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CAROL J. HUCHINGSON
County Administrative Officer

July 25, 2019

Margaret Silveira, City Manager
City of Lakeport
225 Park Street
Lakeport, CA 95453

Dear Margaret:

Thank you for providing Lake County with a copy of the fiscal impacts analysis dated May 2, 2019 which was prepared by Applied Development Economics (ADE) on behalf of the City of Lakeport for the proposed South Lakeport Annexation. County staff have reviewed the analysis and have retained BAE Urban Economics (BAE) to conduct a peer review of the ADE study, which is provided as Attachment A.

We look forward to our upcoming meeting with you next week and we are receptive to hearing about any new tax sharing proposal the City of Lakeport wishes to present based on the information shared below.

Based on our review, as well as the peer review prepared by BAE, we believe that the results of the ADE analysis do not support its core conclusion. More specifically, the analysis states that application of "the 1997 tax sharing agreement between the City and the County would result in a fair distribution of tax revenues reflecting the service responsibilities of both jurisdictions after annexation." This conclusion directly contradicts the findings of the ADE analysis, which found that application of the 1997 tax sharing agreement would result in a significant ongoing revenue surplus to the City of Lakeport, but a fiscal deficit to Lake County that would be sustained through at least 2050. Therefore, the division of service costs and revenues upon annexation, assuming that the 1997 tax sharing agreement is applicable, is not in fact fair and would not meet the standard established under the Lake LAFCo Revenue Neutrality Policy.

It is important to acknowledge that the ADE analysis is predicated on the applicability of the 1997 tax sharing agreement between the City of Lakeport and Lake County, as well as its subsequent amendments. It is the position of Lake County that the 1997 agreement and its amendments are void and unenforceable. As a result, the net fiscal impacts to both the City of Lakeport and Lake County cannot be accurately estimated until a new tax sharing agreement is established and a new applicable tax rate area (TRA) specified.

In addition to the key issues identified above, the peer review conducted by BAE also identified a number of methodological deficiencies in the ADE analysis. Even if the 1997 tax sharing agreement was applicable, the analysis likely underestimates the revenue that would accrue to the City of Lakeport upon annexation, while simultaneously overestimating the revenue and underestimating the costs that would accrue to Lake County over the same period. The analysis also fails to fully document the information used as the basis for the analysis and instead presents only the net results. This means that the calculations presented in the ADE report cannot be readily verified. Where supporting data is provided, the analysis relies on information that is widely known for its lack of reliability (e.g., data from the U.S. Census Bureau's Longitudinal Employer-Household Dynamics, or LEHD, dataset).

Given the information presented in the aforementioned paragraphs related to the peer analysis of the ADE fiscal impact analysis, economic changes in the area, and the change in the revenue distribution between the State and local jurisdictions that has occurred since the execution of the 1997 tax sharing agreement, these circumstances collectively necessitate a reexamination of the assumptions and the development of a new tax sharing agreement.

Again, we look forward to our meeting next week to discuss next steps.

Sincerely,

Carol J. Huchingson
County Administrative Officer

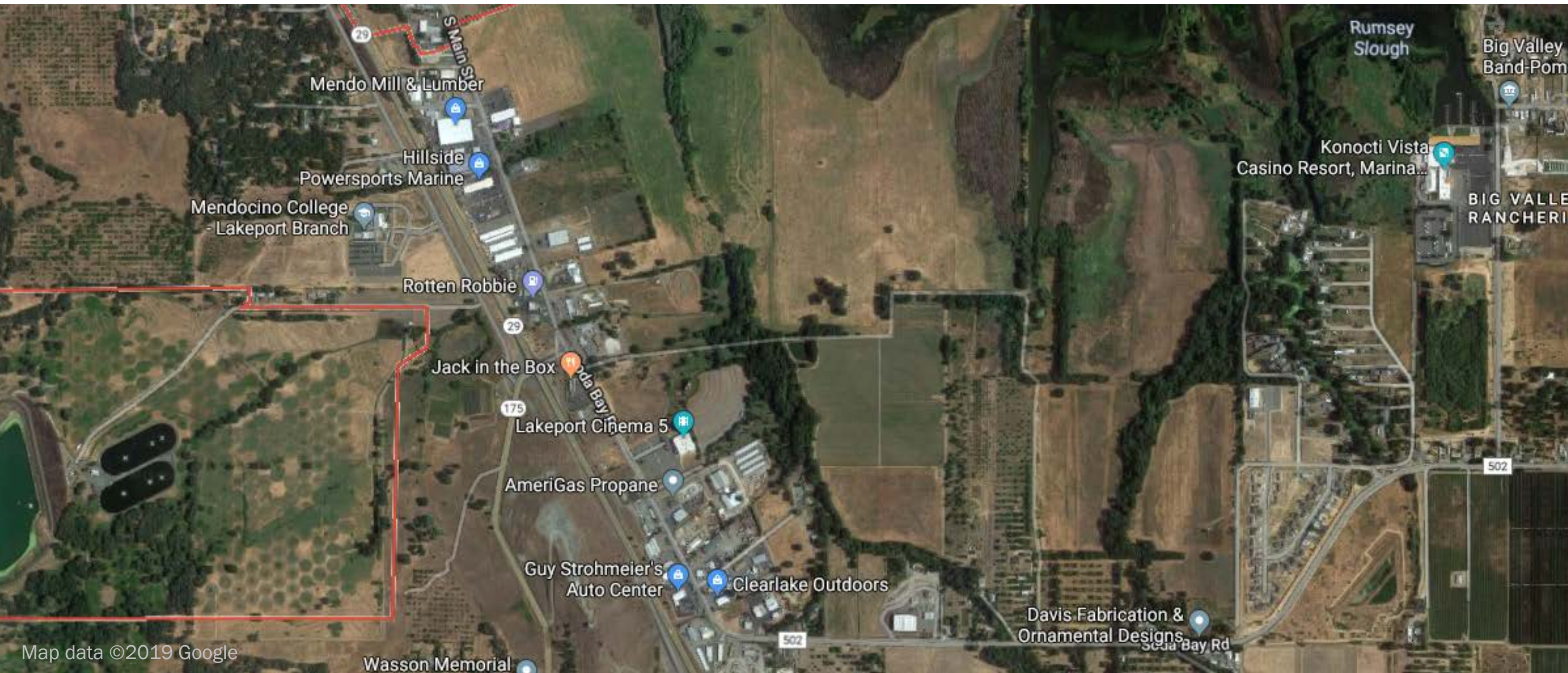
Cc: Tina Scott, District 4 Supervisor
Moke Simon, District 1 Supervisor
Scott DeLeon, Public Works Director
Jan Coppinger, Special Districts Administrator
Susan Parker, Assistant County Administrative Officer

