

# ANALYSIS OF GOLETA'S REVENUE NEUTRALITY AGREEMENT

*August, 2008*

## 1.0 Overview of LAFCO's Revenue Neutrality Agreement (RNA) Policy

The largest barrier hindering incorporation of new cities in California is something called "revenue neutrality." Amended to a 1985 law in 1992 and currently listed as Section 56815 of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, revenue neutrality has caused incorporations across California to grind to a virtual halt. Prior to revenue neutrality (1992), California averaged about four incorporations per year, which was natural given the rapid growth in the state. Since revenue neutrality was adopted, there has been less than one new incorporation per year in California on average. In fact, since 1992 only ten cities have actually incorporated. Revenue neutrality was enacted in 1992. It took an additional five years before the first city, Citrus Heights incorporated in 1997.

This unnatural restriction on self-government has predictably led to strange developments. For example, San Fernando Valley has thus far been unsuccessful in its long struggle to incorporate even though if allowed to, it would be California's second most populous city.

Section 56815 appears rather innocuous at first glance. It says that incorporation "should result in a similar exchange of both revenue and responsibility for service delivery among the county, the proposed city, and other subject agencies." In reality, it has had a stifling effect on self-government in California. Instead of self-determination being the principle underlying incorporation — which should be the case — the welfare of county budgets has become the overriding factor. The revenue neutrality process in incorporations has become what some call alimony payments in the dissolution of an unhappy marriage, i.e., the county and the new city.

The legislation was written by a paid lobbyist of the counties' lobbying arm in Sacramento (CSAC, or the California State Association of Counties). It was then tacked on to other legislation, had no public hearings, and was passed almost without notice or discussion literally in the middle of the night during the annual Sacramento flurry of legislation typical at the end of a session.

The state had recently raided county budgets for educational expenditures, so at the time revenue neutrality passed in 1992, county budgets were in desperate straits; however, once a special interest law has been passed, its benefactors fight vigorously to defend it. CSAC has thus far successfully fended off attempts to revisit the question of how proper revenue neutrality really is.

In reality, there is no standard mechanism to implement revenue neutrality. The law does not specify any formula for satisfying revenue neutrality. It does state that the county can agree to the incorporation without insisting on revenue neutrality, or that revenue neutrality can be satisfied through "tax sharing agreements, lump-sum payments, payments over a fixed period of time, or any other terms and conditions. . . ." In short, **whatever deal the county and new city strike satisfies the law.**

Revenue neutrality may very well be unconstitutional, but it has yet to be fully litigated—and doing so would likely be costly. Citrus Heights began litigating revenue neutrality when the County of Sacramento tried to prevent it from incorporating through an exorbitant revenue neutrality demand of over \$5 million per year indefinitely. However, before the suit was decided, Citrus Heights cut a deal with the

county to lower the payments to \$2 million per year with a cap of 25 years. Remember: this money does not purchase any services for Citrus Heights; it is merely a ransom that Citrus Heights had to pay to get its freedom.

## 2.0 Summary of Goleta’s Revenue Neutrality Agreement (RNA)

In 2001, members of the “Goleta NOW!” organization negotiated an agreement with the County of Santa Barbara that allocated 50% of Goleta’s property taxes and 30% of Goleta’s sales taxes to the County in perpetuity. An additional 20% of Goleta’s sales taxes and 40% of Goleta’s Transient Occupancy Tax (“Bed Taxes”) would be allocated to the County for ten years.

During the campaign for incorporation (Measure H), Margaret Connell, representing Goleta Now!, publically misrepresented the facts, stating that the RNA payments to the County are for “county wide services,” and that “all cities make similar payments to counties for these services.” In fact, RNA payments are not for any services that the County provides to the City of Goleta. The City of Goleta already pays over \$7M per year for services such as the courts, district attorney, public health, and county records. The RNA payment is above and beyond this payment and does not represent any additional services, despite erroneous statements by incorporation advocates.

Goleta currently pays approximately 34% of our General Fund Revenue to the County of Santa Barbara. In comparison, the other 9 cities that have incorporated since Revenue Neutrality became mandatory pay on average 6.2% of their General Fund Revenue. Additionally, the Revenue Neutrality Agreements of the other nine cities end after less than 12 years on average (the longest being 25 years), while Goleta’s continues on in perpetuity (see Figure 1).

