



*State of California*

# LITTLE HOOVER COMMISSION

May 3, 2000

The Honorable Gray Davis  
Governor of California

The Honorable John Burton  
President pro Tempore of the Senate  
and members of the Senate

The Honorable James Brulte  
Senate Minority Leader

The Honorable Robert Hertzberg  
Speaker of the Assembly  
and members of the Assembly

The Honorable Scott Baugh  
Assembly Minority Leader

Dear Governor and Members of the Legislature:

Serious attention is being given to how California organizes and funds local governments. In this report, the Commission examines a number of issues involving more than 2,200 independent special districts that provide important services to virtually every community in the state.

Ironically, these governments that are physically closest to their communities are oftentimes unknown to the people they serve. And in the absence of community involvement, the mechanisms for public accountability are dulled and the value of public scrutiny is lost.

It also is ironic that when they were created, these districts were tailored to the needs of their communities. But as those communities have grown and changed, the districts themselves have been slow to change their boundaries, functions and governance to reflect their communities.

When we began this study, we found that many people had a story about special districts – some praised them, while others reviled them. But few had good information with which to assess fairly and accurately their contribution to California. Recognizing that need, the Commission gathered data that had not been pulled together before to provide a clearer picture of these districts and their attributes.

The picture reveals areas of concern and areas of promise.

Most districts provide modest compensation packages to board members. But the taxpayers and ratepayers in some districts pay for significantly higher meeting stipends and health and life insurance benefits.

The Commission found that many independent special districts have accumulated significant reserves. In addition, some of the well-heeled districts – and particularly those that charge customers fees for the services they provide – continue to receive property tax revenues. Because of the diversity of districts, it is difficult to generalize how these resources are being used. And based on the Commission’s inquiry, much of these revenues are committed in the short term, either legally or by time-honored practice. But these funds are a public resource, that over the long term should be scrutinized like all public resources to determine if they are being put to the highest and best use.

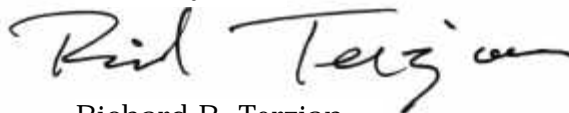
Unlike the special districts they are supposed to scrutinize, many of the Local Agency Formation Commissions (LAFCOs) do not have the resources to be the catalysts for improvement that state policy-makers envisioned. LAFCOs are often unwilling or unable to challenge the status quo, even when it is clear that with a little pushing special districts could be reorganized in ways that lower costs or improve the quality of service.

In some cases, consolidating small districts that offer the same service or large districts offering similar services could be expected to yield efficiencies and other improvements. In other cases, communities might find that special districts have the resources and expertise to meet needs that were not identified when the districts were formed. In all cases, local officials need technical assistance, proven methodologies and the facilitation skills to overcome the barriers to change.

In this examination, the Commission did not judge the performance of individual special districts. One of the Commission’s early discoveries was that the districts are very diverse – in what they do and how well they do it. Rather, the Commission hopes its examination of the overarching issues – along with the implementation of its recommendations – will encourage and enable community leaders, voters and customers to judge the performance of their districts for themselves.

With scrutiny, will come improvement. Where districts need more resources, let the community decide. Where districts have too many resources, let the community decide.

Sincerely,

A handwritten signature in black ink that reads "Richard R. Terzian". The signature is written in a cursive, flowing style.

Richard R. Terzian  
Chairman

# **Special Districts:**

## **Relics of the Past or Resources for the Future?**

**May 2000**

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# *Executive Summary*

Turn the tap and the water flows. On Thursdays the garbage gets collected. When it gets dark, the streetlights go on.

In many communities these are government services that are taken for granted. But democratic government is not designed to function in obscurity or anonymity. Absent citizen involvement, government agencies of all sizes are prone to inefficiencies and public resources are vulnerable to abuse.

The Little Hoover Commission found that independent special districts often lack the kind of oversight and citizen involvement necessary to promote their efficient operation and evolution. And without robust mechanisms of public accountability, inefficiency can become routine and the occasional scandal inevitable. Some examples:

- ❑ Independent special districts, according to the most recent information available, have \$19.4 billion in reserves – nearly 2½ times their annual gross revenues. Yet in many cases, community and state leaders do not know the size of these reserves and why they are being held – and as a result, these resources are often not integrated into regional and statewide plans for fortifying the State’s infrastructure.<sup>1</sup>
  
- ❑ Twenty-four health care districts in California no longer operate hospitals. Most continue to receive property taxes, which might be better spent on other community needs. Some provide services that could be administered by other agencies. Most of the districts report that they have not considered dissolution.
  
- ❑ Consolidations, even when they make sense, are hard to accomplish. It took five years of intense pressure from the Orange County Local Agency Formation Commission to merge three small water purveyors into one. The reorganization, within three to five years, is expected to save more than \$1 million a year. Similar opportunities for savings can be found throughout the state, but are lost because the mechanisms for reform are thwarted by the power of the status quo.

California has 58 counties, 474 cities – and more than 3,800 special districts. About two-fifths of those districts are considered “dependent” because they are governed by a larger entity, such as a county board of supervisors. But more than 2,200 of these districts are “independent,”

governed by their own elected bodies, including park districts, water districts, hospital districts and sanitation districts.

Many independent districts also are “enterprise” districts, like water and sewer agencies, which directly charge customers fees for the services they provide. Others, such as library and park districts, are “non-enterprise” districts, which rely mostly on property tax revenues to serve their communities.

The Commission focused on independent districts – both fee-based enterprise districts and tax-dependent non-enterprise districts.

Many of these independent special districts were created to extend public services – such as drinking water or parks – to rural and slowly developing communities that were beyond the reach of incorporated cities. But many, such as the water districts in Orange County, survive as separate government agencies even after urbanization has paved over the economic or geographic reasons for their independence.

Some districts have evolved in ways that cities and counties cannot – to manage consolidated fire protection services and regional parklands. Others, such as the health care districts, were created to provide a unique service, but persist after that service is provided by another public or private organization. Very few districts close their doors on their own initiative.

If no news is good news, the vast majority of districts are successful, and clearly many are. But most Californians would be hard pressed to identify the providers of some of their most basic services or to assess whether the fees are appropriate and the quality is what it should be.

The essential lesson of the last decade is that successful enterprises – public or private – are those that understand the needs of their customers and continuously strive to improve the services they offer. Similarly, successful organizations evolve to capture efficiencies and to align their core competencies with customer needs. Bigger is not always better, and sometimes smaller is.

But most special districts were formed when California looked different than it does today. Nothing ensures that these districts evolve to whatever size, shape and governance structure makes the most sense – given contemporary technologies, economics and social considerations. Local Agency Formation Commissions (LAFCOs) were created to be the venue for these discussions and catalysts for change. If strengthened, LAFCOs hold the best promise for individual communities to shape their government.



The Commission believes its reforms would yield improvements in three areas:

- ❑ **Improved public involvement and scrutiny.** The complexity and pace of modern life has diminished the electoral process as a mechanism for ensuring that government – and special districts in particular – provide greater value with fewer resources. Special districts need to be more visible to the public they serve and to community and business leaders who can influence decisions.
- ❑ **The efficient evolution of independent special districts.** Fiscal and political pressures have brought about some consolidations and reorganizations of small special districts that collectively serve large urban areas. But Local Agency Formation Commissions can be fortified to more effectively facilitate prudent changes.
- ❑ **More vigorous review of public resources.** Some 195 independent enterprise districts have reserves greater than five times their 1996-97 gross revenue. But these resources are often not incorporated into community and statewide discussions about how to improve infrastructure or reduce the cost of living and doing business in California. Similarly, nearly 600 enterprise districts continue to receive more than \$400 million in property tax revenue, while many other districts providing the same services rely solely on fees. State and community leaders need to openly reconsider how these resources are being used.

To accomplish these reforms, special districts need to be more visible and Local Agency Formation Commissions need to become advocates for improvement. To challenge the status quo, policy-makers need a better understanding of the potential benefits of reorganizing special districts. State and community leaders need to know more about the assets held by special districts, and they must reassess the lingering reliance of some enterprise districts on property taxes.

Many of the Commission's recommendations for special districts should become standards for all governments – making themselves more understood and relevant to their constituents. The recommendations in this report concern independent special districts because that was the focus of the Commission's study – not because other local governments and state agencies are immune to inefficiency.

These recommendations are offered to state policy-makers for formal consideration and some would require state direction and support. But many of these practices could be voluntarily adopted by independent

special districts and Local Agency Formation Commissions working with civic and business leaders in their communities.

A fundamental question facing California is how it will be governed in the 21<sup>st</sup> Century. The government closest to the people is often times a special district. Sorting out the problems and the potential of these districts will help state and community leaders in what should be a continuous pursuit of improved services at lower costs. In that spirit the Commission finds and recommends the following:

**Finding 1: Special districts are often invisible to the public and policy-makers, compromising oversight and accountability.**

In contrast to general-purpose local governments, special districts often operate in relative obscurity, hidden from the scrutiny of the public they were created to serve. The accountability mechanisms that do exist – financial information filed with the State Controller and the electoral process – are often inadequate. Districts submit financial information to the State Controller that is not easily accessed or understood by the public or policy-makers.

Research conducted by the Commission found that in Sacramento and Contra Costa counties the electoral process for special districts is less vigorous than for city council elections. It found that fewer races were competitive, more seats were filled with appointments and fewer voters participated in special district elections than other local elections. Sacramento County did increase participation in special district elections when it consolidated those elections in even years – but not even that effort brought special district elections in line with city councils.

Equally important, the media, interest groups and active citizens who frequently observe the actions of city and county governments understandably do not participate at the same level in special district governance. The city manager of a small Southern California coastal city, speaking in support of a city takeover of a water district, compared an average turnout of 75 people at city council meetings to no citizen attendance at water district meetings.<sup>1</sup>

For this and other reasons, when problems or abuses do occur, they often do not come to the attention of the public or policy-makers until they are egregious and the remedies drastic. In the controversy involving the Water Replenishment District of Southern California, officials from the cities served by the district were shocked to learn the size of the district's reserve funds that took several years to amass. Relationships

with other local governments, as well as broad citizen participation, would enhance the visibility and accountability of special districts.

***Recommendation 1: The Governor and Legislature should enact legislation that would make special districts more visible and accountable. Specifically, the legislation should:***

- ***Require special districts to actively make their activities visible to the public.*** To help the public – as citizens, consumers and voters – to participate effectively, independent special districts should annually develop and publicize the following information, stated in easily understood terms:
  - ✓ District mission and purpose
  - ✓ Summary financial information presented in a standard format and simple language, including reserve funds and their purpose
  - ✓ District policy on the accumulation and use of reserves
  - ✓ Plans for the future, including anticipated revenues, expenditures, reserves and trends in user rates
  - ✓ Per capita tax contributions of property owners
  - ✓ Performance and quality of service indicators
  - ✓ Board member benefits and compensation

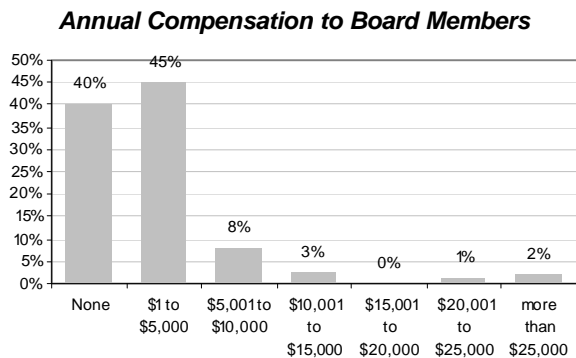
Financial information should be posted on Web sites, provided in property tax bills, customer billing statements, and be available from cities, counties and libraries. Districts should be required to publicly notice all meetings in local newspapers, invite coverage by local cable television and conduct annual mailings to district residents.

- ***Require special districts to submit information to other local governments.*** Independent special districts also should annually and publicly present financial information to county boards of supervisors and city councils, which represent the broader community of interests. Districts also should submit budgets and financial audits to their Local Agency Formation Commission, which could then determine which districts warrant closer scrutiny.
- ***Encourage special district elections to be held as part of even year general elections.*** To increase voter participation in special district elections, counties should be encouraged to consolidate special district elections in even-year general elections.

**Finding 2: Local Agency Formation Commissions, by not aggressively scrutinizing the organization of special districts, have failed to promote the efficient and effective evolution of independent special districts.**

The State created LAFCOs in counties and charged them with fostering the rational and orderly evolution of local government. It subsequently gave them the authority to initiate special district consolidations. But LAFCOs often lack the technical skills or political will to make change. LAFCO officials report that the commissions are often ineffective because they lack independence, clear direction from the State and funds to conduct studies. Another longstanding concern is that compensation paid to board members discourages them from giving up their seats in the name of efficiency. The Commission found evidence that this could be the case in some districts.

These problems are exemplified by California’s 24 health care districts that no longer operate hospitals. Having sold, leased or closed their hospitals, the districts endure. Nearly half of them pay meeting stipends or benefits to elected board members. But LAFCOs consistently fail to examine these districts to determine whether they should be eliminated.



Where consolidations have occurred, particularly in urbanizing communities, services have been improved and costs reduced. Water and sanitary districts in Orange County reduced administrative overhead by eliminating two general managers, cut the number of board members from 17 to five, improved customer service and integrated infrastructure as a result of consolidation. Over time, they expect to save \$1 million annually.

Following a decades-long trend toward a regional fire service, districts in Sacramento County merged to create an agency that will cover nearly 400 square miles and serve 600,000 people. They will save money through lower overhead costs, a reduction in the number of management positions, economies of scale in purchasing equipment and supplies, and a reduction in the number of elected officials.

The Little Hoover Commission believes that decisions about the form and function of independent special districts in California are best made locally. But it finds that LAFCOs often do not have the capacity or will to make informed and economically sound decisions, particularly regarding independent special districts.