bae urban economics

Fiscal Impacts Analysis Peer Review for the Proposed South Lakeport Annexation

Prepared for the County of Lake

July 17, 2019



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bae urban economics

July 17, 2019

Susan Parker
Assistant Administrative Officer
County of Lake
255 N. Forbes Street
Lakeport, CA 95453

Dear Ms. Parker:

BAE is pleased to provide the attached report summarizing the results of our peer review of the fiscal impacts analysis prepared by Applied Development Economics (ADE) on behalf of the City of Lakeport for the South Lakeport Annexation. If you have any questions or concerns regarding our analysis, please do not hesitate to contact me at (530) 750-2195.

Sincerely,

Aaron Nousaine

Aaron Nousaine, MCRP
Vice President

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[Confidential legal opinion dated 04/20/18 from Deputy Counsel Shanda Harry - in support of County's position that three (3) prior agreements between the County and City are not enforceable - not provided]

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INTRODUCTION

Lake County retained BAE Urban Economics (BAE) to conduct a peer review of a fiscal impacts analysis prepared by Applied Development Economics (ADE) on behalf of the City of Lakeport for the South Lakeport Annexation. The draft fiscal analysis report provided to BAE by Lake County staff is dated May 3rd, 2019. This memorandum summarizes the key findings of the peer review, along with recommendations for improvement of the analysis. To develop these findings and recommendations, the peer review included a thorough review of the analysis, and interviews with key County staff knowledgeable regarding the likely impacts of the proposed annexation on service costs and General Fund revenues. BAE also conducted limited data collection and independent analysis to confirm many of the assumptions used by ADE as part of the analysis.

This analysis is being done during an important time in Lake County history. According to the Los Angeles Times, the County has experienced more wildfire activity than any other county in California, with more than 50 percent of the total land area of Lake County impacted,[1] though County officials have confirmed that the total land area impacted by wildfire since 2015 is closer to 60 percent. As a result of the fires, as well as the County's primarily rural economy, the County of Lake is under extreme fiscal strain. For example, the County's largest General Fund department is the Lake County Sheriff's Office. According to Sheriff Brian Martin, the Sheriff's Office is currently understaffed by a factor of one-third, with only 37 of the 55 sworn officers that are needed to properly serve the County's needs. Additional staffing cuts are anticipated in the coming fiscal year. In response to this urgent fiscal need, the Lake County Board of Supervisors adopted a Fiscal Crisis Management Plan on December 4th, 2018 (provided in Appendix A). The purpose of this fiscal impacts analysis peer review is to help the County understand if the fiscal impacts associated with the South Lakeport Annexation, as reported by the City of Lakeport and their consultant, are reasonable and appropriate, and whether said annexation will likely worsen or improve the County's overall fiscal health.

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[1] Reyes-Velarde, A., & Krishnakumar, P. (August 14, 2018). *More than 50% of this California county has burned since 2012. Some residents say they've had enough.* Los Angeles Times. Available at: https://www.latimes.com/local/lanow/la-me-lake-county-fire-epicenter-20180814-story.html

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OVERVIEW OF THE PROPOSED ANNEXATION

The following summarizes BAE's current understanding of the proposed annexation.

Description of the Annexation Area

The City of Lakeport is proposing to annex an area covering 123.64 acres that is adjacent to the southern boundary of the City of Lakeport. The area extends along South Main Boulevard and Soda Bay Road. The area is largely built out, with only four vacant parcels out of a total of 50 parcels located within the proposed annexation area. Nonetheless, the ADE analysis cites a significant potential for intensification of development in the annexation area to accommodate future employment growth, some of which would require redevelopment of existing properties.

Public Service Provision

Lake County currently provides all public services to the proposed annexation area, with the exception of services provided by the local fire, water, and sewer districts. Upon annexation, the City proposes that it will assume responsibility for police, street maintenance, and planning services. Following annexation, Lake County would remain responsible for criminal justice services (e.g., operating the County Courthouse, operating the County coroner office, providing civil service activities like eviction noticing, etc.), health and social services (e.g., providing countywide public health services, etc.), property assessment and recordation (i.e., operating the County Assessor-Recorder's and Auditor's offices), in addition to providing a wide variety of other countywide services. The ADE fiscal impacts analysis indicates that the City does not anticipate assuming responsibility for fire protection, as the Lakeport Fire Protection District already provides service within the City of Lakeport and surrounding areas. The fiscal analysis does not indicate whether the City anticipates assuming responsibility for providing water and sewer service within the proposed annexation area.

Current Revenue Generation

The following summarizes the current revenue generation landscape in the annexation area.

Property Tax Revenue

According to the ADE analysis, the current assessed value of properties located in the proposed annexation area is $23.8 million. This includes $16.25 million in assessed value that is located in TRA 057-032 and $7.55 million in assessed value that is located in TRA 057-042. Based on these valuations, annexation area property owners currently pay approximately $238,051 in property taxes annually, of which $57,896 is allocated to the Lake County General Fund. Upon annexation, the County would retain its current share of the existing property tax base, while any future property tax increment would be split between the City and the County.

