

To Provide Information and Training

Finding 3: Policy-makers and community leaders lack the analytical tools necessary to assess the benefits of consolidation, impeding their ability to advocate effectively for change and overcome the tenacity of the status quo.

The State created LAFCOs to be catalysts for the logical and orderly evolution of local government. They also were specifically directed to pursue the consolidation and reorganization of special districts.

Finding 2 described ways to improve the independence of LAFCOs. But the State also has a role to play in helping LAFCOs and special districts develop the analytical capacity to assess performance and determine when reorganizations would reduce costs or improve the quality of services. Beyond good analysis, the experience of LAFCOs is that the reorganization process requires intensive facilitation. As a result, local officials need to develop or have available the skills necessary to help stakeholders negotiate the reorganization of independent special districts.

The State should establish a program at the California Policy Research Center, or similar institute, to furnish LAFCOs and community leaders with these tools.

A Silent Policy

The State's current policy is silent on when, where and how LAFCOs should go about their task of initiating special district reorganizations. LAFCOs also have few tools – proven analytical models or reliable evaluations of previous reorganizations – to help them conduct credible assessments. A former LAFCO staffer told the Commission: "There is just no reliable, empirical data available to guide LAFCOs in determining when consolidations are warranted. They don't have the ability to follow up and look at long-term benefits. The State could play an important role in this area."³⁸

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Local leaders also can play an important role in promoting the effective organization of local government, particularly where LAFCOs are reluctant. Community leaders can circulate petitions to bring reorganization proposals before LAFCOs. County boards of supervisors and city councils also can initiate reorganization efforts. But they too

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lack the information that would encourage them to invest time and political capital in these efforts.

Few Tools are Available

While there are thousands of independent special districts and there have been dozens of consolidations, LAFCOs do not have a standard methodology for examining potential reorganizations. When can reorganizations be expected to cut costs, generate efficiencies, improve service and increase accountability? Likewise, there is little evidence of reorganization outcomes over time. Without evaluations, lessons that could be learned and applied to the next effort and shared among LAFCOs as best practices are lost.

Lacking reliable data to support reorganization proposals, LAFCOs and community leaders find themselves at a disadvantage to the politically and emotionally charged forces that often align in defense of the status quo.

LAFCO staff told the Commission that successful reorganizations, particularly where there is resistance, require a skilled facilitation process. Staff must be able to elicit the involvement of all of the parties that would be affected by the reorganization. They must be brought to the table and kept at the table throughout what can be lengthy and contentious processes. Disagreements must be mediated, resistance overcome and, where possible, consensus achieved. But there is no State or State-sponsored entity that LAFCOs can turn to for professional skill development and technical assistance they need.

Dana Smith, the Orange County LAFCO executive officer, described a mediated process between two districts in one city where the elected officials would not speak directly to each other, but only through the LAFCO staff. Due largely to the skills of the LAFCO staff, the process moved forward, common ground was identified and progress made on a consolidated infrastructure plan.

Many LAFCO staffs, however, lack the analytical and facilitation skills to effectively manage these types of actions. The LAFCO executive officer in Riverside County described a failed effort to dissolve a small retail water district within the boundaries of a larger municipal water district. To overcome opposition, he needed a detailed rate study that would better identify the costs of the current arrangements and potential savings of consolidation. The staff did not have the expertise. If a knowledgeable consultant had been available, he believes the outcome might have been different.³⁹

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Recently, there has been renewed interest in performance measurement in the public sector. Between 1989 and 1994, resolutions by the Government Accounting Standards Board, the National Academy of Public Administration, the American Society for Public Administration, and the National Governors' Association called for governments to institute systems for goal setting and performance measurement.⁴⁰

At the national level, the Government Performance and Results Act of 1993 requires strategic planning and performance reporting for all federal agencies.⁴¹ In California, state agencies are required to submit strategic plans to the Governor's office for approval. The Department of Finance will only consider budget change proposals when a state agency has an approved strategic plan. Performance measures to assess each agency's successful achievement of its mission, vision, goals and objectives are required components of the strategic plans.

But there is no expectation for local governments, including special districts, to measure performance – and most do not. A 1997 nationwide survey of municipal governments showed that 40 percent or fewer make any kind of meaningful use of performance measures in their management and decision-making processes.⁴² The Commission did not find comparable data for special districts, but the California Special Districts Association and Special Districts Institute report no knowledge of the significant use of performance measures by special districts.

One explanation is that many special districts do not know how to adequately develop and implement performance measurement, and the State has not required or assisted them in doing so.

Building Knowledge and Skills

To effectively advocate for change – especially in the face of opposition – LAFCOs and community leaders need to be armed with analytical tools and facilitation and mediation skills. Fortunately, California is home to a number of top public and private organizations dedicated to public policy research that could be tapped by the State to assist.

California Policy Research Center. The California Policy Research Center at the University of California (formerly the California Policy

Smart Growth

"Smart growth" is a concept for urban planning and development. It involves identifying and achieving community goals for how neighborhoods and cities grow. Smart growth strategies attempt to build on community strengths to achieve economic goals within environmental constraints.

Smart Growth involves:

- ✓ Regional Planning and Coordination
- ✓ Building on Community Strengths
- ✓ Supporting Creative and Entrepreneurial Efforts
- ✓ Integration of Economy, Environment and Equity

California's special districts – given their resources and competencies – could be integral partners in helping communities meet their development and quality-of-life goals.

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Seminar) was created to help inform some of the most important public policy issues facing California. The center works closely with the legislative and executive branches to analyze and help implement meaningful and innovative policies.

Center for California Studies & California Institute for Local Government. The Center for California Studies at California State University, Sacramento and the California Institute for Local Government at the University of California at Berkeley provide research assistance and leadership in addressing key local and state government public policy issues.

California Research Bureau. The California Research Bureau (CRB) conducts research and provides policy assistance to state policy-makers through reports, consultations, training and technical assistance. The California Policy Research Center has developed an initiative with the CRB to make their research more available to health and human services agencies. This effort could be expanded to provide the resources of their local government component to local policy-makers.

School/Law Enforcement Partnership

The School Law/Enforcement Partnership Cadre, sponsored by the Department of Education and the Attorney General, consists of 100 school safety experts from local education and law enforcement agencies. Cadre members provide technical assistance to other local educators and law enforcement officers at no cost to develop school safety programs. The Partnership pays for the travel costs of members and provides resource materials and training; their agencies make them available for Cadre activities 10 to 12 days a year. The Partnership is authorized by statute and paid for from the General Fund.

Additionally, the California Special Districts Association (CSDA) and the Special Districts Institute (SDI) offer training seminars on the management and operation of special districts. The California Association of Local Agency Formation Commissions (CALAFCO) sponsors an annual conference for LAFCO commissioners and staff. The conference provides opportunities for networking and subject-specific training on issues ranging from finance and planning to media relations. The association conducts one or two sessions per year on topics of current interest, where the subject of reorganization has been addressed.

The State could establish a program at one of these or other institutes, or through a partnership of organizations, to conduct research and establish programs to equip policy-makers with the tools necessary to adequately assess and guide the organization of local government. CSDA and SDI could cooperate with the institute to disseminate the information. Tools should assist policy-makers in the following ways:

- To know when to pursue special district reorganizations.*** LAFCOs and community leaders need information on the long-term outcomes of consolidations and other data to help them accurately

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identify and promote opportunities for reorganizations. So armed, they would be more likely to initiate and successfully complete reorganizations.

- ❑ ***To obtain training and technical assistance.*** LAFCOs need access to training and technical assistance to build the skills necessary to effectively facilitate actions involving special districts, and particularly to mediate difficult cases. A cadre of experts could be identified and made available to provide training, skill development and technical assistance to LAFCOs. The state School/Law Enforcement Partnership Cadre provides a model for training and technical assistance to local agencies.

- ❑ ***To implement performance measures.*** The day-to-day operations of special districts could be evaluated and improved through the use of performance measures. Most special districts provide real services that lend themselves to outcome measures that are meaningful to the public and which would provide the public -- and policy-makers -- with a way to gauge their performance. A research institute, working in cooperation with organizations representing special districts, could develop and disseminate standard performance measures for like special districts.

Health care districts in California are a good example of where LAFCOs and community leaders at large need to take a stronger leadership role. California has 24 health care districts that no longer operate hospitals. And LAFCOs have not assertively reviewed the need for these districts to exist, as is expected of them under the law.

If empowered in the ways described in Finding 2, and armed with reliable analytical tools as described in this Finding, LAFCOs and local leaders can become the catalysts for a more efficient evolution of special districts. The following pages explore this issue in depth.

Lake County

The Redbud Health Care District sold its hospital in 1997. The Lake County grand jury has recommended two years in a row that the district be dissolved. But district officials told the Commission that citizens of the district, public agencies, special districts, the Lake County Board of Supervisors and Clearlake City Council support the continuation of the district. The district derives all of its revenue -- \$400,000 annually -- from property taxes.

The county administrative officer said there are three paths to dissolution: Board initiated, LAFCO initiated or citizen initiated. County supervisors have decided they do not want to be responsible for initiating an unpopular action, preferring instead for the public to initiate the process.

The executive officer of the Lake County LAFCO said the reason he had not initiated the dissolution process is that he is a private attorney with other duties, and no staff or resources to conduct such a study. He said if the State wants LAFCO to conduct a study, the State should give LAFCO the funds. The Lake County LAFCO is an independent LAFCO with a \$16,000 annual budget.

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Ailing Health Care Districts

California has 74 health care districts, formed mostly in the 1940s and '50s to build and operate hospitals and deliver health care in rural areas. Twenty four of those districts no longer operate hospitals, but continue to exist. Most of them collect property tax revenues.

As health care financing changed in the 1980s and '90s, public hospitals – especially those in urbanizing areas -- found it hard to compete with the big health systems and hospital chains. Many struggling district hospitals made decisions to affiliate or merge with providers like Sutter Health and Tenet HealthSystems. They leased or sold their hospitals and redefined their missions to survive. Others, like the Los Medanos Health Care District in Contra Costa County, closed their hospital doors and ceased to provide services.

The Commission, with the assistance of the Association of California Healthcare Districts (ACHD), surveyed those districts by mail. The Commission asked districts how their missions had changed, whether they had considered dissolution, and requested financial information. Of the 24 districts, 1 responded to the survey. The remaining five districts failed to respond, even after repeated requests. The survey questionnaire is in Appendix C.

The Commission found the following:

District missions: Sixteen districts reported that they changed their missions after they ceased to operate a hospital. Two districts report they are evaluating their missions following the sale of their hospitals. One district's original mission included ambulance service, which it continues to provide.

Status of the hospitals: ✓10 were leased ✓7 were sold ✓2 were closed.

According to ACHD, of the five districts that did not respond to the survey, four have closed their hospitals and one sold its hospital.

Property tax revenues: Fourteen districts reported receiving property tax revenues in 1998-99 totaling more than \$17 million. Two districts did not respond to this question, but the State Controller's office reports that they received a total of \$1.5 million in property tax revenues in 1996-97. Of the five districts that did not respond to the survey, the State Controller's office reports 1996-97 property tax revenues for three of them, for a total of \$2.2 million.

Expenditures: Ten districts say they spend at least 75 percent of their revenue on direct services to their community, while four provide revenue to the hospitals they previously owned.