**Recommendation 2: The State should provide LAFCOs with the direction and resources necessary to make them a catalyst for the effective and efficient evolution of independent special districts. Specifically, the Governor and Legislature should:**

- ❑ **Require periodic and specific reviews of independent special districts.** The State should require LAFCOs in urbanizing counties, in cooperation with special districts and other local governments, to periodically review services provided by special districts. The reviews should identify areas of duplication and overlap and assess whether services are being provided in the most efficient and cost-effective manner. Where duplication, overlap and inefficiency are identified, LAFCOs should be required to initiate a study. Specific triggers could be established, such as when the fundamental mission of a district changes or reserves exceed defined limits.
- ❑ **Enhance the independence of LAFCOs.** The State should encourage LAFCOs in urban counties to appoint their own executive officer and legal counsel, thereby establishing employment relationships free of the real and perceived conflicts that occur when county employees hold those positions.
- ❑ **Require shared funding of LAFCOs.** To increase the resources available to LAFCOs, enhance their independence and increase their effectiveness, the State should require counties, cities and special districts to jointly fund LAFCOs. Special districts should contribute whether or not they have opted to sit on a LAFCO.
- ❑ **Identify funds for studies.** The State should require special districts that are the subject of a required LAFCO study to fund the study. For financial hardship cases, the State should provide grants or loans, which could be repaid from savings accrued as a result of reorganizations.

**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.**

Reliable information is needed to aggressively and assertively fuel the evolution and optimize the use of special districts. These tools are especially important as communities strive to efficiently provide housing and transportation in growing urban areas, concepts known as “smart growth.” Research is needed that will help policy-makers and community leaders know when consolidations will achieve improved efficiency and service and identify strategies for facilitating those consolidations. Policy-makers also need guidelines, best practices and

access to a cadre of experts who can provide technical assistance and training. Absent these resources, even if LAFCOs are independent and have the political will, resistance from board members and the momentum of the status quo will prevent the evolution of independent special districts.

The State can play an important role in building the competence necessary for effective and informed local decision-making. The California Policy Research Center (formerly the California Policy Seminar) was created at the University of California to inform California's policy-makers about the most pressing issues of the day. The resources of this center, or other private and public institutions like it, could fill the information void that in some communities works to prevent structural reforms.

***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.

**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.**

In 1996-97, the most recent year for which data is available from the State Controller, independent special districts reported \$19.4 billion in retained earnings and fund balances. Enterprise districts, which charge fees for their services, reported \$18.2 billion in retained earnings. Non-enterprise districts, which rely on property taxes, reported \$1.2 billion in fund balances. More than 600 districts reported reserves of \$1 million or more. More than 1,300 districts have reserves in excess of their gross annual revenue.<sup>2</sup> From a state perspective little is known about these funds, including how they are invested or the purposes for which they are earmarked. State law specifies that local government agencies are to make relatively conservative investments. But there is virtually no oversight by the State or other local governments of the investment policies and practices of special districts. And there are no standards guiding the size and use of reserve funds. These issues are of concern, as evidenced by pending legislation that would require all local governments to submit their investment portfolios to the California Debt Advisory Commission in the State Treasurer's Office.

The size of special district reserves raises a number of important policy issues.

- ✓ Special district reserves represent significant public resources. Many districts have good rationales for maintaining reserves at certain levels, including providing a cushion during lean years and permitting investment in infrastructure. But the size of the reserves and how they are invested are often not understood by community leaders and district customers.
- ✓ The State and local communities are grappling with the need to fund infrastructure that will contribute to California's continued prosperity. But the resources of special districts frequently are not considered in plans to meet these needs. The resources and capacities of special districts could play a larger role in planning and financing regional and statewide infrastructure.
- ✓ There are no guidelines for accumulating or using reserves and no oversight of the investment practices of special districts. Reserve and investment policies and practices could be improved through the establishment of guidelines and enhanced scrutiny.

A number of steps should be taken to help communities understand and make the best use of special districts and their assets.

**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.
- **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.

**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.**

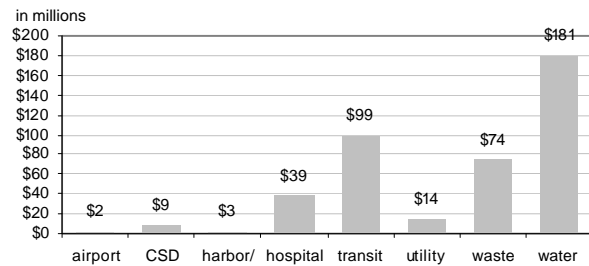
Those enterprise districts that levied property taxes prior to the 1978 passage of Proposition 13 continue to receive property tax allocations. Those districts also charge customers fees for water, sewer and other services they provide. In 1996-97, independent enterprise districts received \$421 million in property tax allocations. Water districts, which generate the highest annual revenues and maintain the largest reserves of all special districts, received 38 percent of that amount, a total of \$161 million.



The allocation formulas may have made sense when they were implemented more than two decades ago. But over time the logic has faded. Significant policy questions are raised by the continuing practice of allocating property taxes to enterprise districts.

✓ Property taxes subsidize the cost of providing services in some districts. This practice allows some districts to rely on these revenues to keep rates low or provide a higher quality of services. Other districts offering similar services must rely solely on fees to cover those costs. The property tax subsidy also can exaggerate inequities among classes of ratepayers within a district.

**Property Tax Allocated to Independent Enterprise Districts**



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

✓ Some districts that continue to receive property tax revenues are among those that have the highest reserves. Meanwhile, non-enterprise districts such as parks and recreation and library districts have seen their revenues dwindle and their ability to provide services diminished.

✓ Taxpayers do not understand how their property taxes are allocated among the special districts serving them. And they do not know how these allocations affect their rates or quality of services, preventing them from providing feedback to district officials.

These issues should be explored in any discussion of property tax allocations to enterprise districts. Beyond the dollars involved, policy-makers and the public must understand the consequences of the current policy for taxpayers generally and for some customers specifically. They also need to understand consequences for districts that cannot charge fees and have seen their property tax revenues diminished.

**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 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.

# ***Introduction***

Californians support and receive services from thousands of special districts. But many Californians do not know what a special district is – let alone which ones serve them.

Special districts provide the most essential of services – water and electricity, fire and flood protection. They also provide amenities that contribute to communities and culture, such as parks and libraries. But because of their sheer numbers, typically narrow focus and low public profiles many districts operate beyond the awareness and scrutiny of their customers and policy-makers. Four retail water districts serve the 80,000 residents of the city of Lake Forest in Orange County. Confused by different rate structures and unable to identify their provider, they contact the city with their complaints.

The Little Hoover Commission has a broad mandate to investigate the operations of state government and its instrumentalities, and to make recommendations for improving service and lowering costs. Special districts, the most numerous of the State's agencies, usually capture the spotlight when individual cases become controversial. The Commission undertook this study amid allegations of abuse and mismanagement in some special districts that caught the attention of state policy-makers and the public. Because controversies usually involve independent special districts – districts governed by their own elected board – those were the focus of the Commission's review.

In previous studies, the Commission has looked at state programs that are administered within California communities. In many of these instances a state agency is charged with ensuring that State goals are met. The relationship between the State and its thousands of special districts is far less clear.

On one hand, the State has given Local Agency Formation Commissions the authority to initiate special district reorganizations. But special districts can muster considerable energy to resist change, particularly when the goal is to consolidate or eliminate obsolete districts. In that regard, the State did not give LAFCOs the independence, the guidance, the analytical tools or the resources needed to get the job done. Without state assistance, and in the absence of local leadership, the goals of the LAFCOs are seldom met. And while the State has crafted and implemented laws intended to limit the proliferation of special districts in favor of cities and counties, other statutes thwart that intent.

In initiating a study of special districts, the Commission saw an opportunity to illuminate an area that affects daily the lives of millions of Californians, and to offer recommendations for optimizing their use and guiding their evolution in the 21<sup>st</sup> Century. Specifically, the Commission asked the following questions:

- ❑ Are the activities and finances of independent special districts adequately scrutinized and understood by the communities they serve?
- ❑ Are Local Agency Formation Commissions effective catalysts for the evolution of special districts when economics, growth patterns or technologies warrant consolidation or dissolution?
- ❑ Is there a role for the State in promoting the improved operation and evolution of special districts? And if so, how should those goals be pursued?

As part of this study, the Commission held public hearings in June and August of 1999. A list of the witnesses is included in Appendix A. The Commission also consulted with special district managers and board members and individuals representing the interests of districts, cities, counties and Local Agency Formation Commissions. It reviewed the work of other groups that had studied or were reviewing state and local governance and finance issues, and talked to numerous individuals knowledgeable about the workings of local government.

To further inform its deliberations, the Commission conducted research in the following areas:

- ❑ ***Special district vs. city council elections.*** The Commission compared special district and city council elections in Sacramento and Contra Costa counties to assess the effectiveness of the electoral process as an accountability mechanism for special districts. Four measures were reviewed: the number of candidates running, contested vs. non-contested elections, incumbency patterns, and voter participation rates.
- ❑ ***Characteristics of LAFCOs.*** The Commission heard that with few exceptions, LAFCOs are ineffective in pursuing special district reorganizations. In-depth interviews were conducted with six LAFCO executive officers to better understand the characteristics of effective LAFCOs, identify barriers to consolidations and solicit additional recommendations for how the State could bolster their effectiveness.

- ❑ **Benefits and compensation to board members.** The Commission heard that board member benefits are often effective deterrents to consolidations or reorganizations. A random sample survey was administered to special districts statewide to determine benefits and compensation provided to board members, including stipends for meeting attendance, health care and life insurance. The California Special Districts Association assisted the Commission to develop and administer the survey and encouraged district participation.
  
- ❑ **Health care districts without hospitals.** Of the 74 health care districts in California, 24 no longer operate hospitals. The Commission asked those districts to describe how their missions have changed and whether they have considered dissolution. Financial audits and business plans also were requested. The Association of California Healthcare Districts supported the Commission's efforts by helping to develop the survey questionnaire and solicit district responses.
  
- ❑ **Special district reserves and property tax allocations.** The Commission heard that some special districts maintain excessive reserves and that property tax allocations to enterprise districts should be reviewed. Data were gathered to quantify reserves held by enterprise and non-enterprise special districts and property tax revenues received by enterprise districts.

Based on the information gathered, the Commission concluded that special districts play a vital role in the health and prosperity of California's communities. It also concluded that these districts could improve the services, play an even more important role in building the state's future, and evolve in ways to improve the quality and reduce the costs of service. These conclusions are detailed in five findings and recommendations.



## ***Background***

The mosaic of special districts reflects the way California developed and the ability of special districts to be tailored to community needs. When created, many districts were innovative solutions to public problems. And those that continue to evolve provide increasing value to Californians.

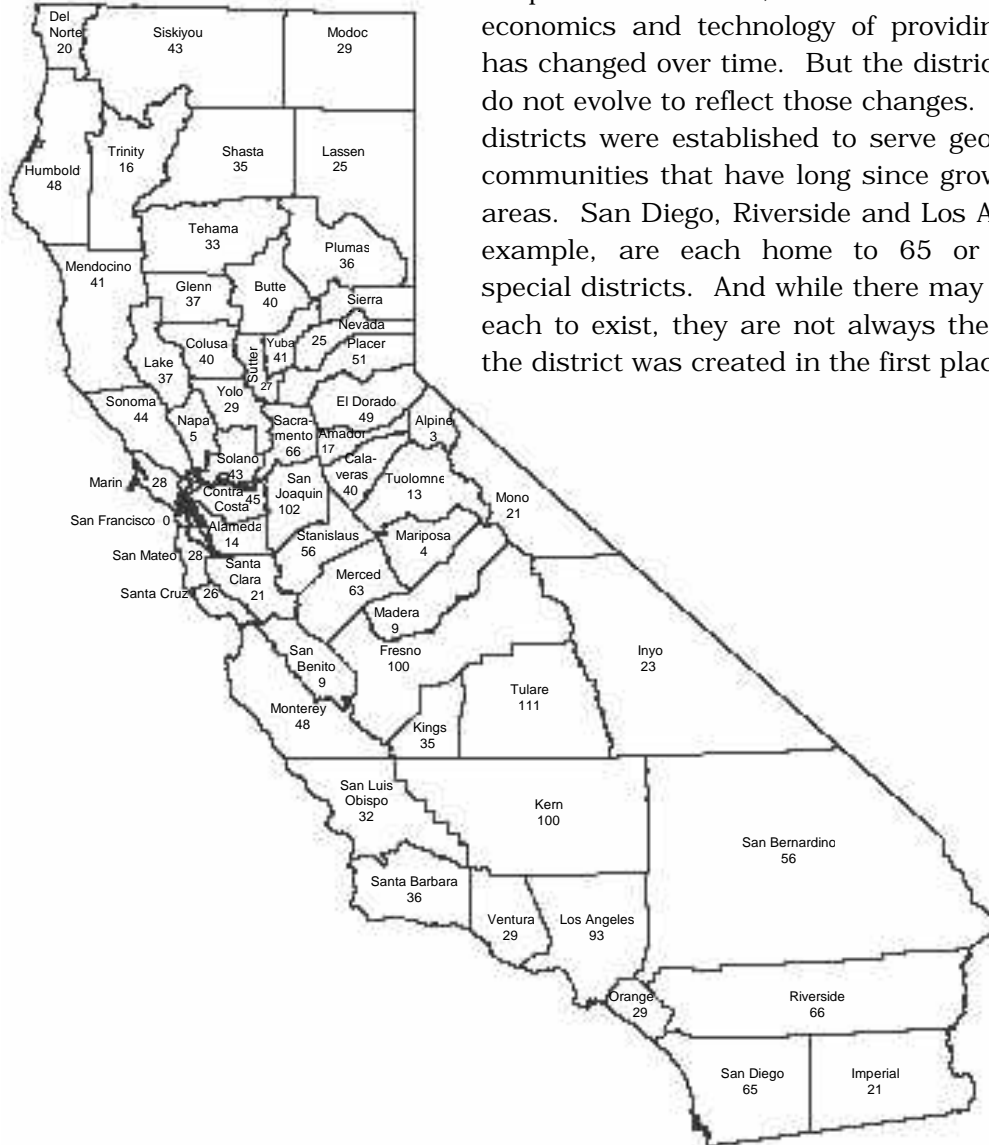
Prior to special districts, citizens in search of public services – particularly municipal services – formed cities or appealed to county supervisors to assume additional responsibilities. But as California developed, some service needs reached beyond the physical boundaries, the financial capacity, or the core competency of multipurpose local governments. The Legislature, through a number of general and special act laws, allowed for the creation of districts as agencies of the State to provide a local service.<sup>3</sup>

The first special districts in California were formed by farmers who wanted to use the power of government – principally eminent domain and the ability to efficiently bond for capital improvements – to develop irrigation projects. Empowered by the Wright Act of 1887, farmers in Stanislaus County formed the Turlock Irrigation District to capture and store Sierra runoff and deliver it to valley farms – creating the first special district in the state and displaying a powerful tool for meeting a public need.<sup>4</sup>

Early in the 1900s, dozens of water districts were formed to develop agricultural and urban water supplies – often reaching far beyond the borders of cities and counties they served. Most of the state’s 74 health care districts were formed between the late 1940s and early 1950s to address a statewide shortage of hospital beds. In the 1950s, the suburbanizing state was swept by a second wave of water district formation. And since much of the development was in unincorporated areas, districts also were created to provide for fire protection, road maintenance, parks and recreation, sewer treatment and waste disposal.