Road Fund Revenue

The ADE analysis asserts that the annexation area also generates around $3,415 per year in annual County Road Funds, which are apportioned from the broader property tax base. It is not clear how ADE estimated the amount of road funds generated from the area, as this is not a value that the County is able to provide.[2] [3] It is likely that the ADE analysis underestimates the amount of revenue generated to the Road Fund, though a more thorough explanation of the methods used to arrive at the estimate above is needed. Upon annexation, revenue that currently accrues to the County Road Fund would be transferred to the City of Lakeport.

Sales Tax Revenue

Data provided to ADE by the County Administrative Officer, and later confirmed by BAE, indicate that the South Lakeport Annexation Area generated approximately $463,953 in sales tax revenue during the 2016-2017 Fiscal Year (FY) from the one percent Bradley-Burns local sales tax allocation. ADE asserts that sales tax receipts have likely grown by approximately five percent or more since the 2016-2017 FY, resulting in an increase in sales tax revenue to around $490,000 in the 2018-2019 FY, though no justification for that estimate is provided. Upon annexation, the City anticipates that all of the one percent local sales tax revenue generated in the annexation area would accrue to the City instead of to the County.

Transient Occupancy Tax (TOT) Revenue

The ADE analysis does not address Transient Occupancy Tax (TOT) revenue generation. Based on a review of the area by BAE and conversations with County staff, there currently are no tourist accommodations located within the annexation area that would generate TOT revenue.

Cannabis Tax Revenue

According to County staff, the annexation area represents one of the only parts of the unincorporated County that could allow the establishment of cannabis-based businesses due to requirements for buffers between such businesses and schools, parks, and daycare facilities. Lake County voters approved Measure K in November of 2018. The measure will go into effect on January 1st, 2021. The measure imposes a four percent gross receipts tax on cannabis dispensaries, micro-businesses, and delivery businesses, as well as a 2.5 percent gross receipts tax on cannabis-based manufacturing, processing, transportation, and distribution businesses. Revenue generated by Measure K would accrue to the County General Fund. The intent of Measure K is to generate revenue intended to help offset the

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[2] Carter, Stephen. Deputy County Administrative Officer. Personal Communication. June 24, 2019.

[3] Lake County staff only have information on the amount of revenue that accrues to the Road Fund for the County as a whole and are not able to provide an estimate of the Road Fund revenues, both property tax and sales tax based, that are generated by properties and sales in the annexation area.

costs associated with regulation of the cannabis industry in conjunction with another County tax on cultivation that is levied on a square footage basis.

The City of Lakeport has likewise established zoning in the Service Commercial (C3) and Industrial (I) zones to allow cannabis retail, distribution, and manufacturing businesses. It is not clear at this time whether the City also plans to establish a similar cannabis tax. If such a tax were to be established, it could significantly increase the amount of local tax revenue that accrues to the City following annexation. ADE provides no discussion of the cannabis tax revenue generating potential of the annexation area.

LAFCO Revenue Neutrality Policy

Applications for annexation, otherwise known as changes of organization or reorganization, are managed and approved by the Lake Local Agency Formation Commission (LAFCo). Lake LAFCo decisions regarding applications for reorganization are guided by the adopted *Policies, Standards, and Procedures* (adopted in May 2009; amended in May of 2014).[4]

Item 2.13 of the *Policies, Standards, and Procedures* outlines the LAFCo's Revenue Neutrality policy, which allows for approval of a proposal for reorganization (i.e., annexation) only if "the proposal will result in a similar exchange of both revenues and service responsibilities among all affected agencies."[5] The policy goes on to state that "in the event the expense of the new service provider is substantially greater than or less than the amount of revenue transferred from the current service provider, the current service provider and new service-providing agency must agree to revenue transfer provisions to compensate for the imbalance." Although the LAFCo policy speaks primarily to impacts to the new service-providing agency, it is the County's position that similar conditions would apply to the current service- providing agency.[6]

In the event that annexation would result in a fiscal deficit to at least one of the affected parties, the policy requires that both agencies enter into a mutually acceptable revenue sharing agreement. In the event that revenue neutrality is not possible due to limitations imposed by State and Federal law, the LAFCo is required to apply all feasible conditions to reduce the imbalance or it may simply deny the application. The policy is deemed satisfied if the agencies have agreed to a tax exchange agreement and the agencies confirm in writing that such an agreement is applicable to the proposal and "provides for a balanced exchange of service costs and revenues."

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[4] Lake Local Agency Formation Commission (LAFCo). (May 21, 2014). *Policies, Standards, and Procedures*. Resolution #2013-0003. Available at: https://www.lakelafco.org/uploads/1/1/4/5/11454087/adoptedupdated_lake_lafco_policies_may_2014.pdf

[5] For a full excerpt of the LAFCo Revenue Neutrality policy, please refer to Appendix B.

[6] Harry, Shanda. Deputy County Counsel. Personal Communication. June 26, 2019.

Tax Sharing Agreement

The ADE analysis is predicated on the terms of a tax sharing agreement executed between the City of Lakeport and the County of Lake in 1997, which was subsequently amended in both 2001 and 2002. Per the City's interpretation of the agreement, the analysis assumes that the County would retain the existing property tax revenues generated in the annexation area. The County would receive a share of future property tax increment based on the post-ERAF allocation factors associated with Tax Rate Area (TRA) 001-001, which was located within the existing City limits adjacent to the annexation area, but which has since been retired. The City would pay to the County a total of $210,000 in six installments over six years in exchange for the transfer of all post-annexation Bradley-Burns sales tax revenues from the annexation area to the City's General Fund.

It is the position of the County of Lake that the 1997 tax sharing agreement, including the two subsequent amendments, are void and unenforceable. Please note that the following reflects BAE's understanding of the County's position regarding the 1997 tax sharing agreement and subsequent amendments and shall not be construed under any circumstances to represent the legal opinion of BAE or its officers. For more information regarding the County's position regarding the 1997 tax sharing agreement, please refer to the memorandum provided by the Lake County Deputy County Counsel regarding the agreements with the City of Lakeport, included as Appendix C.

