

TO: BOARD OF DIRECTORS
FROM: MARIO IGLESIAS
GENERAL MANAGER
CRAIG A. STEELE
GENERAL COUNSEL



**AGENDA ITEM
E-2**

MARCH 8, 2023

REVIEWED: MARIO IGLESIAS
GENERAL MANAGER

DATE: March 8, 2023

**REPORT ON PROPERTY TAX REVENUE EXCHANGE AGREEMENTS
ARISING OUT OF ANNEXATION APPLICATIONS**

ITEM

Consider the Report on Property Tax Revenue Exchange Agreements Arising Out of Annexation Applications and, if Deemed Appropriate, Provide Direction to the General Manager [RECOMMEND CONSIDER REPORT AND, IF DEEMED APPROPRIATE, PROVIDE DIRECTION TO THE GENERAL MANAGER]

BACKGROUND

As your Board is aware, on November 21, 2022, the General Manager received a Notice from the Executive Officer of the San Luis Obispo County Local Agency Formation Committee ("SLO LAFCO") that the landowner for the Dana Reserve Specific Plan site had filed a landowner petition with SLO LAFCO seeking annexation into the District. The delivery and timing of the Notice was surprising to the District, as the landowner already has an annexation application pending with the District. Nonetheless, the District provided a timely response to the Notice and will continue to work collaboratively with SLO LAFCO and the landowner; always with the intent of protecting the interests of the District and its ratepayers.

There are many steps in the annexation process and a number of agreements and other documents that must be produced before SLO LAFCO and your Board can consider the application. This informational report covers only one of the agreements that would have to be negotiated and considered prior to an annexation - a Property Tax Revenue Exchange Agreement ("Tax Agreement") between the District and SLO County. This agreement is an essential part of any significant annexation, because before an annexation proposal can undergo review and consideration by SLO LAFCO, there must be a Tax Agreement in place between the relevant local agencies. (Rev & Tax. Code §99.) The Tax Agreement specifies how the property tax revenue from the area to be annexed will be distributed between those agencies post-annexation. The Tax Agreement helps ensure that new property tax revenue is divided equitably between the public agencies involved. Here, because the landowner proposes that the District annex vacant property in an unincorporated area of the County into the District, there must be a mutually acceptable Tax Agreement between the District and the County.

Revenue and Taxation Code section 99 lays out the process by which public agencies negotiate and address the issue of tax revenue upon an annexation. At a future point in the annexation process, the District and the County will be required to commence negotiations to determine the amount of property tax revenues to be exchanged between and among the local agencies. The negotiation period is for 60 days but may be extended to up to 90 days. In this case, obviously,

no water, sewer, and solid waste services are currently being provided by the County. In the case of “a jurisdictional change that will result in a special district providing one or more services to an area where those services have not been previously provided by any local agency,” a special district “may negotiate on its own behalf, if it so chooses.” (Rev & Tax. Code §99.01.) (emphasis added) Since the District can, and will, negotiate a Tax Agreement on its own behalf, the District can enter into good faith negotiations with the County, and the proposed annexation cannot be finalized unless the District and County agree to a Tax Agreement. (Rev. & Tax. Code § 99(b)(6)). “For annexations involving special districts that will provide services not previously provided to an area ... [i]f no tax allocation agreement is negotiated, the [LAFCO] executive officer cannot issue a certificate of filing and the annexation proceedings terminate.” *Embarcadero Municipal Improvement Dist. v. County of Santa Barbara* (2001) 88 Cal.App.4th 781, 786.

It is a statutory requirement that the District and County approve a Tax Agreement as a precondition to proceeding with the approval of an annexation application. In *Embarcadero Mun. Improvement Dist. v. County of Santa Barbara*, the court emphasized that “Revenue and Taxation Code section 99 has always placed a property tax revenue exchange agreement as an initial hurdle....In sum, the Legislature has made it clear that, in pursuit of the beneficial purposes of reorganization, resolution of the fundamental fiscal question is a precondition, and this resolution must be mutual and consensual.” (Id. at 791–92) The District has no statutory duty to agree to an unfavorable Tax Agreement with the County, irrespective of whether the proposal was initiated by a petition or by resolution of the District. However, the District and the County are required to negotiate in good faith.

In a case that was roughly analogous to the Dana Reserve proposal, a homeowners association in an unincorporated area filed an application with LAFCO by a petition for a proposed annexation into a city. See, *Greenwood Addition Homeowners Assn. v. City of San Marino* (1993) 14 Cal.App.4th 1360, 1364. The city manager for the City entered into negotiations with the county regarding the property tax revenue exchange agreement. The negotiations never resulted in an agreement, and the negotiations adjourned and never resumed. The City Council resolved to take no further action on the annexation proposal, and terminated the tax transfer negotiations. LAFCO in turn notified the county and plaintiffs that the Greenwood application would not be set for hearing, because of the government parties’ failure to meet the requirements of Revenue and Taxation Code section 99(b)(6). The homeowners sued and argued, among other things, that the City had been under a ministerial duty to negotiate “and determine” the exchange of property tax revenues within 30 days, which it had not done. The Court of Appeal disagreed, holding that Revenue and Taxation Code Section 99 does not impose a duty to reach an agreement, but only provides a “statutory duty to enter into genuine and vigorous negotiations.” (Id. at 1377.)¹

