SENATE COMMITTEE ON LOCAL GOVERNMENT
Senator María Elena Durazo, Chair
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HEALTH CARE DISTRICTS: COUNTY OF SAN DIEGO

Establishes a working group to study the provision of health care services in healthcare districts in the northern region of San Diego County.

Background

Local government boundaries. The Legislature has the authority to create, dissolve, or otherwise modify the boundaries and services of local governments. Beginning in 1963, the Legislature delegated the ongoing responsibility to control the boundaries of cities, county service areas, and most special districts to local agency formation commissions (LAFCOs) in each county. The responsibilities and authority of LAFCOs have been modified in subsequent legislation, including a major revision of the LAFCO statutes in the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (CKH Act) (AB 2838, Hertzberg).

Local governments can only exercise their powers and provide services where LAFCO allows them to. LAFCOs' boundary decisions must be consistent with spheres of influence that LAFCOs adopt to show the future boundaries and service areas of the cities and special districts. Before LAFCOs can adopt their spheres of influence, they must prepare municipal service reviews (MSRs) which analyze population growth, public facilities, and service demands. LAFCOs may also conduct special studies of local governments.

MSRs and efficient service delivery. MSRs are a key tool that LAFCOs use to achieve their statutory purposes to, among other things, encourage the efficient provision of government services and the orderly formation and development of local agencies. MSRs must contain determinations with respect to each of the following:

- Growth and population projections for the affected area;
- The location and characteristics of any disadvantaged unincorporated communities within or contiguous to the sphere of influence;
- Present and planned capacity of public facilities, adequacy of public services, and infrastructure needs or deficiencies;
- Financial ability of agencies to provide services;
- Status of, and opportunities for, shared facilities;
- Accountability for community service needs, including governmental structure and operational efficiencies; and
- Any other matter related to effective or efficient service delivery, as required by commission policy.

In conducting an MSR, LAFCOs must comprehensively review all of the agencies that provide the identified service or services within the designated geographic area. LAFCOs can, but are not required to, assess various alternatives for improving efficiency and affordability of infrastructure and service delivery within and contiguous to the sphere of influence, including, but not limited to, the consolidation of governmental agencies.

Healthcare districts. Near the end of World War II, California faced a severe shortage of hospital beds. To respond to the inadequacy of acute care services in rural areas, the Legislature enacted the Local Hospital District Law to provide medically underserved areas without access to hospital facilities the ability to form special districts that could be a source of tax dollars for constructing and operating community hospitals. SB 1169 (Maddy, 1994) changed the name of the law to "The Local Healthcare District Law" to better reflect the shift in the provision of healthcare services outside hospital settings.

There are currently 76 healthcare districts in California. Most of these were established in the first two decades following enactment of the Local Hospital District Law to build and operate hospitals. However, over the years, many of these healthcare districts have closed or sold their hospitals. Only 33 healthcare districts own and operate hospitals, while a handful of others own either the hospital or the land and lease the hospital to another entity to operate the hospital. The remainder operate ambulance services, clinics, skilled nursing facilities, or do not provide any direct health services.

Healthcare districts, like other special districts, are subject to review in a municipal service review or special study by a LAFCO to examine the efficiency and effectiveness of the services they provide. Similarly, healthcare districts must also receive approval from LAFCO to exercise its powers or change its boundaries.

A five-member board of directors manages each healthcare district. Each member must be a registered voter residing in the district and serves a four-year term, with the exception of the initial board. The board of supervisors of the county with the greatest share of land in the district appoints the initial board. Upon appointment, the board selects two members by lot to serve two-year terms with the remaining three serving four-year terms.

Most healthcare districts receive a share of local property taxes. Some levy special parcel taxes, and some charge for services. Some healthcare districts generate revenues from district resources, such as property lease income, and some districts receive grants from public and private sources.