KEY FINDINGS FROM THE ADE ANALYSIS

The following is a brief summary of the key findings from the analysis conducted by ADE.

Impacts to City of Lakeport

The ADE analysis concludes that the City of Lakeport would receive approximately $1.15 million per year in property and sales tax revenues upon annexation, including additional sales tax revenue generated above and beyond the amount that currently accrues to the County based on application of the City's supplemental sales tax add-ons, including Measure I and Measure Z. The analysis anticipates that the City's service costs following annexation would equal only $235,500 per year. This would net the City approximately $914,500 per year in surplus revenue. However, the analysis also concludes that future development may increase the City's incremental service cost; therefore, reducing the net surplus to $864,900 by 2030. While ADE estimates that the net surplus would be reduced even further upon buildout of the area, full buildout is not likely to occur until some point beyond the year 2050.

Impacts to the County of Lake

ADE estimates that County service costs to the area following annexation would equal approximately $88,700 per year. They likewise estimate that the County would continue to receive approximately $80,200 per year in property tax revenue and other incidental charges. According to the ADE analysis, annexation would result in a net fiscal deficit to Lake County, beginning on day one of the annexation and extending into the future until such time as future development generates sufficient offsetting revenue. The analysis assumes, based on a series of three separate projection scenarios, that robust (re)development in the annexation area would increase the amount of property tax revenue that accrues to the County to approximately $117,200 by 2030. ADE likewise estimates that County service costs would increase by another $65,400, to a total of $154,100 per year. The result is a continued net fiscal deficit to Lake County of $36,900 per year through 2030. While the analysis concludes that full buildout of the annexation area would eventually generate a net positive fiscal impact to the County, it also acknowledges that full buildout "would most likely extend beyond 2050, except under extraordinary accelerated growth assumptions." Therefore, the ADE analysis concludes that Lake County would experience a significant net fiscal deficit resulting from annexation that would likely be sustained over the next thirty years or more, if not indefinitely.

ADE's Final Determination

As summarized on page 2 of the report, ADE concluded that application of "the 1997 tax sharing agreement between the City and the County would result in a fair distribution of tax revenues reflecting the service responsibilities of both jurisdictions after annexation." ADE also concluded that "the terms of the agreement therefore meet the standards of the Lake

LAFCo Review Neutrality policy that require annexations to provide sufficient revenues to both jurisdictions to fund necessary governmental services."

KEY FINDINGS FROM THE BAE PEER REVIEW

BAE's review of the *Fiscal Analysis of the Proposed South Lakeport Annexation* determined that the primary conclusion reached by ADE is incorrect.

The ADE analysis determined that the distribution of revenues based on the 1997 tax sharing agreement is fair based on the conclusion that it met the standard set by the Lake LAFCo Revenue Neutrality Policy. However, as outlined above, the Revenue Neutrality Policy of Lake LAFCo requires that service costs and revenues should be balanced (i.e., revenues being equal to or greater to costs) for both affected agencies. Based on ADE's own analysis, the impact of implementing the provisions of the 1997 tax sharing agreement would result in a significant ongoing revenue surplus to the City of Lakeport, but a long-term sustained fiscal deficit for Lake County. ADE also clearly acknowledges that the growth and development necessary for revenues to eventually offset service costs to the County is unlikely to occur until after 2050, if at all. There is also reason to believe that ADE's growth projections are overly aggressive. Therefore, the division of service costs and revenues upon annexation, assuming that the 1997 tax sharing agreement is applied, is not in fact fair and likely would not meet the test required by LAFCo for revenue neutrality. Furthermore, it is the position of Lake County that the 1997 agreement and its two subsequent amendments are void and unenforceable. Therefore, the ADE analysis does not accurately reflect the revenue and service cost impacts associated with annexation, which cannot be determined until a new revenue sharing agreement is established between the City and the County.

In addition, there are a number of significant methodological deficiencies in the ADE analysis that likely result in the underestimation of the revenues that would accrue to the City of Lakeport upon annexation, while simultaneously overestimating the revenues and underestimating the service costs that would accrue to Lake County. The remainder of this memorandum identifies these deficiencies and recommends ways to improve the analysis so that it may be used as the basis for negotiation of an updated tax sharing agreement between the City and County.

Recommendations for Improvement of the ADE Analysis

Conclusion that Development Will Offset Costs

The primary conclusion of the ADE report that the revenue sharing agreement is fair is predicated on ADE's finding that future development will generate County revenue sufficient to offset the County's ongoing cost of providing services to the annexation area. However, ADE's own analysis indicates that adequate development will not likely occur until after 2050, even under relatively aggressive growth assumptions, as discussed below. ADE should revise the analysis to clearly acknowledge that annexation of the South Lakeport area would result in a significant and sustained fiscal deficit to Lake County. The ADE report should also more clearly articulate how the firm determined that such a condition equated to a "fair" and equitable division of resources and responsibilities between the two affected agencies, given that ADE projects substantial fiscal surpluses for the City during the same time period that it projects fiscal deficits for the County.

Projections of Future Growth

The ADE projections of future employment growth in Lakeport are based on a combination of data sources, including the Longitudinal Employer-Household Dynamics (LEHD) dataset published by the U.S. Census Bureau, as well as the California Employment Development Department (EDD), the California Department of Transportation (Caltrans), and Woods and Poole, a private data vendor. Based on a review of the information provided in the ADE report, we believe that the growth projections significantly overstate the employment growth potential of the City of Lakeport and the annexation area. It is BAE's understanding that the ADE projections do not address anticipated population growth, which is appropriate if the area is not anticipated to accommodate residential or hotel development in the future.

