

## MEMORANDUM

TO: Board of Directors  
Sequoia Healthcare District

FROM: Mark D. Hudak

DATE: May 12, 2008

SUBJECT: Process and Consequences of District Dissolution

---

The Sequoia Healthcare District (the “District”) recently entered into an agreement with Catholic Healthcare West for the redevelopment of Sequoia Hospital. With this arrangement in place, the District is no longer actively involved in the management of the hospital, other than to ensure compliance with the provisions of the development agreement. Under these circumstances, at least one Board member has suggested that the District should consider dissolving. This memorandum will provide information regarding the process for dissolving a healthcare district and the likely consequences of dissolution, including the disposition of District assets and the effect on property taxes. This information may be useful in the Board’s strategic planning process.

### EXECUTIVE SUMMARY

When a healthcare district dissolves, a successor agency is appointed to “wind up” the district’s affairs. The remaining net assets are distributed to one or more public agencies. By law, no payments or refunds can be made to taxpayers from the remaining assets.

The effect on future property tax assessments is less clear. A dissolved district may not continue to levy and collect property taxes. Under one theory, the increment of property taxes that had been apportioned to the dissolved district would be redistributed among other public agencies within the tax rate area. A second theory holds that this increment would no longer be collected, so that each property’s assessment would be lowered by that amount. There is no definitive case law or Attorney General opinion on this point. It is more likely that the entire 1% property assessment allowed under Proposition 13 would continue to be collected and the increment that had been apportioned to the dissolved district would be shared by the remaining cities, counties, and special districts within the tax rate area.

## DISCUSSION

### I. The Process for Dissolving a District

The process for dissolving a special district is detailed in the Cortese-Knox-Hertzberg Local Government Reorganization Act (“Cortese-Knox”), Government Code §56000 et seq.<sup>1</sup> This Act establishes the Local Agency Formation Commission (LAFCo) for each county and governs the creation, merger, and dissolution of local public agencies. Each county LAFCo includes representatives from the Board of Supervisors, cities, and special districts and a community member, as well as several alternates.

Under Cortese-Knox, a district can be eliminated in three ways: (a) by consolidating with a like district (i.e., two sewer districts unite); (b) by merger into a different entity (i.e., sewer district taken over by a city); or (c) by dissolution. Under consolidation and merger, there is a surviving entity that inherits the assets, liabilities, and taxing power of the district being eliminated, and the law governing these processes is fairly clear. No further discussion of these methods is warranted.

Outright dissolutions of districts are very rare, so little is known about how dissolutions actually occur. There are few reported cases or Attorney General opinions to provide guidance in understanding and applying the relevant statutes. In addition, recent amendments to Cortese-Knox have given the local LAFCOs broader powers to impose terms and conditions as part of a dissolution, and the limits of these powers have not been tested in any reported appellate decision. Consequently, the following discussion is based on the most likely interpretation of the statutes governing dissolution, but there are no definitive legal standards.

A proposed dissolution of a district may be initiated in three ways. First, the governing board of the district may vote to dissolve. Second, a specified percentage of voters within the district can sign a dissolution petition that is filed with LAFCo. Third, LAFCo itself may recommend dissolution.

Regardless of how the dissolution process is initiated, LAFCo has jurisdiction over the decision-making process. LAFCo would hold public hearings, issue reports, and determine whether dissolution is in the public interest. Ultimately, LAFCo would vote to dissolve or not dissolve the district. That decision is final as to any type of district except a healthcare district. A decision by LAFCo to dissolve a healthcare district must be submitted to the voters for confirmation.

Once the decision to dissolve a district is final, LAFCo appoints a successor entity<sup>2</sup> to “wind up” the affairs of the district, much as the affairs of a dissolving private corporation would be wound up. In essence, the successor entity collects the district’s assets, pays off short-term debts, and manages the practicalities of closing down the district. Normally, the successor entity is the largest city within the district, based on assessed property values.

---

<sup>1</sup> All further statutory references are to the Government Code unless indicated.

<sup>2</sup> In this context, the term “successor” does not mean that the public entity would carry on the district’s purposes and duties on a long-term basis.

When all of the current liabilities of the district have been paid and provisions made for the payment of any long-term obligations, the successor entity then distributes the remaining net assets and cash to each city and the county in which the district had operated , based on the percentage of assessed property values. These funds, once distributed, may be used by the cities and county for any purpose. §57462.

This is the basic model for dissolution. LAFCo has received additional powers to design a dissolution plan for a district that could vary this model. Under a recent amendment to §57450, LAFCo has been given the power to impose terms and conditions as part of a dissolution. These terms and conditions are found in §56886 and are very broad. Under §56886, LAFCo may be able to direct the net assets of the district to a single public entity, such as the county, and may be able to impose conditions such as the use of the assets for particular purposes. Because of the recent nature of these amendments to Cortese-Knox, there are no reported decisions defining the limits of the terms and conditions that LAFCo may impose as part of a dissolution.

Whether the net assets of the district are distributed to a single entity or to multiple cities, Cortese-Knox is clear that no payments, refunds, or reimbursements may be made to the taxpayers from the net assets. §57454. So, dissolution of the District would not have any immediate financial benefit to residents.

## **II. Continued Ability To Collect Taxes After Dissolution**

Ordinarily, when a district dissolves, all of its governmental powers cease. §57450. This would include the power to levy and collect taxes.

There is one recognized statutory exception. If the dissolving district has issued long-term obligations secured by the district's tax revenues (such as bonds), the successor entity shall continue to collect the taxes until the obligations are paid in full. §57458.