The purpose and size of special districts varies greatly. But most were formed for similar underlying reasons: to provide urban services outside of city limits, to provide regional services that transcend the limits of a single city, to provide services beyond the capacity of existing local governments, or to fill a gap in services between other governmental agencies.

**Number of Special Districts  
in Each County**



The rationale for many special districts – the size and shape of the district, the demand for services, and the economics and technology of providing those services – has changed over time. But the districts themselves often do not evolve to reflect those changes. For instance, many districts were established to serve geographically distinct communities that have long since grown into large urban areas. San Diego, Riverside and Los Angeles counties, for example, are each home to 65 or more independent special districts. And while there may be good reasons for each to exist, they are not always the same reasons why the district was created in the first place.

***Taxonomy of Special Districts***

Some special districts provide one specialized service – managing a cemetery or a memorial hall, or operating a sewer treatment plant. Other districts provide multiple services, taking on the character of a full-fledged city; the Bear Valley Community Services District, for example, maintains roads, provides drinking water, hauls away garbage and provides police protection to a town in the Tehachapi Mountains.

They can be as large as the Metropolitan Water District of Southern California, serving more than 16 million people in six counties, or as small as the Halcumb Cemetery District in Shasta County, which patiently waits for the day it can serve its 5,000 mountain residents.



The State Controller’s office, which gathers financial data on special districts, puts the count at 4,787. That number includes 659 joint powers agencies and 233 public nonprofit corporations. The Controller’s data reveal an important element: that special districts can be defined and divided in different ways, and the policy issues that surface depend on which groups of special districts are being examined. Special districts are most often delineated by their legal authority, the services they provide, how they are governed and administered, and how they are funded.

**By Statutory Authority**

Special districts are authorized under either a principal act or a special act. Approximately 60 principal act statutes provide a framework for voters to create a particular type of district anywhere in the state. For example, Health and Safety Code sections 32000-32492 authorize and prescribe the powers of California health care districts: “A local hospital district may be organized, incorporated and managed, as provided in this division and may exercise the powers herein granted... .” Statutes provide for cemetery, road maintenance, fire protection, irrigation and resource conservation districts.

The Legislature also has created special act districts when it is persuaded that unique needs require a unique district. The Humboldt Bay Harbor Recreation and Conservation District and the Alameda County Flood Control and Water District are examples of the approximately 125 special act districts.<sup>5</sup>

**By the Services They Provide**

A common way of grouping special districts is by the services they provide. Water districts are the most numerous, followed by fire protection, community services, cemetery and memorial districts. There are 47 mosquito abatement districts and eight citrus pest districts.<sup>6</sup>

<b>Independent Special Districts</b>			
Air Pollution	7	Maintenance	23
Airport	9	Municipal Improvement	4
Cemetery/Memorial	279	Parking	3
Community Services	283	Pest Abatement	61
Drainage	28	Police Protection	3
Fire Protection	342	Recreation & Park	96
Flood	35	Reclamation	132
Garbage Disposal	1	Resource Conservation	92
Harbor & Port	12	Sanitary/Sanitation	117
Healthcare/Hospital	74	Separation of Grade	1
Highway Lighting	4	Utility	55
Library	14	Water	458

Source: State Controller, 1996-97 financial data, on file. Counts for districts that reported reserves and gross revenue information to the Controller. Does not include transit districts or 86 districts identified by the Controller as inactive. Health district count is from the Association of California Healthcare Districts.

While water districts may be organized under one of a number of different statutes, they have long been politically united to pursue common goals of providing reliable water supplies to a growing population in a region with a Mediterranean climate. Similarly, there are

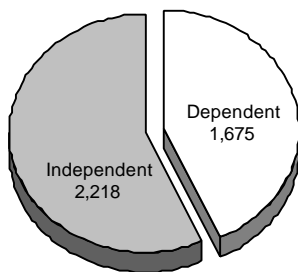
associations representing the interests of sanitation districts, recreation and park districts and port authorities.

### **By Their Governance**

A major distinction among special districts is between dependent and independent districts. Dependent districts are subdivisions of another multipurpose local government; county boards of supervisors or city councils typically govern dependent districts. Independent districts are those with their own governing board, usually elected directly by voters.

A few agencies, like most cemetery districts, are governed by boards that are appointed by city councils or county boards of supervisors.

**The Majority of Special Districts are Independent**



Source: State Controller, 1996-97 data. Does not include JPAs or nonprofit corporations.

The Controller's Office reports that there are 1,771 dependent districts, including 76 joint powers agencies (JPAs) and 20 nonprofit corporations. According to the Controller, there are 3,016 independent districts, including 583 JPAs and 215 nonprofit corporations.<sup>7</sup>

Regardless of their governance structure, districts have many of the same governing powers as other local governments. They can enter into contracts, assume debt and levy taxes and assessments. And they can sue and be sued. But the governance structure can determine how districts operate, the visibility of their decisions and how they are held accountable to the public.

### **By Their Source of Funds**

Another factor that determines the nature of districts is their source of revenue. Districts that finance their operations with fees for the services they provide are known as enterprise districts. Special districts that are funded through property taxes are known as non-enterprise districts.

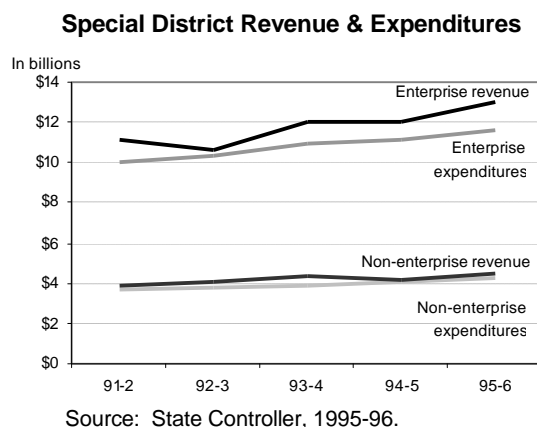
Enterprise districts typically have customers who consume goods or services: electricity, drinking or irrigation water and waste disposal. Some highly specialized agencies also can be enterprise districts, such as port districts. Fees are set by the governing board to recover the costs of providing services from the customers of those services.

Non-enterprise districts typically provide services that indirectly benefit the entire community, whether it is actually consumed or not – such as fire or flood protection, memorial hall and cemetery districts. The costs of these services are often recovered through property taxes.

Some districts are hybrids – collecting fees and providing enterprise services, while also fulfilling non-enterprise functions that are funded

through taxes. In 1996-97 districts reported enterprise activities generating \$13.4 billion dollars in revenue. Non-enterprise districts reported \$4.6 billion in revenue.<sup>8</sup>

As the chart shows, enterprise districts received and spent significantly more public funds than non-enterprise districts. The chart also provides the first glimpse of one issue concerning enterprise districts in particular – that revenue consistently exceeds expenditures, providing the opportunity for enterprise districts to establish reserves.



## ***The State’s Role: Financial Reporting***

As separate government agencies, virtually all special districts are designed to be accountable directly to the people who elect their leaders – whether those leaders are city council members or county supervisors who occasionally wear the hat of special district board members or whether those directors serve on independent boards.

The State plays a nominal role in gathering and reporting financial information that is intended to aid in this accountability. Regardless of type or size, all districts are required to report their financial transactions to the State Controller.<sup>9</sup> By law, the State Controller annually compiles and publishes these transactions in the *Special Districts Annual Report*.<sup>10</sup> The information reported by the Controller is in most cases not independently verified, because most districts have not completed their audits before the deadline set by the Controller. The Controller’s staff performs a “desk review” of the information submitted by districts, focusing on “consistency, reasonableness and format.” The Controller does not have oversight or audit responsibilities and the Controller’s report does not assess the performance or the fiscal health of the districts.

## ***Local Agency Formation Commissions***

Concerned about the evolution of local government, the Legislature in 1963 passed the Knox-Nisbet Act, which created a Local Agency Formation Commission (LAFCO) in every county, except the city-county of San Francisco. The act charged LAFCOs with the following:

- ✓ Regulate the formation and boundaries of cities and most special districts.
- ✓ Discourage urban sprawl.

- ✓ Promote logical growth.

The Legislature later revised the procedures for changing boundaries of local governments with the District Reorganization Act of 1967 and the Municipal Reorganization Act of 1977. In 1985, the laws governing local boundary changes were consolidated into the Cortese-Knox Local Government Reorganization Act.

In 1993, the Legislature and the Governor enacted AB 1335 (Gotch), an amendment to Cortese-Knox that gave LAFCOs the authority to initiate boundary change proposals for special districts. The law allows LAFCOs to initiate consolidations, dissolutions, and mergers and create subsidiary districts if the proposals would:

- ✓ Cost the same or less than alternatives.
- ✓ Promote public access and accountability.
- ✓ Be consistent with the recommendations of a LAFCO study.
- ✓ Be discussed at a public meeting within each district that is affected.

In the Cortese-Knox Act, the Legislature stated a bias toward general purpose government:

*The Legislature finds and declares that a single governmental agency, rather than several limited purpose agencies, is in many cases better able to assess and be accountable for community service needs and financial resources and, therefore, is the best mechanism for establishing community service priorities.<sup>11</sup>*

The Legislature also intended that LAFCOs proactively push the evolution of special districts. For reasons explored in this report, LAFCOs are often ineffective in this regard. Between 1994, when AB 1335 was implemented, and 1997, only one LAFCO-initiated proposal resulted in a special district reorganization.

## ***The Legislature as Super-LAFCO***

In the absence of LAFCO-initiated reorganizations, the Legislature occasionally has acted as a “super-LAFCO” and attempted to force special district reorganizations.

- In 1995, in the wake of the Orange County bankruptcy, then-Assembly Speaker Curt Pringle became aware of the amount of money that special districts had in the failing county investment pool. He also learned that 57 elected officials were serving 32,000 people in the Dana Point area of Orange County. He introduced

legislation to consolidate 25 water and sanitary districts in the county. The legislative efforts, while unsuccessful, put pressure on district officials to merge or be merged.<sup>12</sup>

- ❑ In the same year, then-Senator Bill Lockyer introduced legislation to combine a sanitary district and water district in Alameda County into a single agency. Lockyer withdrew the bill, but not until a study had been conducted that showed that minor cost savings would be offset by higher short-term operational expenses and potentially higher compensation and benefits. Since that time, however, the two districts have developed a joint reclamation master plan to study the feasibility of using recycled water, coordinate employee training to reduce costs, and are exploring the joint use of facilities for some of their operations.<sup>13</sup>
- ❑ In 1995, Senator Polanco considered a proposal to reorganize three water districts in Los Angeles County. However, legislation was not introduced on this subject, as the end of the legislative session was approaching and staff anticipated some objections to the proposal.<sup>14</sup>

While none of these measures succeeded, they are evidence that the evolution of special districts is not always smooth and rational.

## ***The Policy Debate***

Periodically some policy-makers have expressed concern about the proliferation and fragmentation of local governments, including special districts. In their eyes, California’s 58 counties, 474 cities and more than 3,800 special districts are evidence of an uncoordinated, unwieldy and complex system of local government.

In the wake of Proposition 13 in 1978, there was particular concern that more cities and special districts would form to capture locally generated revenue. Similarly, there were concerns that fiscally strapped counties and cities might encourage the creation of special districts to shift service obligations to separate agencies. The evidence, however, does not support this “conventional wisdom.”

<b>Local Governments per 100,000 Population: California Compared to the Rest of the United States</b>				
	<b>Counties</b>	<b>Cities</b>	<b>Special Districts</b>	<b>School Districts</b>
<b>1992</b>				
California	0.19	1.49	9.05	3.49
Other 49 States	1.33	8.39	12.83	5.95
<b>1977</b>				
California	0.26	1.85	9.96	4.96
Other 49 States	1.51	9.35	12.02	7.12

Source: Paul G. Lewis, *Deep Roots: Local Government Structure in California*, Public Policy Institute of California, 1998.

Paul G. Lewis, author of *Deep Roots: Local Government Structure in California*, found that the number of special districts has increased only gradually since the 1970s.<sup>15</sup> Other researchers have found that the total number of districts has changed little – less than 3 percent – since the passage of Proposition 13. The greatest growth has been in the number

of county service areas and joint powers agencies – governments created by governments. If it were not for the growth in those categories, the total number of special districts would have actually dropped nearly 8 percent since Proposition 13 was enacted.<sup>16</sup>

Still, there is concern that as communities have developed, the underlying patchwork of special district governments has become unnecessarily redundant, inefficient and unaccountable. Reform advocates argue that many special districts – particularly in urban areas – could be consolidated to reduce duplication and capture economies of scale. In urban areas, districts often provide the same services provided by cities and counties and overlap one another, occasionally creating conflicts and competition. The large numbers of districts make it hard for the public to understand who provides what services and to assess their performance. The narrow focus and low public profiles of many districts diminish the chances that policy-makers and the public will actively monitor the activity of those districts.

Officials with special districts assert that they are an efficient means of providing local public services. They contend special district government is responsive and accountable – through direct elections of board members, open meetings, financial reporting requirements, audits and reviews by county grand juries.

At the same time, election results and academic research show that the public often prefers the government closest to them. Even when presented with more efficient and effective options, the public will often opt to maintain the government that they know, trust and believe can be more responsive to their needs.

