payment term of up to twenty-five years in order to make the annual payments more manageable to you.

After carefully considering your August 15, 2008 proposal (attached), in which you offered two options, we find that neither option is acceptable.

With respect to Option 1, you indicate that the proposed town could make $215,000 in payments from your roads revenues for the County to perform road maintenance. The County is amendable to entering into an agreement to provide a level of road maintenance services that is commensurate with $215,000 in revenue, but the County cannot provide services beyond that level as it would amount to a County subsidization of your township.

Option 2 offers a $1.1 million mitigation payment in today's dollars to satisfy an already capped payment that, in effect, makes this an offer of ten cents on the dollar and which

Board of Supervisors: Donald F. Gage, Blanca Alvarado, Pete McHugh, Ken Yeager, Liz Kniss
County Executive: Peter Kutras, Jr.

2-006

does not account for the erosion of the value of your future payments from inflation, and, thus, is worth less to us than the nominal amount you offer.

In summary, we have been very clear that our General Fund must be made whole and that our Road Fund cannot subsidize your incorporation. We propose that the town make annual payments of $500,771 over a twenty-five year period in order to accomplish the mitigation payment of $10.3 million, as reflected in the attached spreadsheet.

We are committed to reaching an agreement, but we cannot accept an offer at any cost. While you wish to minimize the impact of the incorporation, $872,000 is a substantial sum that is badly needed. As we have stated previously, the County has had to produce $1 billion in budget solutions since 2003, and we have a second round of reductions scheduled in October to address State impacts on the County. Our projected shortfall for next year is over $300 million and our five-year forecast is equally bleak so, indeed, we are at the point where every dollar matters.

$872,000 could pay for nurses in our neonatal intensive care unit, deputies in the streets, shelter for the homeless, food for the hungry. These are the people who would suffer if the County is not protected in this incorporation process.

We look forward to further conversations to identify a mutually beneficial outcome.

Sincerely,

Peter Kutras, Jr.
County Executive

c: Board of Supervisors
Gary Graves, Assistant County Executive
Sylvia Gallegos, Deputy County Executive
Ann Miller Ravel, County Counsel
Phyllis Perez, Clerk of the Board
LAFCO of Santa Clara County

San Martin Analysis

25 Year Payment Plan - Annual Payment of $500,771

	County's General Fund Loss for the first 10 years only		$500,771 annually for 25 years (starting in Yr-1)	
Yr.	Nominal Dollars	NPV	Nominal Dollars	NPV
		3%	$ 500,771	
1	(898,160)	(872,000)	500,771	486,185
2	(925,105)	(872,000)	500,771	472,025
3	(952,858)	(872,000)	500,771	458,276
4	(981,444)	(872,000)	500,771	444,929
5	(1,010,887)	(872,000)	500,771	431,969
6	(1,041,214)	(872,000)	500,771	419,388
7	(1,072,450)	(872,000)	500,771	407,173
8	(1,104,624)	(872,000)	500,771	395,313
9	(1,137,762)	(872,000)	500,771	383,799
10	(1,171,895)	(872,000)	500,771	372,621
11			500,771	361,768
12			500,771	351,231
13			500,771	341,001
14			500,771	331,069
15			500,771	321,426
16			500,771	312,064
17			500,771	302,975
18			500,771	294,150
19			500,771	285,583
20			500,771	277,265
21			500,771	269,189
22			500,771	261,349
23			500,771	253,737
24			500,771	246,346
25			500,771	239,171
26				-
27				-
28				-
29				-
30				-
31				-
32				-
33				-
34				-
35				-
Total	(10,296,398)	(8,720,000)	12,519,275	8,719,999
			[redacted]	(1)

Assumptions:

We have used the 3% discount rate (long-term inflation rate) for calculating the NPV of the future inflows/outflows.

San Martin Neighborhood Alliance

"Together We Make A Difference"

August 15, 2008

To: Sylvia Gallegos
From: Richard van't Rood
RE: proponents proposals for revenue neutrality

Proponents offer the following two proposals for revenue neutrality.