In addition, amendments to §§57450 and 56886 give LAFCo broad powers to design a dissolution plan for a district. Conceivably, LAFCo could impose terms and conditions that would require the continued collection of the district's taxes by the successor entity for purposes other than the payment of long-term obligations, such as continued support for healthcare programs, health insurance for the uninsured, or a county-run hospital. Section 56886(t) authorizes LAFCo to order the continued imposition of taxes within a territory, although it is not clear whether this subsection is meant to apply to dissolved districts or only to new districts being created through merger, consolidation, or incorporation. On balance, it is most likely that LAFCo could not issue an order allowing the successor entity to continue levying the taxes of the dissolved district, except as necessary to repay existing bonds.

## **III. Disposition of District's Property Tax Share**

Assuming that the dissolving district has no long-term debt, what happens to the portion of property taxes that it has been collecting? Is the tax bill for each property within the district reduced, or is the district's portion of the property tax re-distributed to the other agencies which share in the overall assessment? There is no definitive statute, court case, or Attorney General opinion that provides a clear answer.

A healthcare district is authorized to levy several types of property taxes and assessments. Section 32200 of the Health & Safety Code allows a district to impose an assessment, not to exceed \$0.20 per \$100.00 of assessed value, for general operating purposes. A district may also levy a special assessment for the purpose of acquiring, constructing, and maintaining facilities, subject to voter approval. H&S Code §32240. However, once a district dissolves, it no longer has the power to continue collecting these assessments.<sup>3</sup> If the assessment pre-dated Proposition 13, it is likely that the amount of property taxes that had been apportioned to the district would be shared by the other districts within each tax rate area.

Proposition 13 was approved by the voters in 1978. Proposition 13 imposes a maximum property tax rate of 1%, based on the assessed value of each property. Taxes in excess of this 1% general tax rate must be approved through special procedures, usually with a two-thirds vote.

At the time Proposition 13 went into effect, the property taxes being levied by counties, cities, schools, and local districts cumulatively exceeded the 1% maximum in most areas. In order to comply with the 1% maximum, the Legislature enacted a series of implementing statutes, found in Revenue & Taxation Code §96 et seq. Each property was placed in a “tax rate area.” The county auditor determined which agencies were entitled to share in the property taxes for each tax rate area and the amount of taxes each had been assessing. Each taxing agency was then required to accept its proportionate share of these revenues immediately before Proposition 13, based on the 1% maximum. As a consequence, each agency received less revenue than before, in most cases.

In subsequent years, the county auditor is required to apportion the available funds collected under the 1% general tax rate among the taxing agencies for each tax rate area, based on the percentages from the prior fiscal year. R&T §96.2.

The formulas set out in the Revenue & Taxation Code are not specific about what happens when a district that has been sharing in the 1% general tax rate dissolves. The most likely outcome is that the 1% general tax rate will continue to be collected and each remaining taxing agency will get a proportionate increase, helping to offset the shortfall created by the limits in Proposition 13. Nothing in the Revenue & Taxation Code authorizes the county auditor to make a permanent reduction of the 1% general tax rate. The county auditor is only permitted to re-apportion the 1%, once collected. Under this procedure, the tax bill for each property within the dissolved district would remain unchanged.

If the district’s assessment was approved after the effective date of Proposition 13, the outcome would be different. A post-Proposition 13 assessment is in addition to the 1% maximum, so it would never have been subject to the apportionment process for assessments that existed prior to Proposition 13. Other local agencies would have no claim to share in a special assessment approved by district voters after 1978.

A local district does have the power to decline its share of property tax revenues. Revenue & Taxation Code §96.8 allows the governing board of a district to decline some or all of its share of the general tax rate on a one-year basis. When this occurs, the 1% general tax rate

---

<sup>3</sup> For purposes of this discussion, I assume that LAFCo would not order the continued collection of these assessments. See Section II above.

is reduced accordingly and each property's taxes would be lower by that amount. The decision to decline its share of the property must be made each year, prior to August 1. Section 96.8 does not allow a district to decline its taxes permanently or for a period longer than one fiscal year. If a district were to dissolve, it would not be in a position to make this annual decision.

#### **IV. Application to Sequoia Healthcare District**

If SHD were to dissolve, its principal liability would be the balance of the funding obligation owed to CHW for the redevelopment of Sequoia Hospital. The principal assets would be cash and investments, the 525 Veterans building, and the contingent revenue from the EBIDA sharing arrangement with CHW.

If dissolution proceedings were initiated by a Board vote, or by LAFCo, or by a voter petition, LAFCo would hold a series of public hearings and, under Government Code §56886, would recommend a number of terms and conditions for the dissolution. This dissolution plan would then be submitted to the voters. If the majority of voters approved the dissolution, LAFCo would appoint a successor agency to wind up SHD's affairs.

LAFCo could follow several paths – it could recommend that a single agency, such as the county, receive all of the assets of SHD and appoint the county as the successor agency. LAFCo might condition this course on the county's commitment to use the net assets and future revenue from CHW for healthcare purposes. Or, LAFCo could determine that the net assets of SHD should be distributed to the cities within the district and appoint the largest city to do the winding-up. Under this scenario, the cities could use the net assets and future revenue from CHW for any municipal purpose. LAFCo could recommend a hybrid course. However, none of the net assets or future revenues could be returned to residents.

SHD would no longer collect any tax revenue after the date the voters approved the dissolution. Based on the most likely interpretation of the sections of the Revenue & Taxation Code that implement Proposition 13, the taxes that had been apportioned to SHD would then be shared by the county, the cities, and the special districts, depending on the tax rate area for each property.