City of Rialto
California

Information presented to
the Commission at the
5-18-16 LAFCO hearing.

May 16, 2016

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Mr. James V. Curatalo
LAFCO Chair
215 North D Street
San Bernardino, CA 92415-0490

Subject: Agenda Item #9 on LAFCO's May 18, 2016 Meeting

Dear Chair Curatalo:

The City of Rialto reviewed the staff report to the Board for the Local Agency Formation Commission for San Bernardino County and offers the following clarifications to the information presented:

Errors and Clarifications to Staff Report

1. **Section 2** of the report indicates that the City does not have any adopted goals or policies promoting the development of new mineral extraction activities within the community and that somehow Rialto might compromise public health and safety and the implementation of existing mining agreements. This statement is untrue. The City hosts two significant mining operations along Alder Avenue that have been designated as Open Space in the General Plan to protect ongoing activities. In addition, the Mineral Resources Section of the Rialto General Plan prioritizes the protection of areas designated for mineral extractions.

   The City of Rialto asserts that it would respect the existing agreements and allow the operations in accordance with existing laws and agreements. The City instead believes that the County derives substantial revenue from the Cemex facility, and proposes to retain that revenue to support its service costs. A fairer solution would be to balance the assets and the liabilities by allowing the City to take the Cemex property along with the islands and that may be one potential mitigation measure for the burden imposed by the island annexations.

2. **Section 3** of the LAFCO report states that the City's fiscal consultant prepared only the worst case scenario for the annexation of the five islands. This is not true. The City's fiscal analysis includes projected impacts with utility users tax (UUT) and without UUT. Recurring deficits are projected for the existing development in the five islands of $523,929 with UUT and $761,757 without UUT. In addition, the City's report showed the fiscal impact assuming that the County's mutual aid fire services were still provided, and this showed an ongoing deficit of about $127,450 for existing development.

3. **Section 3a** of the report implies that the City's consultant used a different methodology than used for the Lytle Creek annexation, ostensibly to make the islands look less favorable relative to the Annexation Area. In particular, the report asserts that the consultant did not include In-Lieu Property Tax of Vehicle License Fees (VLF) and In-Lieu Property Tax for Sales and Use Tax. Again this is not true, because the application of these two factors is different for an island annexation which is largely developed than for an undeveloped area, as is explained in the consultant's report, and is summarized below.

- <u>In Lieu Property Tax of VLF (Vehicle License Fee).</u> While the LAFCO analysis estimates this revenue for current valuation of the five islands, SRHA does not project this revenue pursuant to SB89 legislation that states that upon annexation, the current valuation of the annexing area is not considered for calculating in lieu property tax of VLF to the City. Per legislation, only increases in gross assessed valuation after annexation generate property tax in lieu of VLF to the City. The SRHA fiscal analysis for both the five islands and the Lytle Creek Specific Plan projects property tax in lieu VLF for only the projected new valuation after annexation to the City.

- <u>In Lieu Property Tax for Sales and Use Tax.</u> In 2004, the state established an excise tax equal to 0.25% of taxable property for repayment of bonds to close the State's budget deficit. To guarantee the bond repayment, the 1% sales tax rate was lowered to 0.75% and the 0.25% was used for bond repayment. The 0.25% reduction of sales tax revenue was replaced through a series of revenue swapping procedures including property tax.

  In August 2015, the State Department of Finance Director notified the State Treasurer and the Board of Equalization to end the revenue swap on December 31, 2015 because escrow accounts are established to retire the bonds. Starting January 1, 2016 sales tax reverts to the original 1% amount.

  SRHA estimates sales and use tax for the existing retail uses in the five island annexation area at the full 1% rate, and does not project in lieu property tax for sales and use tax. LAFCO projects in lieu property tax for sales and use tax on a per capita basis which is an incorrect method, because the jurisdiction only receives sales tax via the 0.25% reduction in sales tax as backfill if there is sales tax generated in the annexation area in the first place – and there is minimal sales tax generated in Island #4 from a small convenience market.

4. **Section 3b** of the report implies that the consultant's report improperly includes fire service costs in the fiscal assessment. The City of Rialto strongly disagrees with this assumption and on May 11, 2016 we provided the following comment to your staff that unfortunately did not make it into the staff report:

   > While it is certainly helpful that the County will continue to provide mutual aid services to Rialto (primarily south Rialto) after annexation of the islands -- and we appreciate the gestures in that regard delivered by the CEO -- the City of Rialto intends to move pretty quickly over the next 1-3 years to establish fire service in south Rialto that would significantly reduce the mutual aid support from the County. The City is searching for sites to build a permanent fire station in south Rialto, and may implement interim siting solutions to enhance service levels well before the new station is constructed (even as early as late 2016). Our response time to south Rialto customers is inadequate at the moment, and our City Council wants aggressive actions to resolve the service deficit. In this event, the balance of mutual aid services between the City and County would substantially change, wherein the City would probably be providing far greater service to County constituents than the County would be providing to Rialto constituents. Consequently, we believe it would be inappropriate in your analysis of island annexation costs to exclude fire service costs as analyzed in the Stan Hoffman report. That will probably represent the true cost to the City in the near term.