1. "Below Cost" Road Maintenance. The Proponent proposes a "below cost" road maintenance contract between the County and the new town as a mechanism to make revenue neutrality payments to the County. Under this scenario, the town would pay to the County the town's road revenues of about $215,000 per year and the County would perform the road maintenance during the revenue neutrality period. The payments to the County for road maintenance would not be restricted funds to the County. The town would then pay $735,000 per year to make revenue neutrality payments. Road maintenance contract payments of $215,000 will be $145,000 more than the lost revenue to the Road Fund ($69,323) based on table 3. Over a 10 year revenue neutrality period, this would provide payments to the county general fund of about $8.8 million over 10 years, and keep the Road Fund whole.

When considering this option, please note the following:

This option pays the county all of its general fund shortfall without impacting the Road Fund. This option eliminates any financial detriment to the county as a result of the incorporation.

This option provides a mechanism that pays the County more for road maintenance than it loses due to incorporation. If the town does not incorporate, the county will still be obligated to maintain San Martin roads. Therefore, under this option the County Road Fund would recover all lost road fund revenue, and the general fund will be "made whole."

Also, under this option, the county will not have to reduce staff in its roads department for the duration of the revenue neutrality agreement.

This option is not an offset of Road Fund revenues against the County General Fund.

To the extent federal funds are received for San Martin streets, this can be added to the payment. See Michael Murdter email dated March 3, 2008.

2. All Surplus to County. Under this option, the town will pay all its surplus to the county. The projected cumulative surplus in year 10 is $1,059,000. This scenario is based on the revenue neutrality agreement between Contra Costa County and Alamo. Alamo, which is twice the size of San Martin and has substantially more surplus than San Martin, will pay $3 million in year 10 under their revenue neutrality agreement. Under this option, the San Martin will pay the projected surplus based on table 1, exclusive of the first transition year, on an annual basis with an inflation factor based on actual inflation, to the extent inflation is not in the tables. The term for revenue neutrality will be 10 years.

Under applicable law, LAFCO has discretion to compel this option should there be no agreement with the County.

Please keep in mind it is the LAFCO commission that determines revenue neutrality. The applicable standard in the California Supreme Court is that there is no abuse of discretion where there is no "unusual financial detriment" to the County as a result of the incorporation. See Board of Supervisors v. Local Agency Formation Com., 3 Cal.4th 903, 838 P.2d 1198 (1992), (LAFCO was within its discretion to find revenue neutrality for the Citrus Heights incorporation even where there was a modest financial detriment to the county.) A modest detriment in the Citrus Heights case was 1 percent of the county revenue. In the Citrus Heights case, the commission determined that a modest economic detriment to county would not bar approving the incorporation plan and submitting it to the voters.

In the case of San Martin entire $870,000 alleged annual loss to the County general fund is less than two hundredth percent (.02%) of the County's total revenue and less than four hundredth percent (.04%) of discretionary revenue. The "modest" detriment in the Citrus Heights case was 50 times as much. Clearly, under the Citrus Heights standard articulated by the Supreme Court, LAFCO has the discretion to find revenue neutrality. This does not require LAFCO to offset Road Fund savings against General Fund losses to find revenue neutrality.

Furthermore, this option removes any financial incentive for the town to incorporate satisfying the legislative intent of Government Code section 56815(a). Finally, the Commission can find that the cost of services transferred to the town are substantially equal to the revenues transferred to the town. 56815(b).

The revenue neutrality negotiations provide the proponent and the county an opportunity to negotiate terms and conditions that would mitigate the possible negative impacts of LAFCO imposed terms and conditions for revenue neutrality. If the County does not like option 2, option 1 may be more acceptable. Here, the LAFCO will act based on the fiscal analysis from EPS and the legal opinion from BB&K. The fiscal analysis indicates the town is feasible and the legal opinion indicates the LAFCO commission has the ability to find revenue neutrality.

The County Roads Department's FY09 Five Year Expenditure Plan shows a gap of $358 Million between resources and needs. This proposal will relieve the Road Fund of significant costs which will help address deferred maintenance and capital needs.

This option is consistent with most other revenue neutrality agreements in that the revenue neutrality payment is paid out of surplus revenue received by the new town.