The first issue is that all three projection scenarios use 2017 as the base year. It appears that no effort was made to adjust the base year to 2018 or 2019, which would reduce the total future growth potential, acknowledging growth that occurred during the intervening years. This could reasonably be done by calculating the average annual growth rate over the projection period, then benchmarking to the most recent jobs estimates provided by the EDD. In the event that the most recent available estimates are not for the current year, ADE can estimate a current year value based on the projected average annual growth rate for the first five years or so of the projection period.

The second issue is the reliance on LEHD data to establish the share of countywide employment that is based in the City of Lakeport. Although the LEHD dataset is one of the few free data sources that publish place-level employment estimates, the dataset is known to be very inaccurate, particularly when used to identify characteristics within very small geographic areas. The errors are also often compounded when utilizing industry level data, due to small sample size. For example, the LEHD dataset reports that the number of jobs in the City of Lakeport in 2015 was 3,138, compared to the 2011-2015 American Community Survey (ACS) that shows an estimate that is 589 jobs higher at 3,727.[7] In addition, the most recent data available from the LEHD is for 2015, which is outdated. BAE recommends purchasing place-

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[7] For the purposes of this peer review, BAE collected data from the 2013-2017 ACS, which provides five-year place-level estimates where the mid-point of the survey period is 2015, which coincides with the time period associated with the LEHD data referenced by ADE. While not exact, this data provides the most reasonable comparison possible based on no-cost publicly available data.

level data from the Quarterly Census of Employment and Wages (QCEW) dataset, which are available for 2017, as a custom tabulation through the California EDD. The QCEW data used for the custom tabulation is the same as what the EDD uses to generate the publicly available county-level dataset.

The third issue is that the projections fail to recognize is that employment in the City of Lakeport has decreased since 2010, both in real terms and as a share of countywide employment. For example, the ADE report identifies an annual average employment growth rate for the City of Lakeport of 2.5 percent from 2010 to 2017, but provides no data to substantiate that figure. According to estimates from the 2006-2010 and 2013-2017 ACS, which represent the most reliable cost-free source for place-level employment data, employment in the City of Lakeport decreased from 4,698 jobs on average between 2006 and 2010 to 4,022 jobs on average between 2013 and 2017. This indicates an effective average rate of change of -3.1 percent per year, equaling a loss of 676 jobs. By comparison, the EDD reports that total employment countywide grew by approximately 2.0 percent from 2010 to 2017. This means that if the ACS jobs estimates are correct, employment in the City of Lakeport represents a smaller share of countywide employment in 2017 than it did in 2010. It should also be noted that the LEHD data indicate a similar trend, though with a smaller rate of change. This trend should be substantiated based on an evaluation of QCEW data purchased from the EDD. The resulting trend should then be incorporated into ADE's growth projections.

Estimation of Development Capacity

The study does not fully explain or document the method used to convert from acreage to additional new supportable building square footage. The study should document all assumptions used to allow the reader to follow each calculation when necessary. For example, the ADE report should identify how the "percent developed" figures were developed, as reported in Table 2, as well as the Floor Area Ratios (FARs) used to convert site acreage into maximum buildout capacity expressed in square feet. The analysis should also more thoroughly explain how the "existing development constraints" are applied. For example, Table 2 indicates that for parcel number 008-001-01 there are two types of development constraints, flood and riparian habitat. For the flood constraint, the table identifies a value of 90 percent. It is not clear how the 90 percent figure is then applied. Does this mean that 90 percent of the site area is undevelopable due to flood constraints?

Estimation of Road Fund Revenue

The study should more clearly identify how ADE estimated the amount of revenue that accrues to the County Road Fund based on property and sales taxes paid. ADE estimates that the County Road Fund receives approximately $3,415 per year in Road Fund revenue from the proposed annexation area, but does not clearly identify how that value was estimated. Interviews with County staff indicate that they are unable to clearly identify the amount of revenue generated to the Road Fund from the annexation area. County staff only have access to information on Road Fund revenue by source for the County as a whole.[8] Depending on the method used to apportion the countywide Road Fund revenue, the amount of money that accrues to the Road Fund based on property and sales taxes paid within the annexation area could be significantly higher than currently estimated. For example, this area represents one of only a small number of developed commercial areas in the unincorporated County. Thus, the area represents an above average concentration of assessed value and taxable sales, which generate above average Road Fund revenues compared to the rest of Lake County. If total countywide Road Fund revenues were apportioned based on acreage, then ADE would have significantly underestimated the amount of Road Fund revenue that would be transferred from the County Road Fund to the City Road Fund upon annexation. To allow the County and other interested parties to determine whether the method used to apportion Road Fund revenues is appropriate, ADE must first provide a thorough description of how the estimate was calculated. A more reasonable alternative method may be to apportion Road Fund dollars based on the distribution of assessed value and taxable sales within the County; though such an estimate may need to be normalized based on differing tax rates/shares.

Projected Future Assessed Value

The analysis estimates projected incremental growth in assessed value based on per square foot average real estate sale prices of $150 and $250 for retail and service commercial uses, respectively. Based on a review of comparable sales in Lake County for properties built within the last ten years, as reported by ListSource, BAE estimates that the weighted average sale price for recently constructed retail space is likely closer $162 per square foot, while the weighted average sale price for recently constructed general commercial space is around $185 per square foot. Recognizing that ADE anticipates that buildout of the annexation area will feature more general commercial space than retail, the difference in values likely lead to an overestimation of the property tax revenue likely to accrue to the County due to new development within the annexation area, to the extent that such development occurs.

In addition to retail and general commercial uses, the analysis also projects future land use demand for industrial, office, and institutional uses. It appears that no valuation figure was provided for industrial uses, nor did ADE clearly indicate which valuation figure was applied to which of the other uses. Also, it is not clear whether ADE assumed that institutional uses would be exempt from property taxes. These details need to be more clearly described in the report to allow the reader to assess the accuracy and appropriateness of the calculations.

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[8] Carter, Stephen. Deputy County Administrative Officer. Personal Communication. June 24, 2019.

