Date of Hearing: April 20, 2016

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Susan Talamantes Eggman, Chair
AB 2737 (Bonta) – As Amended April 11, 2016

SUBJECT: Nonprovider health care districts.

SUMMARY: Requires a "nonprovider healthcare district" to spend at least 80% of its annual budget on community grants awarded to organizations that provide direct health services, and prohibits more than 20% of its annual budget to be spent on administrative expenses. Specifically, **this bill**:

1) Requires a "nonprovider healthcare district" to spend at least 80% of their annual budget on community grants awarded to organizations that provide direct health services, and prohibits more than 20% of their annual budget to be spent on administrative expenses.

2) Defines "nonprovider health care district" to mean a healthcare district that meets all of the following criteria:

    a) The district does not provide direct health care services to consumers;

    b) The district has not received an allocation of real property taxes in the past three years;

    c) The district has assets of $20 million dollars or more;

    d) The district is not located in a rural area that is typically underserved for health care services; and,

    e) The district, in two or more consecutive years, has dedicated an amount to community grants that is less than twice the total administrative costs and overhead not directly associated with revenue-generating enterprises.

3) Defines "direct health service" to mean "ownership or direct operation of a hospital, medical clinic, ambulance service, transportation program for seniors or persons with disabilities, a wellness center, health education, or other similar service."

4) Defines "administrative expenses" to mean "expenses relating to the general management of a healthcare district, such as accounting, budgeting, personnel, procurement, legislative advocacy services, public relations, salaries, benefits, rent, office supplies, or other miscellaneous overhead costs."

5) Provides that, if the Commission on State Mandates determines that this bill contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made, pursuant to current laws governing state mandated local costs.

EXISTING LAW:

1) Establishes the Local Health Care District Law that defines the powers and duties of healthcare districts, including, but not limited to, the following:

a) Operating health care facilities, such as hospitals, clinics, skilled nursing facilities (SNFs), nurses' training schools, and child care facilities;

b) Operating ambulance services within and outside of the district;

c) Operating programs that provide chemical dependency services, health education, wellness and prevention, rehabilitation, and aftercare;

d) Carrying out activities through corporations, joint ventures, or partnerships;

e) Establishing or participating in managed care;

f) Contracting with and making grants to provider groups and clinics in the community; and,

g) Other activities that are necessary for the maintenance of good physical and mental health in communities served by the district.

FISCAL EFFECT: This bill is keyed fiscal.

COMMENTS:

1) **Healthcare Districts.** Near the end of World War II, California faced a severe shortage of hospital beds. To respond to the inadequacy of acute care services in the non-urban areas of the state, the Legislature enacted the Local Hospital District Law, with the intent to give rural, low-income areas without ready access to hospital facilities a source of tax dollars that could be used to construct and operate community hospitals and health care institutions in medically underserved areas, to recruit physicians and support their practices. The Local Hospital District Law (now called the Local Health Care District Law) allowed communities to create a new governmental entity – independent of local and county jurisdictions – that had the power to impose property taxes, enter into contracts, purchase property, issue debt, and hire staff. In general, the process of creating a hospital district started with citizens in a community identifying the need for improved access to medical care.

   According to the Association of California Healthcare Districts, there are currently 78 districts, of which three have stand-alone skilled nursing facilities, 54 are rural, 34 hospitals, 20 of which are critical access, and five have stand-alone clinics. These institutions provide a significant portion of the medical care to minority populations and the uninsured in medically underserved regions of the state and are mainly funded by Medicare, Medi-Cal, and district tax dollars.

6) **Bill Summary.** This bill requires specified healthcare districts to spend at least 80% of their annual budget on community grants awarded to organizations that provide direct health services, and prohibits more than 20% of their annual budget to be spent on administrative expenses. This bill only applies to "nonprovider healthcare districts," which must meet all of the following criteria: a) the district does not provide direct health care services to consumers; b) the district has not received an allocation of real property taxes in the past three years; c) the district has assets of $20 million or more; d) the district is not located in a rural area that is typically underserved for health care services; and, e) the district, in two or

more consecutive years, has dedicated an amount to community grants that is less than twice the total administrative costs and overhead not directly associated with revenue-generating enterprises. Additionally, this bill defines "administrative expenses" and "direct healthcare service." The parameters of this bill were established to address one healthcare district, Eden Township Healthcare District (District). This bill is sponsored by the City of San Leandro.