Sincerely,

SAN MARTIN NEIGHBORHOOD ALLIANCE

Richard van't Rood
Chairman, SMNA Incorporation Committee

RVR/djk

cc: Sylvia Hamilton
Freddi Comperchio
Cleo Logan

	County Proposal				Road Fund Credit Proposal	
	County's General Fund Loss for the first 10 years only		**$500,771 annually for 25 years (starting in Yr-1)**		**$180,000 annually to Yr- 25 (starting in Yr-7)**	
	Nominal Dollars	NPV 3%		NPV 3%	Nominal Dollars	NPV 3%
Yr	(872,000)		500,771		180,000	
1	(898,160)	(872,000)	500,771	486,185		0
2	(925,105)	(872,000)	500,771	472,025		0
3	(952,858)	(872,000)	500,771	458,276		0
4	(981,444)	(872,000)	500,771	444,929		0
5	(1,010,887)	(872,000)	500,771	431,969		0
6	(1,041,214)	(872,000)	500,771	419,388		0
7	(1,072,450)	(872,000)	500,771	407,173	180,000	146,356
8	(1,104,624)	(872,000)	500,771	395,313	180,000	142,094
9	(1,137,762)	(872,000)	500,771	383,799	180,000	137,955
10	(1,171,895)	(872,000)	500,771	372,621	180,000	133,937
11			500,771	361,768	180,000	130,036
12			500,771	351,231	180,000	126,248
13			500,771	341,001	180,000	122,571
14			500,771	331,069	180,000	119,001
15			500,771	321,426	180,000	115,535
16			500,771	312,064	180,000	112,170
17			500,771	302,975	180,000	108,903
18			500,771	294,150	180,000	105,731
19			500,771	285,583	180,000	102,651
20			500,771	277,265	180,000	99,662
21			500,771	269,189	180,000	96,759
22			500,771	261,349	180,000	93,941
23			500,771	253,737	180,000	91,205
24			500,771	246,346	180,000	88,548
25			500,771	239,171	180,000	85,969
Total	(10,296,398)	(8,720,000)	12,519,275	8,719,999	3,420,000	2,159,272

AGENDA ITEM #5:

UPDATE ON (a) PAYMENT OF LAFCO STAFF COSTS, (b) COMPLIANCE WITH DISCLOSURE REQUIREMENTS, AND (c) PROPOSED SCHEDULE FOR SAN MARTIN INCORPORATION PROCESS

The staff report for Item #5 will be provided at the LAFCO Meeting. Attached for your information is a letter from the Proponents concerning payment of LAFCO staff costs.

San Martin Neighborhood Alliance

"Together We Make A Difference"

September 2, 2008

Board of Commissioners
County of Santa Clara
Local Agency Formation Commission
70 West Hedding Avenue, 11th Floor, East Wing
San Jose, California 95110

RE: San Martin Incorporation

Dear Commissioners:

The Proponents for Incorporation lodge these specific objections to the fees charged by LAFCO.

1. The charges are far above the cost other LAFCOs charged for incorporation.

When the proponents and LAFCO entered into the agreement for LAFCO fees early in the process, it was estimated in the agreement that LAFCO staff costs would be about $100,000. While the estimate seemed high when compared to most other LAFCO charges[1] for staff time, proponents considered the amount to be a worst case scenario. In addition, many of the tasks to which the proponents objected had not been contemplated. Other LAFCOs charged as follows:

- Riverside County-$32,000 each for Wildomar and Menefee Valley. This total included about $16,000 for preparation of the negative declaration without an outside consultant. The total costs also included extensive review of the proponent-prepared Comprehensive Fiscal Analysis (CFA).
- San Diego County-60 percent of actual costs. The San Diego County LAFCO recognizes the governmental role in incorporation.
- Santa Barbara County-$50,000 flat fee for Goleta.
- Contra Costa County-$8,000 flat fee for Alamo.
- Orange County-$50,000 estimated cost for Rossmoor.

[1] In Monterey County, the proponents have been required to pay only about $150,000 for all expenses including staff time and consulting fees for CFA and environmental reports. The staff time component is only about $40,000 of this amount. There were offsets there for litigation expenses (LAFCO lost their case against the proponents and were ordered to pay proponent's legal fees) and failure to provide timely invoices.

The Santa Clara County LAFCO's overall charge for this incorporation application is clearly excessive.

2. ***The boundary dispute initiated by LAFCO staff was contrary to proponents' intent and the Incorporation Guidelines.***

The boundary dispute initiated by LAFCO staff placed LAFCO staff and proponent in an adversarial role. The LAFCO commission voted to override the LAFCO staff's attempt to modify the proponent's boundary application.