Thus, the District can effectively terminate a proposed annexation by electing not to adopt a Tax Agreement, so long as it has entered into good faith negotiations. This is because SLO LAFCO has no authority to proceed unless there is a Tax Agreement approved by resolution by the governing bodies of both the District and the County. If the District and County reach an agreement, the governing bodies will approve it, it will be forwarded to SLO-LAFCO and the Executive Officer will then issue a certificate of filing that permits the annexation proposal to be set for public hearing. (Govt. Code, § 56658(g).) The District, of course, intends to negotiate with the County in good faith. However, the General Manager has been told informally that the

¹ This holding was before the adoption of the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000, but cases decided under the repealed acts are often still authoritative because the statutory changes made by the Act were largely nonsubstantive. (*L.I.F.E. Committee v. City of Lodi* (1989) 213 Cal.App.3d 1139, 1144 n3.)

County does not intend to share property tax revenue with the District. Further, a consultant for the County has asked the District's General Manager to justify the District's "need" for any share of the property tax revenue, which the District is not required to do.

The County's position on this issue to date apparently is driven by the erroneous assumption that the District needs the revenue that additional water customers would generate through the purchase of Supplemental Water. The County apparently is unaware that the District has multiple pending requests from purveyors to purchase supplemental water, which would provide additional water revenue to the District. The County's position to date also appears to make the erroneous assumption that the District's rate revenue covers all the costs of the District's operations. This assumption ignores publicly available District documents and history, which show that property tax revenue (including revenue produced from annexations) covers the added burden of constructing and maintaining infrastructure needed to import water onto the Nipomo Mesa for the benefit of properties inside and outside of the District's service area. While districts always hope to cover all expenses with rate revenue, hope is a long way from reality. Ultimately, the District assumes that the County will negotiate in good faith, in furtherance of the parties' long history of sharing property tax revenue from annexations. New customers and new infrastructure increase the District's operational expenses in ways that are not always captured in rate revenue. The County has acknowledged that reality since at least 1985.

HISTORY

The need for mutually agreeable Tax Agreements as a part of the annexation process arose after the voters adopted Proposition 13 in 1978. Prop. 13 limited property tax rates and local government's authority to change them. The first annexation of property into the District after 1978 was in 1985, and there have been 25 approved annexations since then. In all of those annexations, the District and the County entered into Tax Agreements. In 1992, the County offered to the District a tax sharing percentage of 7.83% for 5 annexations, but the District took no new property tax revenue for annexations that year. The reasoning behind the District's decision is unclear. What is clear is the County offered a tax sharing agreement to the District for these annexations and the District declined. In the 23 other approved annexations after 1978, the County and the District agreed to transfers of property tax revenue that averaged roughly 6.494% of the increased property tax revenue from the annexed properties. Through these Tax Agreements, the residents of the annexed properties equitably joined their neighbors in paying a portion of their property taxes to the District for the benefit of having important services provided by the District.

A historical description of the District's approved annexations and the property tax sharing agreements is attached as Attachment A.

Generally, a Tax Agreement provides that the County keeps the base property tax revenue produced in the tax year before the annexation takes place. The County and the affected District then share the additional property tax revenue generated as a project develops and the property value increases. As demonstrated by Exhibit A, the history of Tax Agreements between the District and the County certainly are precedent for this proposed annexation. None of the factors that led the District to agree to receive no property tax revenue from the 1992 annexations is applicable today. Furthermore, this proposed annexation will set precedent for future annexations. Although there is no reason to justify the District receiving no property tax revenue from the Dana Reserve project, and no reason has been articulated by the County, we can anticipate that the County would treat future annexations similarly if it was permitted to inequitably retain all future property tax revenue from the Dana Reserve project.

In staff's view, the District's fair and equitable share of the new property tax revenue from new annexations to the District is in a range that aligns with the historical range of County offers for the past seven annexations, all since the year 2000. Staff requests that the Board give direction in this regard to the General Manager, for use in negotiations with the County.

FISCAL IMPACT

For fiscal year 2022-2023, the SLO County Property Tax Manager's estimate of the District's property tax revenue was \$801,631. The District's budget, adopted by your Board allocates that revenue to various District purposes in given years. However, and most significantly, District has pledged the "Ad Valorem Tax Revenue" (property tax revenue) it receives each year to pay the debt service for the 2013 Certificates of Participation and the 2013 Refinancing of the bonds that financed the construction of the Nipomo Supplemental Water Project. Thus, with very few exceptions, the property owners of the District are paying for important District infrastructure needs, over time, with their property tax revenue. It would be inequitable for new property owners in future annexed land to not share that responsibility.