Current district roles: All of the districts that have sold or leased their hospitals described continuing oversight roles relating to the terms of the lease or sale. For example, they ensure the hospitals are well-maintained, that necessary licenses are maintained, that the hospitals are operated for the benefit of the community, and that residents with unmet health care needs are served.

Ten districts have at least one district board member on the corporate board of the hospital they leased or sold. All five board members from the Eden Township district serve on the board of the hospital sold to Sutter Health.

Some districts reported clearly the types of services they provide, including grants to local agencies and organizations. Others described health prevention and education services. For some districts oversight of the lease or sale was the only apparent function.

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Bloss Memorial and Del Puerto health care districts have closed their hospitals. Del Puerto's original mission included the operation of an ambulance service, which it continues to do. The district reports it is the only such provider in the area, serving approximately 20,000 residents. Notes to its 1999 financial statements indicate possible new services are in the planning and proposal stage.

The Bloss Memorial Health Care District reported that it operates three rural health clinics and a dental surgery center serving a population that is 90 percent Medi-Cal eligible.

- **Few districts have explored dissolution:** Fifteen districts reported that they have not considered dissolution. Two reported that dissolution was considered, and two have been the subject of grand jury reviews.

The Petaluma Health Care District reported that dissolving the district was discussed after the hospital was leased in 1997. But the board decided at its first meeting following the lease to focus on community health and services other than the hospital.

The Selma Health Care District reported that the board thought about dissolving the district, but abandoned the idea because it believes there are health care services it could provide. The district is considering providing teen pregnancy prevention and diabetes and other health education programs.

No district reported having been the subject of a LAFCO study or request to consider reorganization.

- **Two grand jury reviews:** Redbud and Camarillo Health Care Districts have been the subjects of county grand jury reviews. The Lake County grand jury recommended dissolution of the Redbud district, but local policy-makers are supporting the district and protesting the grand jury recommendation.

The Ventura County grand jury recommended the Camarillo district continue to exist. It did, however, find that property owners are not "fully cognizant" of their annual tax contribution used to support the district. The grand jury recommended that the district annually set forth in its publications the per capita tax contributions of property owners. It also recommended the district establish definitive guidelines for the accumulation and use of its reserve fund.

- **The Los Medanos Community Hospital District:** The Los Medanos district in Contra Costa County has been embroiled in a controversy over dissolution since the district went bankrupt and closed its hospital in 1994. While the board has remained split on dissolution, a citizen's Committee to Dissolve Los Medanos Hospital District has collected enough signatures to bring the issue before the LAFCO. Since the hospital closed, the district has continued to conduct board meetings and collects roughly \$1.5 million in property tax revenues annually. The district failed to respond to the Commission's survey and to subsequent requests for a response.

When questioned in November 1999 about the role of the Contra Costa County LAFCO in the controversy, the LAFCO executive director explained that she had been involved in "informal talks" regarding the district for several years. She considered the district to be inactive, but did not know what facilities it still owned or any other details of its operation. She stated: "In general, Contra Costa LAFCO considers initiation as a last resort." She explained that due to the board's position (divided on dissolution), LAFCO would not initiate a dissolution. "Hostile" LAFCO-initiated reorganizations, she explained, are often "politically messy and expensive."

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The Policy Debate

The questions posed by these districts are whether they are performing important functions and whether an independent government agency is required to perform them. If the functions are critical could a county department or non-profit agency perform the functions more efficiently? Supporters fear that if these districts are dissolved, the property tax revenues they generate will no longer be available to support important community public health needs.

Current Policy

Under current law, when a hospital district sells or leases 50 percent or more of its assets, the transfer must be approved by a majority of the voters in the district. But the vote on the sale or lease of the hospital does not involve a referendum on the fate of the district itself. In fact, most of the sale and lease agreements include provisions for a continued role for the district after the transfer of the hospital.

Dissolution under hospital district law (Health and Safety Code section 32121(p)(1)), unlike most other special district laws, requires approval by a majority of the voters within the district.

Dissolution can be initiated several ways: By citizens gathering signatures from registered voters; by LAFCO if it conducts the required study; or by the elected officials of the county or city in which the hospital exists. The Commission found no examples of LAFCO-initiated hospital district dissolution; a health care district in Needles is the only district to be put out of business by voters.

Depending on the circumstances, dissolution proposals could include the following:

- ✓ Identification of a successor agency such as the county, which would perform ministerial functions associated with debt payments, lease and sale agreement oversight, or provide health-related services previously provided by the district. In these cases, property tax received by the district would be reallocated to the successor agency providing the services.
- ✓ Dissolution of the district, but with no successor agency. In these situations the law requires that the property tax be returned to the State and reallocated by the State. The State is not required to reallocate the property tax to the area previously served by the district or to the respective county. Furthermore, there is no requirement that it be earmarked for health care services.

Few Incentives Exist to Dissolve Hospital Districts

Under current policy, there is little incentive for citizens or policy-makers to initiate the dissolution of a hospital district, even when it no longer operates a hospital. Knowing that the property tax dollars will be returned to the State citizens are unlikely to initiate a dissolution. Likewise, policy-makers have little or no incentive to pursue potentially unpopular actions that would either: 1) result in property tax revenue being returned to the State, or 2) even if they could keep the revenues locally they would have not have much flexibility about how it should be spent.

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Evaluating Alternatives

When a health care district ceases to operate a hospital, it may indeed be time for the district to disappear. There may be instances where the unique circumstances and needs of the community argue against dissolution. But two missing elements prevent a case-by-case review: 1) objective information to enable policy-makers and the public to make informed decisions about whether the district should continue and, 2) incentives for the public and policy-makers to pursue reorganization of these entities.

- Information is needed.** Policy-makers and the public need information to permit them to understand what would be gained and what would be lost as a result of the dissolution of a district. A review that would provide answers to the following questions could facilitate that understanding:
 - ✓ What savings would accrue from the elimination of the elected board, including meeting stipends and other benefits, and overhead expenses?
 - ✓ What services would potentially be eliminated and how important are those to the community?
 - ✓ What other entities in the community could provide the services and at what cost?

- Incentives are needed.** For policy-makers and the public to expend the time and resources to dissolve a hospital district, especially in light of the vote requirement, incentives are needed. The most powerful incentive could be the knowledge that the revenue would remain locally, to be allocated according to the needs and desires of the community.

Currently, for a county to retain property tax revenue from a dissolved district with no successor agency, specific legislation must be enacted. Few counties go to the trouble. To provide an incentive for scrutinizing these districts, the State could change the law to return all or a portion of the property tax revenues to counties upon the dissolution of a special district.

Recommendations for Reform

The recommendations in this report would provide the scrutiny necessary to determine if these districts should continue or be dissolved. These recommendations, applied to hospital districts, would:

- Require LAFCO review.** As recommended in Finding 2, when the fundamental mission of a special district changes – such as when a hospital district sells, leases or closes its hospital – LAFCOs should be required to initiate a process to determine if the district should continue to exist.

- Create analytical tools.** As recommended in Finding 3, the State should develop a specific methodology for assessing which of these hospital districts should be dissolved and how remaining functions could be more efficiently administered.

- Create Incentives.** As recommended in Finding 5, the State could offer incentives for communities to reorganize districts that no longer operate hospitals. State legislation could return property tax revenues to counties upon the dissolution of a health care district that has no successor agency.

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Summary

Policy-makers and community leaders need analytical tools to help them assess the performance and organization of local government and to successfully identify and advocate for reorganizations when they are supported by the evidence. And they need access to training and technical assistance to successfully facilitate special district reorganizations. Research institutes such as the California Policy Research Center, and other public and private organizations, have the expertise to assist the State. They could develop and deliver reliable information and strategies to assist policy-makers and community leaders to make the best decisions and guide local government in the 21st Century.

Recommendation 3: To equip policy-makers and the public with the tools necessary to assess and guide the organization of independent special districts, the Governor and Legislature should establish a program at the California Policy Research Center, or similar institute, to do the following:

- Develop guidelines and protocols for special district consolidations.** The consulting research center should conduct research to identify conditions when consolidation or reorganization of special districts will result in cost-savings, improved service and other benefits.
- Study the long-term outcomes of consolidations and reorganizations.** The consulting research center should review and quantify the long-term outcomes of special district consolidations and reorganizations.
- Establish a cadre of trainers.** The consulting research center should establish a cadre of experts to provide training and technical assistance to LAFCOs, enabling them to perform periodic reviews and analyze and facilitate special district consolidations. They could also be called to advise in instances where conflicts arise between special districts and their customers.
- Develop performance measures.** The consulting research center, in cooperation with the California Association of Local Agency Formation Commissions, California Special Districts Association and Special Districts Institute, should develop and encourage special districts to establish and report performance measures as a means of building public understanding and support.

UNDERSTANDING SPECIAL DISTRICT RESERVES

Understanding Special District Reserves

Finding 4: Hundreds of independent special districts have banked multi-million dollar reserves that are not well publicized and often not considered in regional or statewide infrastructure planning.

Independent special districts reported more than \$19.4 billion in reserves to the State Controller in 1996-97, the most recent year for which this information is available. These retained earnings represent nearly 2½ times the annual gross revenues of these districts. These enormous public resources also are largely unknown and unexamined by the public or policy-makers, and are often not considered in statewide or regional infrastructure planning and financing. Enterprise districts – those districts that collect fees for services – hold most of the reserves. Special districts should be required to aggressively publicize their reserves and policy-makers should integrate them in infrastructure planning. Guidelines for the accumulation and use of prudent reserves should be established.

Financially Autonomous Governments

Independent special districts are financially autonomous units of local government with the same governing powers as other local governments. They can enter into contracts, acquire real property and issue debt. Enterprise districts can charge fees for their services.

And most special districts – enterprise and non-enterprise – establish reserves. While all districts operate under statutory authority, there are no specific provisions in district laws that govern the accumulation and use of reserves. Furthermore, there are no formal guidelines or widely accepted standards to guide special districts in the accumulation and use of reserves. Some districts establish formal reserve policies. But others do not, and make decisions year-to-year about how much money to bank.

Districts report reserves in annual financial statements to county auditors and in reports to the State Controller. Most districts prepare those reports using the Generally Accepted Accounting Principles (GAAP) for local governments, which describe in detail what is to be reported and how it is to be reported.

In the aftermath of the Orange County bankruptcy, the State required each county to establish an investment oversight committee to monitor

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county investment policies and practices. But no similar entity scrutinizes the investment practices of a county's independent special districts. Nor is there any oversight by the State. Legislation has been proposed that would require all local government agencies to annually submit their investment portfolios to the California Debt Advisory Commission in the State Treasurer's Office.

State law does prescribe the types of investments that local government agencies – including special districts – are permitted to participate in, and requires that they establish and annually review investment policies.⁴³ Among the types of investments allowed by law are treasury notes, federal agency paper, short-term IOUs, money market funds, and state and county investment pools. According to the State Treasurer's Office, much of the money invested by local public agencies, including special districts, is held in the state Local Agency Investment Fund (LAIF) and county investment pools. And while the law permits some discretion by local governing boards, the Treasurer's Office believes that most districts, in the wake of the Orange County bankruptcy, tend to "err on the side of the conservative" in their investment practices.⁴⁴

How Districts Report Reserves

Enterprise Districts

In financial statements and reports to the State Controller, enterprise special districts report the difference between revenues and expenditures as fund equity. Fund equity, in turn, is divided into contributed capital and retained earnings. A district's retained earnings represent the equity that it derives through fees and charges from the provision of services. Contributed capital is equity obtained from other sources, such as facilities developers have built and contributed to a special district.