The proponents proposed and discussed with the LAFCO Executive Officer boundaries and alternatives on November 6, 2006 prior to circulating the petitions. The proponents did this in an effort to follow the Governor's Office of Planning and Research (OPR) guidelines (Page 8) and local policy which strongly recommend that proponents and LAFCO staff develop logical boundaries and alternatives early in the process, even before the incorporation process starts. The proponents made every effort to propose boundaries and alternatives early in the process. The proposed boundaries were approved by the LAFCO Executive Officer after some modifications before the petition was even circulated.

The OPR guidelines on Page 19 state *OPR recommends that incorporation proponents begin consultation with LAFCO as early as possible to reduce the likelihood of having to pay for the development and analysis of additional boundary alternatives after the application is filed.* The proponents did everything they could to determine the boundaries before the application was filed, including discussion of Areas 4 and 5. LAFCO failed to follow the guidelines by proposing alternative boundaries very late in the process.

In August 2007, LAFCO staff mentioned verbally that were considering altering the proposed boundaries. On August 16, 2007, proponents raised a written objection to further boundary changes based on LAFCO's verbal statement. LAFCO staff again proposed alternative boundaries in November 2007 only about a week before revenue neutrality discussions were to commence and after the draft CFA and environmental initial study were already released.

The boundary changes were again proposed entirely on the LAFCO staff's own initiative. None of the changes proposed in November 2007 were initiated by the proponents.

The LAFCO staff created a dispute over boundaries that consumed the parties in debate and contributed to the inability to focus on revenue neutrality negotiations. Ultimately, after many hours of work on both sides, the LAFCO Commission decided to proceed with the proponent's boundaries. Proponents believe fully half of the staff time and all the legal fees from Kathy Kretchmer charged to date were for tasks opposing the proponent's boundary. The debate was neither timely nor viable. Proponents should not have to pay for those tasks.

3. The CFA contained numerous errors.

The many versions of the CFA contained numerous errors that were either not discovered or ignored by LAFCO staff. It is the LAFCO staff's responsibility to review the consultant's work for accurateness. In Santa Clara County, LAFCO takes the position that the consultant works for LAFCO and the proponents were not allowed to speak with, or influence, the consultant in any way. As such, the LAFCO staff is the only party that may influence or provide quality control of the CFA.

Proponents found numerous errors in the preparation of the many versions of the CFA including:

- Major discrepancies in the auditor's ratio
- Major discrepancies in the road maintenance budget
- Failure to include a comparable cities table
- Failure to comply with revenue neutrality statutes
- Failure to comply with the OPR and local guidelines
- Errors in first year revenue and expenses

A major component of the LAFCO staff time is the processing of corrections to the CFA that were pointed out by the proponents. Everything had to pass through the LAFCO staff. This created much confusion that was very public. In addition, proponents were allowed very little, if any time to provide comment prior to drafts being made public. As a result, there were no less than nine versions of the draft CFA circulated to the public. This created much unnecessary work to explain to the Commission and the public the reasons for this. The many LAFCO staff reports generated in this regard would have been unnecessary if LAFCO staff had consented to work with the proponents in developing the reports rather than becoming the proponent's adversary. In addition, LAFCO had to rely on the proponents to provide quality control review of the CFA drafts because of the failure of the LAFCO staff to do so.
The proponents incurred significant expenses in reviewing the various draft CFAs. Some of these errors were discovered in a peer review by Gary Thompson who was hired by proponents at their expense to expose the numerous errors. The proponents also spent many hours reviewing the reports and finding many more problems. These tasks performed by the proponent and their expert were the job LAFCO was supposed to perform. The proponent

should have not have to pay for providing the quality control that LAFCO staff was supposed to perform and their failure to do so resulted in nine drafts of the CFA.

4. ***Conflicts of interest created by the nature of the relationship between the County and LAFCO created additional expense.***

The problems with the CFA were exacerbated by the County's inherent conflict between the County Executive and LAFCO staff. From the outset, LAFCO counsel (counsel paid for by the County) had advised the LAFCO staff that the road maintenance expense could not be considered in revenue neutrality negotiations. LAFCO staff had the opinion throughout the revenue neutrality negotiations that the incorporation was not feasible due to the erroneous legal advice of counsel paid for by the County. LAFCO staff did nothing to encourage the County to negotiate in good faith. This created an impasse that prevented any agreement with the County for revenue neutrality. The entire revenue neutrality negotiation was a waste of time and money for the proponent.