These tensions persist in many communities throughout the state, seldom rising to the top of political agendas until particular controversies or scandals put a spotlight on problems. To better understand the issues of visibility, accountability and the evolution of special districts, the Commission reviewed three individual case studies. Several key policy issues emerged from these case studies that guided the Commission's research and informed its conclusions:

## **1. Water Replenishment District of Southern California**

The controversy involving the Water Replenishment District of Southern California (WRD) contributed to the Commission's decision to conduct this study. The Commission examined the WRD to learn more about the larger policy issues of governance, efficiency and accountability that are raised among special district governments in other locales.

Established in 1959, the WRD provides groundwater for 3.5 million residents in 43 cities in southern Los Angeles County. A five-member board, elected by geographical division, governs the district. Prior to 1991, the WRD shared an administrative staff of three with the Central Basin and West Basin municipal water districts, which provide supplemental water to many of the same cities served by the WRD. The WRD broke away from the West Basin and Central Basin districts in 1991 and expanded its staff and the scope of its activities.

In 1998, the district came under fire from a number of the cities it serves for its water rates, contract bidding practices, the size of its reserve, and for allegedly violating the State's open meeting laws. Dissatisfied with the district's response to their concerns, the cities of Artesia, Downey, Lakewood, Norwalk, Pico Rivera, Santa Fe Springs, Signal Hill and Cerritos filed four lawsuits against the district and its directors. Policy issues raised by this case are pertinent to other special districts, including:

- ❑ **Obscure and unaccountable.** Independent special districts are often criticized as being invisible and unaccountable to the public. Well-managed districts publicize their activities and solicit ideas from customers. Other districts work anonymously and beyond scrutiny until a scandal ensues.

Cities served by the WRD assert the district conducts its business behind closed doors and in violation of the State's open meeting laws, discussing and acting on matters not appropriately noticed. One tangible consequence was fees set far greater than the cost of providing the service, which resulted in the accumulation of a large cash reserve.

- ❑ **Duplication and Inefficiency.** Duplication and inefficiency are common criticisms of special districts. The Commission heard that the WRD is unnecessarily duplicating functions performed by other districts. Several witnesses told the Commission that consolidation, particularly of water and sewer districts in urban areas, results in improved service, infrastructure and efficiency.

## 2. Sacramento County Fire Districts

As the Commission began its study, the American River and Sacramento County fire protection districts were negotiating a merger for the second time in recent years. Earlier merger talks fell apart over concerns by the Sacramento County fire district about workers' compensation and retirement plans and the elimination of elected board positions. Subsequently, three new directors were elected to the Sacramento

County fire board. In June 1999, the new Sacramento County board and American River board voted to renew efforts to merge the two districts that serve 600,000 residents in northern and eastern Sacramento County and a small portion of Placer County.

Representatives from the two districts negotiated several issues: the boundaries for board member districts, composition of the new board, labor issues, and the effect of reorganization on tax revenue.

In October 1999 the districts filed a petition with the county LAFCO to merge. LAFCO and the County Board of Supervisors approved the measure, which will become effective in December 2000. Combining the two districts is expected to save \$500,000 in administrative costs and reduce response times. One fire chief position and five elected director positions will be eliminated. Policy issues raised by this case study include:

- ❑ ***Understanding the benefits of consolidation.*** In spite of their disagreements, officials with both fire districts agreed that reorganization would improve service and reduce costs. But how to credibly calculate the savings that can be expected from mergers – which are essential facts in overcoming the parochial interests of the status quo – is a problem in many similar situations.
- ❑ ***Dependent vs. independent LAFCOs.*** Sacramento County has had a large number of fire protection and other special districts that have been slow to merge even when it makes economic sense. One factor in the slow evolution of the districts is the county's Local Agency Formation Commission. The county LAFCO is staffed part-time by county employees with many other responsibilities, reducing its effectiveness as a catalyst for change.
- ❑ ***Overcoming parochial interests.*** An issue in the districts' reorganization proposals was the resistance of directors to support a merger that would reduce the number of elected positions. This issue is sometimes voiced as reducing democratic representation. But this problem has been solved elsewhere by "grand-fathering" incumbents onto the new board and phasing the surplus seats out over time, which is an indication that some of the concern is about the continued participation of incumbents rather than representation over the long-term.

### **3. Orange County Water Districts**

In 1993, South Coast Water District was a small water district that realized that to be more efficient it had to be bigger. At the time,



neighboring districts were not interested in a reorganization and there was no political support for consolidating districts.

Following the Orange County bankruptcy, the number of small districts in the county – and the large reserves they had invested in the failing county fund – increased political interest in consolidation. The City of Dana Point applied to take over the South Coast Water, Capistrano Beach Water and Dana Point Sanitary districts. The districts, in turn, each filed alternative consolidation applications. The Orange County LAFCO agreed that consolidating the agencies would increase accountability and improve service. A study funded by the districts concluded that the South Coast Water District was the best provider in Dana Point, and recommended that the smaller districts be merged into it. The LAFCO agreed.

The consolidation eliminated 15 elected board positions. Two general manager positions were eliminated through retirements. The consolidation agreement mandated that all employees keep their jobs and that reductions in staff occur through attrition.

The City of Dana Point, however, remains convinced that citizens would have been better served had the city taken over the services. The city manager believes that the decision was made on political grounds rather than factual ones, asserting the districts hired consultants and public relations specialists who “worked the LAFCO staff, board and public.” He claims the benefits promised by the consolidation have not materialized.<sup>17</sup>

The consolidation of water and sanitary districts in the Dana Point area of Orange County provided the Commission with important insight on two issues:

- ❑ **Local government turf issues.** This case exemplifies the potential for turf issues to become barriers to consolidation. Elected officials from separate local government agencies often claim to represent the same constituents, with animosity between special districts and cities widespread.
- ❑ **Independent vs. dependent LAFCOs.** In contrast to Sacramento County, the LAFCO in Orange County has an independent staff and budget. Reform advocates argue that independent LAFCOs have the time, resources and develop the skills necessary to analyze consolidation alternatives and facilitate the negotiations that result in reorganizations.

## ***Recent Reform Efforts***

In 1997, the Legislature enacted AB 1484 (Hertzberg), establishing the Commission on Governance for the 21<sup>st</sup> Century. The Commission was charged with reviewing and making recommendations for reforms to governance in California. Specifically, it was charged with examining the Cortese-Knox Local Government Reorganization Act of 1985 and Local Agency Formation Commissions governed by the Act.

Having a broader mandate and aware that the Little Hoover Commission was reviewing special districts, the commission did not address specifically the governance, accountability and efficiency of special districts. It did review other issues related to special districts and made, among others, the following recommendations that are relevant to this study:

- ✓ That the Cortese-Knox Act be amended to declare that single purpose agencies have a legitimate role in local governance, while recognizing that multi-purpose agencies may be the best mechanism for service provision, particularly in urban areas.
- ✓ That LAFCOs be neutral, independent and provide balanced representation for counties, cities and special districts.
- ✓ That special districts be given the automatic option to select two LAFCO members.
- ✓ That special districts not be required to give up their right to exercise their latent powers as a condition of LAFCO membership.<sup>18</sup>

In its final report, *Growth Within Bounds*, the Commission on Governance for the 21<sup>st</sup> Century made additional recommendations for strengthening LAFCO powers and increasing public involvement in government.<sup>19</sup>

The Little Hoover Commission conducted its study within the context of the long history of debate over special districts. It understood quickly that while the size and purpose of special districts may change over time, the districts are sure to remain an integral part of the local government landscape. For those reasons, it focused on the visibility, accountability and appropriate evolution of independent districts.

## ***Toward Visibility and Accountability***

### **Finding 1: Special districts are often invisible to the public and policy-makers, compromising oversight and accountability.**

Most independent special districts are single purpose and provide one service, such as water, sanitation or fire protection. Narrow in scope and given little consideration until a problem occurs, these districts rarely evoke public scrutiny. Much of the public may not even realize that they are indeed governments. The traditional oversight and accountability mechanisms – the electoral process, public meetings and financial reporting – have not been effective in promoting the kind of rigorous examination required of democratic institutions. To increase their visibility and accountability, special districts should be required to aggressively publicize information about their finances and activities to policy-makers and the public.

### ***Existing Accountability Mechanisms***

Independent special districts are local governments with their own elected boards, subject to mechanisms designed to hold them accountable to the public and policy-makers, including:

- ***The electoral process.*** Most special district board members are elected by division or at-large, typically for four-year terms. Like other elected officials, they are subject to removal from office if voters become disenchanted with their policies or performance. There are some exceptions: county boards of supervisors, for example, appoint memorial and cemetery district board members. Also, small districts often do not have enough candidates for a contested election or have no candidates at all. In either case, appointments become the responsibility of the county supervisors.
- ***Sunshine laws.*** Like all local governments, special districts are required to conform to the Ralph M. Brown Act, the State's open and public meeting law, and to make minutes of their meetings publicly available. Districts also must comply with the Public Records Act.
- ***Financial audits.*** Districts annually adopt budgets and programs at open and public meetings, and file their budgets with county auditors. They are required to have annual or biennial independent audits. In some cases, county auditors conduct audits; elsewhere, independent audit firms perform the audits.

- ❑ **State Controller reports.** Special districts are required to annually report their financial transactions to the State Controller, who compiles and publishes the information in the *Special Districts Annual Report*. Districts also submit copies of their financial audits to the State Controller. The Controller's function is primarily ministerial, including a desk review of the information, focusing on "consistency, reasonableness and format." The Controller does not have oversight or audit responsibilities that would help to assess the performance of special districts or hold them accountable for fiscal decisions.

Occasionally, the activities of a special district have raised enough concern that a review by the State Auditor has been undertaken, as was recently the case with the Water Replenishment District of Southern California. The activities of special districts can also be subject to review by local grand juries.

## ***Challenges to Effective Oversight***

The formation of a special district is a fundamentally democratic action – the creation of a government by a community of people. But the traditional democratic means of providing oversight are not adequate.

Special districts seldom generate much public interest because of the singular and generally non-controversial nature of their activities. As a result, the mechanisms for oversight and accountability – the electoral process, the public venue and financial reporting – are often ineffective. Advocates of multiple governments tout the efficacy of these mechanisms in ensuring accountability and contend that any lack of public participation signals satisfaction, but the evidence shows otherwise.

- ❑ **The electoral process is not rigorous enough.** Researcher Nancy Burns found in *Formation of American Local Government: Private Values in Public Institutions* that few citizens are aware of and participate in special district government. Citing an earlier study, she reports that following their formation, special districts usually have a miniscule number of voters participating in elections, with involvement of 2 to 5 percent of the electorate regarded as an unusually high turnout.<sup>20</sup>

To gauge the adequacy of the electoral process in special district elections, the Commission studied election results in Sacramento and Contra Costa counties for the years 1983 through 1998.<sup>21</sup> The research compared the rigor of the electoral process in city council elections to that in special district elections by reviewing voter

participation, incumbency patterns and contested elections. The Commission found differences between special district and city council elections in four areas: the number of candidates running, seats filled through contested elections, incumbency rates and voter participation.

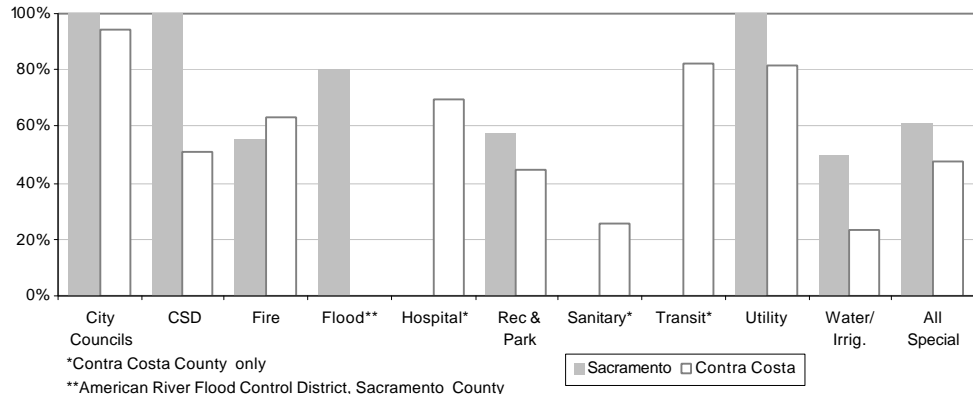
<b>Independent Special Districts in Sacramento &amp; Contra Costa Counties in 1998</b>	
<b>Sacramento</b>	<b>Contra Costa</b>
3 Community Services (CSD)	4 Community Services (CSD)
11 Fire	3 Fire
1 Flood – American River Flood Control	3 Health/Hospital
10 Recreation & Park (Rec & Park)	6 Municipal Advisory Council or Municipal Improvement (MAC)
4 Resource Conservation	5 Recreation & Park or Regional Park (Rec & Park)
1 Utility – Sacramento Municipal (SMUD) provides electricity	1 Resource Conservation
9 Water or Irrigation (Water/Irrig.)	8 Sanitary
3 Landowner Water – not included in election data	2 Transit (also serve neighboring counties)
	1 Utility – East Bay Municipal (EBMUD) provides water and sewer
	5 Water or Irrigation (Water/Irrig.)

Sources: Sacramento LAFCO, Directory of Service Providers, Nov. 1998.  
 Contra Costa Registrar of Voters, electionspossible, on file.

**1. Contested Elections.** Special district board members may either win a contested election, run uncontested (in which case they are appointed by the county board of supervisors), or be appointed by the board of supervisors if not enough candidates filed for the available seats. The Commission found that fewer candidates ran for special district seats than ran for city council seats. In addition, while city councils consistently had enough candidates to hold elections, special districts frequently did not.

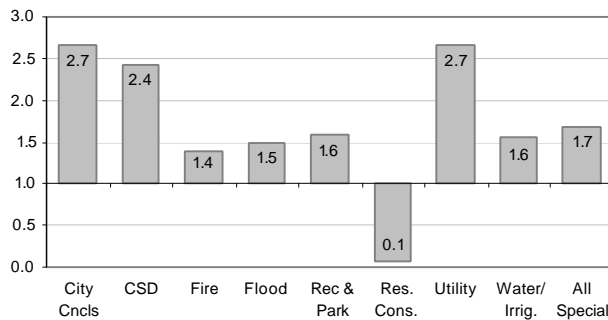
The chart on the following page depicts the percentage of seats that were filled through contested elections between 1990 and 1998. In Sacramento County, all city council, utility district (Sacramento Municipal Utility District – SMUD) and community services district (CSD) seats were filled through contested elections. Fire, flood (American River Flood Control District), park and recreation, resource conservation, and water and irrigation district seats were filled by a combination of contested elections, appointed uncontested candidates, and appointments. In Contra Costa County, all types of districts and city councils had at least one seat filled by appointment. In both Sacramento and Contra Costa counties, all seats on resource conservation district boards were filled by appointees.

