



DATE: January 24, 2017
TO: Mayor and City Council
FROM: City Manager

SUBJECT

Consideration of a Resolution on the Local Agency Formation Commission Draft Special Study of the Eden Township Healthcare District

RECOMMENDATION

That the Council adopts a resolution and provides comments on a draft letter from the Mayor to the Local Agency Formation Commission responding to the draft Special Study of Governance Options for Eden Township Healthcare District.

SUMMARY

In June, the Council approved a resolution authorizing the City Manager to make an application to the Alameda County Local Agency Formation Commission (LAFCo) asking the Commission to consider the dissolution of the Eden Township Healthcare District (ETHD). Formed by vote in 1948, the original purpose of the Eden Township Healthcare District (also known as the Eden Healthcare District) was to build and operate Eden Hospital in Castro Valley to serve residents of the City of Hayward, the City of San Leandro, and the communities of San Lorenzo, Ashland, Cherryland, Fairview, and Castro Valley. The District built and operated Eden Medical Center until the 1990s, when strict seismic safety requirements proved cost prohibitive and the District partnered with Sutter Health to run the medical center. After the District acquired San Leandro Hospital in 2004 and leased the facility to Sutter Health, a renegotiation of the original agreement gave Sutter the option to buy the hospital. When Sutter attempted to exercise this option to purchase San Leandro Hospital in 2009, the District refused to transfer ownership until compelled to do so in court. As a result, the District owes Sutter a \$19 million settlement and no longer owns or operates a hospital.

The district currently owns and rents two medical office buildings and provides grants to health-related programs and organizations in the community. According to an Alameda County Grand Jury report, the ETHD spends 88% of its budget on real estate, administration, legal, and consulting fees, while 12% is allocated for grant awards. Two East Bay Assemblymembers introduced bills this past year addressing the relatively small proportion of the District's budget allocated to grants, and the District's continued existence without a

hospital. A 2012 survey commissioned by the District revealed that the majority of residents in the District didn't know that it existed. Dissolving the District would have minimal, if any, impact on residents, and would allow District resources to be more efficiently allocated to agencies and organizations providing effective direct healthcare services to residents.

As a result of the Council's request in June, the Local Agency Formation Commission hired a consultant to prepare a special study of the ETHD. A draft of the special study (https://www.acgov.org/lafco/documents/ETHD_PublicReviewDraft2016-12-20.pdf) was completed in December and disseminated for public review and comment on December 22. The report includes a summary of the study findings and an analysis of governance options for the District. Comments on the draft special study are due to LAFCo by February 3. The Mayor, in coordination with the City Manager, has prepared a draft comment letter on the special study (Attachment IV). Once the Council provides feedback on this draft letter, the Mayor will finalize and send to LAFCo before the deadline.

BACKGROUND

Formed by vote in 1948, the original purpose of the District was to build and operate Eden Hospital in Castro Valley. The boundary of the District includes most of the City of Hayward, the City of San Leandro, and parts of unincorporated Alameda County, including the communities of San Lorenzo, Ashland, Cherryland, Fairview, and Castro Valley, and has remained nearly unchanged since its formation. Property taxes funded the ETHD's operations, including the purchase of Laurel Grove Hospital and subsequent creation and operation of the Eden Medical Center until 1977, when the District ceased levying taxes.

In 1994, the California State Legislature passed SB 1953, creating the Hospital Seismic Upgrade Program and requiring all hospital buildings to meet stricter seismic safety standards within a 15- to 20-year timeframe. Faced with spending up to \$300 million to bring Eden Medical Center into compliance with the law, in 1998, the District negotiated a partnership with Sutter Health, transferring substantially all the hospital's net operating assets and operations to the non-profit, and establishing an 11-member joint board to govern the medical center.

The Eden Township Healthcare District purchased San Leandro Hospital in 2004 and negotiated a lease agreement for the newly acquired hospital with Sutter Health that required Sutter to retrofit the Eden Medical Center buildings in accordance with the State's seismic safety standards, or pay \$260 million to Eden Healthcare District for their replacement. Two years later, Sutter Health found that replacing the medical center would cost more than \$400 million, and was no longer feasible. Sutter and the ETHD renegotiated their partnership, resulting in an agreement that relinquished ETHD's seats on the Board, required Sutter Health to complete the construction of a replacement facility, and granted Sutter the option to purchase San Leandro Hospital.