2) **Author's Statement.** According to the author, "The Eden Township Healthcare District was established to serve the health needs of Castro Valley, San Leandro, San Lorenzo, Hayward and other nearby communities. At one point, Eden owned and operated a hospital and provided direct healthcare services to the community. Currently, Eden no longer owns or operates a hospital and does not provide any direct health services to the public. Aside from managing buildings they own, Eden primarily serves as a grant making entity with the purpose of providing grants to community non-profits to provide healthcare services to the public. In 2013 and 2014, Eden spent almost twice as much on salaries and benefits for its three employees compared to what it gave out in community grants for healthcare services. The basic foundation for a healthcare district's existence is to provide healthcare services to the community it serves. When that basic premise [is not] being followed, rules need to be set in place for the benefit of the community."

3) **Eden Township Healthcare District.** According to Alameda County Local Agency Formation Commission's (LAFCO) 2012 municipal service review (MSR), the District was established by the voters in 1948 to finance construction of Eden Hospital, which opened in 1954. In 1998, the District transferred all of the net operating assets and operations of the hospital to Sutter Health. In 2004, the District purchased San Leandro Hospital and leased it to Sutter Health. In order to comply with seismic safety laws, the District entered into an agreement with Sutter Health to replace Eden Medical Center. The agreement also gave Sutter the option to purchase San Leandro Hospital. On December 21, 2011, an appellate court ruled in favor of Sutter in litigation over the terms of the 2008 agreement. On October 31, 2013, Sutter transferred San Leandro Hospital to the Alameda Health System, the public health authority that operates Alameda County's health care system.

   Currently, the District provides grant funding to health-related organizations through a Community Health Fund and owns three office buildings, where it leases office space to healthcare providers. The District does not receive any property tax, special tax, or benefit assessments. The main source of revenue is rental income. The District consists of 130 square miles and includes the City of San Leandro, most of the City of Hayward, and the unincorporated areas of Castro Valley and San Lorenzo, and is governed by a five-member board of directors elected to four-year terms.

   Alameda LAFCO's MSR identified three governance structure options for the District: a) annexation of City of Dublin by the District; b) dissolution; and, c) consolidation with Washington Township Healthcare District. The MSR found that while the District no longer owns and operates a hospital, it is premature to dissolve the District pointing to the grant funding, leased office space, and an indication from the District of their willingness to provide direct services in the future.

4) **Controversy and Subsequent Legislation.** Recent controversy surrounding several healthcare districts has brought greater media and legislative scrutiny on several issues, including their fiscal management. The Assembly Committee on Accountability and

Administrative Review conducted several hearings regarding healthcare districts, and focused specifically on healthcare districts that do not operate hospitals. Additionally, the Legislative Analyst Office (LAO) produced a report entitled, "Overview of Health Care Districts", in April 2012 in response to several healthcare districts that have declared bankruptcy since 2000. There have also been concerns regarding districts maintaining reserve balances in the tens of millions of dollars. For example, Peninsula Health Care District and Beach Cities Health District have each reported over $45 million in unrestricted net assets (reserves) at the end of June 2011.

Additionally, according to the LAO report, several LAFCOs have considered dissolving districts. Five districts have been dissolved or otherwise reorganized since 2000. Since that time, the Contra Costa County LAFCO consolidated Mount Diablo Healthcare District into the City of Concord. The Mount Diablo Healthcare District did not operate a hospital and similar concerns were expressed about the amount of revenue spent on administrative costs, instead of on grant funding for community health needs.

A Bureau of State Audits' (BSA) audit of Salinas Valley Memorial Health Care System found that the District's Board violated open meeting laws to grant overly generous compensation, retirement, and benefits to the chief executive officer. This Committee heard several bills addressing the employment contract between a healthcare district and hospital administrator, including AB 2115 (Alejo) of 2012, AB 2180 (Alejo), Chapter 322, Statutes of 2012, and, AB 130 (Alejo), Chapter 92, Statutes of 2013.

AB 2418 (Gordon and Dickinson) of 2012 would have required healthcare districts to expend 95% of any property tax revenue on current community healthcare benefits. AB 2418 sought to exclude salaries and benefits paid to staff, benefits provided to board members, and expenses of hiring a consultant from the definition of community healthcare benefit. AB 912 (Gordon) Chapter 109, Statues of 2011, created an expedited process for the dissolution of special districts.