**Seats Filled Through Contested Elections**  
1990-98, Sacramento & Contra Costa Counties



**2. Candidate participation.** Overall, there were more candidates per seat for city council races than special district elections in Sacramento.<sup>22</sup> The differences were particularly striking in fire, flood, resource conservation, and water and irrigation districts. On average, candidates in these districts had a greater than two in three chance of winning. In contrast, the average city council candidate was only half as likely to win.

**Candidates per Seat**  
Sacramento County, 1983-1998



1 candidate per seat = unopposed election  
Less than 1 per seat = at least 1 appointment made

Resource conservation districts, which were scheduled to elect 12 board members between 1983 and 1998, did not hold a single contested election, and only one candidate filed.

As the chart on the left illustrates, more candidates filed for each available seat on a city council (2.7) than for each special district vacancy (1.7) in Sacramento County. In community services districts (CSDs) and the Sacramento Municipal Utility District (SMUD), which are high-profile districts, more than two candidates filed per vacancy. Other special districts, however, ranged from 1.6 to 0.1 candidates per seat, which means that so few candidates filed that all seats were filled by appointment.

**3. Incumbency patterns.** A slightly higher percentage of special district seats are contested and won by incumbents in both Sacramento and Contra Costa counties than their city council counterparts. The variation between counties, however, was greater than the differences between special districts and city councils. Incumbents ran for and won a greater percentage of seats in Sacramento than in Contra Costa.

In Sacramento County contested elections, incumbents won 48 percent of the special district seats, compared to 44 percent of the city council vacancies. Similarly, Contra Costa County special district incumbents won 30 percent of the contested seats, while city council incumbents won 23 percent of the contested seats.

Special district board members are also much more likely to begin their stints on special district boards as appointees. Subsequently, they may run for re-election or simply be reappointed to the board. If they face a contest for re-election, these board members have the advantage of incumbency, although the voters did not originally elect them. In Sacramento County, between 1983 and 1998, 36 percent of fire district incumbents (27 people), 33 percent of recreation and park district incumbents (17 people), and 43 percent of water and irrigation district incumbents (20 people) began their board careers as appointees.

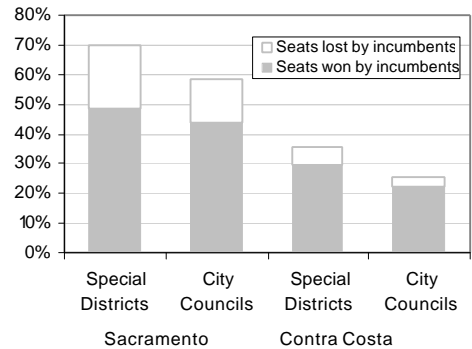
**4. Voter participation.** The Commission found lower levels of voter participation in Sacramento County special district elections, as compared to city council elections.<sup>23</sup>

In the 1990 to 1998 Sacramento County general elections, there were 18 city council and 233 special district elections.<sup>24</sup> During that period, voters selected 41 city council seats and 439 seats on special district boards. To determine participation, the Commission compared the number of votes cast to the number of votes that could have been cast if all registered voters voted for all of the seats available. On average, registered voters cast 55 percent of their allowed city council votes and 45 percent of their special district votes.<sup>25</sup>

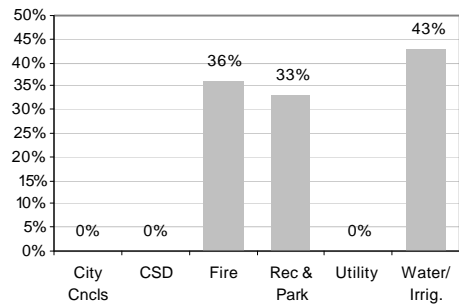
Sacramento has made an effort to increase voter participation in special district elections. Prior to 1988, many special districts held their elections in odd-numbered years. Voter turnout is typically much lower for odd-year elections, which lack the statewide issues to draw voter interest. City council elections between 1983 and 1987, for example, averaged 47 percent voter participation.

**Incumbency Patterns**

**Seats Contested By Incumbents 1990-1996**

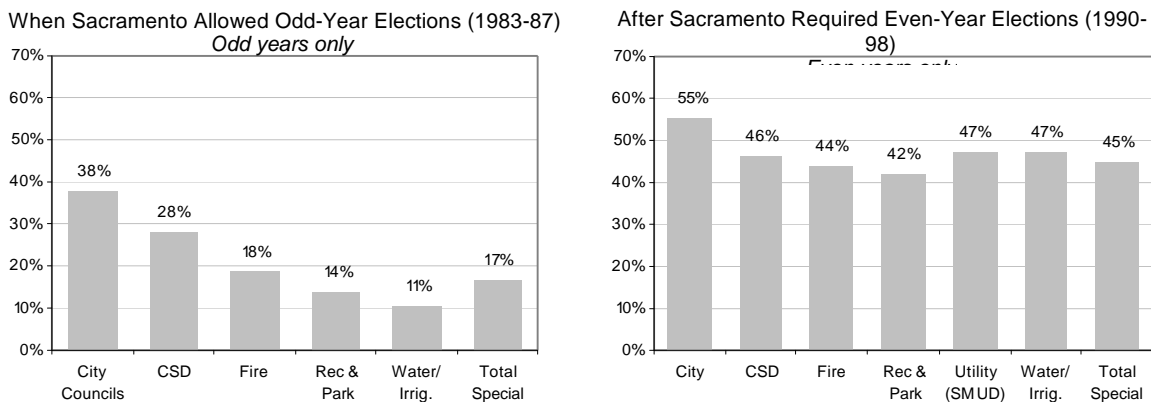


**Incumbents Beginning As Appointees Sacramento County, 1983-1998**



For odd-year elections alone, city councils averaged a 38 percent voter participation rate. Water and irrigation districts averaged an 11 percent participation rate, and fire districts averaged 18 percent.<sup>26</sup> The rate of participation in local elections increased significantly in 1988, when all city council and special district elections were placed on the general election ballot in even years. The data, however, also show that special district elections still do not receive the same level of participation as city council elections.

**Average Voter Participation**



- ❑ **Open meetings are not enough.** Designed as the venue for public scrutiny of public agency activities, the public process as practiced by special districts is largely ineffective. The Brown Act, in effect, requires that people come to the government, not that government comes to the people. But the people generally do not go to special district government, either because they are unaware of its existence and activities, or because it is inconvenient.

Today, many businesses and larger government agencies recognize and take advantage of the opportunities presented by technology to provide better customer service. “Brick and mortar” operations of the

past are now on-line. Many special districts, on the other hand, do not maintain a presence on the Internet. When they do, they often fail to provide information necessary to facilitate rigorous public scrutiny of the district’s policies and performance, or to invite input electronically from customers unable or unwilling to attend public meetings.

**Public Meetings on the Internet**

Some cities, like Santa Monica, provide live video streaming of their city council meetings on the Internet. Others are also posting the video on their Web sites. These practices allow citizens to view a public meeting they are interested in from their work site or home, or at times they find convenient.

Many districts contacted by the Commission reported practicing the most minimal of public notice by posting meetings and agendas only at



district headquarters – locations rarely frequented by members of the public. Most do not routinely use newspapers, cable television or radio to make their activities known to their customers.

Californians by and large do not have an easy, one-stop way to determine which districts serve them, and when and where those districts meet. The Internet is one effective way for citizens to find out detailed information tailored to their communities. In simple applications, citizens can find out the time and place of meetings. But increasingly public meetings are being “broadcast” on the Internet to anyone interested in participating.

Many districts hold meetings at times convenient for the staff and elected officials, but that preclude attendance by citizens faced daily with the pressures of balancing family, work, school and other demands of contemporary life.

- **Financial reporting is inadequate.** For financial reporting to be useful to the public and policy-makers, it must be easy to get, easy to understand and easy to respond to. Currently, district financial reporting meets none of these criteria.

Prepared according to principles and standards developed by and for professionals, district financial information is difficult for persons lacking training in public finance to understand. The Controller’s report, *Special Districts Annual Report*, is prepared with largely unaudited information from districts and is two years old when it is made available. Distributed to the Governor, Legislature, special districts, libraries and county auditors, it is of little utility for community leaders and local policy-makers interested in examining special districts.

Budgets and audits submitted to county auditor controllers are public documents. County auditors may review budgets to ensure that they balance, or that districts have “done the math” correctly. In some counties, monthly reports are generated for the districts’ use. The budgets are not provided to the public or policy-makers. Audits are typically given a cursory review to ensure that they are prepared in accordance with established standards, and are then filed away. Absent a controversy, these documents are unlikely to ever be viewed

**Public Notice is Inadequate**

During the course of its study, the Commission used a newspaper clipping service to obtain articles from across the state that contained special district news. Of the hundreds of articles that crossed the Commission’s desk, few provided notices of district board meetings, pertinent district financial information or reference to a Web site for more information.

**Riverside County Special District Meeting Times**

	Daytime	Evening
Community Services	1	6
Health*	2	1
Recreation & Park	1	3
Resource Conservation	6	1
Sanitary	1	1
Water/Irrigation	15	10

\*A fourth health district meets only once a year.

by policy-makers or the public – who are mostly unaware that the reports exist or do not know how to obtain them.

Districts also are not required to submit financial information to city or county elected officials or Local Agency Formation Commissions, which represent the broader community interests. As a result, district financial information is largely meaningless as a tool to evaluate the effectiveness and efficiency of services provided by districts, or to make comparisons with neighboring districts or services provided through a city or county.

## ***Making Finances and Activities Known***

Among the attributes of special district governments are the ability to provide specialized services desired by the residents of a given area, governance by an elected body close to and responsible to the voters, and a lack of conflicting policy issues. These very characteristics, however, also give rise to the lack of visibility and accountability for which special districts are criticized.

Long concerned about these shortcomings, policy-makers have attempted to address the challenges to good government presented by the obscurity of special districts. Historically, efforts to make local government better understood, efficient and accountable have focused on changing government, not making it more visible. As described in the

### ***American River Fire Protection District***

Some districts, including the American River Fire Protection District in Sacramento County, have taken it upon themselves to aggressively publicize their activities and solicit public input.

#### **Increasing Public Awareness**

- ✓ Regular newsletters.
- ✓ Well-advertised Web site.
- ✓ Media encouraged to attend all meetings.
- ✓ Meetings aired on cable TV.
- ✓ Regular radio and newspaper coverage.
- ✓ Public Saturday strategic planning meetings.
- ✓ Evening board meetings.

In 1998, the district formed a citizen's task force and charged it with reviewing long-term strategies and addressing issues regarding the fiscal concerns of the district. The task force expanded its charge, examining issues of public awareness and involvement. It concluded that district residents were "woefully uninformed" about the operations of the district. The task force encouraged the board to provide increased opportunities for district residents to work closely with the board and district staff and to survey public attitudes toward the district on a regular basis. It recommended a "sustained and imaginative" public information and education campaign that would include advertisement of the existence of the district's Web site and encourage its use as a method of

obtaining public feedback. The district subsequently implemented a number of other strategies to increase public awareness and participation. The district reports it has received a tremendous amount of positive feedback from the public, particularly for televising its meetings.

background and Finding 2, the goal of most of these efforts has been a reduction in the number of local governments.

But even if policy-makers are successful in limiting or reducing special districts, they promise to remain an important fact of California life. The State could play an important role by addressing the persistent concerns about their lack of visibility and accountability.

The California Society of Municipal Finance Officers recognizes the importance of public awareness and understanding of the financial activities of cities and provides incentives for cities through its annual *Excellence in Public Communications* awards. Several cities have found innovative and effective ways to inform the public about their budget processes. These cities have made an effort to describe their budgets in language that the average citizen can understand, and to provide budgetary information in an easily accessible, reader-friendly format. They make use of graphs and formatting to summarize information and highlight major programs and savings. Short flyers and newsletter-style pieces are mailed to residents, providing them with basic information that is not intimidating. Several cities also provide budget information on their Web sites.

The examples provided by the American River Fire District and other local governments show opportunities to take government to the public and to raise the visibility and accountability of all special districts. Reforms in three areas could improve the electoral process, the public process and make financial reporting more effective:

- ❑ **Information to the public.** Public awareness of and participation in special district government – including the electoral process – could be increased if districts took advantage of all available means to publicize their activities and invite public participation. All districts could maintain Web sites that provide information on their mission, purpose, activities and finances. Widely advertised interactive Web sites could invite public input 24 hours a day, seven days a week, reducing the reliance on public meetings to provide public

***San Diego Citizen's Budget***

The City of San Diego presents a four-volume budget. Volume 1, titled the "Citizen's Budget," includes a "Citizen's Guide to the Budget" that walks the reader through each section of the budget, using sample graphs and charts from departmental budget pages. The Citizen's Guide also describes the allocation and budget processes and defines city fund types. The Citizen's Budget provides summaries of city revenues – including revenue carried over from the previous year – expenditures, capital improvements, number of city employees per thousand residents, and other financial information. The full budget provides detailed information on departmental revenue and expenditures and lists the outcomes of selected performance measures. All four volumes of the budget are available on the city's Web site. The Web site also provides information on community budget forums and offers an opportunity for citizens to comment on the budget.

San Diego's Citizen's Budget can be accessed at: [www.ci.san-diego.ca.us/budget](http://www.ci.san-diego.ca.us/budget).

accountability. And Web sites could be linked to those of cities, counties and Local Agency Formation Commissions. County and Local Agency Formation Commission Web sites could permit citizens to enter their zip code and learn which districts serve them. Districts could also inform the public through cable television, local newspapers and radio, newsletters, property tax bills and bills for service.