5. **Section 3d** addresses the localized infrastructure deficiencies. The estimated cost of improving the islands to City standards was estimated to be $8.1 million. To argue that because the City has not installed similar improvements everywhere within its boundaries, that it should be willing to assume this burden for annexed areas is absurd. For the first time in many years, the City used one-time revenues from land sales proceeds to invest $2 million toward neighborhood capital facilities. Adding another $8+ million in capital deficiencies suggesting that we will get to it someday does not make the cost go away and does not recognize our policy and our actions to improve existing deficiencies. Moreover, as other parts of our analysis express, the annexations provide inadequate revenue to absorb the operating costs, let alone the capital costs associated with annexation.

The island annexations also create an immediate unfunded capital deficiency for communitywide infrastructure of $11.2 million (for parks, fire stations, police stations, civic facilities, etc.). Similarly, this obligation does not disappear just because there is no immediate requirement to address the deficiency. Eventually, the City must either find new revenues to address the impacts, or dilute the service standard for all Rialto residents.

6. **Section 3e** suggests that we failed to include revenue from the Lytle Creek Development Agreement that was set-aside to compensate for the potential costs of annexing the islands. The Development Agreement provided $630 per unit designated to help upgrade the localized infrastructure in the islands, because the City and Developer anticipated that LAFCO would attempt to link the two annexations together. A couple of points worth noting:

   a. First, the Development Agreement contemplated 8,407 units that would generate $5 million in capital improvement funding. With deletion of Neighborhoods 1 & 4 from the annexation (a decision made by Lytle and the County), the maximum number of units decreased from 8,407 to 6,260 – a reduction of 2,147 units and $1.4 million in capital funding. The revised funding (in today's absolute $) is $3.9 million as indicated in the report. It should be noted, as will be discussed further below, that this one-time development agreement fee for capital facilities was not included in the consultant's report because it is not considered an ongoing revenue source that can be used for operations and maintenance. Instead, it will be used to offset some of the capital cost deficiencies.

   b. Second, this funding accrues as building permits are pulled over time (assume a 3 year delay to start and a 20 year build out cycle). The Development Agreement fee amount does not adjust over time. Even if every unit allowed under the specific plan is developed, the present value of this income stream is approximately $2.1 million. Compare this to the present value capital deficiencies of $8± million, and the City accrues an immediate capital cost deficiency of $5.9 million.

   c. Third, the Lytle Creek Development Company is seeking various permits from the state and federal governments, and may lose additional units as a concession. The City expects to receive less than $3.9 million in Development Agreement fees, and the present value of this contribution is considerably less than that.

   d. Fourth, the staff report suggests that the City should use this uncertain one-time development agreement fee revenue stream to support the service deficits during the initial annexation years. This revenue stream will not exist until Lytle commences building and the service deficits commence on the first day after annexation. The City considers the Development Agreement fee a one-time revenue source reserved for capital improvements and would not under any circumstances use the money to subsidize ongoing operations. This contradicts good municipal financial practice.

City of Rialto's Posture regarding Island Annexations

The City of Rialto is on record several times indicating its willingness to annex the islands, subject to the negotiation of reasonable terms with the County. As the staff report notes, the City incorporated modest financial contributions from Lytle Creek toward the dilapidated infrastructure in the islands. However, the City and County have not negotiated a reasonable compact that would prevent the islands from becoming an unsustainable burden upon the existing residents of Rialto. The County and City need to reach agreement on some combination of additional operating revenues and capital cost contributions in order to make the islands a feasible decision for both parties. We have had promising discussions on a variety of mitigation measures but no agreements to date. LAFCO, however, should not hold Lytle hostage to these negotiations. And in fact, the County will be saving considerable costs for not having to service these scattered islands in the future – maybe the avoidance of some of these future savings could be considered in helping Rialto to offset some of the early deficits, at least, until substantial retail development is up and running in Lytle Creek.

A few short statements in closing:

- The Lytle Creek Annexation Area adds 3,187 housing units and 236,000 square feet of commercial space. By applying a special tax of $104 per unit upon the 3,187 units, the Annexation Area produces a $514,521 annual surplus at build out (with an 8% utility tax). If the utility tax sunsets, then the Annexation Area produces an annual deficit of ($491,250). The City has been willing to assume the risk that the Annexation Area underperforms because it recognizes that it makes good planning sense to develop the project within the service boundaries of a single jurisdiction.

- The City prepared a simple cashflow comparing the expected costs and revenues from the Lytle Annexation Area and the island annexations. Over a 20-25 year build out of the Lytle Creek Project, the cost to service the islands exceeds the expected income derived from the Lytle Annexation Area by $6.6 million (under the best-case scenario with the utility tax at 8% and a CFD fee of $104 per unit). The net present value cost to annex the islands is ($4.5 million).

- The City also modeled the expected sources of capital for infrastructure compared to the estimated costs. The islands require $8.1 million in localized infrastructure to satisfy City standards. The islands also create an immediate unfunded capital deficiency for communitywide infrastructure of $11.2 million. The present value of the Lytle Creek

Development Agreement Fees (assuming the best-case scenario) is $2.1 million. Consequently, the City assumes a capital liability with a present value of $17.2 million.

It is unjust to request that the City assume liabilities of over $20 million in exchange for an asset worth approximately $4.5 million (present value of $2.5 million operating income plus $2.1 million capital contribution) So-called "good government" aside, this is an awful deal for the residents of Rialto and puts undue stress on an already constrained municipal budget.

The City of Rialto requests that the Commission approve the third option in the report: to approve LAFCO 3201 without the requirement to address the five North Rialto Islands. The City is engaged in good faith negotiations with the County to annex the islands and, assuming that terms acceptable to both can be negotiated, the City commits to commence annexation proceedings.

Sincerely,

Michael E. Story
City Administrator