5) **Related Legislation**. AB 72 (Bonta) of 2015, on the Senate Inactive File, would have authorized the District, until January, 1 2026, to impose special taxes within the District, subject to the approval of two-thirds of the District's voters.

   AB 2471 (Quirk), pending in this Committee, would require LAFCO to order the dissolution of a healthcare district without an election, if the district meets specified criteria. The District meets the criteria established by AB 2471. The Committee may wish to consider the necessity of this bill, if AB 2471 is signed into law.

6) **Policy Considerations.** The Committee may wish to consider the following:

   a) **Identifying the Problem.** This Committee has heard several bills aiming to address many of the same issues raised by the proponents of this bill in regards to the District. These issues include healthcare districts that 1) do not operate hospitals; 2) do not expend adequate funds on community needs; and, 3) expend funds on administrative costs, instead of providing benefits to the community. The Committee may wish to consider, if it is necessary to legislate how an independent special district expends its revenue to a specified percentage. If so, then the Committee may wish to consider whether the author and proponents of the bill should more appropriately address these issues, pursuant to the local process provided by existing law, to initiate the dissolution of the District.

b) **Healthcare Districts and LAFCO.** The relationship between LAFCOs and healthcare districts is unique in comparison to other special districts. The Local Healthcare District Law and the formation of some healthcare districts predate the Knox Nisbet Act, which created LAFCOs and formalized the process for establishing a hospital district. Due to the unique nature of healthcare services and the long history of healthcare district's principal act, the Committee may wish to consider, beyond the scope of this individual bill, if there is a need to more clearly define the relationship between LAFCOs and healthcare districts, and undertake a closer examination of healthcare district's service boundaries, the process of dissolution for healthcare districts, and the considerations LAFCOs are required to make when doing an MSR and determining the sphere of influence for healthcare districts.

c) **Compliance.** The Committee may wish to consider the logistical challenges the District may encounter when trying to comply with the provisions of this bill.

i) **Other Costs.** The Committee may wish to consider how costs not defined by this bill will be addressed. For example, the District must comply with requirements in the Ralph M. Brown Act, elections for board positions, or any outstanding debt for construction or maintenance of District owned facilities.

In the 2010-11 fiscal year, the District's Board voted to temporarily suspend grants to offset legal expenses over the dispute with Sutter Health over the closure of the San Leandro Hospital. Following that case the District is legally required to make specified payments to Sutter. Additionally, in 2011 the District made a $3 million loan to St. Rose Hospital to fund their operating expenses. St. Rose is an independent hospital located in Hayward and has experienced significant operating losses. The Committee may wish to consider how the requirements established by this bill would affect scenarios like these recent examples.

ii) **80/20.** Some costs included in the definition provided for administrative costs are easier to determine than others. For example, due to compensation reporting requirements for local agencies, including healthcare districts' salary and benefits are easy to access and determine. According to the State Controller's website, in 2014 the District reported eight employees with total wages at $318,231 and total retirement and health costs at $23,401. Reported in the number of employees are five board members. The total wages for the three employees of the District, Chief Executive Office, Senior Accountant, and Executive Officer's Assistant are $312, 131. The Committee may wish to consider that the 20% cap on administrative costs must include all other expenditures of the District because 80% of the budget must be expended on community grants.

7) **Arguments in Support.** According to the City of San Leandro, "…one of the top priorities for the City of San Leandro is a legislative solution to help address the financial sustainability of San Leandro Hospital. With the resolution of the six-year lawsuit between Eden Township Healthcare District and Sutter regarding San Leandro Hospital, it is imperative to activate Eden's obligation to the San Leandro community and create a sustainable environment for the hospital. The basic foundation for a healthcare district's existence is to provide healthcare services. When a healthcare district isn't following that

basic premise, rules need to be put in place. Fortunately, AB 2737 serves to create an appropriate set of rules to address this issue."

8) **Arguments in Opposition.** According to the Association of California Healthcare Districts, "While we can appreciate that there may be local concerns about the level, type, and cost of services provided, we assert that the best approach to addressing those concerns is through engagement with the duly elected trustees of the district. Statewide measures like AB 2737 have the effect of bypassing an important local discourse and are likely to impose unintended consequences on other local agencies not involved in the controversy."

REGISTERED SUPPORT / OPPOSITION:

Support

City of San Leandro [SPONSOR]

Opposition

Association of California Healthcare Districts
California Special Districts Association

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