In addition to the problems created by the conflict of interest, the CFA was not correct at the time of the revenue neutrality discussions. As was later pointed out by the proponent, the CFA was not accurate leading to misinformation being given, not only to the County Executive Officer, but also to the public. All this led to substantial extra fees and costs for the proponent.

When there was no agreement for revenue neutrality, LAFCO staff was required under its own guidelines to recommend terms for revenue neutrality in the public review CFA. LAFCO staff ignored this requirement and released a public review draft CFA that still contained errors and LAFCO failed to recommend the terms for revenue neutrality.

Proponents continuously objected to the County attorney's and LAFCO staff's position which ultimately resulted in withdrawal of the County attorney from representing LAFCO, but not before the proponents had spend a lot of time and money pointing out this conflict of interest. LAFCO's new independent counsel now has confirmed the County's legal position was and still is incorrect.

Nevertheless, the proponent believes the earlier opinion of County counsel has "poisoned the well" and made it impossible for LAFCO staff to be objective. The LAFCO staff are all employees of the County Executive Department of the County. The County Executive and County counsel have taken a position opposing the incorporation based on the County counsel legal opinion, and the earlier incorrect version of the CFA LAFCO staff used for her July 2, 2008 opinion the incorporation is not feasible. Given their employer's opposition to the incorporation and their employer's threats of litigation against LAFCO, the LAFCO staff have, so far, refused to give any opinion of revenue neutrality as required by the OPR and local guidelines.

The LAFCO staff conflict of interest is apparent in staff's continuing the opposition to the incorporation by the LAFCO Executive Officer by rendering an opinion at her first opportunity on July 2, 2008 stating the incorporation was not feasible. This opinion was rendered amidst objections by the proponents to the revised erroneous CFA tables. The tables were erroneous in that they used unsubstantiated opinions of the County road maintenance cost. The County changed its estimated road maintenance cost to negate the effect of LAFCO's new counsel's legal opinion on revenue neutrality. While recognizing the County's new road maintenance costs could not be substantiated, the consultant revised the CFA tables again.

The adversarial context of the entire incorporation process so far has been created by the conflict of interest of the LAFCO staff with the County. This has greatly added to the cost of the process for the proponents.

Throughout the process, LAFCO staff, who are all County employees, have had open communication with the County staff regarding development of the CFA and the incorporation boundaries. Proponents were at the mercy of LAFCO staff for any information from the County. The County staff was instructed (by the County Executive) not to communicate with the proponents. County staff had open communication with the LAFCO consultants during revenue neutrality negotiations. Proponents were prohibited from any such communications. It should be noted that this information was discovered only through a freedom of information request served by the proponents on the LAFCO staff. This situation was extremely unfair and prejudicial to the proponents in the processing of the application.

The proponents are in the best position to help the LAFCO staff and consultants develop cost projections and analysis of the budget for San Martin because proponents are residents of the town and familiar with its services. The LAFCO staff refusal to allow the proponents involvement in the process has greatly increased the LAFCO staff costs billed to the proponent as well as resulting in significant time and costs being incurred by the proponents.

Given the adversarial nature of this application and the obvious conflicts, proponents believe LAFCO should bear responsibility for the extra costs. If the process was fair and open, as it should be, the cost would have been far less. It is simply wrong to try and make the proponents pay for the untenable situation which has been created by LAFCO staff.

5. ***LAFCO staff charges are excessive and create a profit to the County or LAFCO.***

The LAFCO Executive Officer spent 25 percent of her time on the incorporation in FY 07/08. The analyst spent 8 percent of her time and the clerk spent 7 percent of his time. The actual expense for LAFCO staff (salary and benefits) in FY 07/08 was $361,000 for all LAFCO activities. LAFCO has charged $91,426 for its staff time in FY 07/08 on the incorporation and not including attorneys fees. That amount is almost twice the hourly rate received by all the LAFCO staff. Either LAFCO or the County is making a 50 percent gross profit on the LAFCO salaries. LAFCO is a government-mandated agency. It is not a profit center. We should not have to pay for more than the actual cost of the staff time spent processing the application. The staff cost to the proponent should be one half this amount.