- **Information to local policy-makers.** Special district visibility and accountability would be enhanced, as would opportunities for more effective regional planning, if policy-makers in larger local government agencies understood the state of special district finances and activities. Special districts could annually present budgets, audited financial statements and future plans to boards of supervisors, city councils and Local Agency Formation Commissions. Detailed information on district reserves, including district policies on the accumulation and use of reserves, should be provided. So informed, local policy-makers could provide the oversight needed to prevent occasional but costly controversies like that of the Water Replenishment District of Southern California.
  
- **Information to state policy-makers.** Special district financial and activity information is needed by state policy-makers charged with developing and enacting policies that guide the evolution of government, define the state-local relationship and determine how infrastructure and services will be provided. State policy-makers, armed with information about district finances, could assess the solvency of districts, their ability to provide critical services, and the appropriateness of their reserve policies and practices.

To be useful, financial information should be provided in standard, uniform and easily understood formats. Summary financial documents should foster comparability, accountability and utility. Sources of revenues, expenditures and services provided should be identified, as should reserve funds and their purposes.

## **Summary**

The debate about special districts is often about which ones can be consolidated or eliminated. The Commission believes the first step should be making all independent special districts more visible – improving the electoral process, the public process and financial reporting. Visibility could become the norm rather than the exception. For citizens and community leaders to provide the necessary oversight, they need the relevant information.

**Recommendation 1: The Governor and Legislature should enact legislation that would make special districts more visible and accountable. Specifically, the legislation should:**

- ❑ **Require special districts to actively make their activities visible to the public.** To help the public – as citizens, consumers and voters – to participate effectively, independent special districts should annually develop and publicize the following information, stated in easily understood terms:
  - ✓ District mission and purpose
  - ✓ Summary financial information presented in a standard format and simple language, including reserve funds and their purpose
  - ✓ District policy on the accumulation and use of reserves
  - ✓ Plans for the future, including anticipated revenues, expenditures, reserves and trends in user rates
  - ✓ Per capita tax contributions of property owners
  - ✓ Performance and quality of service indicators
  - ✓ Board member benefits and compensation

Financial information should be posted on Web sites, provided in property tax bills, customer billing statements, and be available from cities, counties and libraries. Districts should be required to publicly notice all meetings in local newspapers, invite coverage by local cable television and conduct annual mailings to district residents.

- ❑ **Require special districts to submit information to other local governments.** Independent special districts also should annually and publicly present financial information to county boards of supervisors and city councils, which represent the broader community of interests. Districts also should submit budgets and financial audits to their Local Agency Formation Commission, which could then determine which districts warrant closer scrutiny.
- ❑ **Encourage special district elections to be held as part of even year general elections.** To increase voter participation in special district elections, counties should be encouraged to consolidate special district elections in even-year general elections.



## Strengthening LAFCOs

**Finding 2: Local Agency Formation Commissions, by not aggressively scrutinizing the organization of special districts, have failed to promote the efficient and effective evolution of local government.**

Local Agency Formation Commissions were created in response to the rapid and haphazard development of cities and special districts in the years following World War II. LAFCOs, charged with promoting the rational and orderly evolution of local government, were specifically empowered in 1994 to initiate special district reorganizations. But despite the intent of the Legislature, LAFCOs have failed to effectively guide the evolution of special districts. As a result, districts formed in a different time to meet different needs survive today – even if they are no longer the most effective service provider or the reason for their formation has ceased to exist. If LAFCOs are to be aggressive in scrutinizing the organization of special districts, they need a mandate and resources.

### ***“Watchdog” Agents of the State***

LAFCOs were established to function as “watchdog” agencies with local appointees. They can initiate special district reorganizations if they conduct a study that finds the reorganization would cost the same or less than alternatives, and would promote public access and accountability. LAFCOs are responsible for the cost of studies they initiate, unless the entities involved agree to contribute to cover the costs.

Most LAFCOs have five commissioners: two county supervisors, two city council members and a public member. The exceptions are those commissions dubbed the “Big Four” – Los Angeles, Sacramento, San Diego and Santa Clara – which have specific statutory provisions for membership. Several small counties also have different configurations. In 1993, AB 1335 (Gotch) required LAFCOs to add two special district members if a majority of a county’s independent special districts asked for representation. Currently, special districts have seats on 25 LAFCOs (44 percent).<sup>27</sup>

LAFCOs are described as dependent or independent, depending on whether their staffs are considered employees of the county or the commission. Of the 57

#### ***A LAFCO Executive Officer’s “Other Hats”***

The Sacramento County LAFCO executive officer also administers the county’s Community Development and Neighborhood Assistance Agency, serves as the Agricultural Commissioner/Sealer of Weights and Measures, and oversees the following county functions: Airports, Animal Care and Regulation, Cooperative Agricultural Extension, Environmental Management, Environmental Review and Assessment, Planning and Community Development, and Parks, Recreation and Open Space.

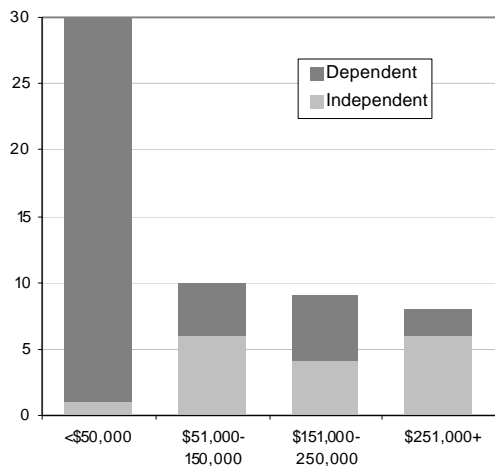


LAFCOs, 40 of them (70 percent) are dependent.<sup>28</sup> They have executive officers and staff who are county employees who typically allocate a percentage of their time to LAFCO work. They may also administer and oversee numerous other county functions. For example, in Sacramento County the executive officer is a county employee who devotes approximately 10 percent of his time to LAFCO duties. Independent LAFCOs appoint their own executive officers and legal counsel, who serve at the pleasure of the commission.

State law requires counties to fund LAFCOs and provide them with equipment, supplies and office quarters. County boards of supervisors allocate funds to LAFCOs based on commission estimates of the amount that will be needed in the following fiscal year, prior year funding and other criteria. LAFCOs also can charge fees for processing boundary changes.

In 1998-99, California counties budgeted \$7,170,570 for LAFCOs, with wide variations among counties. A survey by the California Commission on Governance for the 21<sup>st</sup> Century found that independent LAFCOs have larger budgets and recovered higher proportions of their costs through fees than did their dependent counterparts.

**LAFCO Budget Ranges**



Source: Commission on Local Governance for the 21<sup>st</sup> Century, Appendix G.

Thirty commissions have budgets of less than \$50,000. All of these are county-dependent LAFCOs, except Lake County. Ten LAFCOs have budgets between \$51,000 and \$150,000. Six of these are independent commissions and four are dependent on county staff. Nine LAFCOs have budgets between \$151,000 and \$250,000. Five of these commissions are dependent and four are independent. Eight LAFCOs have adopted budgets of more than \$250,000. Six of these are independent and two are dependent.<sup>29</sup>

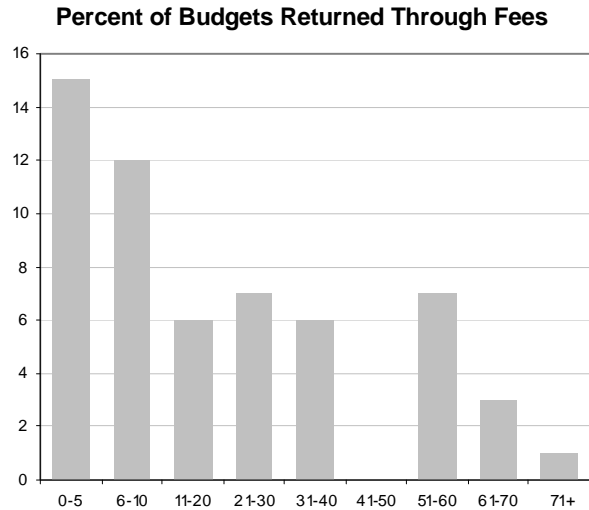
The Commission on Local Governance for the 21<sup>st</sup> Century also found that of the \$7,170,570 budgeted for LAFCOs statewide, 22 percent is returned to the



counties through fees collected by LAFCOs. Fees as a percentage of their budgets vary widely among dependent LAFCOs. They range from 5 percent to 75 percent, with a mean of 20 percent. Among independent LAFCOs, fees recovered ranged from 5 percent to 66 percent, with a mean of 26 percent. Independent LAFCOs recovered about \$1.2 million, or 70 percent of the total amount recovered throughout the state.

***Barriers to Reorganization***

The law gives LAFCOs the authority to initiate special district reorganizations. However, since the implementation of AB 1335, LAFCOs have generally failed to pursue special district reorganizations.



Source: Commission on Governance for the 21<sup>st</sup> Century, Appendix G.

A 1996 survey by the California Association of Local Agency Formation Commissions (CALAFCO), found that 18 of the 67 special district reorganization studies undertaken since the implementation of AB 1335 had been initiated by LAFCOs. Only one LAFCO-initiated proposal had actually resulted in the elimination of a special district.

The Senate Local Government Committee conducted a hearing in January 1997 in response to concerns that AB 1335 had not spurred special district consolidations. The committee concluded that only one LAFCO had taken advantage of its power to initiate special district reorganizations.

The Little Hoover Commission conducted in-depth interviews with six LAFCO executive officers to assess the ability and willingness of LAFCOs to initiate reorganizations, and to better understand the barriers to reorganizations. Interviews were conducted with LAFCO officials from Contra Costa, Fresno, Orange, Stanislaus, Riverside and Yolo counties. They represent rural, urban and urbanizing counties and are located in northern, central and southern parts of the State. Three are dependent and three are independent LAFCOs. The interviews reinforced testimony the Commission heard in public hearings.

The six counties involved in the interviews collectively have 311 independent special districts and 198 dependent special districts.<sup>30</sup> While all of the counties have experienced significant development, few

changes have been made in the structure of special district government. Since 1994:

- ✓ Two of the LAFCOs had each initiated one reorganization involving independent special districts. One effort involved an inactive fire district in Yolo County and the other involved the merger of a water district with a city in Orange County. Both proposals received LAFCO approval.
- ✓ One LAFCO initiated a reorganization of six Community Service Areas (CSAs), dependent districts governed by the Contra Costa County Board of Supervisors. The districts were considered inactive and the proposal to dissolve them was approved.
- ✓ In all, 22 special district reorganizations were submitted to the six LAFCOs. Of the 22, the LAFCOs approved 16, denied three and three were withdrawn.

In interviews and testimony to the Commission, the staff of county LAFCOs identified five barriers to the effective evolution of special districts:

**The State could establish clear criteria to make it easier to consolidate and dissolve districts.**

1. **Permissive and vague state policy.** Given the controversies inherent to reorganizations, LAFCO staff said they do not have clear statutory language to back up their efforts to push for the evolution of special districts. They emphasized that while the policy intends for LAFCOs to be proactive, it fails to provide criteria or guidelines for when reorganizations should be considered. The Stanislaus County LAFCO executive officer said: “The State could establish clear criteria to make it easier to consolidate and dissolve districts...”<sup>31</sup>
2. **Lack of independence.** The independence of LAFCO staff is a persistent issue that has not been adequately resolved. The Commission – and others researching this issue – have consistently heard that when staff is employed directly by the LAFCO they can work independently and objectively toward the goals of the LAFCO, rather than the goals of the county. This issue was described as particularly problematic in urbanizing counties where opportunities for reorganization are greatest. Two examples demonstrate the problem:
  - ✓ California Association of Local Agency Formation Commission officials described a county where the LAFCO staff is given a recommendation on a proposal by the county administrator and told to write a report to support it. The county employed this

tactic, it was explained, because it did not want to take on any more controversy or address tough issues about governance.

- ✓ CALAFCO officials also described LAFCOs where the county administrator or planning director performs the duties of the LAFCO executive officer. In these “strange” relationships, the executive officers’ primary loyalty is to their employers, not the commissions, and the commissions recognize that the executive officers do not really report to them.

At the same time, the workload in rural counties often does not justify the cost of full-time, independent staff. The Commission on Governance for the 21<sup>st</sup> Century found that many LAFCOs with low or no activity only meet as needed. For example, at the time of its survey, Del Norte LAFCO had not met in 18 months, Amador had not met in 12 months, Mariposa had not met in 24 months and Sierra had not met in 36 months. Nearly one-third of all LAFCOs meet three or fewer times per year.<sup>32</sup>

3. **Inadequate funding.** LAFCOs report that they do not have the resources necessary to aggressively pursue special district reorganizations – even if they had the political will. LAFCOs must have the staff or pay consultants to examine potential reorganizations and facilitate the public review process. The Riverside County LAFCO executive director told the Commission: “The Riverside LAFCO does not have the staff or resources to undertake the types of studies needed, or to engage in protracted battles... Even though the Palm Desert consolidation was a ‘no brainer,’ the Palm Desert board fought it.”<sup>33</sup>

The financial burden for LAFCOs falls overwhelmingly on counties; cities and special districts do not share in the fiscal responsibility. If funding were shared, LAFCO officers said the costs of the required studies are still a deterrent to pursuing reorganization opportunities. CALAFCO reports that consolidation studies cost between \$25,000 and \$50,000, depending on the number of agencies and the complexity of the issues.

**As LAFCOs Become Involved,  
Public Disclosure is Needed**

The Fair Political Practices Commission has declared that groups advocating for and against secession from Los Angeles should be required to disclose who is funding their campaigns.

In contrast to ballot initiative proposals or candidate elections, campaigns to change the boundaries of local governments are not subject to financial disclosure requirements until after a county LAFCO has reviewed the proposal and the issue has qualified for the ballot.

The heated controversy over the secession of the San Fernando Valley from Los Angeles has generated concerns about this “loophole” in the law as large sums of money are expended to influence the Local Agency Formation Commission.

While the FPPC agreed that disclosure should be required, it disagreed on the specifics of how groups would disclose campaign finance information. Reforms to address the issue are contained in pending legislation, which would implement recommendations from the Commission on Governance for the 21<sup>st</sup> Century. Specifically, the bill would require that contributions to influence a reorganization proposal be disclosed and reported in the same manner as local initiative measures.