In 2009, Sutter began construction on the new medical center and shortly thereafter exercised the purchase option for San Leandro Hospital. The ETHD became concerned that Sutter intended to close the hospital, and refused to transfer ownership of San Leandro Hospital to

Sutter. Sutter sued for breach of contract, and was ultimately victorious in acquiring the hospital and winning a \$19.7 million judgement against the ETHD.

Today, the ETHD no longer owns or operates any hospitals. Investments and real estate are the District's main revenue sources. The District owns and leases three medical office buildings in the East Bay – the San Leandro Medical Arts Building, Eden Medical Building, and until recently, Dublin Gateway Center (the latter located outside of District boundaries). Revenue from the lease of these properties funds the administration of the District, debt and settlement payments, maintenance of the properties, and a Community Grant Fund that provides funding to health-related organizations and programs serving residents of the District.

Acting on a citizen complaint that the District “does not adequately provide for the healthcare needs of its residents” and questioning whether the District should exist, the 2015-16 Alameda County Civil Grand Jury found that the Eden Township Healthcare District has failed to effectively execute its mission (<https://www.acgov.org/grandjury/final2015-2016.pdf#page=43> and <https://www.acgov.org/grandjury/final2015-2016.pdf#page=57>). The report charged the District with spending a disproportionate amount of its resources on the oversight and management of its real estate holdings despite the minimal impact these activities have on delivering healthcare services. Additionally, the report found that the District lacks information about the needs of its residents and does not take any steps to address those needs, fails to collaborate with the County Health Care Services Agency, and has no concrete action plan, timeline, funding, or rationale for achieving its stated goals. The Grand Jury ultimately recommended that the electorate be provided an opportunity to vote on the continued existence of the District in the next board election.

This year, two bills were introduced into the State legislature by East Bay lawmakers to address the continued existence of the Eden Township Healthcare District. AB 2737 (Bonta) requires that healthcare districts that no longer provide direct healthcare services or levy taxes and meet several other criteria must spend at least 80% of their annual budgets on community-based grants to organizations providing direct healthcare services, and no more than 20% of their annual budgets on administrative expenses. AB 2471 (Quirk), currently inactive, would specifically require the Alameda County LAFCo to dissolve the ETHD if the District does not currently receive a property tax allocation, has substantial net assets, and does not provide a direct healthcare service. Both bills are intended to address the continued existence of the Eden Township Healthcare District in the absence of hospital ownership, lack of direct service provision, and small proportion of its annual budget dedicated to grantmaking.

In June 2016, the Hayward City Council submitted a request to LAFCo to prepare a special study addressing concerns expressed by community stakeholders about the District. At the July 14, 2016 LAFCo meeting, the Commission considered and approved the Council's request. On October 18, 2016, the City Council approved a Resolution in support of the dissolution of the Eden Township Healthcare District.

DISCUSSION

The purpose of conducting the special study was to review the services the District currently provides, its financial position including any future obligations, and a fiscal analysis of various governance options, including dissolution. To conduct the study, a consultant reviewed background documents and information, including the 2013 Municipal Services Review conducted by the LAFCo, financial audits and budgets, financial and service projections, and the Alameda County Grand Jury report. Additionally, the consultant conducted interviews with stakeholders from the City of Hayward, the City of San Leandro, Alameda County, and Eden Healthcare District staff and board members. Members of the general public had the opportunity to provide input at three special public hearings, and a public hearing conducted during a regularly scheduled LAFCo meeting.

A draft of the special study (https://www.acgov.org/lafco/documents/ETHD_PublicReviewDraft2016-12-20.pdf) was completed in December and disseminated for public review and comment on December 22. The public comment period extends through February 3, and the LAFCo will hold a special meeting to discuss the draft study on January 31, 2017 at the Castro Valley Library.

Study Findings

The study's findings are based on an analysis of the adequacy of public services, the financial ability of the agency to provide services, the District's accountability for community service needs including governmental structure and operational efficiencies, and any other matter related to effective or efficient service delivery. The findings reported in the study are as follows:

- A. Dissolution of the District without continuing its services is unwarranted.
 - The study determined that the District provides services of value to the community, including the expenditure of funds for healthcare grants generally consistent with the needs of the community as identified by other agencies.
 - The District continues to budget \$500,000 to \$600,000 annually, which could increase to \$2,000,000 per year after the fulfillment of the ETHD's obligation to Sutter Health.
 - The consultant found the District to be accountable for its financial resources and decision processes and that expenditures for administration and overhead are not excessive relative to total costs.
 - The report stated that though relying on real estate revenues presents some risk to District assets, the sale of District buildings would result in decreased revenue for healthcare services over the long-term.