Retained earnings can include funds that districts designate as "restricted," for example, to bond debt service; funds restricted by the board for capital projects; and funds otherwise restricted, sometimes legally committed, for a specific purpose. It can also include "unrestricted" funds for which there may be tentative plans or no plans. "Reserves," as used in this report for enterprise districts, represents those funds identified in reports to the State Controller as retained earnings. It does not include equity reported as contributed capital.

Non-enterprise Districts

Non-enterprise districts report the difference between revenues and expenditures as fund balances. In governmental accounting, the fund balance includes the broad categories "reserved" and "unreserved" – with some subcategories within each. "Reserved" funds are set aside because the district has entered into a commitment in which it is obligated to make payment once a vendor or contractor delivers a product. "Unreserved" fund balances are not obligated and include "designated" and "undesignated" funds. "Unreserved designated" fund balances are those funds that have been set aside for a specific purpose, but where there is no binding agreement that the funds be spent for that purpose. "Unreserved undesignated" funds are those funds for which there is no committed or planned use. As used in this study for non-enterprise districts, fund balances include "reserved" and "unreserved" fund balance categories.

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Proposition 218, passed by the voters in 1996, provides that property-related fees – e.g. fees for water, sewer and refuse collection – may not exceed the cost to provide the service. And fee revenue may not be used for any purpose other than providing the property-related service. Taxpayer groups assert that Proposition 218 was intended in part to prevent districts from setting fees so high that large reserves can accumulate. Alternatively, the Legislative Analyst's Office has asserted that fees that vary depending on usage, such as water, are not property-related fees and therefore are exempt from the provisions of Proposition 218.⁴⁵ The Attorney General's office also has issued opinions interpreting the Proposition, but the legal issues have not been settled. The Controller's data, however, show that reserves of many enterprise districts are growing, indicating the revenue may be exceeding the cost of providing service.

Reserves Are Not Well-Known to the Public

The financial autonomy of special districts, the lack of guidelines for the accumulation and use of reserves, and the existing reporting mechanisms present several problems for the public and policy-makers.

1. Some reserves appear unreasonably large.

Because district financial information is not widely disclosed or easily understood, the public and policy-makers are largely unaware of the existence and purposes of the reserves held by special districts. Some districts have amassed huge surpluses, often in multiple reserve funds. A former assistant county administrator and budget officer told the Commission: "I am astounded by the size of some reserves in cities and special districts."⁴⁶

The Metropolitan Water District of Southern California, for example, reported retained earnings of \$4,046,288,932, as of June 30, 1999. The district told the Commission that its retained earnings are a component of its total equity and reflect the accumulated earnings of an enterprise fund since the district's inception in 1929. The district's operating revenues for the year ending June 30, 1999 were \$708,881,000. The district's retained earnings equaled 571 percent of its operating revenues for that period. The table in Appendix D provides information from the State Controller's Office on the 25 enterprise districts with the highest retained earnings in 1996-97.⁴⁷

The troubled Water Replenishment District of Southern California exemplifies the problem – and the consequences – when a district's reserve policies do not reflect community sentiment. Authorized to replenish the groundwater in two major basins in Los Angeles County,

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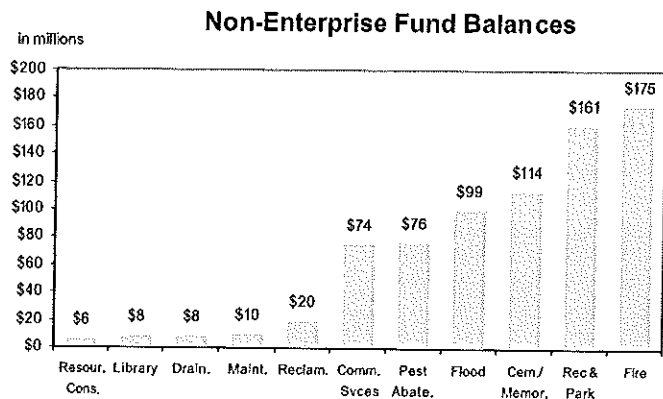
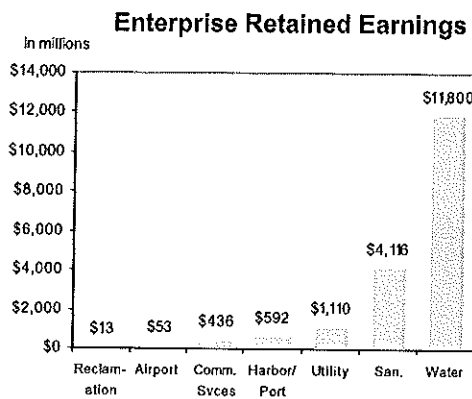
the district collects assessments from the 43 cities that pump groundwater from the basins. With no requirement for disclosing financial information in a way that is easily understood, the district over 10 years accumulated \$67 million in unreserved fund balances, an amount equal to 164 percent of its 1996-97 gross revenue.⁴⁸

In challenging the district's business practices, officials of the cities served by the district were astounded to learn the size of its reserves. The district is the subject of a critical report by the State Auditor, has been sued by the cities it serves, and has spent hundreds of thousands of dollars defending its activities in what district officials describe as "war."

The WRD is a telling example of the consequences of policies that permit districts to operate in obscurity. The district, however, is not the exception among enterprise districts when it comes to large reserves that have not been publicly scrutinized.

The State Controller's statewide special district financial data for 1996-97 shows:

Independent district retained earnings and fund balances:	\$19.4 billion
Enterprise district retained earnings:	\$18.2 billion
Non-enterprise district fund balances:	\$ 1.2 billion
Number of districts reporting reserves in excess of \$1 million:	645
Districts reporting reserves that exceed annual gross revenue:	1,343
Districts reporting reserves at least triple annual gross revenue:	592



Source: State Controller, data for enterprise district retained earnings and non-enterprise district fund balances. 1996-97 fiscal year.

2. District resources are not integrated into infrastructure planning.

Special districts are not required to participate in the development of county or city general plans or to cooperate and coordinate their activities with neighboring local governments.⁴⁹ And despite a renewed

UNDERSTANDING SPECIAL DISTRICT RESERVES

interest in regional cooperation and headway in some areas of the state, many special districts still tend to pursue their own agendas, often focusing on parochial issues. As a result, special district finances and activities are often unknown to other policy-makers and not integrated in local, regional or state infrastructure planning and financing.

As a state, California faces an enormous infrastructure bill. The rising costs are driven by the growing population, the increasing price of land, and demands for new types of infrastructure – from computer networks in schools to treating polluted runoff. Consider:

- ✓ The Department of Finance estimates unmet capital outlay needs at \$40.4 billion over the next 10 years. That estimate does not include transportation. But it does include \$18.2 billion in local projects that may require state funding.⁵⁰
- ✓ The California Business Roundtable estimates transportation needs at \$15-25 billion over the next 10 years.⁵¹
- ✓ The Legislative Analyst has raised concerns that the State will have increasing difficulty financing state infrastructure projects if it continues to finance local projects. Two-thirds of the \$35 billion in state general obligation bonds approved by voters since 1986 have been for non-state facilities.⁵²

While efforts are underway to understand California's infrastructure needs, the State has not comprehensively assessed the public infrastructure and developed long-term plans for building and maintaining those projects. Similarly, communities and regions do not have an integrated process for assessing community infrastructure needs, identifying resources available for financing those needs, and putting together plans for building and maintaining that infrastructure.

Enterprise special districts play an important role in providing infrastructure to their communities. The issue is whether, given their financial resources, they could play an even larger role, and whether they should ever turn to the state for financial help.

Probably the most common reason why enterprise districts say they need large reserves is to pay for capital projects associated with building or renovating infrastructure. But the role and resources of these districts are often not adequately considered

Water District Retained Earnings

Water districts reported \$11.8 billion in retained earnings in 1996-97, representing 65 percent of the retained earnings of all enterprise districts.

In 1996, California voters passed Proposition 204, the "Safe, Clean, Reliable Water Supply Act," a nearly \$1 billion water bond measure.

In March 2000 another \$1.97 billion bond measure known as the "Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bond Act" was passed by voters.

Neither measure was crafted to consider the resources already available to water districts. The measures do not prevent districts with large reserves from tapping the funds. And some projects funded by the bond measures will benefit districts with reserves or the capacity to raise their own infrastructure funds.

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in discussions about how the state should meet its infrastructure needs and which projects should receive state support. Similarly, in many communities, the resources of water and sanitation districts are not considered in discussions of related water quality projects.

Coachella Valley County Water District

The Coachella Valley County Water District, an independent enterprise district in Riverside County, reported \$643,684,000 in retained earnings to the State Controller in 1998-99, including \$485 million in infrastructure. The district's gross annual revenue that year was \$46,885,000. In 1996-97 it ranked in the top 25 enterprise districts for retained earnings. Self-described as the most diversified water district in the state, it is a Colorado River and State Water Project contractor, a domestic water retailer, performs groundwater management, sanitation, irrigation, flood control and drainage functions.

When asked to describe its reserves, district staff identified more than 25 separate funds designated as restricted reserved. They included funds designated for construction, capital improvements, system replacement, water importation, emergency repairs, debt service to the State Water Project, and others. Asked if these various funds and their purposes could be readily identified in a review of the district's financial statement, staff stated they could not. The district does not have a written policy on the accumulation and use of reserves.

The executive director of the Association of California Water Agencies, for example, argued for support of Proposition 13 on the March 2000 ballot: "As the supply and quality of California's water move closer to the brink, investments such as Proposition 13 become increasingly urgent priorities for the entire state. Our water, our economy and our way of life face serious impacts unless California takes action immediately."⁵³

When lawmakers and voters approved this measure they committed future taxpayers to the costs of paying off the bonds. For Proposition 13 bonds the State will make principal and interest payments from the General Fund for about 25 years, with average annual payments of about \$135 million.⁵⁴ Given the enormity of the obligation, the resources of enterprise districts should be known to the public and policy-makers as they craft proposals and deliberate the fate of these measures.

3. Special district reserves are obscure.

Financial reporting rules do not require information to be presented in ways that would provide for the public or policy-makers to understand or scrutinize how districts use public funds in general, and reserves in particular. As described in Finding 1, financial information is neither easily understood nor widely distributed to the public and policy-makers.

For example, when the chief financial officer of a large water district was asked if he thought the public could understand the district's financial statement or budget, he replied: "It is rare that the public can interpret the numbers."⁵⁵ He added that even the district's board was unable to understand the documents. To facilitate the board's understanding, the district began providing additional detail in attached "notes" to the financial statement. But no such help was provided for the public.

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Additionally, the Commission was told that there is too much “wiggle room” in the established accounting rules. Specifically, the accounting rules allow for inconsistent treatment of contributed capital and manipulation of reserve reporting.⁵⁶ As an example, one district’s financial statement showed retained earnings of \$2 million, while in fact the district had \$3.5 million in cash. The flexibility in the accounting rules, which allows districts to record developer fees as revenue, where it shows up in retained earnings, or to record it as contributed capital where it does not, accounts for the discrepancy in this case. The accounting rules will change in 2003 to address this specific problem.