4. **The structure of LAFCOs.** LAFCOs are comprised of elected city, county and special district officials, who when they sit as LAFCO directors are expected to scrutinize and possibly eliminate the positions held by other elected officials. As such, they are subject to local political pressure to preserve the status quo.

LAFCO staff told the Commission that in exploring reorganizations, the benefits of consolidation are often difficult to quantify and wide public support is hard to obtain. Coupled with the inevitable and often formidable opposition from the entities affected, commissions succumb to narrow politics rather than the broader public interest. Many believe that without a mandate from the State, LAFCOs will never aggressively seek to consolidate and eliminate districts. One former LAFCO staff member described it as LAFCOs' need for a "beard to hide behind."

5. **Benefits and compensation to elected officials.** The benefits and compensation that independent special district members receive deters them from supporting reorganizations that would eliminate their positions, according to several LAFCO staffers.

**Special Districts Survey**

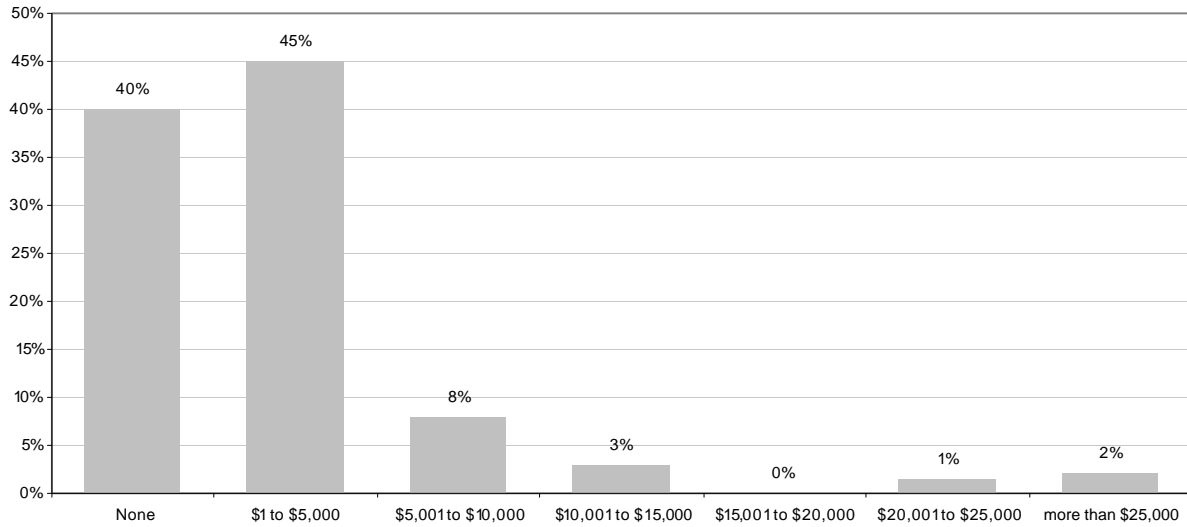
Surveys were sent to a random sample of 513 of the total 1,839 special districts in the California Special Districts Association database, stratified by district type and geographical area. 258 responses were received, resulting in a 14 percent sample. The Commission obtained at least a 10 percent sample for each type of special district. The survey form can be found in Appendix B.

The Commission, with the assistance of the California Special Districts Association (CSDA), surveyed independent special districts to quantify the benefits and compensation that districts provide elected officials and to assess from the perspective of the districts the role that benefits may play in discouraging reorganizations.

The survey revealed that most special districts compensate their board members at a minimal level or not at all – the majority of board members receive less than \$5,000 annually. The chart on the following page displays the distribution of compensation among board members.

As shown in the table opposite, the most common form of compensation is a meeting or monthly stipend. A significant number of districts also provide health and life insurance benefits. Most districts that provide health benefits to board members also extend them to spouses, and a few extend these benefits to former board members. Other forms of compensation include retirement benefits, workers' compensation, and car allowances. The majority of districts also pay for board members to attend conferences or classes.

**Board Members Who Receive Benefits and Compensation**  
**Percentage of Board Members by Annual Value**



**Board Member Compensation**  
**By District and Benefit Type**

	Stipends (Payment per Meeting)						Confer- ences %	Health Benefits %	Life Insurance %	Sample Total	
	%	min	max	mean	median	mode				#	#
Airport	50%	\$100	\$100	\$100	\$100	\$100	67%	33%	0%	6	9
Cemetery/ Memorial	38%	\$10	\$80	\$49	\$50	\$50	52%	7%	7%	29	228
CSD	43%	**\$6	\$100	\$63	\$50	\$100	43%	0%	0%	37	286
Fire	29%	\$20	\$100	\$62	\$75	\$75	58%	13%	6%	31	294
Harbor & Port	20%	*\$300	\$300	\$300	\$300	\$300	80%	40%	20%	5	18
Health	47%	\$75	\$100	\$98	\$100	\$100	83%	33%	10%	30	56
Library	0%	-	-	-	-	-	43%	0%	0%	7	9
Pest Cont.	83%	\$25	\$100	\$49	\$49	\$50	75%	8%	8%	12	59
Park & Rec	50%	\$50	\$100	\$90	\$100	\$100	80%	0%	0%	10	88
Pollution	100%	\$100	\$100	\$100	\$100	\$100	67%	0%	0%	3	4
Reclamation	67%	\$40	\$175	\$103	\$100	\$100	44%	0%	0%	9	96
Resource Conservation	^0%	-	-	-	-	-	80%	0%	0%	5	114
Sanitary	100%	\$25	\$100	\$87	\$100	\$100	69%	31%	23%	13	78
Utility	80%	\$20	^\$463	\$62	-	-	60%	40%	20%	10	55
Water	78%	\$25	\$229	\$108	\$100	\$100	73%	33%	16%	49	441

NOTE: Some districts pay their board members monthly stipends. These have been converted to per meeting figures based on the average number of board meetings per month.

\*One district pays each director \$600 per month. Directors meet twice a month.

\*\*\$25 yearly stipend.

^One district pays \$15 for mileage.

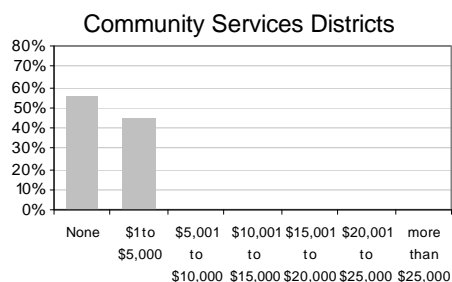
^^One district pays its directors \$926 per month. Directors meet twice a month.

In its analysis, the Commission looked specifically at community services districts (CSDs), fire, health, park and recreation, sanitary/sanitation and water districts. Overall, 56 percent of these districts provide meeting stipends or monthly compensation to their board members, 20 percent provide health insurance, and 9 percent provide life insurance. None of the community services or park and recreation districts surveyed reported providing health or life insurance. Sixty-six percent of the districts reported that they cover the cost to send directors to conferences and seminars.

The survey results also revealed significant differences among the types of districts when it comes to benefits and compensation. Here is a look at the benefits and compensation paid to board members of five different types of districts:<sup>34</sup>

**Community Services Districts**

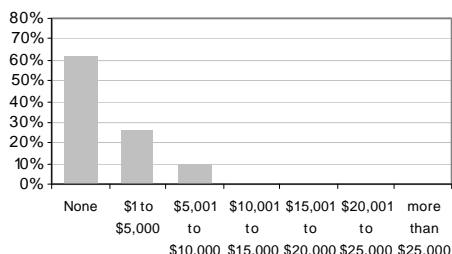
**Annual Compensation Per Board Member**



In the Commission's sample, no community services district provided its board members with more than \$5,000 in compensation in 1999. The majority (56%) do not provide any compensation, and none of the districts provide health or life insurance benefits.

Fourteen percent of the community services districts spent more than \$1,000 per director in 1999. The full range of compensation went from a high of \$4,480 per board member (Bear Valley) to a low of \$25 per board member (Westridge).

**Fire Protection Districts**



**Fire Protection Districts**

The majority of fire districts do not provide compensation to their board members, according to the survey. Of the 32 percent that do provide compensation, no district spends more than \$10,000 annually on each board member. Twenty-nine percent of the districts provide meeting or monthly stipends, 16 percent provide health benefits, and 6 percent provide life insurance benefits.

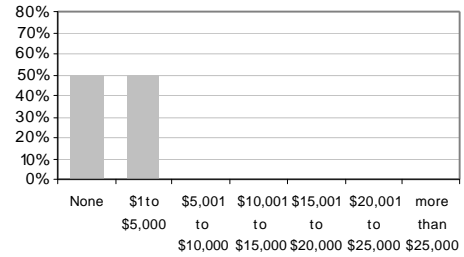
District expenditures on all forms of compensation vary widely. In 1999, fire district expenditures per board member covered the following ranges:

	<b>Maximum</b>	<b>Minimum</b>
<b>Stipend</b>	\$1,245 Half Moon Bay	\$300 Industrial
<b>Health Benefits</b>	\$5,032 Linda	\$3,024 Menlo Park
<b>Life Insurance</b>	\$132 Mammoth Lakes	\$65 Sacramento Co.

**Park & Recreation Districts**

Half of the park and recreation districts surveyed provide annual compensation – in the amount of \$5,000 or less per board member. None of these districts provide health or life insurance benefits. Meeting compensation ranges from \$510 (Arden Manor) to \$4,740 (Conejo).

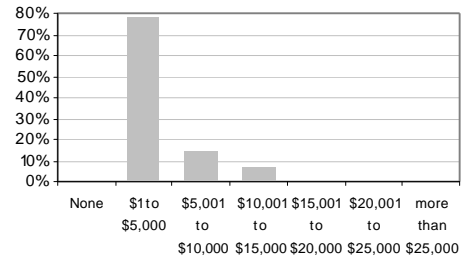
**Compensation Per Board Member  
Park & Recreation Districts**



**Sanitary Districts**

All of the sanitary districts in the Commission’s sample provide compensation – 78 percent spent \$5,000 or less per board member in 1999. In addition to a stipend, 31 percent provide health and 23 percent provide life insurance benefits.

**Sanitary Districts**



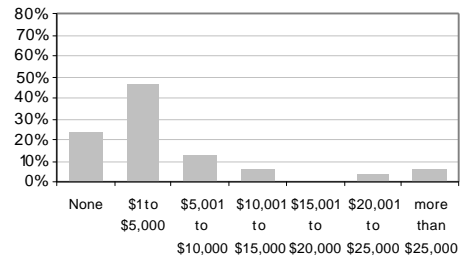
District expenditures on stipends and health benefits vary widely. In 1999, sanitary district expenditures per board member covered the following ranges:

	<b>Maximum</b>	<b>Minimum</b>
<b>Stipend</b>	\$7,120 West County	\$480 San Andreas
<b>Health Benefits</b>	\$8,412 Truckee	\$828 Carmel Area
<b>Life Insurance</b>	\$190 Napa	\$125 Midway City

**Water Districts**

The majority of water districts provide their board members with annual compensation of \$5,000 or less – and 22 percent do not provide compensation. In addition to meeting or monthly stipends, 33 percent provide health insurance and 16 percent provide life insurance.

**Water Districts**



A small number of districts provide board members with large compensation packages. Of all the districts responding to the Commission’s survey, the only districts that reported spending in excess of \$25,000 per director were water districts: Central Basin, Irvine Ranch, and West Basin.

Districts with similar revenues also provided vastly different benefits packages. Marin Municipal Water District, for instance, provided each board member with \$4,200 for meeting attendance in 1999. Board members did not receive health, life insurance, or other benefits. Central Basin Municipal Water District,

in contrast, provided each director with annual compensation and benefits worth \$39,800 – including a meeting stipend, health and life insurance benefits, and a monthly car allowance. The two districts reported similar gross revenues in 1996-97 – \$40.3 million and \$54.5 million respectively.

District expenditures on all forms of compensation vary widely. In 1999, water district expenditures per board member covered the following ranges:

	Maximum	Minimum
<b>Stipend</b>	\$29,270 Central Basin	\$225 Bella Vista
<b>Health Benefits</b>	\$6,837 Central Basin	\$180 Rainbow
<b>Life Insurance</b>	\$8,750 Irvine Ranch	\$21 Rainbow

Most districts responding to the Commission’s survey said that in their experience benefits and compensation had not been a deterrent to consolidation. Most of those districts, however, had not been involved in a reorganization. On the other hand, the general manager of the South Coast Water District, which has been involved in consolidation efforts since 1976, said that compensation and benefits, including health and life insurance, have created concerns for directors considering consolidation.<sup>35</sup>

A source that asked to remain anonymous told the Commission that a proposed merger of the Los Alisos Water District with the Irvine Ranch Water District was stalled by board member resistance that involved benefits and compensation. To overcome the opposition and close the deal, Irvine Ranch agreed to provide the five outgoing Los Alisos board members with the following: their current maximum allowable meeting stipend (10 meetings a month at \$165 per meeting, or \$1,650 per month) for three years; and the same benefit package as is afforded paid employees, including health, dental, retirement and life insurance. Once the proposal is filed with LAFCO, the terms of the agreement will be public.<sup>36</sup>

**I believe that providing full time benefits for a part-time job has prevented some directors from looking objectively at consolidation due to fear of losing their seat.**

Another survey respondent representing a fire district wrote: “I believe that providing full-time benefits for a part-time job has prevented some directors from looking objectively at consolidation due to fear of losing their seat.”<sup>37</sup>

Many districts reported modest compensation packages that seemed unlikely to be an obstacle to reorganization. In others, however, meeting compensation can amount to thousands of dollars of



additional income per year. In addition, directors and sometimes their spouses stand to lose life insurance and health benefits if their board seat is eliminated. In these cases, there appears to be merit to the assertions by some LAFCO staff and special district officials that compensation levels discourage directors from supporting reorganization efforts.

In some cases, the economical reorganization of special districts is thwarted by all five barriers: vague state policy, a dependence of LAFCOs on county staff and resources, inadequate funding for studies, structure of LAFCOs, and benefits and compensation to board members.

## ***Making LAFCOs More Effective***

Over the years, several strategies have been considered by policy-makers to address the failure of LAFCOs to actively pursue special district reorganizations, and to make government more easily understood, efficient and accountable. Proposals have included replacing LAFCOs with something else, replacing special districts with something else, and legislation to force special districts to reorganize.