Distressed hospitals. Hospitals across the state have had to confront a multitude of challenges over the last several years. The COVID-19 pandemic led to an unprecedented surge in patients and required a surge in the need for healthcare workers. These challenges piled onto of existing challenges, such as increasing expenses and the need for infrastructure improvements. For hospitals with significant numbers of patients from disadvantaged communities, hospitals are heavily reliant on reimbursement from Medi-Cal, the state's program to provide health care services to qualified, low-income individuals.

Over the past couple of years, many community hospitals have faced fiscal challenges, and in some cases bankruptcy. Since 2015, nine rural hospitals have closed, with many more at risk of closing. For example, Watsonville Community Hospital (WCH), a hospital that provides service across southern Santa Cruz and northern Monterey counties, filed for bankruptcy under private

ownership on December 5, 2021. SB 418 (Laird, 2022) created the Pajaro Valley Healthcare District, and AB 178 (Ting, 2022) allocated $25 million to it, so that the newly created healthcare district could acquire the hospital through bankruptcy proceedings.

In January 2023, Madera Community Hospital, which served predominately rural areas in the Central Valley closed its facilities, and in March 2023 filed for bankruptcy. Residents now face a 45-minute drive to the next nearest hospital in Fresno. Other hospitals risk similar fates without additional resources.

To respond to these financial challenges that hospitals face, AB 112 (Committee on Budget, 2023) gave $150 million to the newly created Distressed Hospital Loan Program, which offers interest-free, working capital loans to financially distressed hospitals while they implement turnaround strategies to regain financial viability.

San Diego County healthcare districts. There are four healthcare districts in San Diego County, three of which are located in northern San Diego County:

- *Palomar Health.* Palomar Health is the largest, owns and operates two hospitals: Palomar Medical Center Escondido, a 288-bed acute care hospital that opened in 2012 after district voters approved a $496 million bond measure in 2004, with the only trauma center in northern San Diego County; and Palomar Medical Center Poway, formerly known as Pomerado Hospital, a 124-bed acute care hospital with an adjoining 129-bed skilled nursing facility. Prior to constructing the new hospital in Escondido, Palomar operated the original Palomar Hospital in downtown Escondido, and after opening the new facility, continued to operate the old campus for a few more years, specializing in labor and delivery, pediatrics, and neonatal intensive care, but this campus was closed in 2015 to consolidate services at the Escondido and Poway facilities. Palomar receives approximately $25.5 million in property tax revenue from the 1% ad valorem tax assessed on property values within its boundaries.
- *Tri-City Healthcare District.* Tri-City is located on the north coast of San Diego County, including the Cities of Vista, Oceanside, and Carlsbad. Tri-City owns and operates Tri-City Medical Center in Oceanside, an acute care hospital licensed for 386 beds. Tri-City receives approximately $11.7 million in property tax revenue from the 1% ad valorem tax on assessed property values within its boundaries.
- *Fallbrook Regional Health District.* Fallbrook is the smallest of the San Diego healthcare districts, located in unincorporated areas just to the north of Tri-City, and bordered by Camp Pendleton to the west, and Palomar Health to the east. Fallbrook Hospital District was formed in 1950 (later renamed the Fallbrook Regional Health District) to help shore up support for a small community hospital. A 20-bed facility was built and opened in 1960, later expanded to a 50-bed facility, but after years of losing money, was forced to close in December 2015. Fallbrook Regional Health District no longer owns or operates a health facility, but uses its revenue from its property tax base for grants to enhance community health. Fallbrook receives approximately $2.3 million in property tax revenue.