4. There are no guidelines for prudent reserves.

Some special districts establish formal reserve policies, while others do not. Among districts that do have policies, there is a wide variation of what is considered appropriate. The Commission talked with 10 enterprise districts that rank in the top 25 among all enterprise districts for retained earnings. Five of the districts reported that they have reserve policies, while five reported that they do not. When asked how long it took them to accumulate their retained earnings, all of the districts reported that retained earnings had accumulated since the formation of the district.

Four districts illustrate the variations in reserve policies that exist in the absence of guidelines.

- **Central Contra Costa Sanitary District.** The Central Contra Costa Sanitary District provides wastewater treatment and sewer services to 425,000 residents in central Contra Costa County. It has a board-approved policy that targets 10 percent of the district’s annual operating expenses as a prudent reserve for extraordinary expenses. In 1999-2000, district reserves are budgeted to be \$4 million. Operating expenses are budgeted at \$34.4 million – resulting in a reserve just under 12 percent. The district has established 75 percent of one year’s capital expenditures as the target reserve to support capital project expenditures. In 1996-97, the district’s retained earnings were 427 percent of its annual gross revenue of \$50,322,689.

- **Irvine Ranch Water District.** The Irvine Ranch Water District provides domestic and reclaimed water to 150,000 residents in 123 square miles of Orange County. The district told the Commission that its replacement fund comprises a good portion of its reported retained earnings. However, the district could not tell the Commission an approximate dollar amount in that fund. The assistant to the general manager was also unable to provide the

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Commission with an established informal or written board policy on reserves. The district's 1996-97 retained earnings represented 361 percent of its 1996-97 gross revenue of \$77,399,000.

- ***Moulton-Niguel Water District.*** Moulton-Niguel provides water and sewer services to 151,000 residents in 36 square miles of Orange County. Moulton-Niguel's chief financial officer identified seven separate funds designated as restricted reserved, totaling \$58.4 million. The district has \$161 million in unrestricted reserved funds, including some depreciation on infrastructure and other non-cash balances. The chief financial officer said the district has no policy on the accumulation and use of reserves. The district controller described a long-range plan that is reviewed annually or biennially. He stated that \$22 million is reserved for future infrastructure and growth, some of which is earmarked for specific projects. Moulton Niguel's retained earnings comprised 381 percent of its 1996-97 gross revenue of \$56,749,289.⁵⁷

- ***Water Replenishment District of Southern California.*** The Water Replenishment District serves 3.5 million residents in 420 square miles of southern Los Angeles County. It provides primarily ground water, with additional recycled and storm water sources. The State Auditor found that while the Water Replenishment District had a reserve policy, it was not a prudent one. The district consistently overestimated the amount of water it would need, the Auditor said, thereby inflating the estimated cost for replenishment activities. It purchased less water each year than it originally estimated, but in setting rates for subsequent years, it did not take into account the savings from the previous year. As a result, reserves continued to increase.⁵⁸ In 1996-97, the district's retained earnings represented 120 percent of its annual gross revenue of \$40,892,140.

Overcoming Autonomy and Diversity

Independent special districts are both autonomous and diverse, and scrutiny of their prerogative to establish and maintain reserves is largely unwelcome. Taken together, these factors have conspired to deter examination and solutions. The Commission solicited input from special district officials, city government officials, and others to explore potential remedies. The Commission found that responses are needed on several fronts.

1. Developing solutions to particular problems.

The WRD controversy put a spotlight on special district reserves and spurred discussion about ways to address its problems specifically, and

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special district reserves generally. Implementation of the reforms detailed in Finding 1 would make the financial activities and reserves of all districts more visible and, over time, could prevent abuses and excesses.

However, where abuses or excesses are identified, the first and preferable alternative is for community leaders and district officials to work together to resolve problems. Solutions should include the implementation of policies for the prudent accumulation and use of reserves.

Where local efforts to resolve problems fail, intervention by the State is often the next step. But that intervention is always costly and contentious. In the case of the WRD, the State Auditor told the Joint Legislative Audit Committee that an examination of the district would cost state taxpayers at least \$87,000. In addition, the district has employed numerous lobbyists, lawyers and others to defend its policies and practices – costs ultimately borne by those it is suppose to serve.

The State Auditor recommended the district establish a reserve limit that the district disagreed with. In response, legislation has been proposed that would specifically prohibit WRD from imposing charges on its customers if its reserves exceed the \$10 million recommended by the State Auditor.⁵⁹

In the course of its study the Commission also received recommendations for another way to address the specific problems presented by the WRD. Neighboring water districts and the Southern California Water Company recommended that the governance structure of the WRD be modified to include representation on the board by water professionals of its major groundwater extractors. Legislation has been introduced to implement this reform. Additional public resources are sure to be expended by those advocating for these reforms and by the WRD in defending the status quo.

The Southern California Water Company also told the Commission that no organization needs a reserve the size of the WRD's, but acknowledged that among special districts WRD is not alone in accumulating and maintaining large reserves. The water company, and others, encouraged the Commission to explore the issue further.⁶⁰

2. Determining and requiring prudent reserves.

In examining the issue of reserves, the Commission questioned why special districts need reserves, the purposes for reserves, and how guidelines for prudent reserves could be established.

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Interviews with district financial staff illuminated some of the rationale for maintaining these funds, and the different reserve categories that are used. Reserves are used to pay for or contribute to the costs of planned capital projects, to repair and maintain infrastructure, to purchase equipment, to cover emergencies, to provide a cushion for lean economic times and to cover debt obligations.

Unable to identify principles or accepted standards for establishing reserves by special districts, the Commission queried district and local government officials and their representatives about current practices and what they regard as advisable.

The general managers of the South Coast and El Toro water districts cite targets of 5 to 10 percent of annual operating expenses. When asked to describe common practices regarding reserves, they said district practices vary widely.⁶¹

For comparison, the League of California Cities said there are no benchmarks, industry standards or good recommendations for the accumulation and use of reserves by cities. League officials said that each city determines its policy and practice based on its financial strength (what it can afford) and its political will (what is acceptable to the public). The League said reserve policies and practices range from targets of zero to 25 percent of annual operating expenditures in the

general fund; but they are aware of districts with reserves of 50 and even 100 percent. Officials described a 3 to 5 percent target among “a lot” of cities, and “many” with targets between 5 and 25 percent.⁶² Reserves, as so described, would not include funds legally restricted to specific purposes or designated for capital projects, for instance.

The most frequently cited reason for the lack of guidelines, and the justification for not establishing them, is the diversity among special districts. What is prudent in one district may not be prudent in another, it is argued. For example, the need for reserves can depend in part on where the district is in its evolution. A young district with the expectation of

expansive growth and capital improvements may need greater reserves than an older, built-out district whose expenditures are primarily maintenance and replacement. The need for reserves is also predicated on a district’s revenue certainty or uncertainty.

These arguments have merit, but they do not justify the current absence of guidelines that, coupled with the obscurity of many districts, nurture

GFOA Fund Balance Guideline

The Government Finance Officers Association recommends that governments develop policies “to guide the creation, maintenance, and use of resources for financial stabilization purposes.” It states that policies should establish how and when a government accumulates reserves and identify the purposes for which reserves may be used. It suggests that identifying minimum and maximum reserve levels may be advisable.

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environments ripe for abuse. Furthermore, enterprise districts have the ability to charge fees, making them less vulnerable to economic downturns and revenue uncertainty. It could be argued that they have less need for large reserves than districts without the ability to charge fees and, when necessary, raise fees to cover the cost of services.

Two efforts to define prudent reserves for cities may inform similar efforts for special districts:

- **Analysis of reserve policies among cities.** Anita Lawrence, the finance director for the City of Camarillo, has long been concerned about the reserves held by cities. She told the Commission that cities are floundering when it comes to establishing policies on reserves.

She has surveyed cities with populations between 10,000 and 200,000 to identify their reserve policies and the criteria used to establish the policies.

Her preliminary analysis showed that when establishing reserves, several key elements were important: Cash flow, vulnerability to natural disasters, exposure to economic uncertainty, and potential impacts of state and federal actions. She agrees that the circumstances of individual entities should be considered, as well as the political attitudes of the community and governing body. She is adamant, however, that guidelines can and should be developed.

She expects to publish her findings in the Summer of 2000 and anticipates that they may be applicable to special district governments, as well.

- **City of Lake Forest.** The city of Lake Forest was concerned that despite efforts since its incorporation in 1991 to establish reserves, it still did not have any target level or goal. City leaders initiated a study in 1997 to try to answer the question: "How much should the city keep in its general fund reserves?"

Using the financial data of cities that had received awards for their budgeting practices from the Government Finance Officers Association, the study compared the city's revenue data with that of other cities nationally, statewide and within Orange County, with similar revenue and population characteristics.

International City Managers Assn.

The International City Managers Association comes at the problem of reserves from another angle. It recommends assessing the fiscal health of city governments in terms of solvency, and defines a city government as solvent if it meets the following criteria:

- ✓ It has sufficient incoming revenues to pay its bills for a year.
- ✓ It has three months of operating expenses in reserve.
- ✓ It is program solvent, meaning it can continue to provide services for current and expected growth.

Source: Thomas Gardner, Director, Vitetta Group.

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The study revealed that in all instances Lake Forest had a much higher percentage of reserves (76 percent of general fund revenues) than the average for cities in its category (20.4 percent). Based on the findings, it was recommended that the city establish its target general fund reserves at 30 percent of revenues.

A like methodology, using special district budget information available from county auditor controllers could provide important information about reserve practices among enterprise special districts, allow for comparison among districts, and advance necessary public dialogue about what is prudent.

The information and insights gained from the experiences of city governments may be instructive for policy-makers wrestling with how to determine and implement guidelines for special district reserves.

3. Making reserves visible.

As with special district finances generally, the biggest problem with reserves is that the public and policy-makers do not know about them. To hold districts accountable, prevent costly controversies and plan for infrastructure, the public and policy-makers need information about special district reserves – just as they do about other aspects of their finances and activities. While district officials should determine what is “prudent,” that judgement also should be made by community leaders and the public.

The State could enhance the visibility and understanding of district reserves by requiring that they be publicized in ways easily understood by the public. Reserve information, like other district financial data, should be easily accessible and routinely provided to the public and policy-makers. It should be highlighted in budget presentations at district meetings and meetings of city councils and boards of supervisors. It should be received by LAFCOs and state legislators, and available on Web sites as described in Recommendation 1. To make reserves easily understood, individual fund categories and their purposes should be clearly identified and explained in financial reports tailored to the needs of the public and policy-makers.

4. Integrating reserve information in infrastructure planning.

Some districts have been criticized for impeding effective regional planning and have exempted themselves fiscally and programmatically from the process. To make it possible for district reserves to be considered in local, regional and statewide infrastructure planning, the public and policy-makers must first be aware of the reserves and their prospective uses.

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The next step is to ensure that districts and their resources are in fact integrated in infrastructure planning and financing. In some cases, there may be infrastructure needs that can be met by districts if their missions or boundaries were expanded. In other cases, the customers of special districts may be the direct beneficiaries of regional or state infrastructure projects, and so those districts should contribute to the costs of projects. At a minimum, general-purpose governments, regional planning agencies and state policy-makers need to assess the resources of districts prior to developing bond measures and other infrastructure plans.