- ❑ ***Regional planning agencies.*** Lawmakers mandated regional planning agencies when legislation authorizing LAFCOs to initiate special district reorganizations failed to provide the needed impetus. Some lawmakers hoped that one day those agencies would evolve into bonafide regional governments. But instead, Californians became more steeped in local control and regional government failed to materialize.
- ❑ ***Home Rule Community Charters.*** The California Constitution Revision Commission in 1996 recommended Home Rule Community Charters that would be required to provide methods for reducing the number and costs of local governments. A 1998 bill by Assemblymember Hertzberg (AB 2368) would have allowed general-purpose governments to decide which services special districts should provide. Amended to restrict the proposal to Los Angeles, it died in the Senate in the wake of opposition from labor interests and special districts.
- ❑ ***Regional “super-governments.”*** In the 1980s, then-Assembly Speaker Willie Brown proposed a number of regional “super-governments” to replace single-purpose agencies. But the proposal, which would have given the Governor and legislative leaders appointing authority to the regional boards, failed.

- **Special legislation.** Suggestions have been made that the Legislature consider adding legislative members to help LAFCOs overcome local politics and the tenacity of the status quo. And while it has shown little interest in this approach, the Legislature has acted as a sort of “super-LAFCO” by considering bills that would reorganize specific districts. Some of those efforts are described in the background section. Viewed as antithetical to “home rule,” the bills also proved unsuccessful. But they underscore the sentiment among some policy-makers that mechanisms for streamlining local government are not always effective.

Absent an appetite for fundamental reform, the issue becomes how the State can help LAFCOs overcome the power of local politics and promote the public interest. The following reforms could make LAFCOs more effective in guiding the evolution of special district governments:

- **Give LAFCOs a mandate.** The Commission heard that while independence and resources are important, LAFCOs are unlikely, without a mandate, to ever effectively scrutinize and guide the evolution of local government. LAFCOs, particularly in urbanizing areas, could be emboldened by a State mandate to identify areas where multiple districts provide similar services. Where duplication, overlaps and inefficiencies are identified, LAFCOs could be required to initiate a study. All reorganization alternatives should be considered, including consolidation, dissolution, and making the district dependent rather than independent. Specific criteria that could trigger a LAFCO review could include:
  - ✓ When a district’s founding mission changes.
  - ✓ When the district’s solvency and ability to provide efficient and effective service is in question.
  - ✓ When a city incorporates.
  - ✓ When there are vast inequities in rates charged by neighboring districts.
  - ✓ When violations have been issued by regulatory agencies.
  - ✓ When levels of services are not satisfactory or are inconsistent among neighboring districts.

Finding 3 will discuss in detail a State-led process to develop empirical data and provide training to assist LAFCOs in fulfilling such a mandate.

- **Provide LAFCO with resources.** Persistent funding shortages cited by LAFCOs could be addressed by requiring cities, counties and special districts to share equally in the funding of LAFCOs. Shared funding would increase the resources available to LAFCOs to conduct studies and process reorganization actions, level the fiscal playing

field among all of the stakeholders, and enhance LAFCO independence and objectivity.

In 1997, AB 270 (Torlakson) would have required cities and special districts to pay shares equal to that of the county to fund LAFCOs. Additionally, it would have required LAFCOs to maximize fees to process actions, and would have required the addition of special districts representation on all LAFCOs. The bill, opposed by cities, died on the Senate floor. The Commission on Governance for the 21<sup>st</sup> Century, in its final report, recommended that the costs of LAFCO be shared equally by all of the agencies that appoint members to LAFCO.

Special districts are an integral part of the local government landscape and they should contribute to its effective functioning. To encourage special district participation in LAFCOs and to provide LAFCOs with resources, districts could be required to share equally in the funding of LAFCOs, whether or not they choose to seat members. Furthermore, in choosing to seat members, special districts should not be required to give up their latent powers.

If the State requires LAFCOs to initiate special district reorganization studies under certain conditions, the State could require the affected districts to fund the study. The State could establish a fund in the Governor's Office of Planning and Research to which districts that claim financial hardship could apply. Full or matching funding could be provided based on a review of the district's finances and a finding regarding their ability to pay.

- ❑ **Eliminate inherent conflicts.** The State could encourage LAFCOs to appoint their executive director and legal counsel in urban counties where the workload justifies it and where policy-makers determine that the dependent status of LAFCO has hindered the pursuit of special district reorganizations.

## **Summary**

LAFCOs have not aggressively examined the organization of special districts and pursued reorganizations as intended by the State – even when there is substantial evidence that districts should be consolidated or eliminated. But the State has failed to provide LAFCOs with clear policy direction, the necessary resources and, most importantly, has not required them to do so. LAFCOs need a mandate from the State and they need resources and, in some instances, independence to function effectively.

Given these tools, and coupled with the enhanced visibility recommended in Finding 1, LAFCOs would be better equipped to overcome the barriers to reorganization they have identified. For example, if districts were required to fully disclose and widely publicize the benefits and compensation they provide to directors, board policies in these areas would conform with public expectations and specious arguments against reorganization would become transparent.

***Recommendation 2: The State should provide LAFCOs with the direction and resources necessary to make them a catalyst for the effective and efficient evolution of independent special districts. Specifically, the Governor and Legislature should:***

- ❑ ***Require periodic and specific reviews of independent special districts.*** The State should require LAFCOs in urbanizing counties, in cooperation with special districts and other local governments, to periodically review services provided by special districts. The reviews should identify areas of duplication and overlap and assess whether services are being provided in the most efficient and cost-effective manner. Where duplication, overlap and inefficiency are identified, LAFCOs should be required to initiate a study. Specific triggers could be established, such as when the fundamental mission of a district changes or reserves exceed defined limits.
- ❑ ***Enhance the independence of LAFCOs.*** The State should encourage LAFCOs in urban counties to appoint their own executive officer and legal counsel, thereby establishing employment relationships free of the real and perceived conflicts that occur when county employees hold those positions.
- ❑ ***Require shared funding of LAFCOs.*** To increase the resources available to LAFCOs, enhance their independence and increase their effectiveness, the State should require counties, cities and special districts to jointly fund LAFCOs. Special districts should contribute whether or not they have opted to sit on a LAFCO.
- ❑ ***Identify funds for studies.*** The State should require special districts that are the subject of a required LAFCO study to fund the study. For financial hardship cases, the State should provide grants or loans, which could be repaid from savings accrued as a result of reorganizations.

## ***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.”<sup>38</sup>

**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.**

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

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.<sup>39</sup>

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.<sup>40</sup>

At the national level, the Government Performance and Results Act of 1993 requires strategic planning and performance reporting for all federal agencies.<sup>41</sup> 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.<sup>42</sup> 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.

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



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**

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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.

### **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 Tenent 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.

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."

## **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.

## **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.

## **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 21<sup>st</sup> 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***

**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

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.<sup>43</sup> 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.<sup>44</sup>

### ***How Districts Report Reserves***

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#### **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.



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.<sup>45</sup> 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.”<sup>46</sup>

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.<sup>47</sup>

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,

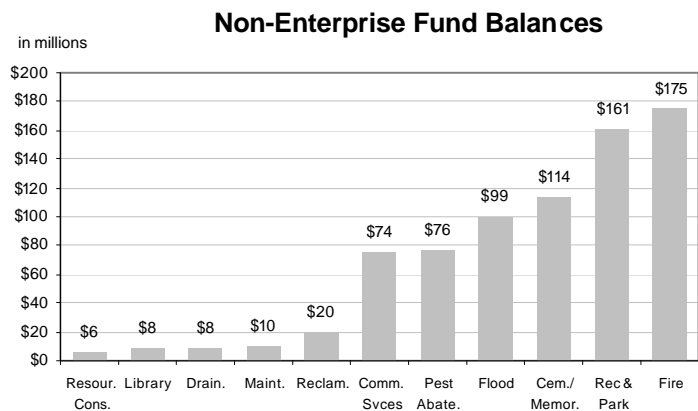
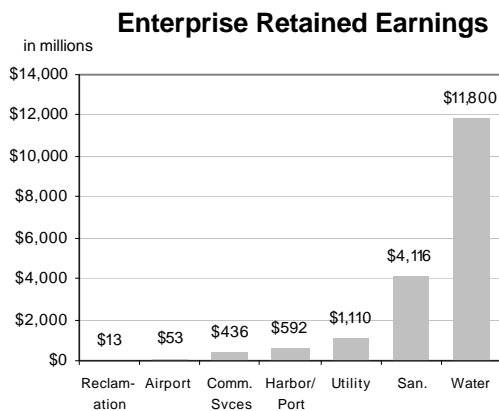
the district collects assessments from the 43 cities that pump groundwater from the basins. With no requirement for disclosing financial information in a way that is easily understood, the district over 10 years accumulated \$67 million in unreserved fund balances, an amount equal to 164 percent of its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

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.<sup>49</sup> And despite a renewed

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.<sup>50</sup>
- ✓ The California Business Roundtable estimates transportation needs at \$15-25 billion over the next 10 years.<sup>51</sup>
- ✓ 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.<sup>52</sup>

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.

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."<sup>53</sup>

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.<sup>54</sup> 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."<sup>55</sup> 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.

Additionally, the Commission was told that there is too much “wobble room” in the established accounting rules. Specifically, the accounting rules allow for inconsistent treatment of contributed capital and manipulation of reserve reporting.<sup>56</sup> 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

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.<sup>57</sup>
  
- ***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.<sup>58</sup> 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

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.<sup>59</sup>

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.<sup>60</sup>

## **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.

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.<sup>61</sup>

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.<sup>62</sup> Reserves, as so described, would not include funds legally restricted to specific purposes or designated for capital projects, for instance.

***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.

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



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.

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.

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.

- ❑ ***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

**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.**

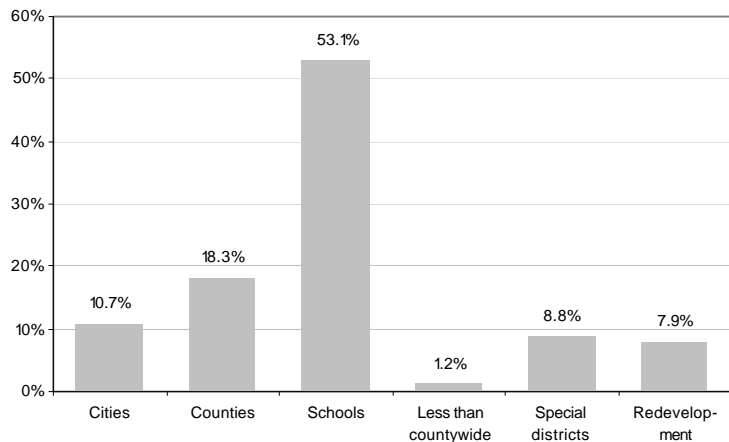
Enterprise special districts that levied property taxes on their customers before Proposition 13 was enacted in 1978 continue to receive a portion of the property tax revenues that are now allocated by the State. The policy of sharing property tax revenue with some enterprise districts made sense immediately 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.

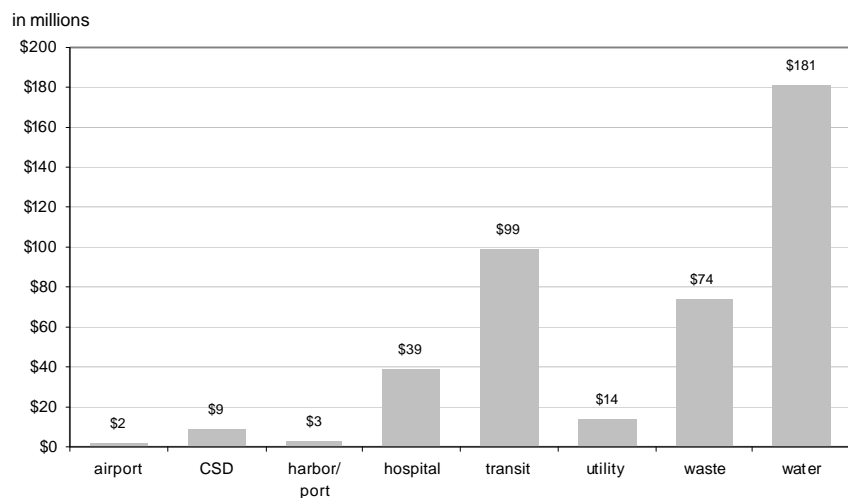
## **Historical Formulas**

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.<sup>63</sup> 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.<sup>64</sup> Those agencies that had levied

### **Property Tax Allocated to Independent Enterprise Districts**



# receiving property tax	4 of 9	90 of 194	7 of 13	59 of 75	6 of 22	40 of 62	92 of 117	251 of 577
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Source: State Controller, 1996-97 Property Tax Data, on file.

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.<sup>65</sup> 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.<sup>66</sup>

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.”<sup>67</sup> 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

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.<sup>68</sup> 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



**PROPERTY TAX ALLOCATIONS TO ENTERPRISE DISTRICTS**

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.<sup>69</sup>

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.

<b>15 Districts are in the “Top 25”</b>	<b>(In Millions)</b>			<b>Property Tax as % of:</b>	
<b>For Both Retained Earnings and Property Tax Revenue</b>	<b>Property Tax</b>	<b>Gross Revenue</b>	<b>Retained Earnings</b>	<b>Gross Revenue</b>	<b>All Prop. Tax* to Enterprise Districts</b>
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%
<b>Total</b>	<b>\$103.2</b>	<b>\$1,295.</b>	<b>\$3,863.</b>	<b>8.0%</b>	<b>36.4%</b>

\*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

health care districts that no longer operate hospitals.<sup>70</sup> 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

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... .” <sup>71</sup>
  
- ❑ **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.<sup>72</sup>
  
- ❑ **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:<sup>73</sup>
  - ✓ 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?

✓ 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:<sup>74</sup>

✓ 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.

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.

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.

***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?

- **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

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.





# **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.

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**



# 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



## 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?

\$ \_\_\_\_\_



**(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.

**LITTLE HOOVER COMMISSION**

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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](mailto: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:

	<b>1995-96</b>	<b>1996-97</b>	<b>1997-98</b>	<b>1998-99</b>	<b>Anticipated 1999-2000</b>
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?

- (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.

## 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%





## 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

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.

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.

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.

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