The LAFCO budget for FY 08/09 forecasts only $40,000 revenue from application fees for all LAFCO activities. If LAFCO does not expect to recover more application fees, why is it seeking over $100,000 windfall from the proponents?

6. ***The confusion created by the conflicts of interest, failure to provide quality control of the CFA data, and creation of the boundary dispute have compromised the proponent's ability to raise funds.***

The proponents had planned a major fundraiser in May 2008 to raise a substantial amount of the anticipated staff cost. This fundraiser had to be cancelled because the County Executive Officer and the Board of Supervisors took a position hostile to the incorporation in April 2008 that led many to believe that the incorporation efforts were over. The LAFCO staff, employed by the County Executive, resisted all efforts to seek a correct legal opinion for revenue neutrality. It took a threat of litigation by the proponents and a vote of the LAFCO Commission to seek competent legal advice. Even then, LAFCO staff looked for every opportunity to render an opinion that the incorporation is not feasible, contrary to the facts and independent counsel legal opinion. Raising funds for the incorporation is difficult enough without the constant confusion created by the mishandling of the incorporation application.

7. ***The proponent spent many hours and dollars to address the deficiencies in the CFA and the failure of LAFCO to act.***

The proponents have spent a lot of time and money doing many tasks that are LAFCO's responsibility. The proponents should not have to pay LAFCO to correct problems they should have discovered and fixed themselves. The proponents should not have to pay for nine iterations of the CFA.

8. LAFCO erroneous staff time and other charges to the incorporation effort.

Based on a review of LAFCO staff time charged to the incorporation effort, there are numerous instances of incorrect charges to the incorporation effort, e.g., individual LAFCO staff charging different amounts of time for their presence at the same meeting. These errors have been pointed out before. It is more practical to adjust the fees based on the product than trying to adjust individual time entries.

In addition, under the agreement with LAFCO, staff was required to prepare monthly statements for review by proponents. Instead, LAFCO produced quarterly statements one to three months after the latest entry in the statement. In most cases, the statements were not produced until a few days before LAFCO hearings. It seems the statements were for the benefit of the Commission more than for the proponents. It is very difficult to respond to billings with time entries that are as much as six months old.

Summary

Based on the foregoing, the charges for staff time are clearly excessive. To restore fairness to this process, proponents propose that the staff fees be limited to amounts similar to those of other incorporations. It is wrong to force proponents to have an open checkbook to pay for this adversarial process.

Yours sincerely,

SAN MARTIN NEIGHBORHOOD ALLIANCE

Richard van't Rood

RVR/djk

LAFCO
Local Agency Formation Commission of Santa Clara County

ITEM NO. 5

LAFCO Meeting Date: September 10, 2008

TO: LAFCO

FROM: Neelima Palacherla, Executive Officer
Dunia Noel, Analyst

SUBJECT: **Update on:**
(a) Payment of LAFCO Staff Fees
(b) Compliance with Disclosure Requirements
(c) Schedule for Proposed Incorporation of the Town of San Martin

Agenda Item # 5

Staff Recommendation

Accept report and provide direction to staff.

Disclosure Requirements

AB 1998 which transfers the responsibility for enforcing the disclosure requirements from LAFCO to FPPC on January 1, 2009, was signed into law by the Governor on July 22, 2008. In light of this information, and because of the significant cost involved in modifying the forms, legal Counsel recommended that we continue to use the FPPC forms until the end of this year and until new, more applicable forms are developed. This information was provided to the commission and the proponents in July. As mentioned at the July LAFCO meeting, both proponents and opponents of the incorporation proposal are subject to the disclosure requirements.

LAFCO Counsel has prepared explanatory information regarding compliance with the AB 745 disclosure requirements using the FPPC forms. This information along with links to FPPC forms such as FPPC Forms 410, 460, 497 and 511 is available on the LAFCO website at:
http://santaclara.lafco.ca.gov/annexations&Reorg/AB745%20Forms/ExplanatoryNote.pdf

The proponents are in the process of preparing the disclosure forms; several of these forms are overdue. For example, Form 410 should have been filed within 10 days of receiving $1,000 in contributions. Apart from the preliminary disclosure information provided by SMNA (which is posted on the LAFCO website), LAFCO received lists of contributions and expenditures to SMNA. See Attachment A. However, the FPPC forms require more extensive disclosure which has not yet been provided by SMNA.