While potentially controversial, policy-makers must be fully aware of and consider the reserves held by special districts as they fashion comprehensive plans to meet the state's infrastructure needs. As agents of the State, special districts and their resources should not exist in isolation and obscurity.

Summary

Democracy demands that the public and policy-makers have access to information that permits them to understand and assess the operation of all levels of government. This is especially true when the entities control significant public resources. Special districts, particularly enterprise districts, must be required to make information about their reserve funds visible. They must be required to participate with and have those resources considered by the public and policy-makers as they build California's future. The following reforms would help prevent costly controversies and minimize expensive and time-consuming responses to individual problems.

Recommendation 4: The Governor and Legislature should enact policies that will ensure prudent management of special district reserve funds and incorporate these resources into regional and statewide infrastructure planning. Specifically, the State should require:

- Districts to publicize their reserves.*** Districts should be required to clearly identify and publicly report, in terms understandable to the public, the size and purpose of reserves and how they are invested. The information should be included in budgets and audited financial statements, highlighted on district Web sites, reported to boards of supervisors and city councils and sent to customers, as described in Recommendation 1. Special districts also should be required to adopt and publicize policies for the accumulation and use of reserves by the district.

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- ***Policy-makers to integrate enterprise district reserve information into infrastructure planning.*** The services and assets of enterprise districts should be included in regional and statewide infrastructure planning. To this end, special districts should be required to coordinate their activities with other districts and general-purpose governments and to participate in the development of county general plans.

- ***Guidelines for prudent reserves.*** The Governor and Legislature should appoint a panel including experts in finance, management and government, and community representatives, to recommend guidelines for establishing and maintaining prudent reserves by special districts. The panel also should review the investment policies and practices of districts and determine if additional oversight is warranted.

PROPERTY TAX ALLOCATIONS TO ENTERPRISE DISTRICTS

Property Tax Allocations to Enterprise Districts

Finding 5: Property tax allocations to some enterprise districts create inequities among districts and distort the true costs of services. A significant portion of the property tax allocated to all enterprise districts subsidizes districts with the highest reserves.

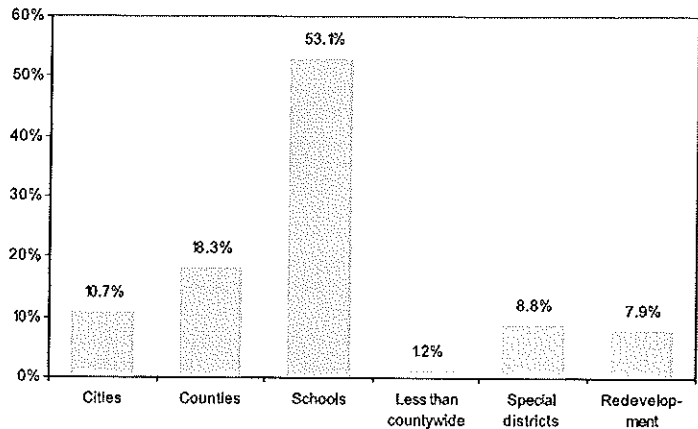
Enterprise special districts that levied property taxes on their customers before Proposition 13 was enacted in 1978 continue to receive a portion of the property tax revenues that are now allocated by the State. The policy of sharing property tax revenue with some enterprise districts made sense immediately after Proposition 13 – which cut tax rates and severed the link between specific taxpayers and specific government agencies. With property tax revenue pooled at the State, there was some logic to divide it among agencies that historically received it. That policy, however, makes less sense with each passing day.

In 1996-97, enterprise special districts received \$421 million in property tax revenue. A sizable portion of that revenue – more than \$100 million – went to 15 enterprise districts that also had some of the largest reserves.

One consequence of this policy is the inequity among districts offering similar services. To some degree, all taxpayers are effectively subsidizing the services received by the customers of districts receiving property tax revenue. The policy also raises questions about the allocation of scarce resources among all agencies providing local services. Property tax revenue that goes to enterprise districts is not going to public safety, parks and recreation, libraries and other “non-enterprise” community services that cannot recover their costs through fees. Many of those districts struggle to provide services with declining resources.

The State should reconsider the allocation of property taxes to enterprise districts generally, and should specifically examine those districts that receive property taxes and have large and growing reserves.

Property Tax Allocations, 1997-1998



Source: Senate Committee on Local Government (1999), page 8.

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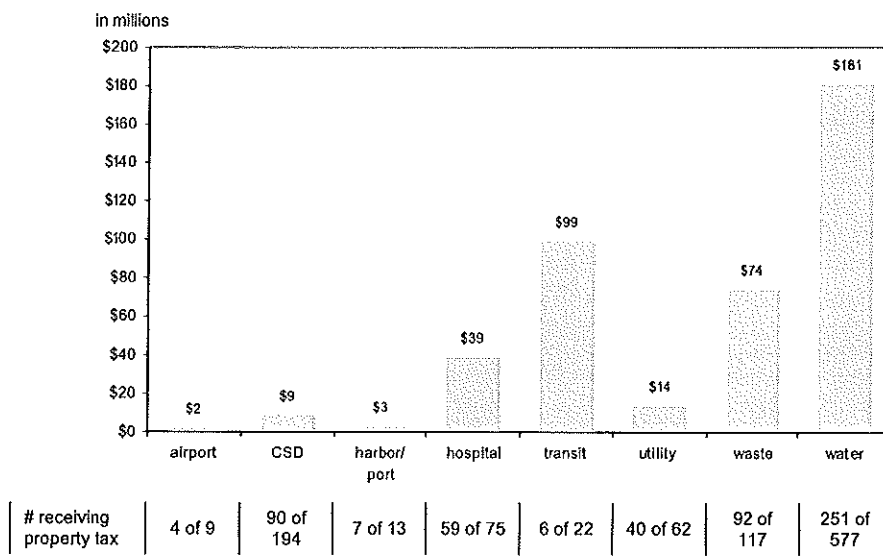
Historical Formulas

Property owners in California pay more than \$20 billion in property taxes each year, making these revenues the third largest source of tax revenues in California.⁶³ For public agencies, property taxes are a coveted source of revenue because of their predictability and relative stability over time. Policy-makers, however, continually grapple with issues of property tax equity, control and reallocation.

The Legislature, as authorized by the California Constitution, allocates property tax revenues to counties, cities, special districts, redevelopment agencies, community college districts and schools. The property tax base and tax rates are prescribed by the Constitution, while state statutes guide the allocation of the revenues. The allocation formulas are based on numerous statutes created over the years to address the impact, first of Proposition 13, and later, of the Educational Revenue Augmentation Fund (ERAF), which was created during the fiscal crisis of the early 1990s. The allocation system is commonly referred to as “AB 8,” after the legislation (Chapter 282, Statutes of 1979, L. Greene) that implemented the system. Schools, a state responsibility, receive 53 percent of all property tax revenues.

Allocations of the 1 percent property tax rate to special districts are based on policies adopted by the Legislature in the weeks following the passage of Proposition 13 in 1978. At that time, remaining property tax revenues were allocated based on shares of the property tax that agencies received from 1975-1978.⁶⁴ Those agencies that had levied

Property Tax Allocated to Independent Enterprise Districts



Source: State Controller, 1996-97 Property Tax Data, on file.

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higher rates to provide enhanced services prior to the passage of the initiative captured and continue to receive higher revenues. Agencies that levied lower or no taxes received lower or no revenues. The allocation formula, which cemented the differences in place, continues today. In 1997-98, special districts received 8.8 percent of property tax revenues.⁶⁵ Independent special districts received \$437 million in 1996-97 – \$420.6 million was allocated to enterprise districts and \$16.7 million to non-enterprise districts.⁶⁶

The Legislature in 1987 recognized the inequity created by the formula and shifted some property tax revenue from counties to cities that previously received little or no property tax revenue. Policy-makers, however, did not include special districts in that reallocation of revenue.

Allocation Formulas are Outdated

The allocation of property tax revenues is difficult to administer and understand, complicating the work of policy-makers and confounding taxpayers. Formulas for allocating property taxes enacted in the late 1970s often fail to reflect the contemporary needs and desires of local communities. Formulas are now locked in place that provide subsidies to some districts, prevent others from delivering services that the public wants, and preclude understanding by the public of what their property tax buys and from whom.

The Legislature – in enacting AB 676 (Brewer) declared that California's system for allocating property taxes is "seriously flawed."⁶⁷ It stated that the system does not reflect modern needs and preferences of local communities, or the relative need for funding by cities, counties, special districts, redevelopment agencies and schools to deliver their mandated and discretionary services.

Special districts are an important part of the growing debate over how to revise tax structures to improve the control by local communities of local resources and how to improve accountability of government to taxpayers. One issue is the role of independent special districts in providing specialized services. Revenue flowing to a district dedicated to a single purpose – such as abating mosquitoes – is not easily reallocated to other public health or even broader community needs. A second factor is that some districts can charge fees for services while others cannot. Among the resulting problems:

- ***Inequities among enterprise districts.*** In 1996-97, 562 enterprise districts received \$421 million in property tax revenue. Ninety-two of those districts received at least 25 percent of their gross revenue from

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property taxes. The remaining 549 enterprise districts had to rely entirely on fees – such as water and sewer rates – to cover the costs of providing service.

Prior to Proposition 13, districts could choose to assess higher property taxes on their particular customers rather than raise rates, and often did to pay off bonds used to finance capital projects. Proposition 13, however, rolled back property taxes to a uniform 1 percent of assessed value and limited the rate at which the valuation can be increased for tax purposes.

In the wake of Proposition 13, state policy-makers decided to distribute property tax revenue based on what districts historically collected, which prevented tax-dependent districts from having to drastically raise rates to cover expenses. The customers of those districts, however, were no longer paying higher rates, and so their service was effectively subsidized by taxpayers outside of those districts. And over time, the inequities have grown.

The reasons why districts relied on property taxes, and how they use that revenue now, varies greatly among the districts consulted by the Commission. In some districts property tax revenue was used to

pay for project debt that has since been paid off. In other districts, the tax revenue is used to finance new capital projects or to service debt that is continually being “rolled over” to finance new projects.

Several districts told the Commission that their property tax revenue is used to pay their bond debt service to the State Water Contract. Others said the original purpose for their tax assessment no longer exists and the revenue is now used to offset rates or pay for specific operational costs. Most districts reported that eliminating their property tax revenues would result in rate increases to their customers.⁶⁸ None of the districts said they would scrutinize expenses to reduce costs or would contribute less to their growing reserves.

How Districts Use the Property Tax

Irvine Ranch Water District said that the district's property tax revenue is pledged to the payment of debt service. They added that the district has used property taxes to pay for its bonded indebtedness since the 1960s, and that it has bonds outstanding until 2033. In 1996-97, property tax revenues represented 6.4 percent of IRWD's revenue.

San Bernardino Valley Municipal Water District, in 1996-97, received 19.8 percent of its revenue from property tax shares. The district reported it allocated those funds to debt service on the State Water Contract and its own general obligation bond debt.

Central Contra Costa Sanitary District received 11.1 percent of its revenue from property taxes in 1996-97. The district stated that it exercises discretion in allocating those revenues to capital projects or to pay its bond debt.