Selection of Substitute Tax Rate Area

As noted earlier, the 1997 tax sharing agreement indicates that the South Lakeport area would be moved into TRA 001-001 upon annexation, assuming that the tax sharing agreement is applicable. However, TRA 001-001 was retired following execution of that agreement. The ADE analysis assumes the South Lakeport area will be annexed into TRA 001-002, but provides no justification for the selection of this TRA. A review of TRAs in the Lakeport area indicates that TRA 001-002 is not adjacent to the annexation area, but is separated by some distance. ADE and the City of Lakeport should provide justification for the selection of this TRA; although selection of a replacement TRA will likely require further negotiation between the City and the County. Further, assuming the existing revenue sharing agreement is no longer valid, there is no requirement that a new revenue sharing agreement replicate a property tax allocation scheme that is identical to an existing TRA; rather the parties can negotiate a tax sharing agreement with specific allocations between the City and the County that meet the LAFCo revenue neutrality requirements while maintaining the existing property tax increment allocation factors for other tax-receiving entities whose service responsibilities are not affected by the proposed annexation.

Missed Sales Tax Payment

On page 17 of the report, ADE reports the payment schedule associated with the $210,000 that is to be paid by the City to the County over what is reported to be a six-year period, as per the 1997 agreement. However, the payment schedule provided as part of the 1997 agreement involves payments equaling a total of $210,000 over a seven-year period. the payment schedule provided in the ADE report is missing one payment of $7,500 to be paid in year seven. When summed, the payments listed in the ADE report total only $202,500. ADE should confirm that the figures used to calculate the net fiscal impacts reflect the correct total.

Calculation of Service Costs and Revenues

There are two main issues with the way that ADE reports estimated service costs and revenues. The following apply to the analysis of impacts to both the City and County.

The first is that all values are reported as net estimates. Therefore, it is not possible to evaluate the validity of the ADE calculations, as only the final values are provided. ADE should revise the report, outlining the method used for calculating each major cost and revenue line item. Costs and revenues should be calculated and reported separately. This typically includes reporting the values upon which the cost and revenue multipliers are based, which are typically taken directly from the City and County budget documents. This allows the reader to confirm for themselves that the correct values were used and to track exactly how the calculations were prepared. The analysis should then show exactly what service population estimates are applied in each case and what the resulting cost or revenue multipliers are.

The second methodological issue present in this portion of the analysis is that it is never clear which of the three projection scenarios is being applied as part of the impact calculations. None of the tables indicate which projection scenario is being used. While the narrative provides some limited discussion of how impacts differ between scenarios, the analysis is difficult to follow. ADE should revise both the tables and the analysis to clearly identify which projection scenario is being applied in each case and how the likely impacts differ as a result.

Impacts to the Lake County Sheriff's Department

The ADE report uses a commonly applied method for estimating changes in municipal revenues and service costs known as a cost/revenue multiplier approach. This essentially means that ADE takes the current revenue or cost line item from the municipal budget and normalizes it based on the current service population to create an average cost or revenue figure per service population, which is also known as a multiplier. The service population typically equals the resident population plus one-half of the jobs; though in some cases it may differ. The cost or revenue multiplier is then applied to the future incremental growth in service population to estimate the future cost or revenue impacts, respectively. In many cases, this is the preferred approach as it is both efficient and reasonably accurate. However, in this case, BAE recommends using an alternative method for estimating impacts to key City and County departments, particularly for law enforcement services. This is because this service category accounts for a disproportionate share of the General Fund budget; thus, a small miscalculation can result in significant errors in the analysis.

Responsibility for law enforcement is expected to change from the Lake County Sheriff's Office to the City of Lakeport Police Department. BAE recommends that ADE conduct additional research to better understand the impacts of annexation on both of these agencies using a case study methodology. To apply a case study method, BAE recommends conducting interviews with representatives of each agency to better understand the likely impacts and when those impacts are likely to occur. For example, incremental changes in calls for service do not always result in matching changes in staffing; for example, a ten percent decrease in calls for service may not warrant the elimination of a sworn officer position, where a 20 percent decrease may. Some changes in demand can be addressed through reorganization of staffing and beat areas, where others cannot. Also, certain changes in calls for service may warrant significant changes in the department's needs for facilities and equipment.

According to the Lake County Sheriff's Office, the annexation of the South Lakeport area would not significantly reduce the need for Sheriff's Office staffing due to the need to maintain service levels in the surrounding area. It would, however, likely result in the loss of at least one Sheriff's Deputy due to the anticipated reduction in County revenue. While this could be fiscally positive in some sense, it is not a desirable outcome, because this would deteriorate service quality in the surrounding area. In other words, the Sheriff's Office would lose an officer, not because of a lack of demand, but because of a lack of funding.[9] The Sheriff's Office is already understaffed by a significant margin due to lack of funding, which contributes to ongoing challenges with the recruitment of new deputies. Therefore, while annexation would transfer responsibility for law enforcement services, annexation would also result in a disproportionate transfer of revenue that would further exacerbate existing deficiencies in service provision throughout the remainder of the unincorporated area.

Impact of Annexation on Special Districts

Although a fiscal impact analysis of this nature typically does not evaluate the anticipated impacts to special districts, a representative from the water and sewer district that currently serves the proposed annexation area has expressed concerns regarding the annexation. In particular, the concern is that if the City assumes water and sewer service within the annexation area, the service population remaining within the special district would be too small to justify the continuation of service. This would potentially leave existing residents and businesses in the remainder of the district that is not annexed to the City without water and sewer service, or if service is continued, the service charges may have to increase to unsustainable levels due to the need to spread the district's fixed costs over a smaller base of ratepayers. As part of this analysis, the City of Lakeport should confirm whether or not it is the City's intent to assume responsibility to provide water and sewer service within the annexation area. If the City intends to do so, then the analysis should be amended to include an analysis of impacts to the special district.

[9] Martin. Brian. Lake County Sheriff. Personal Communication. June 19, 2019.