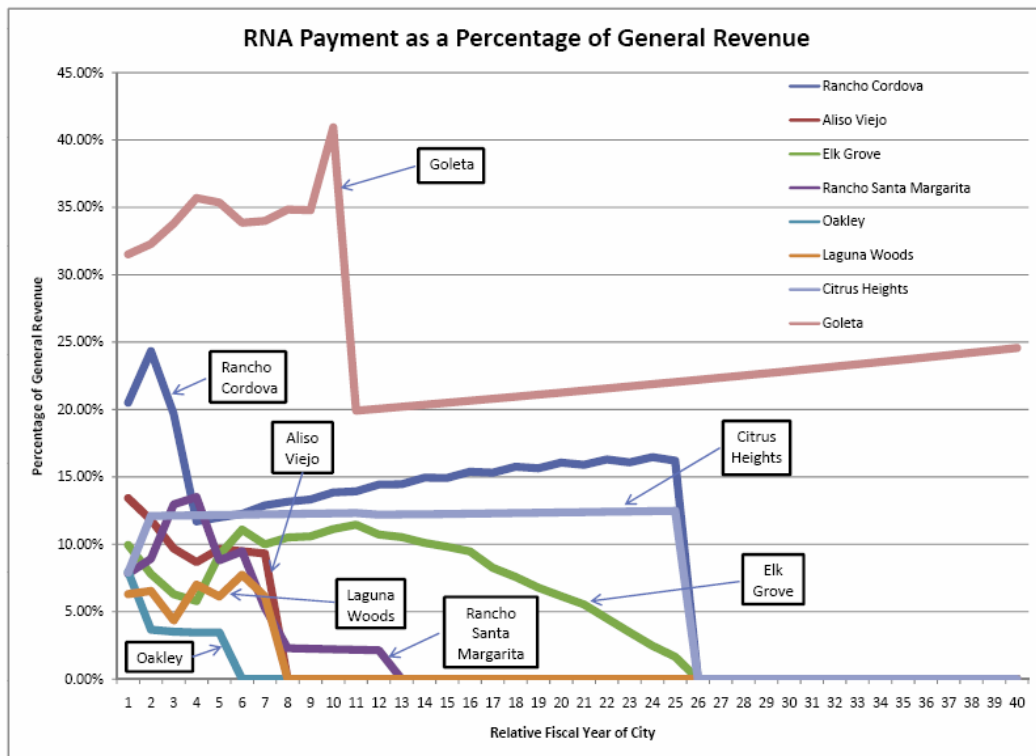
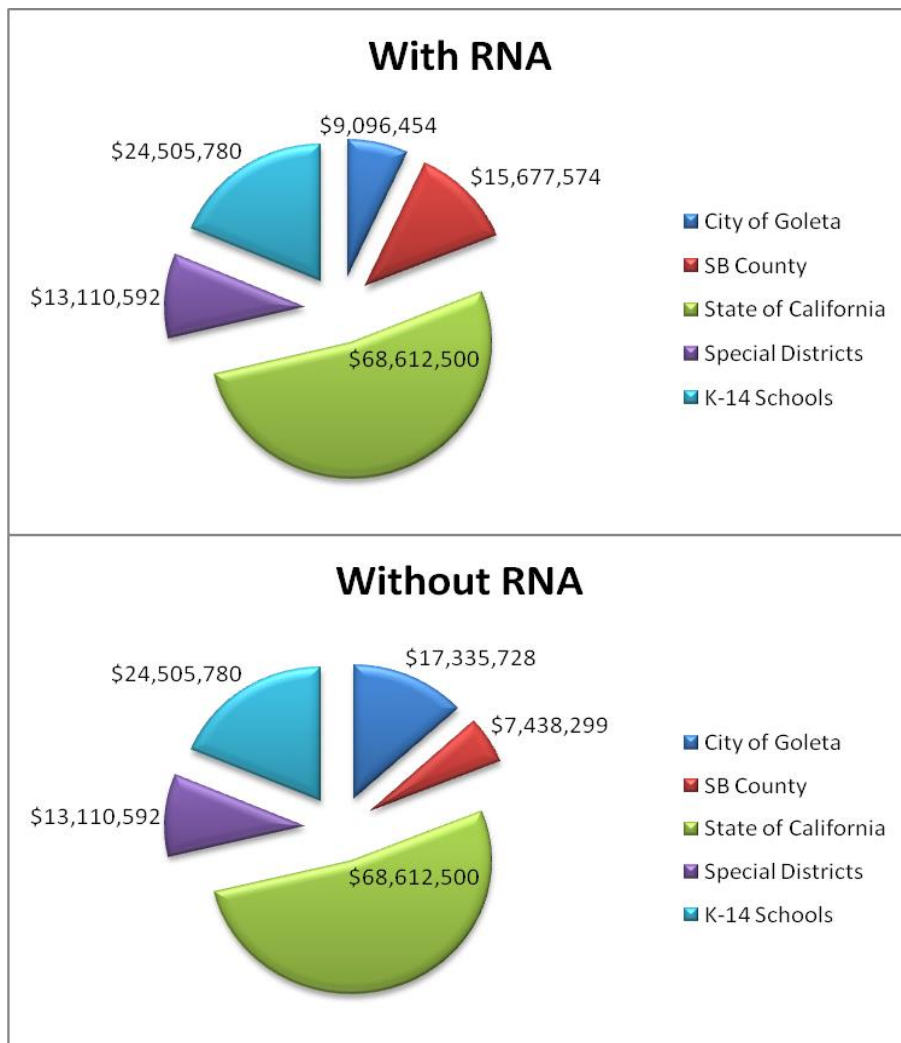