Some districts that perform primarily enterprise functions also perform non-enterprise functions. For example, the Santa Clara

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Valley Water District imports water, recharges groundwater and wholesales water to cities and counties – all enterprise services that it charges fees to provide. It also is responsible for flood control, a non-enterprise activity that the district describes as heavily dependent on the property tax. Approximately 17 percent of the district’s revenue is property tax shares. Sixty-eight percent of that amount annually is allocated to non-enterprise flood control activities.⁶⁹

Property tax revenues have allowed many enterprise districts to charge less than neighboring districts charge for a like service. In addition to the inequities created, this policy distorts the true cost of providing services.

- **Property tax revenues flow to some districts with large reserves.** Among the enterprise districts receiving property tax revenues are some that have accumulated the largest reserves. Some 36 percent of all of the property tax revenue received by enterprise districts goes to just 15 districts that also are among the top 25 districts in terms of retained earnings. Those 15 districts are listed in the table below.

15 Districts are in the "Top 25" For Both Retained Earnings and Property Tax Revenue	(In Millions)			Property Tax as % of:	
	Property Tax	Gross Revenue	Retained Earnings	Gross Revenue	All Prop. Tax* to Enterprise Districts
Santa Clara Valley Water	\$17.3	\$101.7	\$391.0	17.0%	6.1%
Inland Empire Utilities (San Bern.)	\$11.1	\$63.8	\$187.4	17.4%	3.9%
Orange Co. Sanitation No. 3	\$9.4	\$37.7	\$211.7	25.0%	3.3%
Eastern Mun. Water (Riverside)	\$9.4	\$104.8	\$217.2	9.0%	3.3%
Orange Co. Sanitation No. 2	\$8.9	\$35.9	\$192.4	24.7%	3.1%
Moulton-Niguel Water (Orange)	\$8.3	\$56.7	\$216.1	14.7%	2.9%
Central Contra Costa Sanitary	\$5.6	\$50.3	\$214.7	11.1%	2.0%
East Bay Mun. Utility (Alameda)	\$4.9	\$266.4	\$597.3	1.8%	1.7%
Irvine Ranch Water (Orange)	\$4.9	\$77.4	\$279.6	6.4%	1.7%
San Bernardino Valley Mun. Water	\$4.5	\$22.9	\$192.5	19.8%	1.6%
El Dorado Irrigation (Alpine, Amador, Sac.)	\$4.2	\$28.1	\$137.2	15.1%	1.5%
Coachella Valley Co. Water (Riverside)	\$4.1	\$84.0	\$281.2	4.9%	1.4%
L.A. County Sanitation No. 5	\$4.1	\$38.0	\$141.3	10.8%	1.5%
San Diego Co. Water	\$3.9	\$259.4	\$435.0	1.5%	1.4%
Calleguas Municipal Water (Ventura)	\$2.6	\$67.9	\$168.2	3.9%	0.9%
Total	\$103.2	\$1,295.	\$3,863.	8.0%	36.4%

*Does not include transit or hospital districts.
Source: State Controller, 1996-97 retained earnings and property tax for enterprise districts, data on file.

- **Property tax revenues fund districts that no longer provide the service for which the district was formed.** In 1998-99, approximately \$17 million in property taxes were allocated to 14

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health care districts that no longer operate hospitals.⁷⁰ Five of those districts report spending less than 25 percent of their revenue on direct services in their community. Additional health care district information is contained in Finding 3.

- ***Non-enterprise districts have been hit the hardest.*** In the aftermath of the 1992-93 ERAF shift of funds from local governments to the schools, a number of non-enterprise and non-public safety special districts, which do not have the option of raising fees, have been impacted the most.

Counties and cities and some public safety districts have been granted relief through a number of measures – including Proposition 172, the half-cent sales tax increase for public safety services; state funding of trial courts; the state COPS program; and changes in state formulas for fines and property forfeitures. But non-enterprise districts that do not provide public safety services have not received comparable relief. Recreation and park districts have been forced to charge higher fees, reduce services and close facilities. Many small independent library districts have struggled to remain open.

Despite the losses experienced by non-enterprise districts, enterprise districts have continued to receive taxes based on the pre-Proposition 13 formula. While policy-makers have touched on the issue in a number of forums, the problems have not been resolved.

Of Enterprise Districts and Property Tax Revenues

The property tax revenue received by enterprise special districts is a small part of a much larger debate over the need to reform state and local finances. But as an issue, it can be separated and solved without fundamentally restructuring the state and local fiscal relationship. Numerous policy reviews have come to that conclusion, although few have been willing to instigate the controversy likely to ensue from a serious attempt to address this inequity.

J. Fred Silva, who has been involved in state fiscal policy-making for years and is now a government relations expert at the Public Policy Institute of California, testified:

What issues should be the focus of the Little Hoover Commission's work... Finance issues. Focus on the financing of enterprise and non-enterprise districts. Specifically, review the use of the property tax to finance enterprise services.

In principal it is easy to say that enterprise districts should not receive property taxes. But the individual circumstances of special districts vary

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significantly. Any change in the status quo will be difficult and much of the applicable law is constitutional rather than in statute. As a result, the approach has to be more sophisticated.

Other studies of state and local government finance have considered property tax allocations to special districts. Alternatives have been discussed, but consensus on solutions has been elusive:

- **California Constitution Revision Commission.** The California Constitution Revision Commission recommended the creation of a citizens charter commission on local government efficiency and restructuring in each county. The commissions would develop government services plans, reallocate local costs and revenues, and let the voters decide on new "Community Charters." To foster local control, the non-school share of the property tax would be allocated by the charter, not state law.

- **The Commission on Governance for the 21st Century.** The commission heard testimony on property tax allocations to enterprise districts, but did not examine the issue in depth. In its final report, *Growth within Bounds*, the commission suggested that "future government reformers may wish to consider reallocating a portion of property tax revenues currently accruing to enterprise districts...." ⁷¹

- **Speaker's Commission on State and Local Government Finance.** The commission heard that there is inadequate public understanding of which agencies receive property tax allocations. It recommended that to increase public understanding of how local services are funded that a state agency or county auditors report the amount of property tax revenues that individual agencies receive and the services funded by that revenue. ⁷²

- **Senate Committee on Local Government.** The Senate Committee on Local Government identified property tax allocations to enterprise special districts as one of four policy issues on this topic that lawmakers will grapple with in 2000. The committee raised the following policy questions in its summary report of the September 1999 interim hearing:⁷³
 - ✓ Should the Legislature stop enterprise districts from subsidizing their operations with property tax revenues?

 - ✓ Should the Legislature reallocate property tax revenues from enterprise districts to other local governments, including non-enterprise districts?

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✓ If so, should the Legislature phase-out these subsidies to avoid price increases?

□ ***Legislative Analyst.*** In AB 676, the Legislature directed the LAO to identify alternatives for restructuring the property tax allocation system to accomplish three goals: 1) increase taxpayer knowledge of the allocation of property taxes; 2) provide greater local control; and 3) correct the skewed land use incentives faced by local governments. Among the LAO's conclusions:⁷⁴

✓ The current property tax allocation system presents particular problems for cities and counties that provide municipal services through independent special districts. Local officials and citizens, lacking the authority to change the allocation of property taxes, are stuck with formulas that do not reflect the current priorities of the community. The LAO cites as examples water districts that continue to receive property taxes based on 25 year-old formulas. They continue to receive tax revenues despite changed community needs and the general trend for water and other enterprise services to be funded by user charges rather than general taxes.

✓ Special purpose agencies vs. general purpose governments is one of four key tensions inherent in local finance and property tax allocation system reform proposals.

✓ State laws controlling the allocation of property taxes may have discouraged some special purpose governments, such as water and sanitation districts, from evolving away from property taxes to user fees.

Among the LAO's alternatives: Maintain property tax rate stability, state control over tax allocation and the current role of special district governments. Shift the emphasis toward local control of the property tax rate and therefore modestly toward general purpose government. Shift the emphasis significantly toward general purpose government by making property taxes formerly allocated to special districts available to cities and counties as general purpose revenues. And finally, promote general purpose government by assigning responsibility for providing all local services to cities and counties, which could in turn delegate responsibilities to special districts.

The LAO expressed optimism that despite the failures of past efforts reforms could be accomplished if policy-makers are mindful of three considerations: 1) No perfect solution exists; 2) Solution of the problem requires focused attention; and 3) funds are needed.

PROPERTY TAX ALLOCATIONS TO ENTERPRISE DISTRICTS

The alternatives contained in the LAO report – and the work of other commissions and task forces that have reviewed the issue – could advance the goal of meaningful tax allocation reform, including property tax allocations to enterprise districts. Those who have studied the issue and witnessed first-hand the difficulty that policy-makers have with resolving it told the Commission that policy-makers have the information needed to begin to make reforms now.

The Little Hoover Commission also found that a relative handful of enterprise districts with the highest reserves receive a substantial portion of the property tax allocation to all enterprise districts. These are resources that might be better allocated to reflect present-day community needs and priorities. The Legislature could address these possible inequities now and, at the same time, contribute to the larger analysis of property tax allocations to enterprise districts.

Property Tax Allocation Policy Questions

Because of the diversity of districts, any reallocation of property tax revenues will likely have to be based on a case-by-case review of districts and how they use that revenue. Among the questions that should guide these public decisions:

- ✓ How do property tax allocations impact rate structures and exaggerate inequities among ratepayers? Between big and small users? Between commercial and residential users? Between low-income users who have trouble paying for essential services and customers who do not?
- ✓ How do property tax allocations factor into the abilities of enterprise districts to build and use reserves?
- ✓ What is the history of property tax use by districts? Is it tied to specific projects? Would user fees more appropriately fund those projects?
- ✓ If the community could, would it reallocate this revenue to a higher public priority?

Alternative mechanisms that would permit a case-by-case review of property tax allocations to enterprise districts, include:

- **Joint legislative review.** The Legislature, through the Joint Legislative Sunset Review Committee, has provided valuable scrutiny to the licensing boards within the Department of Consumer Affairs. The systematic review provided for detailed evaluations of individual boards, and provided for the Legislature a basis for making case-by-case changes to the entities. A similar review of enterprise districts with large reserves and large property tax allocations could be an effective means of assessing changes on a district-by-district basis.
- **State Auditor Review.** The Legislature could direct the State Auditor to examine enterprise special districts that receive property taxes and that have the highest reserves. The Auditor could be directed to assess how the property tax revenue is used, whether those functions could be funded through established fees, and the potential for a reduction in property taxes to be offset by more efficient operations on the part of the district.

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- **Reviews by County Supervisors.** The State could encourage and empower county boards of supervisors to initiate audits and public examination of enterprise districts that receive property tax revenues. As an incentive, counties that conduct reviews and reach conclusions that the property tax revenue could serve a higher community need could be allowed to reclaim and reallocate that revenue.

Summary

Property tax allocations to enterprise special districts are just one of many issues that must be considered in any comprehensive analysis of the current property tax allocation system. But lawmakers should specifically review property tax allocations to enterprise special districts – particularly those districts with the largest reserves. A number of mechanisms could be used to explore these issues on a district-by-district basis, including ones that would allow state or local officials to determine if the revenue should be reallocated elsewhere.