Palomar Health Financial Struggles. According to a December 2, 2024 article in Becker's Hospital Review, Palomar Health posted a $165 million annual operating loss for the fiscal year that ended June 30, 2024, a -18.5% margin. This compared to only a $29.5 million loss (-3% margin) million in the prior fiscal year. Moody's downgraded Palomar Health's rating to "B2,"

reflecting "very thin" cash balances and ongoing cash flow losses, and that prior financial challenges were exacerbated by a cyberattack on the system's outpatient arm. The San Diego Union-Tribune published an article about their finances on December 8, 2024, stated that Palomar Health was asking lenders not to enforce borrowing terms that could push them into bankruptcy. According to this article, Palomar has large debt service payments, resulting from the close-to $1 billion construction of their new Escondido hospital, financed in part with $496 million in general obligation bonds paid for through a special parcel tax levy that voters approved in 2004. The article states that several key developments have recently challenged Palomar's profitability, including Kaiser Permanente opening nearby San Marco Medical Center in 2023, repatriating some services that it previously contracted with Palomar to provide. The article quoted Palomar executives as saying that plans to increase the number of services offered at its main Escondido campus have been slower to materialize than initially estimated.

Palomar Health was awarded $8.6 million from the Distressed Hospital Loan Program, with a due date of December 20, 2024. The recently enacted Budget Act of 2025 included an extension for this bridge loan, with a monthly payment program beginning in December 2025, discharging the loan after 24 payments.

San Diego LAFCO is currently conducting an MSR on the four health care districts in San Diego County, including Palomar, Tri-City, Fallbrook, and Grossmont. This MSR serves as a follow-up to an earlier MSR completed in 2015. San Diego LAFCO expects to release a complete MSR draft for public review by October 2025.

Discussions with LAFCO staff indicate that Palomar is in a precarious financial position, with debt exceeding 1.8x its capital assets and total obligations of $1.7 billion, which indicates potential insolvency. LAFCO staff also note that Palomar has operational and governance issues, including:

- *Limited financial reporting*. Recent financial disclosures exclude key components like employed physicians, obscuring true financial health.
- *Management concerns*. The introduction of Mesa Rock, an independent management company, raises questions about oversight and accountability.
- *Transparency concerns*. The scope and accuracy of financial performance reports are questionable, potentially misleading stakeholders.

The author wants to review healthcare service provision in northern San Diego County.

Proposed Law

Assembly Bill 356 requires the Department of Health Care Access and Information to convene a working group to study and make recommendations regarding the provision of health care services in healthcare districts in the northern region of San Diego County.

The working group must include representatives of each of the following areas:

- Each of the three healthcare districts in northern San Diego County;
- San Diego LAFCO;
- The San Diego Delegation of the California Legislature;
- Hospitals operating in San Diego County;

- Trade associations representing healthcare districts;
- Trade associations representing hospitals;
- Trade associations representing special districts; and
- Those representing labor interests engaged in health care in the northern region of the County of San Diego and any other relevant stakeholder interests, as determined by the department.

AB 356 directs the working group to:

- Review and discuss the statutory or other responsibilities of each healthcare district to provide health care services to the communities they serve and evaluate their capacity to meet those responsibilities; and
- Examine whether current resources, funding, and organizational structures in the northern region of San Diego County can fulfill the goal of providing adequate health care access to all residents, including underserved and vulnerable communities.

The working group must convene as soon as practicable following the enactment of the bill and report to the Legislature on or before June 1, 2026 on its findings and recommendations to the California Legislature.

AB 356 sunsets on June 1, 2030 and includes other technical provisions to implement the bill.

Comments

1. Purpose of the bill. According to the author, "Public health care districts are essential pillars of California's health care system, providing accessible, culturally competent, and affordable care, especially to underserved and vulnerable communities. In San Diego County, public health care districts represent a critical public investment designed to ensure democratic accountability and responsiveness to local health needs. However, governance instability and financial distress facing the Palomar Health Care District—a cornerstone of health care for nearly 850,000 residents—threatened access to essential healthcare services. Similar instability occurred for Tri-City Healthcare District (Palomar's neighboring district). Now, both Tri-City and Palomar have partnered with large hospital groups to move towards stability. In the past year, these entities have seen massive changes, and at this point of inflection, it is more important than ever to analyze the adequacy of healthcare services to ensure that all partners in the group continue to prioritize and maintain a high level of healthcare. Furthermore, by analyzing the entire healthcare ecosystem of North County San Diego, this bill takes a proactive step, without any further delays, to ensure San Diegans continue to receive the healthcare they need. By addressing these pressing issues, we can safeguard vital health care access, protect vulnerable populations, and maintain the public accountability and community-specific care that residents depend upon."