Revised Schedule for the Incorporation Proposal

The public hearing for the San Martin incorporation proposal was originally scheduled for the October 1st LAFCO meeting. Due to a schedule conflict, the public hearing on the incorporation will be held on November 7th at 2:30 PM. The following is the revised schedule:

Revenue Neutrality Terms

1	August 2008	No Agreement reached between Proponents and County at end of Negotiation Period, LAFCO must Impose Terms for Revenue Neutrality
2	September 10, 2008	LAFCO Meeting to discuss Options for Revenue Neutrality and Commission provide direction to Staff re. revenue neutrality terms
3	September 2008	LAFCO staff / consultant prepare terms and revise CFA

LAFCO Public Hearings: Final Approval

1	September 2008	Release revised public hearing draft CFA with revenue neutrality terms
2	Before November 7, 2008, preferably by October 17	Proponents pay LAFCO Fees
3	October 17, 2008	Issue Public Hearing Notice for November 7, 2008 LAFCO Hearing on Incorporation Proposal
4	October 17, 2008	Issue EO Staff Report with Analysis, Recommendations and Findings
5	October 2008	Hold an Informational Workshop in San Martin
6	November 7, 2008	LAFCO Public Hearing on Incorporation Proposal: LAFCO Adopts Findings, Terms and Conditions. Set Date for Reconsideration Hearing.

7	November 8, 2008	Final LAFCO Resolution sent to Proponents and Affected Agencies
8	December 8, 2008	Last Day to Request Reconsideration of LAFCO Resolution adopted on November 7, 2008
9	Following LAFCO Approval	Prepare Final Boundary Map and Legal Description
10	December 12, 2008	Potential Meeting Date for LAFCO Reconsideration Hearing (To confirm availability with Commissioners)
11	December 3, 2008	Regular scheduled LAFCO Meeting Date

Election Related Dates

1	TBD	Deadline for submittal of Final LAFCO Approval Documents to County for BoS Meeting
2	TBD	BoS' Meeting to 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	TBD	EO to Submit Impartial Analysis to LAFCO (within 5 days of BoS calling election)
5	E-113 to 88 February 6 to March 6, 2009	City Council Candidates may be Nominated for Elections by Voters Signing a Nomination Paper
6	E-83 March 11, 2009	Deadline to Submit Arguments For or Against the Measure
7	E-76 March 18, 2009	Deadline for LAFCO to Submit Impartial Analysis to Registrar of Voters
8	E-0 June 2, 2009	Election Day

9	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

LAFCO Staff Fees

As of the end of July 2008, LAFCO staff costs for the incorporation proposal amounted to $153,473.65. This amount includes a cost of $40,361.32 incurred in the months of May through July for legal services provided by Best Best and Krieger. Pursuant to the Fees Agreement, LAFCO must receive payment in full prior to the public hearing.

ATTACHMENTS

Attachment A: SMNA disclosure documents

ITEM NO. 5
ATTACHMENT A

Palacherla, Neelima

From: Sylvia Hamilton [sylviaLRS@hotmail.com]
Sent: Tuesday, September 09, 2008 11:27 PM
To: Palacherla, Neelima; Noel, Dunia
Subject: SMNA Disclosure
Attachments: Disclosure Schedule A 090808.doc; Disclosure Schedule E 090808.doc

Hello Neelima & Dunia,

Attached please find Schedule A & E. More work needs to be done but this provides you with most of the information you desire.

Take Care,
Sylvia

Incorporation of the Town of SAN MARTIN
Proponents Financial Disclosure (Jan. 1st – Aug. 16th, 2008)

Schedule A (Contributions Received)