- B. The District could improve the efficiency and effectiveness of its operations.

The consultant recommended that the District, or its successor agency, take several actions to improve the efficiency and effectiveness of its operations, including:

- Annual revision of the District’s Strategic Plan
 - Pursuit of the Special Districts Leadership Foundation’s “District Transparency Certificate of Excellence”
 - Preparing an annual cash-based budget and forecast and a multi-year Capital Improvement Program
 - Tracking hours and resources allocated to real estate activities and community services to accurately evaluate overhead as a percentage of budget
- C. Dissolution and naming a successor agency to continue services could reduce certain costs and improve decision-making.
- The study examined several options for the dissolution of the ETHD, including transferring District assets to a non-profit, a newly-created County Service Area (CSA), and the County and/or cities.
 - Transferring District assets to a successor agency could reduce overhead and administration costs by eliminating the cost of elections, some costs related to the District’s legal settlements, and by providing administrative support to the grant program.
 - City and County representatives could be included on the board of the successor agency, increasing representation and interagency cooperation.
 - In any of the scenarios listed above, the LAFCo would be responsible for the dissolution process.
- D. No other viable reorganization options have been identified.
- Consolidation of the ETHD with another District is not viable – Washington Township Healthcare District is not willing to consolidate with the ETHD.
 - The ETHD could not become a subsidiary district to a city without significantly reducing the boundaries of the District and failing to serve a large portion of current District residents.
- E. LAFCo should consider amending the ETHD’s current Sphere of Influence, whether or not the District is dissolved.
- Portions of the ETHD include areas of several cities with few or no residents. Additionally, a small portion of San Leandro is excluded from the District, as is a portion of Hayward.
 - The study recommends expanding the District boundary to include the remainder of San Leandro, but notes that the parts of Hayward not included in the District are served by Washington Township Healthcare District and should not be included in the expansion.

Notably, the report does not substantively address whether the ETHD is the most appropriate, effective, or efficient entity to provide health care services to its constituents, whether its services reach a broad number of constituents or a particularly needy population among them, or whether its services uniquely and impactfully serve the community’s needs. These questions were not included in the scope of the report; however, in a time of increasing

demand for services and scarce resources with which to provide those services, they are crucial questions for the evaluation of public programs and entities.

Governance Options

As summarized in the findings, the report analyzed several governance options for the ETHD (Attachment II). The LAFCo will consider taking action on these governance options upon receipt of the final report. In all cases included below, the District's liabilities, long-term debt, and judgment obligations must be repaid. The governance options identified in the report are:

1. Status Quo: The current District would remain intact in the Status Quo option, and the Board of Directors would continue to be elected and conduct District business.

The District is currently governed by a directly elected Board, providing some measure of public accountability. The District's real estate assets provide a sustainable non-tax source of revenue for grantmaking to community health care providers, with a higher annual return on investment (6-8%) compared to cash investments (1-2%), though real estate is more sensitive to market fluctuations than more common public investment options. Maintaining the status quo would require no reorganization proceedings or special elections.

However, allowing the District to continue operations as-is would fail to solve many of the issues that led to the commission of the special study. While the District is governed by an elected Board, recent elections have been uncontested and many residents in the service area are unaware that the District exists, indicating a lack of public accountability. Compared to other governance options, the District, as it is currently, has relatively high administrative costs. The District provides possibly redundant services and duplicates the efforts of other health care agencies that operate within its service area. Furthermore, AB2737 may require the disposition of the District's assets.

2. Dissolution with No Continuation of Services: Dissolution would eliminate the ETHD and its assets would be liquidated and distributed to other public agencies, after obligations of the ETHD have been paid. LAFCo would appoint a successor agency to wind up the affairs of the ETHD and manage the liquidation and distribution of assets.

Dissolving the ETHD, liquidating the District's assets, and discontinuing services would provide the opportunity for a one-time distribution of funds to community health care resources. The report also notes that this option would ultimately eliminate administrative costs and reduce redundancies and duplication of efforts. Dissolving the District and discontinuing services would eliminate possible redundancies in service provision and duplication of efforts to provide health care to constituents. However, dissolution of the District with no continuation of services also eliminates an ongoing and sustainable source of health care funding (albeit small at present) for community providers.