2. Adding value. One of the main purposes of LAFCOs is to leave decisions about local service provision to local elected officials that have greater context and understanding of issues on the ground. For this reason, the courts often refer to LAFCOs as the Legislature's watchdog over boundary changes. The CKH Act charges them with ensuring that local agencies—including healthcare districts—deliver governmental services efficiently and effectively. To fulfill this mission, LAFCOs conduct MSRs to identify service deficiencies and propose governance changes that may improve service delivery. AB 356 establishes, outside of the regular LAFCO process, a working group for reviewing services provided by healthcare districts in northern San

Diego County. The bill tasks the working group specifically with reviewing the responsibilities of healthcare districts to provide healthcare services, as well as examining whether current resources, funding, and organizational structures can fulfill the goal of providing adequate healthcare. These responsibilities appear to have significant overlap with the purposes of San Diego LAFCO's upcoming MSR, which is expected to analyze the fiscal health and governance of healthcare districts in this area. However, the working group may be able to offer additional technical recommendations relating to specific health care services because of the inclusion of various healthcare industry representatives. The Committee may wish to consider whether the report required by AB 356 will provide sufficient value over the local LAFCO process.

3. Crystal ball. Healthcare districts have been the subject of repeated scrutiny over the last several years. In 2017, the Assembly Local Government Committee held an oversight hearing on healthcare districts and found that of the 79 healthcare districts in existence at the time, many provided no direct healthcare services and instead only provide grants to other organizations. That same year the Little Hoover Commission issued a report that LAFCOs could do more to assess whether every healthcare district should continue to operate. In a few cases, healthcare districts have been subject to legislative efforts to dissolve or reorganize them, including:

- AB 2471 (Quirk, 2016) would have required the Alameda County LAFCO to order the Eden Township Healthcare District's dissolution if the District met specified criteria. This bill died on the Senate Inactive File;
- SB 522 (Glazer, 2018) dissolved the existing Board of Directors of the West Contra Costa Healthcare District and required the Board of Supervisors of Contra Costa County to either serve as or appoint the district board;
- AB 903 (Frazier, 2021) would have dissolved the Los Medanos Community Healthcare District and designated the County of Contra Costa as the successor agency to the district. This bill failed passage in the Senate Governance and Finance Committee; and
- AB 918 (Garcia, 2024) created the Imperial Valley Healthcare District to provide healthcare services across Imperial County and dissolved Pioneers and Heffernan Memorial Healthcare Districts.

While AB 356 only requires a report to the Legislature with recommendations, it could set the stage for future legislation to take direct action on healthcare districts in northern San Diego County outside of the LAFCO process.

4. Another county heard from. The Senate Rules Committee has ordered a double-referral of AB 356: first to the Committee on Health, which approved AB 356 at its July 9th hearing on a vote of 9-0, and second to the Committee on Local Government. Due to the timing of the Committee's respective hearings, amendments agreed to in the Committee on Health will be taken in the Committee on Local Government. The amendments:

- Grant the working group until July 1, 2027 to provide the report with its findings and recommendations; and
- Make clarifying changes to the hospital representation on the working group.

5. Special legislation. Section 16 of Article IV of the California Constitution prohibits special legislation when a general law can apply. AB 356 contains findings and declarations explaining the need for legislation that applies only to northern San Diego County because of the uniquely integrated services provided by the local health districts of the area.

Assembly Actions

Assembly Health Committee:	13-0
Assembly Appropriations Committee:	11-0
Assembly Floor:	63-4

Support and Opposition (7/11/25)

Support: California Association of Local Agency Formation Commission
San Diego Lafco

Opposition: Association of California Healthcare Districts (ACHD)
District Hospital Leadership Forum
Palomar Health

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