DATE ≥ $100 ea	CONTRIBUTIONS	PURPOSE	CODE	AMOUNT	CUMLUTATIVE TO DATE
4/3/08	Charles & Cecilia Logan San Martin, CA	Contribution	IND	$500	$500
4/9/08	Richard & Jenny van't Rood San Martin, CA	Contribution	IND	$800	$800
April 2008	Spaghetti Social (SS) Auction 4 items	Fundraising	IND	$570	$570
August 2008	Car Show (CS) Auction 6 items	Fundraising	IND	$1415	$1,415
CS Sponsor	CALSTONE San Martin, CA	Fundraising	OTH	$1000	$1,000
CS Sponsor	South Valley Disposal & Recycling Gilroy, CA	Fundraising	OTH	$1000	$1,000
CS Sponsor	South Valley National Bank Morgan Hill, CA	Fundraising	OTH	$250	$250
< $100 ea					**Total ≥ $100 = $5535**
3/14/08 -7/21	Small Sales (26 Hats $182, Several Small contb. $209, Recycle $335, 7 Shirts $75, 7 Poll Vol $350, 8 Trailer Raffle Tkts $155)	Fundraising	IND	$1,306	$1,306
April 2008	Spaghetti Social (SS) → Raffle 35 items SS Auction → 12 items	Fundraising	IND	$817 $406	$1223
April 2008	SS Sales (drinks, shirts, hats, pens, small Contribution & trailer raffle)	Fundraising	IND	$435	$435
April 2008	SS Ticket Sales	Fundraising	IND	$1,481	$1,481
August 2008	Car Show (CS) → Auction 12 items CS Raffle → 34 Items	Fundraising	IND	$665 $1355	$2020
August 2008	CS Sales (Income from Contribution, Food, Shirts, Hats, Pens, Drinks, Trailer Raffle)	Fundraising	IND	$1,450	$1450
August 2008	CS (Classic Car Registration & Entrance)	Fundraising	IND	$6,155	$6,155
August 2008	CS Vendors '8' Regular Vendors & '1' Food Vendor	Fundraising	IND	$1,401	$1,401
					Total < $100 each = $15,471
	GRAND TOTAL -- SCHEDULE A ALL CONTRIBUTIONS				**$21,006**

Incorporation of the Town of SAN MARTIN
Proponents Financial Disclosure -- Jan. 1st – Aug. 16th, 2008

Schedule E (Payments Made)

DATE ≥ $100 ea	PAID TO:	PURPOSE	CODE	AMOUNT	CUMLUTATIVE TO DATE
1/1/08 3/13	Wenzler & Kelly Irvine, CA	Legal Analysis	PRO	$3,000 $2,254	$5,254
2/1/08 4/3 4/13	LAFCO (CFA 3rd payment) LAFCO (CFA 4th deposit & final payment)	Incorporation Process	PRO	$9,970 Deposit $5,000 $19,740	$34,710
3/13/08 5/12	Scott Browne Grass Valley, CA	Legal Analysis	PRO	$2,500 $250	$2,750
5/11/08	William Brown Palo Alto, CA	Legal Analysis	PRO	$3,000	$3,000
5/23/08	Jaguar Technologies (SMNA Website)	Administrative Costs	OFC	$191	$191
7/21 – 7/29/08	Re-imbursement to several members for misc. items such as banners, postage, fliers, signs, copies …..	Administrative Costs advertising	LIT	$395	$395
8/18/08	Steve's Silk-screening Morgan Hill, CA	Car Show T-Shirts	FND	$1,000	$1,000
8/13/08	National Trophy, Inc Gilroy, CA	Plaques for Car Show Awards	FND	$218	$218
5/6/08 8/16	San Martin Country Park San Martin, CA	Park Rental for Car Show	FND	$500 $500	$1,000
8/16/08	JJ Hawg Band	Live Music For Car Show	FND	$500	$500
8/16/08	Norcal Portable Potty Rentals San Martin, CA	Car Show	FND	$175	$175
8/20/08	Catering by Diana Morgan Hill, CA	Car Show Food Vendor	FND	$1344	$1344
< $100 ea					**Total ≥ $100 = $49,537**
4/16/08	Spaghetti Social Fundraiser (Total cost of decorations, food, program, filers, utensils, clean hall …..)	Celebrate our Community's Seniors	FND	$835	$835
8/11/08	Pacific Diversified Insurance Gilroy, CA	Insurance	PRO	$26	$26
8/16/08	Car Show (Total costs of drinks, food, fliers, programs, & lunch for volunteers, CDF, Sheriffs, Band …)	Car Show Needs	FND	$617	$617
					Total < $100 = $1,478
	GRAND TOTAL – Schedule E ALL EXPENSES				**$51,015**