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APPENDIX A: FISCAL CRISIS MANAGEMENT PLAN

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FISCAL CRISIS MANAGEMENT PLAN

A collaborative effort of Lake County Department Heads

ADOPTED BY THE LAKE COUNTY BOARD OF SUPERVISORS DECEMBER 4, 2018

I. Evaluate and act on all available means for achieving cost savings and/or improving upon efficiencies

Priorities:

Continually evaluate our capacity to sustain non-mandatory functions

Research best practices for service delivery models

Implement acceptance of credit card payments for all fees, County-wide

Consolidate facilities where feasible

Reorganize programs and regionalize caseloads requiring travel in self-funded departments

Improve upon our ability to effectively manage the high cost of employee turnover

Convert to paperless check issuance

Consider options for privatization

Collaborate with community partners

Bring energy efficiencies to fruition

II. Focus on generation of additional revenues and claiming of essential reimbursements

Priorities:

Explore alternatives to our current A87 administrative cost allocation plan

Fill our new Tax Administrator position

Develop best practices and conduct annual sales of tax defaulted properties

Develop and implement best practices for debt collection

Fully staff disaster claiming functions to enable critical reimbursements

Strengthen and efficiently staff offices that drive revenue generation

Identify, surplus and sell County-owned properties not required for public use

In coordination with the local AB 109 Commission, revisit allocation methodology for AB 109 funds for local law enforcement

Pave the way for future revenues through local Economic Development efforts

Evaluate existing Williamson Act contracts

Adhere to periodic Master Fee Schedule updates

III. Enhance use of technology to better meet workload demands

Priorities:

Expand use of modern customer service tools, including chat, email and self-service telephone systems

Implement electronic document and workflow management tools

Research best options for digitization of records

Identify processes utilized by multiple departments that can be automated, to include County-wide implementation of credit card payments for services

Broaden access to automated legal research tools

Simplify internal processes causing duplication of work, such as tracking of work hours with both paper and Executime

Utilize webinars and online training opportunities

IV. Reduce permanent position allocations* in the General Fund by an estimated

-5% in FY 19/20

-6% in FY 20/21

-7% in FY 21/22

-18% cumulative

Where necessary, reallocate staffing to meet business needs

**In recent months, an average of 20% of permanent position allocations in the General Fund have been vacant. The intent is to eliminate vacant positions.*

V. Partner with your Board for success

Priorities:

Provide direction as a full Board and collaborate on areas of common interest

Evaluate the expenditure of staff time

Implement necessary policy changes

Be prepared to make unusually difficult budget decisions

Support Department Heads and staff when service reductions are unavoidable

Reaffirm your commitment to Vision 2028

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APPENDIX B: LAFCO REVENUE NEUTRALITY POLICY

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Lake Local Agency Formation Commission (LAFCO)

Policies, Standards, and Procedures

Adopted
May 20, 2009
Resolution 2009-0006

Amended May 21, 2014 Resolution #2013-0003

Table of Contents

e) Pre-zoning or Planning. All territory proposed for annexation must be specifically planned and/or pre-zoned by the planning agency. Pre-zoning or zoning of the territory must be consistent with its general plan and sufficiently specific to determine the likely intended use of the property. No subsequent change to the zoning by a city is permitted by state law for a period of two years under most circumstances.

2.12. Boundaries

a) Definite Boundaries Required. LAFCO will not accept as complete any application for a proposal unless it includes boundaries that are definite, certain, and fully described.

b) Boundary Criteria. LAFCO will normally favor applications with boundaries that do the following:

   i) Create logical boundaries within the affected agency's Sphere of Influence, and where possible, eliminate previously existing islands or other illogical boundaries.

   ii) Follow natural or man-made features and include logical service areas, where appropriate.

c) Boundary Adjustments. LAFCO will normally amend applications with boundaries which:

   i) Split neighborhoods or divide an existing identifiable community, commercial district, or other area having a social or economic identity.

   ii) Result in islands, corridors, or peninsulas of incorporated or unincorporated territory or otherwise cause or further the distortion of existing boundaries.

   iii) Are drawn for the primary purpose of encompassing revenue-producing territories.

   iv) Create areas where it is difficult to provide services.

d) Boundary Disapprovals. If LAFCO cannot suitably adjust the boundaries of a proposal to meet the criteria established in item 2.12 (b) above, it will normally deny the proposal.

2.13. Revenue Neutrality

a) Revenue Neutrality Applicable to All Proposals. LAFCO will approve a proposal for a change of organization or reorganization only if the Commission finds that the proposal will result in a similar exchange of both revenues and service responsibilities among all affected agencies. A proposal is deemed to have met this standard if the amount of revenue that will be transferred from an agency or agencies currently providing service in the subject territory to the proposed service-providing agency is substantially equal to the expense the current service provider bears in providing the services to be transferred.

b) Adjustment to Create Revenue Neutrality. In the event the expense to the new service provider is substantially greater than or less than that amount of revenue transferred from the current service provider, the current service provider and new service-providing agency must agree to revenue transfer provisions to compensate for the imbalance. Such provisions may include, but are not limited to, tax-sharing, lump-sum payments, and payments over a fixed period of time.

c) Failure to Achieve Revenue Neutrality. Where achieving substantial revenue neutrality is not possible because of the limitations of state law, the Commission shall impose all feasible conditions available to reduce any revenue imbalance, or it may deny the proposal. The Commission recognizes that strict compliance with the revenue neutrality standard may be infeasible for certain proposals and that the need for service may sometimes outweigh the requirement for complete revenue neutrality. Where the failure to achieve revenue neutrality is primarily due to the disagreement of the affected agencies, the Commission shall normally deny the application.

d) Revenue Sharing Agreements. Paragraphs a, b, and c of this section will be considered to be complied with if:

i) The affected agencies have agreed to a specific revenue split for the proposal and have filed a copy of that agreement with the Executive Officer with a statement that the agreement adequately provides for revenue neutrality, or

ii) A master tax exchange agreement or agreed-upon formula is in effect between the affected agencies and the agencies confirm in writing that such agreement is applicable to this proposal and that it provides for a balanced exchange of service costs and revenues.