Figure 1: Comparison to Other Recently Incorporated California Cities

It is important to note that California’s two newest cities, Wildomar and Menifee Valley, both in Riverside County, came to an agreement with the County that incorporation was actually beneficial in the long run to both the new city and to the County. Hence, the County of Riverside actually pays the two new cities between \$238K and \$2.1M per year for the cities’ first ten years in order to “help” the new cities get started. Since the agreement was approved by both the new cities and the County of Riverside, LAFCO also approved it, even though the Comprehensive Fiscal Analyses did not support findings of revenue neutrality.

### 3.0 Flow of Tax Revenue for the City of Goleta

As stated above, the County of Santa Barbara already receives a portion of tax revenue from the City of Goleta, in addition to the RNA-mandated payment. In 2007, this payment amounted to \$7.44M. This is calculated using legislated percentages for the sharing of property and sales tax revenue. The City of Goleta allocates 9.96% of our Property Tax revenue, and 3.45% of our Sales Tax revenue directly to the County to pay for services shared by all County residents.



**Figure 2:** Estimated Flow of Tax Revenue for the City of Goleta in 2007

## **4.0 Conclusion**

While the legality and constitutionality of LAFCO's Revenue Neutrality Agreement policy has never been challenged in court, several important precedents have been set over the past 16 years since it was enacted. The cities of Citrus Heights and Rancho Cordova, both in Sacramento County, ended up in lawsuits that were settled out of court, resulting in substantial reductions to their annual RNA payments, and, for Citrus Heights, adding an ending date to the agreement. Additionally, in October 2003, the State Office of Planning and Research issued Incorporation Guidelines that served to clarify the intent and the limits of any Revenue Neutrality Agreement. These guidelines clearly state that it is inappropriate to include the costs of regional services common to the entire County in revenue neutrality agreements. It appears that Goleta's Revenue Neutrality Agreement is currently inconsistent with state policy and that changes are required.

Due to the fact that any legal challenge would be costly and protracted, good-faith negotiations with the County of Santa Barbara should continue to be pursued. Goleta's RNA does allow for arbitration, should negotiations fail, which would be a logical second step prior to any litigation. As a final alternative, litigation should be investigated. Several law firms in the State of California have been successfully utilized by cities seeking to renegotiate revenue neutrality agreements, and could be a good starting point for any legal action against the County of Santa Barbara. Again, due to the cost and schedule impacts, this should be viewed as a last alternative.