3. Dissolution and Naming a Successor to Continue Services: The ETHD would be dissolved and a successor agency would receive and dispose of District assets and continue to provide health care services to the community. Potential successor agencies include a non-profit, the County, or the cities via a Joint Powers Agreement. LAFCo would review and approve a Plan to Provide Services prior to the approval of dissolution and the transfer of assets and services to the successor.

This option presents an opportunity for greater stakeholder and community input into grant making through participation on the Board of Directors of a successor non-profit or Joint Powers Authority. Naming a successor agency to continue services also preserves a wide array of options for the disposition of assets and the maintenance of sustainable revenues streams – for example, a successor entity may continue to manage the District’s real estate as a source of revenue. A successor agency could potentially leverage outside funds such as state or federal grants, and would reduce overhead costs. At the very least, the successor agency would not have to fund elections, and may be able to allocate preexisting administrative resources to continuing the District’s services.

Per the special study, transferring assets and service provision to a successor agency may reduce public accountability through governance by an appointed rather than elected Board. However, the successor agency’s board could include or be comprised of elected officials from the service area, mitigating this issue. If a non-profit or the county serves as the successor agency, limitations will need to be established so that District funds are only allocated to providing health care services within the District’s service area. Additionally, a successor agency does not eliminate the possibility of service redundancies or duplication of effort as a result of multiple agencies providing health care services to the same service area.

4. Dissolution and Creation of a County Service Area (CSA) to Continue Services: The ETHD would be dissolved and a County Service Area, governed by the Board of Supervisors, would be created by voter approval, as well as approval by all cities within the CSA.

Like naming a successor agency, creating a CSA to continue services also preserves a wide array of options for the disposition of assets and the maintenance of sustainable revenues streams. A CSA would have discrete boundaries dictating where funds could be spent.

However, CSAs are governed by the Alameda County Board of Supervisors, some of whom are not elected by District constituents, and who oversee the entire county, not just the District area, reducing public accountability. This could be mitigated by the creation of an advisory board composed of stakeholders and/or elected officials from the constituent jurisdictions. Creating a CSA requires a special election, incurring significant costs not associated with any of the other governance options. A CSA does not eliminate the possibility of service redundancies or duplication of effort as a result of multiple agencies providing health care services to the same service area.

5. Reorganize the ETHD as a Subsidiary District: Creating a subsidiary district would require that the ETHD boundaries be reduced to fit within the limits of one of the cities within the District and be reorganized with a city council sitting as the governing body. This option is not viable as State law requires that a healthcare district have its own Board of Directors.
6. Consolidation with Washington Township Healthcare District: Consolidation is not a viable option. Washington Township Healthcare District has expressed that it has neither interest nor ability to consolidate with the ETHD.

The Mayor has drafted a letter to provide to the LAFCo Commissioners and staff commenting on the special study (Attachment IV). In the City of Hayward's request for the LAFCo to conduct a study or audit of the Eden Township Healthcare District, former City Manager Fran David requested that a number of elements be included in the study. Some of these elements were a review and analysis of the District's past decision-making related to the contract with Sutter Health, and an analysis of the flow and advisability of the District's current funding and/or grant programs in relation to various entities around the County. The scope of the study, based on the Municipal Service Review process, does not encompass a number of the elements that the City requested to be included. The attached letter addresses these discrepancies, and asks that the LAFCo thoroughly examine the ETHD in the context of health care in Alameda County, the District's historic mission, and the long-term needs of our community members. Staff is requesting feedback on the draft letter before the Mayor finalizes the letter to send to LAFCo.

FISCAL IMPACT

The dissolution of the Eden Township Healthcare District would have no direct fiscal impacts on the City. There may be some indirect fiscal impacts to the community if the Agency is dissolved and the assets are distributed to the benefit of the communities within the District's boundaries.

NEXT STEPS

Should the Council adopt this resolution, the City Manager will work with the Mayor to finalize the draft letter commenting on the draft special study to the Local Agency Formation Commission along with a copy of the adopted Council resolution. The Mayor will also work with the City Manager and other partners in Alameda County to ensure that the any action taken is fair, equitable, and to the benefit of the communities within the ETHD's boundaries. If Council does not adopt this resolution, staff will take no further action.

Prepared and Recommended by:

Laurel James, Management Analyst

Approved by:

A handwritten signature in black ink, appearing to read 'K. McAdoo', written in a cursive style.

Kelly McAdoo, City Manager