2.14. Agricultural and Open Space Land Conservation

Among LAFCO's core purposes is preservation of open space and prime agricultural lands. The Commission will exercise its powers to conserve prime agricultural ("ag") land as defined in Government Code Section 56064, and open space land as defined in Government Code Section

APPENDIX C: MEMORANDUM FROM COUNTY COUNSEL

MEMO

TO:	Margaret Silveira, City Manager Kevin Ingram, Community Development Director Linda Ruffing, North Coast Planning
FROM:	Doug Svensson, AICP
DATE:	July 29, 2019
SUBJECT:	**BAE Peer Review of South Lakeport Annexation Fiscal Analysis**

In reviewing the BAE document dated July 17, 2019, many of the comments amount to requests for clarification of our analysis rather than providing evidence that the analysis is flawed. In the few cases where BAE offers an independent analysis, they have made fundamental mistakes that render the comments meaningless. We see no cause from their comments to change the fundamental conclusion of our report that the 1997 agreement produces a fair and equitable distribution of revenues and service cost obligations between the City and the County. Our specific responses to the main BAE points, which begin on page 9 of their report, are provided below.

Page 9. *BAE: ADE analysis shows County will not receive sufficient revenue to offset costs until well after 2050.*

This is incorrect as Table 17 on p. 25 of our report shows that by 2030 the County will receive $117,193 in annual revenues against $65,411 in annual cost, for a net surplus of $51,782. The initial deficit of about $8,500 per year would be offset for 24 years by the $210,000 sales tax payments, but we estimate County will be net fiscally positive without those payments within two years of annexation under the moderate growth scenario, and within three years under the slower baseline scenario.

The fact that the City would receive higher revenue surpluses than the County is due to the fact that the City has adopted local sales tax measures which the County voters have failed to do.

Page 10. *BAE: ADE failed to update the base year from 2017, the magnifying the amount of potential future growth.*

At the time we did the analysis, we used the most current data available including the countywide EDD jobs numbers. However, the buildout estimates for the annexation area are based on current land use information and are not affected by the base year. Furthermore, the procedure suggested by BAE to update the base year is simply an estimating technique no different that the projection methodology and would not and any more certainty to the analysis since 2019 data are not available.

Page 10. *BAE: ADE relied on LEHD rather than ACS to analyze the share of employment in Lakeport compared to the County.*

BAE has made a fundamental mistake here in that the ACS does not measure jobs in place in a jurisdiction but rather the characteristics of the labor force in the jurisdiction. What BAE interprets as industry jobs in Lakeport from ACS is in fact the industry of employment of the workers living in Lakeport. This not the same as the job base physically located in Lakeport, which is what the LEHD measures. Furthermore, we calibrated the LEHD numbers to the countywide EDD job figures to eliminate any undercounting error that may occur in the LEHD data set.

This error by BAE leads to their assertion that jobs in Lakeport are declining when in fact they have been increasing. We have seen labor force decline in many cities where job opportunities were reduced by the recession. Jobs come back more quickly than labor force, which results in a reduction in unemployment rates until the labor market reaches equilibrium again.

Page 11. *BAE: The study does not document the assumptions used to calculate development capacity in the annexation area.*

These assumptions are described on p. 5 under Buildout Potential, indicating the FARs used for each land use designation. Table 2 shows the calculations. The percentages in the column entitles Maximum Allowed Development indicate the proportion of full buildout potential remaining on each parcel. The level of constraint was determined by City staff using current site information.

Page 11: *BAE: Estimation of Road Fund revenue is not explained.*

Table 7 on p. 16 indicates the property tax share for the County Road Fund right underneath the County General Fund factor for the two tax rate areas in the annexation area.

Page 12: *BAE: ADE used the wrong development values to project future assessed value of new development.*

The following development values per sq. ft. were used in our analysis, based on ListSource data for existing development in Lake County. All institutional uses are assumed to be taxable.

Retail	$150
Office	$150
Light Industrial	$250
Institutional	$200

Page 13. *BAE: No justification is given for the use of TRA 001-002 as a model for post annexation property tax distribution.*

This TRA was provided by the County Auditor when it was determined that TRA 001-001 no longer exists. Our analysis does not assume that the annexation area would be annexed into TRA 001-002 but rather that it reflects typical property tax shares for the City and the County given existing service obligations within the City limits.

Page 13. *BAE: The City sales tax payments to the County on page 17 of the report is missing the year 7 payment.*

BAE is correct that the table should show $7,500 in Year 7 and $0 in Year 8. However, the text and the analysis reflect the full $210,000 that would accrue with this correction.

Page 13. *BAE: More detail is needed to evaluate ADE's service cost estimates, particularly the service populations and any revenues netted out of the cost calculations.*

For the City calculations, the City budget is provided on p. 18 of the report, the service population is clearly stated at the top of p. 19, and the service cost adjustments are spelled out in the first full paragraph of page 19.

For the County analysis, the service population is provided in the last paragraph of p. 22 and all the relevant County budget figures are provided in Tables 13-15 plus the Appendix.

The fiscal projections use the moderate growth projection, as stated at the bottom of p. 11.

Page 14. *BAE: ADE should use a case study methodology for estimating County Sheriff impacts.*

The fiscal analysis is focused on changing service responsibilities within the annexation area, not with County services outside the area after annexation. Therefore, it is not clear that a case study approach would change the outcome of the analysis. The County would have many options in making budget decisions to balance costs and revenues in future years and it cannot be assumed that changes in revenue would affect the County Sheriff's Department disproportionately compared to other services the County provides.

Page 15: *BAE: The report is unclear whether the City intends to provide water and sewer service to the annexation area.*

The report states in in both the City and County fiscal impact sections that the City does intend to provide water and sewer service (see pp. 19 and 22). The report does not evaluate residual impacts on the Lake County Sanitation District.