# Audit and Service Review
## of the
# El Camino Hospital District

**Prepared for the**

**Local Agency Formation Commission of Santa Clara County**

**Harvey M. Rose Associates, LLC**
**1390 Market Street, Suite 1150**
**San Francisco, CA 94102**

**(415) 552-9292 (T)**
**(415) 252-0461 (F)**

http://www.harveyrose.com

**July 11, 2012**

# Table of Contents

HARVEY M. ROSE
ASSOCIATES, LLC
public sector management consulting
1390 Market Street, Suite 1150 • San Francisco, California 94102
(415) 552-9292 • (415) 252-0461 (FAX) • info@harveyrose.com


July 12, 2012

Neelima Palacherla
Executive Director
Santa Clara County Local Agency Formation Commission
70 West Hedding Street, East Wing, 11th Floor
San Jose, CA 95110

Dear Ms. Palacherla:

Harvey M. Rose Associates, LLC is pleased to present this revised *Audit and Service Review of the El Camino Hospital District*. This revised report responds to questions posed by the Santa Clara County Local Agency Formation Commission (LAFCo) regarding the finances and operations of the El Camino Hospital District, and fulfills requirements of California State Law pertaining to LAFCo's Service Review responsibilities. In addition, the revised report incorporates certain corrections and clarifications in response to communications received by LAFCo during the public review process.

The Audit was conducted in accordance with *Government Auditing Standards, December 2011 Revision*, by the U.S. Government Accountability Office, Comptroller General of the United States. The Service Review was conducted in accordance with California Government Code Section 56000, et seq., known as the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (CKH Act). The report includes an Executive Summary and six sections with our findings, conclusions, determinations, and recommendations to the LAFCo Board.

We appreciate being provided with this opportunity to serve Santa Clara County LAFCo. Please call me at (415) 552-9292 if you have questions or additional requests.

Sincerely,

Stephen Foti
Principal

# Executive Summary

Harvey M. Rose Associates, LLC is pleased to present this *Audit and Service Review of the El Camino Hospital District* prepared for the Santa Clara County Local Agency Formation Commission (LAFCo). This audit and service review was conducted under authorities granted to the Santa Clara County LAFCo that are contained in California Government Code Section 56000, et seq., known as the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (CKH Act) other relevant sections of State law, LAFCo policies, and LAFCo's Service Review Guidelines, published by the Governor's Office of Planning and Research. In addition, the audit portion of the project was conducted in accordance with *United States Government Auditing Standards, 2011 Revision*, by the Comptroller General of the United States.

## Project Scope

The scope of the Service Review was designed to provide the Santa Clara County LAFCo with determinations required in the CKH Act. The Audit was designed to answer specific questions related to the El Camino Hospital District's governance structure; its financial relationship to the El Camino Hospital Corporation and affiliated non-profit organizations; the financial condition of the District and Corporation; the availability of reserves; the source and use of taxpayer funds used for hospital operations, capital improvements and the acquisition of the Los Gatos Hospital campus; and other related topics.

## Project Objectives

Established in 1956 to provide healthcare services to a more rural community, the El Camino Hospital District grew to become a major healthcare and hospital service provider in suburban Northern Santa Clara County. Over the years, methods of providing services evolved. In 1992, the El Camino Hospital Corporation was created and major assets of the District were transferred, leased or sold to the Corporation. Thereafter, the District designated the Corporation as the entity responsible for providing direct services to District residents. Beginning in 1997, the District assumed control of the Corporation as its "sole member".

In 2009, the Corporation expanded operations by purchasing the Los Gatos Hospital campus, which is located outside of the District and the Sphere of Influence (SOI). This action precipitated the questions that are the subject of this audit and service review. Accordingly, the primary objectives of the proposed Audit and Service Review were to provide answers to the following two questions:

1. Is the El Camino Hospital District providing services outside of its boundaries?
2. Should the District continue to exist and/or continue to receive public funds or could another entity provide the District's services more efficiently?

The Audit and Service Review respond to these questions and provide recommendations to guide Santa Clara County LAFCo as it makes decisions regarding the El Camino Hospital District.

# Description of the El Camino Hospital District and Affiliates

The El Camino Hospital District is a political subdivision of the State of California, formed pursuant to the Local Hospital District Law, now known as the Local Health Care District Law, which is codified in Health and Safety Code Sections 32000-32492. According to the California Healthcare Foundation,[1] the intent of the 1945 law was "to give rural, low income areas without ready access to hospital facilities a source of tax dollars that could be used to construct and operate community hospitals and health care institutions, and, in medically underserved areas, to recruit physicians and support their practices."[2] As discussed in the body of this report, since first codified in 1945, California law has been periodically modified and healthcare district authority and mandates have been broadened.

Today, the El Camino Hospital District is comprised of six legal entities, including the District and five affiliated organizations.

- The El Camino Hospital Corporation and three of its four affiliated entities are non-profit organizations, created pursuant to Section 501(c)(3) of the Internal Revenue Code (IRC). The fourth affiliated entity, CONCERN Employee Assistance Center, was created pursuant to IRC Section 501(c)(4).
- The District is the "sole member" of the Hospital Corporation.
- The Hospital Corporation is the "sole member" of the El Camino Hospital Foundation and CONCERN.
- The El Camino Surgery Center, LLC (ECSC) was established with the Hospital and a group of physicians as members. However, the Hospital purchased all physician shares of ECSC on August 31, 2011 and is now the sole owner.
- Silicon Valley Medical Development, LLC (SVMD) was formed in 2008 as a wholly owned subsidiary of the Hospital.

Even though these organizations are recognized as separate legal entities by the State of California, the thread of ownership and control over the activities and finances of these organizations lead directly back to the El Camino Hospital District.

Notably, when the Corporation was created in 1992, its Board of Directors consisted of a mix of community members as well as District Board members. In 1996, the District prevailed in a lawsuit to regain public control of Corporation activities. Pursuant to the settlement agreement derived from that lawsuit, the District was then established as the Corporation's sole member, the District's elected Board members were installed as the Corporation's Board, and the Hospital's

[1] According to the *Financial Statements of the California Health Care Foundation and Subsidiary, February 28 2011 and 2010*, the "California Healthcare Foundation . . . is a philanthropic organization established as a tax exempt, nonprofit corporation under Section 501(c)(4) of the Internal Revenue Code and the California Tax Code. The Foundation's primary purpose is to promote the availability of, and access to, quality and affordable health care and related services to the people of California . . ."

[2] April 2006, California Healthcare Foundation by Margaret Taylor, "California's Health Care Districts"

Chief Executive Officer (CEO) was added to the Corporation Board as a director. The fact the CEO is hired and may be terminated by the Corporation Board, ensures that the elected District Board of Directors maintains complete control over the Corporation.

Therefore, as the sole member of the Corporation, the District Board has the ability to alter the Corporation's Board membership and, therefore, maintains control of, and is accountable for, the Hospital Corporation. Even if the boards were not the same, there are other characteristics, such as the District's ability to impose its will, financial benefit and financial burden on the Corporation, which link the boards together and create fiscal dependency.

## California Healthcare Districts and ECHD Community Benefits

As of February 2012, there were 73 healthcare districts in California[3]. Of the 73 districts, 43 directly operate a hospital; four directly operate ambulance services; and 15 directly operate other "community-based services", which are typically ambulatory care clinics. The remaining 11 districts, including El Camino Hospital District, have sold or leased their hospitals to non-profit or for-profit organizations. ECHD is unique among these districts because the other ten sold or leased their hospitals to larger multi-hospital systems[4].

ECHD receives the second highest amount of property taxes of any healthcare district in the State, two-thirds of which is spent on capital contributions and debt service and one-third of which is spent on community benefits. According to the most recent information published by the Office of the State Controller[5], 54 healthcare districts received an apportionment of property taxes during the fiscal year that ended June 30, 2010. These apportionments ranged from a low of $102,094 for Muroc Hospital District in Kern County, to a maximum of $27,608,967 for Palomar Pomerado Hospital District in San Diego County.[6] The average property tax apportionment was $2,390,899, while the median property tax apportionment was $714,133. El Camino Hospital District received $16,016,747 in property tax apportionment monies in FY 2009-10, second only to Palomar Pomerado Hospital District and 144% of the third highest allocation in California. Overall, El Camino Hospital District received property taxes that were 670% of the average for all hospital districts in California and nearly three times the average of the 26 districts receiving over $1.0 million in that year.

Despite the significant taxpayer support provided by District residents, the El Camino Hospital community benefit contributions are merely within the range reported by other hospital district service providers throughout the State, including major, multi-hospital organizations. The

[3] According to the Association of California Healthcare Districts, an additional four organizations are currently registered as a healthcare district with the Secretary of State's Office, but either do not self-identify as a healthcare district (Lindsay Local Hospital District, Sierra Valley Hospital District and Selma Community Hospital) or have filed for bankruptcy and closed but have not yet dissolved as a district (Alta Hospital District).

[4] In 2010, Marin Healthcare District regained full control of Marin General Hospital.

[5] Special Districts Annual Report, California State Controller, December 13, 2011.

[6] Five districts serve multiple counties and, therefore, receive property tax apportionments from multiple counties. The analysis provided here is based on the aggregate property tax allocations received by each district.

following table shows the combined community benefit contributions made by the El Camino Hospital District and Corporation in 2011.

**Table 1**
**Total Community Benefit Provided by El Camino Hospital in FY 2011**

| | |
|---|---|
| Government-sponsored health care (unreimbursed Medi-Cal care) | $23,639,790 |
| Subsidized health services funded through hospital operations | $20,616,112 |
| Financial and in-kind contributions | $4,002,154 |
| Traditional charity care funded through hospital operations | $2,772,576 |
| Community Health Improvement Services | $1,857,998 |
| Health professions education funded through hospital operations | $1,171,764 |
| Clinical research funded through hospital operations | $402,216 |
| Community benefit operations funded through hospital operations | $185,830 |
| Government-sponsored health care (means-tested programs) | $150,000 |
| **Total Community Benefit, FY 2011** | **$54,798,440** |

Source: El Camino Hospital 2011 Community Benefit Report, unaudited financial data

Of the $54.8 million contributed in 2010, the El Camino Hospital District contributed $5,039,698 from its property tax apportionment, as shown in the table, below:

**Table 2**
**Portion of Community Benefits Funded by the District in FY 2011**

| | |
|---|---|
| Community health improvement services (community health education, community-based clinical services, health care support services) provided at Mountain view location – includes Partners for Community Health (PCH) programs | $1,603,074 |
| Financial and in-kind contributions (cash donations, grants, sponsorships) provided at Mountain View location – includes PCH programs | $3,361,624 |
| Government-sponsored health care (means-tested programs) provided at Mountain View location – includes Healthy Kids, a PCH program | $75,000 |
| **Total District-funded Community Benefit in FY 2011** | **$5,039,698** |

Source: El Camino Hospital 2011 Community Benefit Report unaudited financial data available on website.

The vast majority of El Camino Hospital's reported community benefit represents the unreimbursed portion of costs for care provided to Medi-Cal and other uninsured or underinsured recipients, other subsidized health services and charity care (shaded rows in Table 1), all of which are quantified using industry standard ratios of costs to charges. While the provision of unreimbursed care is considered a community benefit by State and federal guidelines, these costs are usually accounted for by expected net revenue formulas that result from payer contracts, and are part of the hospital budgeting of its net income (total charges less contractual adjustments) for their expected payer mix. In other words, anticipated losses from providing unreimbursed care are typically recovered from other payers. The remaining categories of community benefit, including financial and in-kind contributions, community health improvement services, education and research, amounted to less than $8 million in 2011. Of this amount, approximately $5 million, or approximately two-thirds, was funded by the District.

When analyzing a significant surrogate measure of community benefit provided by hospitals within the County, ECHD provides a lower percentage of Medi-Cal patient days than all but the Kaiser Foundation hospitals in the County and only one-half to one-third of the services that are provided to this population by Stanford University Hospital and O'Connor Hospital.

## Audit of the El Camino Hospital District

The District, the Corporation and its affiliated entities are one consolidated organization from both a governance and financial perspective. Generally Accepted Accounting Principles (GAAP) require the consolidation for financial reporting because the District, Corporation and other affiliated entities meet very specific criteria. According to GAAP, when establishing whether an entity is a component unit of a primary government, the entity must meet one of the three criteria shown below:

- The entity's governing board is appointed or controlled by the primary government;
- The entity is fiscally dependent on the primary government; or,
- The exclusion of the entity would lead to misleading financial reporting.

The Corporation also meets very specific criteria defined in State law requiring compliance with public disclosure laws, which makes the Corporation subject to the open meeting practices that are required of California governmental organizations.

A 1996 restructuring that resulted from a lawsuit defined the District as the "sole member" of the Corporation and effectively ensured public control of Corporation net assets and activities going forward. While the District and Corporation have strived in recent years to make a greater delineation between the two organizations, ultimately the authority and accountability of both the District and Corporation Boards of Directors stems from the members serving as elected public officials presiding over a political subdivision of the State of California.

The Corporation is well served by this relationship, accruing benefits typically reserved for public agencies, including the levying and use of property tax, as well as access to municipal financing. Further, at its initiation in 1992, the Corporation received approximately $175.5 million in net assets from the District. Subsequently, the Corporation's strong financial health is better than it would otherwise be and is strengthening, with $440 million in unrestricted net assets as of June 30, 2011. The Corporation continues to receive financial support from the District, exceeding $15.5 million annually that is used for the Community Benefits Program and for debt service on the Corporation's Mountain View Hospital.

The following two tables provide details regarding property tax collections and uses for the most recent five-year period.

**Table 3**
**Property Tax Revenues (In thousands)**
**For the Five Fiscal Years Ending June 30, 2011**

| | Fiscal Year | | | | | Five Year |
|---|---|---|---|---|---|---|
| | 2010-11 | 2009-10 | 2008-09 | 2007-08 | 2006-07 | Total |
| One Percent Ad Valorem | | | | | | |
| Restricted for Capital Use | $ 3,368 | $ 2,830 | $ 3,510 | $ 3,207 | $ 3,046 | $ 15,961 |
| Unrestricted | 5,782 | 5,858 | 5,732 | 5,403 | 4,935 | 27,710 |
| General Obligation Bonds Debt Service | 6,643 | 6,920 | 6,658 | 6,181 | 5,041 | 31,443 |
| Totals | $ 15,793 | $ 15,608 | $ 15,900 | $ 14,792 | $ 13,022 | $ 75,115 |

*Source: Report of Independent Auditors and Consolidated Financial Statements with Supplemental Information for El Camino Hospital District for fiscal year 2008-09 through 2010-11 and reports and records provided by management for FY 2006-07 and FY 2007-08.*

**Table 4**
**Property Tax Uses (In thousands)**
**For the Five Fiscal Years Ending June 30, 2011**

| | Fiscal Year | | | | | Five Year |
|---|---|---|---|---|---|---|
| | 2010-11 | 2009-10 | 2008-09 | 2007-08 | 2006-07 | Total |
| Debt Service | | | | | | |
| Interest Payments | $ 4,897 | $ 4,859 | $ 4,655 | $ 98 | $ 3,205 | $ 17,714 |
| Principal Reduction | 1,384 | 1,223 | 726 | 1,813 | - | 5,146 |
| Community Benefits Transfer | 2,025 | 5,731 | 5,403 | - | 500 | 13,659 |
| Capital Expense Transfer | - | 12,458 | 6,253 | - | 2,479 | 21,190 |
| Surplus Cash Transfer | - | - | 12,000 | - | 40,468 | 52,468 |
| Totals | $ 8,306 | $ 24,271 | $ 29,037 | $ 1,911 | $ 46,652 | $ 110,177 |

*Source: Various reports and records provided by District and Hospital management for all fiscal years.*

It is clear that the activities of each entity are directly linked to the resources of the other. Accordingly, the assignment of community benefits, through the provision of services to the underserved and District residents, is fundamental to the mission of both the District and the Hospital. While providing services to the underserved as a measure of community benefits are similar to other hospital districts in the State, it appears to be lower than many hospitals within Santa Clara County based on a review of Medi-Cal inpatient days. Further, significant hospital services, including 40 percent of emergency services and 50 percent of inpatient services, are provided to residents outside of the District's sphere of influence. Since there are no stated standards, ultimately, the Local Agency Formation Commission will decide if this service level and associated community benefits are acceptable.

The following findings respond to the specific questions posed by the Santa Clara County LAFCo for the Audit portion of the study:

1. ***Did/does ECHD fund the purchase, operations, or maintenance of the Los Gatos Hospital or other facilities located outside of the District boundaries?***

   The ECHD did not directly fund the purchase, operations or maintenance of the $53.7 million Los Gatos Hospital. However, the Corporation was able to generate sufficient net assets and cash balances to fund the Los Gatos Hospital acquisition due, in part, to: (a) the funding of debt service for a portion of the Mountain View campus rebuild, as well as capital improvements at the Mountain View campus, with annual property tax contributions from the District; (b) the transfer of excess property taxes from the District to the Corporation, amounting to approximately $52.5 million over the last five fiscal years; and, (c) access to and the use of tax exempt debt financing through the District and the County of Santa Clara as a 501(c)(3) non-profit Corporation.

2. ***Does ECHD contribute revenue to El Camino Hospital Corporation, which in turn purchased the hospital in Los Gatos or other facilities located outside of the District? If so, what is the purpose of the contributions and how are the funds accounted for?***

   The ECHD contributes revenue to the Corporation each fiscal year, amounting to approximately $110.2 million between FY 2006-07 and FY 2010-11. Of this amount, (a) $21.2 million (19.2%) was used to fund capital improvements at the Mountain View campus; (b) $17.7 million (16.1%) was used to pay principal and interest on debt used to fund renovations at the Mountain View campus; (c) $13.7 million (12.4%) was used to fund community benefits; and, (d) $52.5 million (47.6%) in surplus cash was transferred to the Corporation for renovations at the Mountain View campus. These surplus cash transfers may have exceeded the 50 percent threshold established by law, and contributed to the $440.1 million in Unrestricted Net Assets being held by the District, Corporation and affiliated non-profit entities as of June 30, 2011. The funds are accounted for separately in the consolidated financial accounting system maintained by the Corporation.

3. ***Is there a contractual relationship between the District and the El Camino Hospital Corporation? Does the District have an equity interest in the assets of the Corporation? If so, how much? If not, who owns the assets of the Corporation?***

   The contractual relationship between the District and the Corporation is defined by:

   - The 1992 Asset Transfer Agreement;
   - The 1992 Building Sale Agreement;
   - The 1992 Ground Lease and First Amendment; and,
   - The 1992 Management Services Agreement.

   Per the Articles of Organization for the Corporation, and subsequent amendments, the net assets of the Corporation revert back to the District upon corporate dissolution or termination of the lease. However, asset disposition is unclear should the District dissolve and the Corporation continues prior to lease termination.

***4. Does the District separately account for the receipt and expenditure of property tax revenues in a separate fund, or are such revenues commingled with other ECHD revenues?***

All of the District's revenues, including property tax, interest earnings, and lease payments are separately accounted for in the financial system and reported in the annual financial report. With the exception of debt service, the District's resources are transferred to the Corporation for expenditure, but are tracked and monitored through the use of separate accounts.

***5. Are the ECHD's funds commingled with the Corporation's Funds?***

No. While District funds are generally transferred to the Corporation for expenditure, they are separately tracked and monitored using separate account coding in the financial system. Therefore, District funds are not "commingled" with the Corporation's funds.

***6. What measures should ECHD take to establish transparency in the relationship between the ECHD and the El Camino Hospital Corporation?***

The District and the Corporation should establish enhanced budgetary reporting and controls on a cash or accrual basis in order to better reflect the use of District resources. This should include detailed reporting of transfers between entities as well as debt service requirements.

***7. What measures should ECHD take to be more accountable to the public/community that it serves?***

Budgetary and financial information should be reported on a component unit level (i.e., separate budgets and financial reports for the District, Corporation and each of the five non-profit entities). These budgets should provide character level detail and be reviewed, discussed and adopted by the respective boards at public hearings.

***8. What are ECHD's current revenue sources and amounts, including proceeds from various bonds and for what purpose are the revenues and bond proceeds used?***

Primary District revenues include property taxes, interest revenue and lease revenue on the Mountain View land. Proceeds from the sale of the bonds were transferred to the Corporation in prior years for expenditure on the Mountain View expansion and renovation. The District's revenues are used for debt service, transfers to the Corporation for capital acquisition and community benefit grants. See response to Question 1, above; tables 3 and 4; and, Exhibit 4.1 for a fuller explanation.

***9. What is the extent and purpose of ECHD's reserves?***

The District maintains reserves for (a) restricted property tax revenues received but not expended for capital acquisition; and, (b) capital asset replacement, based on accumulated depreciation of existing assets. The Corporation, as the primary operating entity, maintains

additional reserves, including a reserve of District funds transferred for community benefit grant programs that have not been expended.

***10. What is an appropriate/adequate amount of reserves? Does the District have any policies on amount and use of reserves?***

All reserves presently maintained by the District and the Corporation are conservative and not excessive. While the District and the Corporation have established limited policies and procedures on reserves, including an operating reserve and capital assets replacement reserves, a number of reserves that are maintained do not have formal policies and procedures and do not appear to be reviewed or authorized by either of the Boards in a systematic manner. The District should seek guidance from the Government Finance Officers' Association (GFOA) and the Corporation should seek guidance from industry groups to develop reserve policies based on best practices.

***11. Does ECHD have a role in governance/monitoring of hospital services provided by the El Camino Hospital Corporation?***

Yes. The District and Corporation maintain almost identical governing boards, which include identical voting members, so that decision-making is almost indistinguishable between entities. In addition, pursuant to the Corporation Articles of Organization and subsequent amendments, the District is the "sole member" of the Corporation. Essentially, from a governance standpoint, the District and the Corporation are the same entity.

***12. What is ECHD's role and responsibility at the end of the lease agreement between the ECHD and the El Camino Hospital Corporation, as it relates to the assumption of assets and liabilities of the Corporation?***

At the end of the lease agreement in the year 2044, the Amended Agreement states that the related buildings, fixtures, and improvements revert back to the District. Unstated is the disposition of any retained earnings or the transfer of other assets and liabilities. However, per the Articles of Incorporation and subsequent amendments, upon dissolution of the Corporation, all assets and liabilities (i.e., net assets, including retained earnings) would revert back to the District.

# Service Review of the El Camino Hospital District

Service reviews are intended to provide a tool to help LAFCo, the public and other agencies better understand the public service structure and evaluate options for the provision of efficient and effective public services. The Service Review conducted of the El Camino Hospital District revealed the following information for consideration by the Santa Clara County LAFCo Board.

- An emphasis in the law on populations or communities "served" by a healthcare district, rather than populations residing within district boundaries, have generally been interpreted to allow health care districts to extend their influence well beyond jurisdictional territory.

**Excess Capacity Even with Projected Population Growth**

- The County of Santa Clara has excess capacity for many services, estimated to be over 291 Medical/Surgical, 80 ICU/CCU, 188 Obstetrics and 72 NICU beds, based on 2010 discharge and licensure data at a target utilization rate of 85 percent.

- El Camino Hospital has a general acute care inpatient utilization rate of 60.7 percent. Although utilization varies by service, the ECH has substantial excess capacity in the Hospital's Medical/Surgical and Neonatal ICU units.

- On a Countywide basis, El Camino Hospital provides about 9.4 percent of total inpatient services. ECH has 9.4 percent of all licensed beds in the County and 9.5 percent of excess capacity, excluding beds that are becoming unlicensed at the end of 2012.

- Given the population profile of Santa Clara County and hospital utilization rates by age cohort, Countywide inpatient hospital demand is expected to increase by between 9.0 percent and 13.0 percent over the next five to seven years. For El Camino Hospital, this growth is expected to increase by between 5.8 percent and 8.3 percent over the same period.

- With the exception of ICU beds, it is unlikely that growth in local demand will lead to capacity concerns at the Mountain View hospital. Excess capacity is likely to remain in most services, since the Hospital is considering a project to relocate physician offices in the Women's Hospital to make approximately 40,000 square feet available for inpatient use.

**Large Proportion of Services Provided to Person Residing Outside of the SOI**

- Unlike water or sewer districts, which are restricted to providing services at permanent physical addresses, Healthcare District law does not restrict services to a specific territory and, instead, allows health care districts to serve individuals who reside outside of the district boundaries and in other areas. With the exception of the Los Gatos Hospital campus and two dialysis centers located in San Jose, all El Camino Hospital District facilities are located within jurisdictional boundaries.

- Approximately 43 percent of inpatient services provided by El Camino Hospital are for persons who reside within the District. Approximately 50 percent are for persons who reside within the SOI that includes all zip code territory within Sunnyvale and Cupertino. Another 38 percent originates from the rest of the County and an additional 12 percent originates from locations outside of the County.

- Approximately 54 percent of El Camino Hospital emergency department services are provided to persons who reside within the District. Approximately 60 percent are for persons who reside within the SOI that includes all zip code territory within Sunnyvale and Cupertino. Another 29 percent of service volume is provided to patients who originate from the rest of the County and an additional 11 percent to those who originate from locations outside of the County.

**Market Share Consistent Across District Boundaries and SOI**

- El Camino Hospital Mountain View captures approximately 40% of the market share within the District and the SOI that includes all zip code territory within Sunnyvale and Cupertino.

- Patients in these catchment areas seek about 90% of their inpatient care from within the County, predominantly from El Camino Hospital Mountain View, Stanford, and the two Kaiser facilities.

- The El Camino Hospital in Mountain View receives some "in-migration" of inpatient volume from the Los Gatos area. This in-migration volume totaled 1,971 cases in FY 2010, or about 5.6 percent of the area's total cases in that year. This share grew slightly from 5.4 percent of the area's volume in FY2008.

The following findings respond to the specific questions posed by the Santa Clara County LAFCo as part of the Service Review:

1. ***Separate and apart from the review of ECHD's role in relation to the Los Gatos Hospital campus, does the ECHD provide any services outside of its boundaries? What is the District's role in the various El Camino Hospital dialysis centers throughout the County?***

   Although the Corporation is a separate legal entity, as discussed in Section 4, the ECHD is the "sole member" of the El Camino Hospital Corporation. As structured, the elected District Board members sit as a quorum of the voting members of the Corporation Board. Therefore, any activities of the Corporation are, by extension, activities of the District.

   The acquisition and opening of the Los Gatos Hospital extends the range of District services beyond its current boundaries and sphere of influence. In addition, even when viewing the activities of El Camino Hospital Mountain View in isolation, it is clear that a major portion of services are provided to persons who reside outside of the District boundaries and the sphere of influence (see Statement 2, below).

   Providing dialysis services outside of the physical boundaries of the District is consistent with State law [Health and Safety Code § 32121(j)] and with the broader mission of the District and Hospital. However, the location of these centers in East San Jose (2230 Tully Road) and Central San Jose (999 West Taylor Street) presents similar concerns as the acquisition of the Los Gatos Hospital.

2. ***Do the ECHD's current boundaries reflect the population it serves?***

   No. As demonstrated in this report, only 43 percent of the inpatient services provided to residents of zip code areas that are wholly or partially contained within District boundaries. When considering zip code areas that are outside of the District but within the SOI, the proportion of inpatient services received by residents increases to 50 percent. Therefore, approximately half of the services provided by El Camino Hospital Mountain View are provided to residents of neither the District nor the District's SOI. Although a greater proportion of emergency services are provided to residents of the District and SOI,

approximately 40 percent of such services are provided to non-residents from areas throughout the County, State and beyond.

***3. If the ECHD is providing services outside of its boundaries, should its boundaries be extended to include its service area? If so, how would the affected agencies be impacted by such expansion?***

No. As demonstrated in the report, the El Camino Hospital Mountain View facility consistently has a market share of approximately 40 percent of all inpatient services within the District and sphere of influence. Beyond the SOI, the Hospital's market share drops to only four percent in the rest of the County.

In addition, as demonstrated in Section 4, the District, Corporation and five affiliated non-profit entities have been able to accumulate approximately $440 million in Unrestricted Net Assets as of June 30, 2011. In part, this accumulation of Unrestricted Net Assets and the Corporation's ability to acquire the Los Gatos Hospital have occurred as a result of the significant property tax contributions being made by residents of the current District. By expanding the District boundaries to include the SOI, the property tax base and resulting revenues would increase, adding to the Corporation's ability to either expand deeper into the community or accumulate additional Unrestricted Net Assets. Other local government jurisdictions would lose a portion of their 1% levy, and an additional tax would be imposed on residents within the SOI for ECHD debt service. There would be no clear benefit to residents of an expanded District if the District boundaries were to be expanded.

***4. What services is the ECHD currently providing? Is El Camino Hospital District currently providing the services for which it was created? Is there a change in ECHD's mission since its creation?***

The ECHD provides services to its residents through the El Camino Hospital Corporation and its affiliates, using an array of contracts with the Corporation that include a ground lease for the Mountain View Hospital, and the transfer and sale of assets to the Corporation in exchange for providing services to the ECHD community. As discussed in Section 4 and restated above, although the Corporation is a separate legal entity, the ECHD is the "sole member" of the El Camino Hospital Corporation. As structured, the elected District Board members sit as voting members of the Corporation Board. Therefore, any activities of the Corporation are, by extension, activities of the District.

Given this interpretation of the governance and financial relationship between the District and the Corporation, the decision of the Corporation to acquire Los Gatos Hospital and expand services (including operation of dialysis centers) well beyond the established boundaries of the District represents a significant departure from the original intent of the voters when forming the District in 1956. Further, expanding the Corporation reach in this manner is inconsistent with the intent of California Health and Safety Code § 32121(j), which allows healthcare districts, "to establish, maintain, and operate, or provide assistance in the operation of one or more health facilities or health services…at any location within or without the district *for the benefit of the district and the people served by the district*." Given

the geographical distance of the Los Gatos Hospital to the District, the extent to which the acquisition meets the voters' original intent or the purpose of the State law is questionable.

The following Statements of Determination respond to the requirements of California **Government Code Section 56430:**

***1. Growth and population projections for the affected area.***

The District and SOI are expected to experience a five-year population growth rate of 2.8 percent compared with a Countywide population growth rate of approximately 5.0 percent. Also, because of the differences in the populations by age cohort, the District and SOI will experience a lower 5.8 percent inpatient volume increase compared with a 9.0 percent inpatient volume increase for the County overall.

***2. Present and planned capacity of public facilities and adequacy of public services, including infrastructure needs or deficiencies.***

With the exception of ICU beds, it is unlikely that growth in local demand will lead to capacity concerns at the Mountain View hospital in the next five years. In addition, current facility plans under consideration for the Mountain View campus include the possibility of relocating physician offices in the Women's Hospital to make approximately 40,000 square feet available for inpatient use in 2013-14

***3. Financial ability of agency to provide services.***

The District, Corporation and five affiliated non-profit entities collectively held Unrestricted Net Assets of approximately $440 million as of June 30, 2011, which was 76.3% of annual operating expenses in that year. Of this amount, $408 million was reportedly held in cash and investments. Other financial indicators suggest that the combined organization is in a strong position compared with Standard and Poors (S&P) A+ rated hospitals: (a) the Hospital operating margin is 9.4% vs. 3.8% for the S&P group; (b) the Hospital profit margin is 8.3% vs. 6.0% for the S&P group; and, (c) the Hospital debt to capitalization ratio is 17.0% vs. 30.9% for the S&P group (i.e., for this indicator, a lower percentage suggests better performance). Therefore, the District's financial ability to provide services is strong.

***4. Status of, and opportunities for, shared facilities.***

No opportunities for shared facilities were identified during the service review.

***5. Accountability for community service needs, including governmental structure and operational deficiencies.***

To improve accountability, the District and the Corporation should establish enhanced budgetary reporting and controls on an accrual basis in order to better reflect the use of District resources. This should include detailed reporting of transfers between entities as well as debt service requirements. In addition, budgetary and financial information should be reported on a component unit level (i.e., separate budgets and financial reports for the

District, Corporation and each of the five non-profit entities). These budgets should provide character level detail and be reviewed, discussed and adopted by the respective boards at public hearings.

The governance structure of the District, the Corporation and the five affiliated non-profit entities blurs the distinctions between the organizations. As the "sole member" of the Corporation, the District is able to directly impose its will, financial benefit and financial burden on the Corporation, which link the boards together and creates fiscal dependency. In addition, the Corporation serves as the manager and administrator, not only for the Hospital as a nonprofit public benefit corporation, but also for the District, the Foundation, and the affiliated entities. Accordingly, all financial transactions and activities occur through the accounts and records of the Hospital, further blurring distinctions between the entities.

The District should consider changes that would clearly distinguish between the entities for governance and management purposes. This is discussed more fully in Section 6 of this report. In addition, the District should enhance processes for monitoring expenditures for capital improvements and community benefits, through improved budgeting and more transparent financial reporting.

***6. Any other matter related to effective or efficient service delivery, as required by commission policy.***

None identified as part of the service review.

The following Statements of Determination respond to the requirements of California Government Code Section 56425:

***1. The present and planned land uses in the area, including agricultural and open space lands.***

The ECHD has well-developed suburban land use designations without plans for significant changes that would affect the purpose and mission of the District.

***2. The present and probable need for public facilities and services in the area.***

The El Camino Hospital Mountain View campus provides a vital healthcare service in the community. A review of population projections for the District and the County, as well as analysis and capacity by major service, indicates that additional healthcare capacity is not required at this time. Overall, the County is using only 60.9 percent of its licensed beds and El Camino Hospital Mountain View is using 60.7 percent of its licensed beds, suggesting sufficient medical facility capacity in the County and District.

***3. The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide.***

See Statement Number 2.

***4. The existence of any social or economic communities of interest in the area if the commission determines that they are relevant to the agency.***

The commission did not identify any social or economic communities of interest in the area and none were identified as part of the Service Review.

***5. The nature, location, and extent of any functions or classes of services provided by the existing district.***

Although the District does not directly operate El Camino Hospital, it leases the land, transferred and sold assets, and entered into various agreements with the El Camino Hospital Corporation to operate a hospital on property that it owns in Mountain View. In addition, the District has contributed approximately $110 million to the Corporation in the past five years to pay for debt service related to the rebuilding of the Mountain View hospital, other capital improvements and community benefits.

El Camino Hospital is a full service acute care hospital located on a 41-acre campus in Mountain View, California. The campus in Mountain View includes the main hospital, the Women's Hospital, the El Camino Surgery Center, the Breast Health Center, the Oak Dialysis Center, the CyberKnife Center, the Cancer Center in the Melchor Pavilion, the Taft Center for Clinical Research, and the Genomic Medicine Institute. El Camino Hospital Corporation (ECHC) also owns the El Camino Surgery Center, LLC, and Silicon Valley Medical Development, LLC, and has 50 percent ownership of Pathways HomeCare and Hospice.

El Camino Hospital is licensed for 374 General Acute Care beds and 25 Psychiatric beds, for a total of 399 beds, based on data available from the California Office of Statewide Health Planning and Development (OSHPD). In 2012, the number of medical-surgical beds at the Hospital will be reduced by 99 beds in the old hospital, from 279 to 180 licensed beds. The total inpatient bed capacity of the Hospital will be reduced to 310, including 285 Acute Care and 25 Acute Psychiatric beds.

# Recommendations

There are six governance structure options identified in the report:

1. Maintain the District's boundaries and take measures to improve governance, transparency and accountability;
2. Modify the District's boundaries and/or SOI;
3. Consolidate the District with another special district;
4. Merge the District with a city;
5. Create a subsidiary District, where a city acts as the ex-officio board of the district; or
6. Dissolve the District, naming a successor agency for the purpose of either "winding up" the affairs of the District or continuing the services of the District.

Only options 1, 2, and 6 are viable alternatives for the El Camino Hospital District. Option 2, modifying the District boundaries and/or SOI is not recommended. If District boundaries were expanded, the District would receive more in property tax but would not necessarily provide a greater level of service to District residents. In addition, other local government jurisdictions would lose a portion of their 1% property tax levy, and an additional tax would be imposed on residents within the SOI for ECHD debt service. If the SOI were expanded, there would still not be a greater level of service. Accordingly, *there would be no practical benefit from modifying the sphere of influence to better reflect the Hospital's reach.*

Therefore, the Santa Clara County LAFCo should:

1. **Request the District to implement improvements in governance, transparency and public accountability, consistent with the suggestions made in this report. These improvements should include the following:**

    a. The El Camino Hospital District should limit its financial contributions to El Camino Hospital Corporation to payments for principal and interest on debt incurred by the District for the El Camino Hospital Mountain View Rebuild (i.e., a balance of $143.8 million in General Obligation Bonds, discussed in Section 4). In addition, the District should cease all automatic contributions to the El Camino Hospital Corporation to support the Hospital capital improvement program or to be used as a general revenue source. Instead, LAFCo should seek a legal interpretation of the applicability of GAL to the District and, if permitted by law, the District should divert these funds to community benefit programs that more directly benefit the residents of the District. Had this been the practice over the past five years, additional community benefit dollars amounting to approximately $73.7 million would have been available to directly benefit District residents. Should contributions exceed the 50% threshold pursuant to Health and Safety Code 32121 (p)(1), a vote may be required.

    b. Cease all automatic payments to the El Camino Hospital Corporation or its affiliates to support the Corporation's community benefit program and divert these funds to other programs that more directly benefit the residents of the District. Under this approach, the District Board should consider establishing a Community Benefit Trust Fund for the purpose of awarding District funded community benefit grants to public and private non-profit organizations that would provide healthcare related services to District residents. While the Corporation and its affiliates should not be barred from receiving community benefit grants from the District, the organizations should be required to compete for dollars along with other providers that might offer services.[7]

    c. Implement changes to the budget and financial reporting structure of the District, to provide clear and distinct segregation of budget priorities and reporting of financial activities. The budget process should be restructured to enhance transparency and public

[7] Of the $73.7 million, $21.2 million was restricted for capital use in accordance with the Gann Appropriations Limit. As previously noted, there is debate as to the applicability of the Limit to health care districts. In any event, whether for services or for capital use, the expenditure of property tax revenues should be more directly aligned with property tax payers and residents of the District.

accountability, including clear presentation of financial policies, such as those related to reserves, as well as projected and actual revenues and expenditures by purpose and program. The budget should report on specific line items financed by the District, including appropriations that support Mountain View hospital debt service, capital improvements (for example, the district should adopt a capital improvement plan), staffing and operations (including compensation paid to District Board members, executive staff, other employees and consultants, if any), and community benefit programs by grant category and recipient. In addition, the District Board should routinely appropriate all property taxes and non-operating revenues each fiscal year to prevent accumulation of resources, except in designated reserves or trust funds. A strengthened budget monitoring and reporting system should be established to ensure funds, such as community benefit grants, are being spent in accordance with Board policy.

d. Evaluate current and otherwise necessary professional services agreements with firms or individuals (including the corporation) used by the district for services, to ensure that the District receives the administrative and legal support necessary to conduct business and to differentiate between the two entities. Review and revise the District's code of ethics and conflict of interest policy to ensure that the District avoids circumstances of perceived or actual conflicts of interest.

**2. If the improvements described in Recommendation 1 cannot be accomplished by the District within 12 to 18 months of acceptance of this report, or if the Corporation continues to purchase property outside of the District boundaries, request that the District Board initiate changes to the governance structure. If such changes are not initiated within six months of the request for the governance change, consider whether actions to begin dissolution of the El Camino Hospital District are appropriate.**

If the District is not able to implement the suggested reforms within 12 to 18-months, acting as the El Camino Hospital Corporation Board of Directors, the Board should remove the District as the "sole member" of the Corporation and change the membership of the Corporation Board to include majority representation by individuals other than members of the ECHD Board of Directors. This action would result in full control of the Corporation by its Board of Directors and remove the District from its current role in corporate governance. Further, by changing the composition of the Corporation Board, the separation and independence of the two boards would be complete and the actions of the separate boards would be distinct, allowing for greater accountability and transparency.

We believe the separation and independence of the two Boards is an appropriate action due to the purchase and operation of the Los Gatos Hospital campus, which is located outside of the District boundaries and SOI. This fundamental shift in operating and business strategy has moved the Corporation (and by extension, due to Board's role governing both the Corporation and the District) the District away from its principal role as a public entity serving and benefiting District residents. Nonetheless, although we believe separate governance would be the best approach under this alternative, it may be prudent to initially allow the District to attempt reforms referred to in Recommendation 1, before taking the step of requiring modifications to the governance of the two entities.

If satisfactory reforms are not accomplished within the periods suggested, Santa Clara County LAFCo should consider dissolution of the District and make findings in accordance with Government Code Section 56881(b), as follows:

(1) Public service costs . . . are likely to be **less than or substantially similar** to the costs of alternative means of providing service.

(2) A change of organization or reorganization that is authorized by the commission **promotes public access and accountability** for community services needs and financial resources. (Emphasis added).

In addition, Santa Clara County LAFCo would need to identify a successor agency to implement the wind-up of the District, in accordance with Government Code Section 57451.

Contributions toward community benefits and the transfer of surplus District funds, representing nearly 60 percent of total contributions to the Corporation during the past five years, would clearly represent a decline in hospital income going forward and community benefits could potentially decline, unless the Corporation chose to continue contributing at current or increased levels from other sources of funds. Two other factors related to these transfers should also be recognized by LAFCo:

1. The contributions to community benefits, amounting to 19.2% of the total contributions made by the District, have generally gone toward programs that support the Hospital's general mission of providing healthcare services to the broader region. With dissolution, District residents would no longer be paying taxes to support community benefit services that are presently available to residents and non-residents alike.

2. Similarly, a substantial portion of the transfers (47.6%) have been used for capital improvements at the Hospital, due to factors related to the Gann Appropriation Limit, and have allowed the Corporation to accumulate surplus net assets sufficient to purchase Los Gatos Hospital and expand the Corporation service territory, well outside of the District boundaries and Sphere of Influence. Based on the service review, at most, 43 percent of inpatient services and 54 percent of emergency services are provided to District residents. As with community benefits, District residents would no longer be paying taxes to support the cost of Hospital services that are presently available to residents and non-residents alike.

Although the total property tax burden would not be reduced for District residents, property tax receipts would be reapportioned to other jurisdictions within the District's tax rate areas, resulting in additional resources for police, fire, schools and other services provided to District residents.

*GC Section 57451 Identifying a Successor Agency for Purposes of Winding Up the District*

In the event of dissolution, Government Code Section 57451 would require Santa Clara County LAFCo to identify a successor agency for purposes of winding up the affairs of the District. The city that contains the greater assessed value of all taxable property within the territory of the dissolved district will be the successor agency pursuant to Government Code § 57451.

*Implementing Dissolution*

Under the Dissolution alternative, Santa Clara County LAFCo would dissolve the District and initiate steps to wind-up the organization. To achieve dissolution, the following issues would need to be resolved:

1. A successor agency would need to be identified.

2. The financial relationship between the District and the Corporation would need to be wound-up, including an equitable settlement for various leases and agreements, and asset and liability disposition.

This report does not contain determinations for dissolution. