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Written Testimony on Special Districts

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Little Hoover Commission Hearing

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INTRODUCTION

Members of the Commission, thank you for the opportunity to address you on the topic of special districts.

From the perspective of California taxpayers, special districts are neither inherently good nor inherently bad. However, it is a tenet of good government that services should be provided at the level of government closest to the people. While some special districts cover large geographic areas, most are fairly localized which we view as positive.

However, on the negative side of the ledger, many special districts are governed by political appointees rather than having a board that is directly elected. This raises significant issues of accountability. Even when boards are directly elected, many special districts do not receive the same level of scrutiny as do cities and counties.

Because broad pronouncements on special districts generally are unproductive, this paper will address more specific concerns.

STATEMENT OF INTERESTS

The Howard Jarvis Taxpayers Association (HJTA) was formed in 1978, following the passage of Proposition 13 which received nearly two-thirds of the popular statewide vote. Proposition 13 remains very popular today and has frequently been referred to as the "third rail" of California politics.

HJTA's mission statement states that the organization "is dedicated to the protection of Proposition 13 and the advancement of taxpayers' rights, including the right to limited taxation, the right to vote on tax increases and the right of economical, equitable and efficient use of taxpayer dollars."

Notwithstanding the popularity of Proposition 13, both the courts and the California legislature began creating loopholes in the new law almost immediately. As a result of these actions, HJTA passed two additional measures, Proposition 62 in 1986 and Proposition 218 in 1996. Both were intended to ensure that property owners and voters would be the ultimate arbiters of new or higher taxes, fees, charges and assessments.

For example, in the 1980's, municipalities began disguising broad based parcel taxes as "benefit assessments" well beyond the original limited nature of that financing mechanism. Under Proposition 218, benefits assessments must now be carefully tailored to provide direct special benefits to the specific parcels being assessed. Moreover, benefit assessments must now be specifically approved via a ballot process given to the property owners.

SPECIAL DISTRICTS

HJTA's involvement with special districts is generally no different than our interaction with other local government entities. Philosophically, we support local control, "home rule" and autonomy for local public agencies, especially when:

1. In those instances where local entities seek additional revenue they comply with all constitutional requirements, especially those enacted for taxpayer protection including, but not limited to, Propositions 13 and 218.

2. Local governments maintain maximum transparency, follow the Brown Act, undertake common sense solutions to increase voter turnout, post required fiscal transparency information on their respective websites and maintain an adequate reserve that neither abuses taxpayers nor provides an incentive for unethical behavior.

In HJTA's long history interacting with local government entities, our experience has been that most make good faith efforts to comply with the law. On some occasions,

non-compliant actions are simply oversights and quickly corrected when the nature of the violations are brought to their attention. But unfortunately, in some instances, local governments also willfully violate the law. For that reason, HJTA maintains a fulltime, in-house legal presence and has a strong winning record in litigation.

However, one problem with our efforts to seek compliance is that special district activities are often "under the radar." We are aware of instances of long term non-compliance that escape the attention of citizens and even the district itself. For example, in 2014 it was discovered that a fire district was illegally collecting tax proceeds from property owners outside the district and that practice had been ongoing for several years. It took a special act of the Legislature to reimburse property owners for the taxes they had paid illegally.

LITTLE HAS CHANGED SINCE THE 2000 REPORT

Not much has changed from the Commission's report back in 2000. Reserves remain high, voter turnout remains low, and awareness is limited. Dozens of special districts, notably healthcare districts, should be phased out of existence. But many taxpayers being assessed may not even realize that their health care district doesn't even operate a hospital.

One recent development is especially troubling to HJTA. Local government associations are now actively seeking to weaken important taxpayer protections. Adding insult to injury, they expend taxpayer dollars to lobby against the interests of taxpayers. For example, the California Special Districts Association, as well as other local government associations, have ramped up their lobbying for constitutional amendments eliminating Proposition 13's two-thirds vote protections to provide various infrastructure services and dropping it to 55 percent. CSDA and others claim that with cities and counties able to approve general taxes on a majority vote, and with school bonds subject to a 55 percent threshold, that they should be treated the same way and not be subject to a two-thirds vote. However, special districts, by their very nature, provide specific and limited service. They can do this either through a majority vote special assessment, or a two-thirds vote special tax. Moreover, other revenue raising avenues are available without doing violence to Propositions 13 or 218.

Over a dozen legislative attempts to diminish Proposition 13 have been made over the last ten years in the form of proposed constitutional amendments, with none actually appearing on the ballot. Even if that were to occur at some point in the future, the odds of it being approved are low. The last statewide measure that sought to do away with the legislative two-thirds vote for taxes failed by a 2:1 margin.

RESERVE FUNDS

HJTA has consistently supported the idea that government entities maintain prudent reserves. For example, we supported the Gann Spending Limit (Cal.Const., art. XIIIB) which exempted appropriations into a reserve account from being classified as appropriations subject to limitation. More recently, we supported Proposition 1 on the 2014 ballot to establish a rainy day fund with California's General Fund.

However, few can deny that many government entities have abused the public trust by hoarding vast sums of money. The problem remains, as it did in 2000, especially acute with enterprise districts. In 2000, the Commission listed the top 25 enterprise districts with the largest retained earnings and fund balances. For the Imperial Irrigation District, the fund balance jumped from $560 million to 1.6 billion in 15 years on current revenues of $600 million. All of this $1.6 billion is in retained funds, with $1.5 billion falling in the "reserved" retained fund category. For Eastern Municipal Water District, the fund balance has more than doubled to 1.6 billion on annual revenues of $284 million. And yet, retained earnings (reserved and unreserved) on the State Controller's website only total $110 million in 2015.

This raises an issue as to how these funds are being reported. For Sacramento County Regional Sanitation, revenues doubled since 1999 and the fund balance increased to just over a billion dollars on annual revenues of $245 million. Among retained earnings, reserved ($782 million) and unreserved ($307 million) totaled over $1 billion. In our cursory analysis of the Commission's original 25 districts, we found that fund balances have continued to increase dramatically in the range of anywhere from $30-$50 million annually.

It should be noted that during the recession of 2008-2012, reserve fund balances continued to climb across most districts. On paper at least, the economic slowdown appears to not have hampered those districts with the largest reserves. One would

think they would have taken advantage of the weak economy to invest in capital improvements (when construction labor is less expensive) or perhaps return that money to ratepayers struggling with double-digit unemployment. Perhaps the former did occur in some districts, but there can be no denying that, even factoring in capital spending and other expenses that reserves have continued to increase for these 25 districts. Retained earnings as a percentage of revenue that are 400%, 500%, or in the case of Irvine Ranch Water District, over 600% percent higher (1.2 billion on revenues of $185 million) are commonplace.

To reiterate, large reserve funds consisting of multiples of a district's annual budget can only be justified if there is a real plan for major capital investment accompanied by realistic timeline for construction. Ambiguous or undefined projects would be insufficient and, in fact, may be illegal. Proposition 218 states that property-related fees can only be imposed to cover the cost of providing the service. Large reserves suggest excess fees are being imposed above the cost of service.

HJTA recognizes that there has been at least some enhanced transparency as it relates to special district reserves. As a result of legislation passed after the Commission's Report on Special Districts in 2000, the State Controller now lists the top 250 special districts sorted by reserve fund amount. While valuable, this information fails to paint a complete picture of the true liquidity of a district. For instance, one example highlighted in the Commission's 2000 report involved the Metropolitan Water District of Southern California. It reported retained earnings in 1999 of just over $4 billion on operating revenues of $708 million. In 2015, retained earnings jumped to over $6.6 billion ($6 billion reserved) on annual revenues of $1.7 billion.

A more complete breakdown of these reserved retained earnings, perhaps as a result of an audit, would be helpful. This data should be consolidated onto one website. If they don't already, districts should also publish their retained earnings figures on their own websites.

<u>Recommendation</u>: The Legislature should strengthen guidelines, or directly regulate, special district reserve funds as well as mandating periodic reporting and publication of reports on line.

SPECIAL DISTRICTS AND PROPERTY TAXES:

The Commission has requested a discussion regarding the simultaneous receipt of property taxes and fee revenue by special districts. It is important to note at the outset that Proposition 13 has an extraordinary stabilizing effect on the property tax revenue stream. It does this by preventing taxation of unrealized paper gains in the value of real estate so that when the inevitable economic downturn occurs, there is a significantly lessened "shock" to revenue.

We highlight this point because it serves to introduce a fact that the Commission made clear in its 2000 report, namely that property taxes continue to flow to districts with large reserves even when the economy is doing poorly. 15 of the 25 districts that had the largest reserve funds also received the most property tax dollars. The percentage of revenue received by Santa Clara Water District via property taxes nearly doubled and the actual amount increased by $40 million between 1996 and 2014. In that same period, the fund equity jumped from 391 million to 2.4 billion, or 600 percent. Increases in property tax revenue alone accounted for at least one-third of this amount. There were $650 million in retained earnings on annual revenues of $320 million. For the Central Contra Costa Sanitation District, property tax revenues more than doubled to 13 million annually while its fund equity figure jumped more than 300%, from 214 million to 644 million. In San Diego, property tax revenues jumped from $4 million to $12 million for the county water authority while the fund equity increased by over $900 million to $1.5 billion.

As with the reserve fund issue, the "double dipping" of revenue sources remains largely unresolved. There is little doubt that some enterprise special districts which, by their nature, have access to fee revenue, may also be receiving property tax revenue that might more appropriately be allocated elsewhere – especially to entities which do not have the authority to collect fees or other non-tax revenue.

ALLOCATION OF PROPERTY TAX PROCEEDS:

In 2000, the Commission wrote at length about the inequity of how local property taxes are distributed among local agencies. It especially highlighted why enterprise special districts receive a larger share of funds then other special districts (libraries) that do not collect fees. We agree with this assertion, and do believe that using 37 year old

formula's to dictate how property tax revenue is dispersed is both unfair and problematic.

This problem is not just limited to special districts. Even among cities, there are significant fluctuations in their receipt of property tax revenues. However, the California courts have ruled that, while unfair, a city that received no property tax revenue at all under the AB 8 formula did not have a viable legal theory under the California Constitution.

Similarly, there are inequities among special districts that are disadvantaged under antiquated property tax allocation formulas. But the fact remains that all property tax revenue received by special districts, regardless of type, has doubled to nearly $5 billion between 1999 and 2011. Money for non-enterprise special districts receives the lion share of this money at $3.5 billion. However, considering these represent 70% of all special districts, the proportional share provided to enterprise districts which already receive fee revenue is far greater. Property tax revenue to these districts increased by almost $800 million in these 12 years.

Recommendation: The inequities in the distribution of property tax revenues among all local government entities is not the result of Proposition 13. Indeed, the expressed language of that measure states that such revenues are to be allocated "according to law." This vests *all* the discretion in the California Legislature which has, for 38 years, permitted these inequities to continue.

It is easy to identify the cause of legislative intransigence. There can be no reallocation of the one percent property tax without creating losers as well as winners. Nonetheless, the Commission should do all in its power to prod the California Legislature to perform a top to bottom review of all the statutes allocating property tax revenue.

CONSOLIDATING SPECIAL DISTRICTS WITH A FOCUS ON HOSPITAL DISTRICTS

The Commission also requested input regarding the consolidation of special districts. Much of the Commission's earlier report discussed the 25 (one-third) of hospital districts that continue to collect property tax revenue (usually regressive parcel taxes) without operating a hospital. All of the healthcare districts specifically referenced in the report, many without hospitals, continue to exist. Especially without a hospital, or if that hospital is being leased by a private company, should an independent government

entity like a healthcare district continue to provide services? We question whether this is in the best interests of taxpayers. Of course, there's no question that services are still being rendered by these districts. For instance, the Bloss Memorial Healthcare District, an entity without a hospital, provides healthcare at rural clinics, operates an Adult Day health facility, and a women's health center, using a combination of fees and parcel tax revenue. We believe these services are duplicative and unnecessary. Many counties already provide the same services out of their General Fund. Further, many of the people served in the Central Valley community may also qualify for Medi-Cal under the Affordable Care Act.

We note that parcel taxes are exceptionally regressive in the sense that individuals pay the same amount of tax annually regardless of the size of their house, or how often they use the healthcare services. Without a hospital, it would seem like taxpayers would be best served if these healthcare districts folded into other municipal entities and any parcel taxes were repealed.

In the California Legislature, HJTA confronts many issues related to struggling healthcare districts and usually in a negative way. In 2015, HJTA opposed Assembly Bill 72 (Bonta) that authorized the Eden Township Healthcare District to establish a special tax, which could have included a parcel tax. Prior to this, the District received money by leasing out its medical buildings. They have not operated a hospital in years, pay their part-time CEO $156,000 annually and awarded $186,000 in grants in 2014 while paying $364,000 in salary and benefits. Eden Township claimed they needed the money to settle a $20 million judgment against Sutter Health, which ran one of their hospitals. However, they have $40 million in assets and their combined salaries far outpace their annual grant amounts. Thankfully, Assembly Bill 72 failed in the Legislature, but the Healthcare District still remains active.

Other examples, such as Sequoia Healthcare district, abound as well. This district also fails to operate a hospital and is upheld by $9 million in property tax revenue, largely consisting of a parcel tax of about $90 per property owner. Of some concern is the fact that the District has spent millions of dollars on grants and nurses training programs, but ultimately those services have not benefitted taxpayers, either because the nurses don't stay in the area or the grants are provided to entities outside of the District. According to taxpayers, the local LAFCO has placed a "transitional" tag on the district, but legislative authorization is needed to force a vote on potential dissolution of the District.

Finally, the Western Contra Costa Healthcare District, which ran the Doctor's Medical Center (previously known as Doctor's Hospital) before closing its doors due to insolvency in 2015, continues to levy a $52 annual parcel tax to pay off Certificate of Participation bond debt until 2027.

Recommendations: As the 2000 Commission made clear, LAFCO's need to be empowered to take action on behalf of the taxpayers they represent. Legislative authorization should not be needed to place a measure on a ballot requesting dissolution of the district and elimination of parcel taxes. LAFCO's should be allowed to unilaterally place questions on the ballot pertaining to dissolution when the healthcare district in question no longer owns a hospital. LAFCO's should also be required to do an immediate review of any healthcare district that doesn't own a hospital, requesting important details including what the revenues and expenditures are in the district, and how many overlapping services are already offered by another municipal entity. In addition, if any of the districts receive funds under Proposition 13's one percent cap, these funds should be returned to local government entities, not to the state, for appropriate distribution. Every possible measure should be taken to ensure that local government is incentivized to enhance the use of special districts so more taxpayers benefit.

Conclusion

HJTA applauds the Commission for the manner in which it executes its mission to achieve greater efficiency, economy and transparency in California state and local governments. We remain willing and able to assist the Commission in this and future efforts.