When sufficient property tax revenue is available, the District uses that revenue for other purposes, such as paying for infrastructure in support of the Nipomo Supplemental Water Project, a regional project that benefits all county residents within the Nipomo Mesa Water Conservation Area. In addition, the current proposal for the Dana Reserve project includes elements that will impact the District financially and will not be funded by water and sewer rate revenue. Those impacts include the development of water reuse elements in support of non-potable water systems.

The District conservatively estimates that the District's annual share of property tax revenue from the Dana Reserve Specific Plan project, as currently proposed and at build-out, will be between \$550,000 and \$650,000 annually if the District and the County agree to a Tax Agreement consistent with past agreements.

STRATEGIC PLAN

Goal 1. WATER SUPPLIES. Actively plan to provide reliable water supply of sufficient quality and quantity to serve both current customers and those in the long-term future.

B.3 Seek opportunities for mutually beneficial shared use of the Supplemental Water Project pipeline once it is permitted to transmit its full capacity.

A.7 The District will seek to sell temporary water to other purveyors to utilize take or pay water and offset costs.

Goal 4. FINANCE. Maintain conservative, long-term financial management to minimize rate impacts on customers while meeting program financial needs.

B.1 Evaluate, plan for and maintain finances that are adequate for all needs, stable, and reliable over the long-term. B.2 Ensure that purveyors and others pay their fair share of financing water supply, supplemental water, conservation, and sustainability of the regional water supply. Purveyors should pay their share up front before getting water in order to help finance next phases of supplemental water program.

RECOMMENDATION

It is recommended that your Board receive the report and, if deemed appropriate, affirm to the General Manager that the Board endorses the approach of negotiating Tax Agreements for future annexations that are aligned with the percentage share the District agreed to in annexations since 2000.

ATTACHMENT

- A. NCSD - Negotiated Transfer of Property Tax Revenue

MARCH 8, 2023

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ATTACHMENT A

**NIPOMO COMMUNITY SERVICES DISTRICT
NEGOTIATED TRANSFER OF PROPERTY TAX REVENUE**

APPROVED ANNEX #	NAME	YEAR	NCS RESOLUTION #	COUNTY OFFERED	NCS AGREED TO	DIFFERENCE			
1	Ball Annexation	1966	PRE 1978 PROP 13/AB 8 (No property tax negotiation)						
2	Annexation #2	1968							
3	Bevington	1977							
4	Corona Annexation	1985	1984-220	7.43188	7.43188	0			
5	Thompson Road Estates	1986	1986-281	7.61805	7.61805	0			
6	Summit Station	1993	1992-465	7.833913	0	-7.833913			
7	Blacklake Golf Course	1992	1992-465	7.833913	0	-7.833913			
8	Dana School/Regional Park	1992	1992-465	7.833913	0	-7.833913			
9	Baptist Church	1992	1992-465	7.833913	0	-7.833913			
10	Fairview Tract Annexation (Carriage Homes)	1992	1992-465	7.833913	0	-7.833913			
14	Bantz Annexation (Correction to Annex #6)	1996	1994-503	7.833913	7.833913	0			
15	Newdoll Annexation	1997	1996-599/1996-590	4.1858884	4.1858884	0			
16	NCS Wastewater Plant & Shop	1998	1997-627	3.577071	3.577071	0			
17	Newdoll Annexation	1998	1998-637	4.1858884	4.1858884	0			
18	Newdoll Annexation	2000	2000-747	6.2124	6.2124	0			
20	Maria Vista	2001	2001-797	6.05086	6.05086	0			
21	Knollwood	2001	2001-798	6.05086	6.05086	0			
23	Vista Robles LLC	2007	2003-881	6.2124	6.2124	0			
25	Lyn Road	2004	2003-882	6.05086	6.05086	0			
26	Patterson-Lyn Road	2004	2004-909	6.05086	6.05086	0			
28	Craig	2007	2007-1014	6.26491	6.26491	0			

AVERAGE OF OFFERS = 6.494189211

APPROVED ANNEX #	NAME	YEAR	NCS RESOLUTION #	COUNTY OFFERED	NCS AGREED TO	DIFFERENCE
19	Lucia Mar-Nipomo High School	2001	2001-776	0	0	0

PROPOSED ANNEXATIONS - WITHDRAWN, EXPIRED OR DENIED

ANNEX #	NAME	YEAR	NCS RESOLUTION #	COUNTY OFFERED	NCS AGREED TO	DIFFERENCE
11	Dan Blough Annexation	1992	Applicantion withdrawn			
12	Hasting Annexation-Time expired	1994	1994-497	7.833913	7.833913	0
13	Brand Flowers Annexation-Denied by LAFCO	1994	1994-498	7.833913	7.833913	0
22	Pudwill-Time expired	2003	2003-857	6.05086	6.05086	0
24	Nipomo Hills	2003	Applicantion withdrawn			
27	Holloway-Time expired	2006	2006-970	6.31927	6.31927	0