Recommendation 5: Policy-makers should scrutinize the appropriateness of maintaining property tax allocations to enterprise districts. Among the alternatives:

- **Annually review the level of property tax support.** The Controller could annually report the property tax revenue distributed among enterprise districts with the largest reserves. With the assistance of the Legislative Analyst, and as part of the budget process, the Legislature could decide whether to continue or modify this allocation of property taxes.
- **Examine all allocations to enterprise districts.** The Legislature could appoint a task force to examine how individual enterprise districts use property tax revenues. The task force could identify districts that should continue to receive the revenues, those that should receive smaller allocations, and those that should no longer receive property tax revenue.
- **Require a state audit of some districts.** The Legislature could require the State Auditor to examine enterprise districts that receive property taxes and also have the highest reserves. The Legislature could then take specific action to reduce or eliminate the allocations to those districts without a strong rationale for tax funding.
- **Allow counties to reclaim and reallocate property tax revenues.** The Legislature could provide a mechanism for counties, following a public review process, to reclaim property tax revenues from

PROPERTY TAX ALLOCATIONS TO ENTERPRISE DISTRICTS

enterprise districts and reallocate those funds to meet contemporary community needs and priorities.

- ***Enhance public understanding of property tax allocations.***
Property tax bills should identify for taxpayers the independent special districts that provide services to them, along with the tax allocation, reserves and other financial information about those districts.

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Conclusion

Through this review, the Commission has come to understand that thousands of special districts provide valuable services to millions of Californians. But it also found reason to be concerned that the government closest to the people is not always visible or accountable to the people.

When special districts first emerged, they were state-of-the-art government. All of their attributes were tailored to the unique needs of their communities – their boundaries, their functions, their governance and their finances.

Need irrigation water to make the desert bloom? The first step was to create a special district. Need port facilities to capture international trade, form a district. Want to stop encephalitis, form a district. Inspired to build strong bodies and strong minds, form a park district and a library district.

Many of these independent government entities continue to evolve in ways that increase their value and relevance to the citizens they serve.

But others are reluctant to change and to open themselves to scrutiny. Their boundaries are meaningless relics of communities that have lost distinctions. They spend money on their defined missions, regardless of other community needs. In some cases, they hold vast financial reserves that have simply not been publicly examined. In extreme cases, the governing boards are only “governing” contracts with private service providers.

In some cases, small districts that were created to serve once-isolated communities should be merged to efficiently provide services to large urban areas. In a few cases, the districts as separate units of government are no longer warranted and should be put out of business.

In this report, the Commission did not make judgments about individual districts. Not because these districts shouldn't be judged, but because they should be judged by the citizens they serve. The problem is the public and community leaders often do not have the information necessary to determine whether the quality of service is good, the price is fair, and the choices made by special districts reflect the priorities of their communities.

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The Commission found this scrutiny and evolution occurring in communities where special districts are well known to the public and where Local Agency Formation Commissions are assertive catalysts for change.

The Commission's recommendations call for state policy-makers to help special districts function in ways that would reconnect them to their communities. The recommendations also would provide local agency formation commissions with the structure, the resources and the tools necessary to be the force of change that the State expects them to be. And the recommendations provide mechanisms and incentives for examining on a case-by-case basis some nagging issues – including an inequitable reliance on property taxes by some enterprise districts.

Appendices & Notes

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Appendix A

Little Hoover Commission Public Hearing Witnesses

***Witnesses Appearing at Little Hoover Commission Special Districts Public Hearing on
June 24, 1999***

Fred Silva
Advisor, Governmental Relations
Public Policy Institute of California

Stephen P. Morgan
Professor, University of Southern California,
Sacramento Center and
California State University, Hayward

Thomas M. Gardner
Director of Public Management Consulting
Vitetta Group

Harry Ehrlich, President
California Special Districts Association and
Deputy General Manager of Capital Programs
Olivenhain Municipal Water District

Dana M. Smith
Executive Director
Orange County Local Agency Formation
Commission

Phil Batchelor
County Administrator
Contra Costa County

Herb Moniz,
City Manager
City of San Ramon

***Witnesses Appearing at Little Hoover Commission Special Districts Public Hearing on
August 26, 1999***

Keith McCarthy
Mayor
City of Downey

Marc Titel
City Council Member
City of Lakewood

Robert Goldsworthy
President, Board of Directors
Water Replenishment District of Southern
California

Edward C. Little
Member, Board of Directors
West Basin Municipal Water District

Charles A. Horel
President, Board of Directors
American River Fire District

Dean O. O'Brien
President, Board of Directors
Sacramento County Fire District

John S. O'Farrell
Executive Officer
Sacramento County Local Agency Formation
Commission

Michael Dunbar
General Manager
South Coast Water District

Kenneth Frank
City Manager
City of Laguna Beach

Joyce Crosthwaite
Former Assistant Executive Officer
Orange County Local Agency Formation
Commission

Dana M. Smith
Executive Officer
Orange County Local Agency Formation
Commission

James Evans
President, Board of Directors
Midway City Sanitary District

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Appendix B

**Little Hoover Commission
Special Districts Survey Questionnaire
Director/Trustee Benefits and Compensation**

Please respond to the following questions. You may use this form and return it in the enclosed envelope, attaching additional pages if necessary, or respond by e-mail to little.hoover@lhc.ca.gov, using the same format. Thank you for your assistance.

District: _____

Survey Respondent Name & Title: _____

Phone number: _____

- (1) What services does the district provide?

- (2) How many directors/trustees serve on the district board of directors?

- (3) How often does the board meet?

- (4) How many subcommittees does the board maintain?
 - a) Number of subcommittees: _____

 - b) How often does each subcommittee meet?

- (5) On average, how much time do directors/trustees spend per month preparing for board and subcommittee meetings and conducting board activities?

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- (6) Do directors/trustees receive daily compensation for board and subcommittee meeting attendance? Yes ____ No ____ If no, go to question 7.
- a) What is the district's daily compensation rate to directors/trustees for meeting attendance? \$ ____
- b) What is the maximum number of days in a month for which a director/trustee can be compensated for meeting attendance (include subcommittee meetings)?
No. of days: _____
- c) What was the total dollar amount of daily compensation paid to directors/trustees for meeting attendance (include subcommittees) in fiscal year 1998-99?
\$ _____
- (7) Does the district send directors/trustees to continuing education opportunities such as conferences, seminars and other workshops?
Yes ____ No ____ If no, go to question 8.
- a) What was the total amount paid by the district for director attendance at conferences, seminars or workshops in fiscal year 1998-99? Please include registration fees, travel, per diem and any other costs associated with such attendance that were paid by the district. \$ _____
- (8) Does the district provide health benefits to directors/trustees?
Yes ____ No ____ If no, go to question 10.
- a) Does the district extend these benefits to spouses and/or dependents of directors/trustees? Yes ____ No ____
- b) What was the total amount expended by the district in fiscal year 1998-99 for health benefits for directors/trustees and their spouses and/or dependents?
\$ _____

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(9) Does the district provide health benefits to any former directors/trustees?
Yes____ No ____ If no, go to question 10.

a) If yes, please describe the coverage provided.

b) What was the total amount paid by the district in 1998-99 for health benefits for former directors/trustees? \$_____

(10) Do district directors/trustees receive life insurance benefits?
Yes____ No ____ If no, go to question 11.

a) If yes, describe the type of policy provided.

b) Is this benefit extended to former directors/trustees? Yes____ No ____

c) What was the total amount expended by the district in 1998-99 for life insurance benefits for current and former directors/trustees? \$_____

(11) Do district directors/trustees receive any other benefits or compensation?
Yes____ No ____ If yes, please explain.

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(12) In the last 10 years, has your district considered reorganization activities such as consolidation, intergovernmental agreements, annexation or others?

Yes ___ No ___ Please explain.

(13) In your experience, have benefits and compensation provided to directors/trustees ever been a deterrent to district consolidation or reorganization?

a) Yes ___ No ___ Please explain.

b) Please describe any other issues that have been a deterrent to consolidation or reorganization efforts.

Thank you for completing this questionnaire. Please return it to the Little Hoover Commission in the enclosed envelope by November 19, 1999, or by e-mail using the same format. If we do not receive your response by the above date, Commission staff will contact you to conduct the survey by telephone.

Appendix C

Little Hoover Commission Health Care Districts Survey Questionnaire

Please respond to the following questions. You may use this form and return it in the enclosed envelope, attaching additional pages if necessary, or respond by e-mail to little.hoover@lhc.ca.gov, using the same format. Thank you for your assistance.

District: _____

Survey Respondent: _____

- (1) When was the district formed and what was its mission when formed?

- (2) What is the district's current mission? If different from the original mission, when and why did it change?

- (3) If the mission of the district changed, has the board of trustees or other district or agency explored dissolving the district? If yes, please describe what actions have been taken in this regard and the status of these efforts. If no, please describe why not.

- (4) Who does the district serve and what are the most important services provided by the district?

- (5) Do other local entities provide the same or similar services?
Yes_____ No_____ If yes, please identify the entities.

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(6) Has the district formed partnerships with other local agencies to deliver services?
Yes _____ No _____ If yes, please identify the agencies and types of services provided collaboratively.

(7) Please provide the following information regarding the district's budget for fiscal years 1995-96 through 1999-2000:

	1995-96	1996-97	1997-98	1998-99	Anticipated 1999-2000
a) Gross revenue	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
b) Property tax allocation received by the district	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
c) Other sources of revenue (include source and \$ amount)					
d) Retained earnings or reserve funds	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____

(8) What percentage of the district's revenue is expended on direct, health-related services in the community?

(9) What happened to the acute care hospital once administered by the district?

(10) What role, if any, does the district continue to play in the governance or monitoring of services provided by the hospital?

APPENDICES & NOTES

- (11) If the hospital previously administered by the district is now administered by another entity, does the district provide any revenue to the hospital?
a) Yes_____ No _____ If yes, what dollar amount?
- (12) How many trustees serve on the district board?
- (13) How often does the board meet and what is the district's daily compensation rate to trustees for meeting attendance?
- (14) On average, how much time does each trustee spend per month preparing for meetings and conducting board activities?
- (15) What was the total dollar amount of daily compensation paid to trustees for meeting attendance (including subcommittees) in fiscal year 1998-99?
- (16) Does the district send directors to conferences, seminars and other workshops?
a) Yes_____ No_____ If no, go to question 17.
b) What was the total amount paid by the district for trustee attendance at conferences, seminars or workshops in fiscal year 1998-99? Please include registration fees, travel, per diem and any other costs associated with such attendance that were paid by the district.
- (17) Does the district provide health coverage to trustees?
a) Yes _____ No _____ If no, go to question 19.
b) Does the district extend these benefits to directors' spouses and/or dependents? Yes_____ No _____
c) Please describe the coverage provided.
d) What was the total amount expended by the district in fiscal year 1998-99 for health benefits for trustees and trustees' spouses and/or dependents?

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(18) Does the district provide health benefits to any former trustees?

a) Yes ___ No ___ If no, go to question 19.

If yes, how many? _____

b) What was the total amount paid by the district in fiscal year 1998-99 for health benefits for former trustees?

(19) Does the district provide life insurance benefits to trustees?

a) Yes ___ No ___ If no, go to question 20.

If yes, describe the type of policy provided.

b) Is this benefit extended to former trustees? Yes ___ No ___

c) What was the total amount expended by the district in 1998-99 for life insurance benefits for current and former trustees?

(20) Do any trustees of the district also serve as directors or trustees of the acute care hospital once operated by the district? Yes ___ No ___

If yes, how many? _____

Thank you for completing this questionnaire. Please return it, the 1998-99 district audit, and the district business and strategic plans to the Little Hoover Commission by November 8, 1999.

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Appendix D

Enterprise Districts with the Largest Retained Earnings

	County	Name	Gross Revenue	Retained Earnings Dollars	% of Gross Revenue
1.	Los Angeles	Metropolitan Water District of So. Calif.	\$916,495,658	\$3,592,609,447	392%
2.	Los Angeles	County Sanitation No. 2 Refuse Disposal - Working Capital Funds	\$234,486,701	\$638,272,450	272%
3.	Alameda & Contra Costa	East Bay Municipal Utility	\$266,448,000	\$597,332,000	224%
4.	Imperial	Imperial Irrigation	\$252,356,744	\$561,988,395	223%
5.	San Diego	San Diego Unified Port	\$149,404,265	\$496,430,559	332%
6.	San Diego	San Diego County Water Authority	\$259,383,247	\$435,049,278	168%
7.	Santa Clara	Santa Clara Valley Water	\$101,664,957	\$391,029,634	385%
8.	Contra Costa	Contra Costa Water	\$87,587,842	\$360,869,552	412%
9.	Sacramento	Sacramento Regional County Sanitation	\$101,240,872	\$345,276,046	341%
10.	Riverside, Imperial & San Diego	Coachella Valley County Water	\$84,023,076	\$281,262,098	335%
11.	Orange	Irvine Ranch Water	\$77,399,000	\$279,625,000	361%
12.	Sacramento & Placer	Sacramento Municipal Utility	\$735,039,025	\$217,234,482	30%
13.	Riverside & Orange	Eastern Municipal Water	\$104,786,335	\$217,181,106	207%
14.	Orange	Moulton-Niguel Water	\$56,749,289	\$216,127,257	381%
15.	Contra Costa	Central Contra Costa Sanitary	\$50,322,689	\$214,723,540	427%
16.	Orange	County Sanitation No. 3	\$37,730,251	\$211,669,228	561%
17.	Alameda	Union Sanitary	\$38,500,000	\$202,442,000	526%
18.	San Bernardino & Riverside	San Bernardino Valley Municipal Water	\$22,854,120	\$192,483,302	842%
19.	Orange	County Sanitation No. 2	\$35,915,857	\$192,442,891	536%
20.	San Bernardino	Inland Empire Utilities Agency	\$63,787,832	\$187,371,675	294%
21.	Ventura	Calleguas Municipal Water	\$67,863,150	\$168,164,580	248%
22.	Los Angeles	County Sanitation No. 5	\$38,002,041	\$141,306,672	372%
23.	El Dorado, Alpine, Butte & Sacramento	El Dorado Irrigation	\$28,079,246	\$137,229,187	489%
24.	Solano	Vallejo Sanitation and Flood Control	\$18,939,348	\$136,949,813	723%
25.	Alameda	Alameda County Water	\$49,280,900	\$133,227,500	270%

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Notes

- i. The retained earnings presented in this report were provided by the State Controller's office. Prior to the release of the report, the Controller's office asserted that its definition of retained earnings did not include fixed assets or infrastructure. As part of its research, the Commission contacted several districts, which confirmed the accuracy of the Controller's information. Subsequent to the report's release, the Commission has become aware that some districts include some of their fixed assets in the values they report to the Controller as retained earnings. The Controller's office now believes that to accurately separate fixed assets from other retained earnings would require a detailed case-by-case analysis.
1. Kenneth Frank, city manager, city of Laguna Beach, personal communication, Jul. 1999.
2. State Controller, 1996-97 data on special district retained earnings and fund balances, on file. The term reserves refers to retained earnings, fund balances, or a combination.
3. *California Government Code*, Section 56036.
4. Senate Local Government Committee, *What's So Special About Special Districts? A Citizen's Guide to Special Districts in California*, Second Edition, Nov. 1993.
5. Senate Local Government Committee, 1993.
6. Counts taken from data on gross revenues and reserves, State Controller, 1996-97 data requested by the Commission, on file.
7. State Controller, 1996-97 data requested by the Commission, on file.
8. State Controller, 1996-97 data requested by the Commission, on file.
9. *California Government Code*, Section 12463.1.
10. *California Government Code*, Section 12463.1.
11. *California Government Code*, Section 56001.
12. Former Assembly Speaker Curt Pringle, personal communication, Jul. 1999.
13. Steve Hayashi, General Manager, Union Sanitary District, personal communication, Mar. 1999.
14. Office of State Senator Polanco, personal communication, Mar. 2000.
15. Paul G. Lewis, *Deep Roots: Local Government Structure in California*. Public Policy Institute of California, 1998.
16. Stephen P. Morgan, *The Impact of Special District Reorganization*, dissertation presented to the faculty of the School of Public Administration, University of Southern California, Aug. 1996.
17. John Bahorski, City Manager, City of Dana Point, personal communication, Jul. 1999.
18. Latent powers are those powers which are authorized in statute but are not exercised by the district.
19. Commission on Local Governance for the 21 Century, *Growth Within Bounds*, Jan. 2000.
20. Nancy Burns, *The Formation of American Local Government: Private Values in Public Institutions* (1994), page 12.
21. The Commission collected special district and city council elections data from Sacramento and Contra Costa counties. In Contra Costa, there was insufficient data available to calculate voter participation rates over time. Due to the reporting format, voter registration information was only consistently available for odd-year elections, which tend to have lower turnout than general elections. Information on unopposed candidates and appointees also

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was unavailable from Contra Costa County. As a result, the Commission has reported voter participation and detailed information on uncontested seats for Sacramento County only.

22. Detailed information on unopposed candidates and appointees was not available from Contra Costa County.
23. The differences between city council and each type of special district elections are significant for a 99% confidence interval, using a two sample t-Test assuming unequal variances.
24. In districts or city councils that elect by division, each division is counted as a separate election. Elections to fill short-term vacancies are also counted separately from the full-term elections for the same districts.
25. In many special district and city council races, several seats are available, and voters have the option to vote for multiple candidates. One item, for instance, may direct the voter to "vote for no more than 3." The Commission determined the voter participation rate by comparing the total number of votes cast to the total number of votes possible if all eligible registered voters had voted for all available seats ("allowed" votes). The resulting number is the average number of votes cast per registered voter.

There are many reasons why voters may choose to cast only a portion of their allotted votes. In some instances, voters may feel uninformed about the candidates or district. In other cases, they may not want to support candidates who could nudge out their top choice.
26. Differences are significant for a 95% confidence interval.
27. Commission on Governance for the 21 Century.
28. Commission on Governance for the 21 Century.
29. Commission on Governance for the 21 Century.
30. Does not include Orange County dependent districts, as this information was not available from the county.
31. Fran Sutton, executive officer, Stanislaus County LAFCO, interview, Oct. 1999.
32. Commission on Governance for the 21 Century.
33. George Spiliotis, executive officer, Riverside County LAFCO, interview, Nove. 1999.
34. The Commission requested the total amount spent by each district on meeting stipends, health and life insurance benefits in 1999. For comparative purposes, these figures have been converted to average expenditures per board member. Several districts did not report the requested information on meeting compensation total expenditures. When possible, this data has been extrapolated from the district's reported meeting stipend and average number of meetings per month.
35. Mike Dunbar, general manager, South Coast Water District, Little Hoover Commission Survey response, Nov. 1999.
36. Personal communication, Mar. 24, 2000.
37. Kevin P. Eggleston, fire chief, San Miguel Consolidated Fire Protection District, Little Hoover Commission Survey response, Nov. 1999.
38. Joyce Crosswaithe, former assistant executive officer, Orange County LAFCO, personal communication, Dec. 1999.
39. George Spiliotis, Riverside County LAFCO executive officer, interview, Nov. 1999.
40. Theodore H. Poister and Gregory Streib, "Performance Measurement in Municipal Government: Assessing the State of the Practice," Georgia State University, *Public Administration Review*, Jul./Aug. 1999, Vol.59, No.4.

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41. Theodore H. Poister and Gregory Streib.
42. Theodore H. Poister and Gregory Streib.
43. *California Government Code*, Section 53601 et seq.
44. Pat Beal, State Treasurer's Office, personal communication, Apr. 2000.
45. Marianne O'Malley, Legislative Analyst's Office, personal communication, Mar. 2000.
46. Thomas M. Gardner, DPA, Director, Vitetta Group, personal communication, Jun. 1999.
47. The description of the Metropolitan Water District's retained earnings is based on written response to the Commission's questionnaire. Subsequent to the release of the report, MWD provided written clarification that its \$4 billion in retained earnings includes some of its infrastructure. The district reported a \$921 million cash and investment balance as of June 30, 1999.
48. California State Auditor, *Water Replenishment District of Southern California*, Dec. 1999.
49. *California Government Code*, Section 65350 et. seq.
50. California Department of Finance, *Capital Outlay & Infrastructure Report*, 1999.
51. California Business Roundtable, *Building a Legacy for the Next Generation*, Aug. 1998.
52. Legislative Analyst's Office, *Overhauling the State's Infrastructure Planning and Financing Process*, Dec. 1998.
53. Stephen K. Hall, executive director, Association of California Water Agencies, Letter to the Editor, *Sacramento Bee*, 2000.
54. Legislative Analyst's Office, *Ballot Proposition Analysis, Proposition 13*, for Election Tuesday, Mar. 7, 2000.
55. Rudy Muravez, Chief Financial Officer, Santa Clara Valley Water District, personal communication, Jan. 27, 2000.
56. Joe Aguilar, Principal, Vavrinek, Trine, Day & Co., LLP, personal communication, Mar. 2000.
57. Dave Hawley, chief financial officer and Tom Hammatt, controller, personal communication, January, March 1999, Apr. 2000.
58. California State Auditor, Dec. 1999.
59. California State Auditor, Dec. 1999.
60. Joseph F. Young, written correspondence to the Little Hoover Commission, Sep. 1999.
61. Mike Dunbar, general manager, South Coast Water District and Ron Kennedy, general manager, El Toro Water District, personal communication, Mar. 1999.
62. Dan Harrison, Asst. Director, Administrative Services, League of California Cities, personal communication, Jan. 2000.
63. Legislative Analyst report, *Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes*, Feb. 3, 2000.
64. Summary Report from the Interim Hearing of the Senate Committee on Local Government, *Property Tax Allocation*, Sep. 21, 1999.
65. Senate Committee on Local Government, 1999, page 8.
66. State Controller, data requested by the Commission, on file.
67. Chapter 94, Statutes of 1999.
68. Telephone interviews with enterprise districts with the largest reserves.

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69. Rudy Muvarez, Santa Clara County Water District, personal communication, Jan. 2000.
70. Data from Little Hoover Commission survey. Two districts did not respond to this question, and five districts did not respond to the survey. Property tax revenue for these districts is not included in the \$17 million figure.
71. Commission on Local Governance for the 21 Century.
72. The *Final Report* of the Speakers Commission on State and Local Government Finance, Mar. 2000.
73. Senate Committee on Local Government, 1999, page 23.
74. Legislative Analyst, *Reconsidering AB 8: Exploring Alternative Ways to Allocate Property Taxes*, Feb. 2000.

Special Acknowledgements

The Commission would like to acknowledge Joyce Crosthwaite for her assistance in developing survey questionnaires, for conducting interviews with LAFCO executive officers and for her insights into the operation of LAFCOs.

The Commission also appreciates the assistance of the California Special Districts Association and the Association of California Healthcare Districts in the Commission's surveys of special districts.



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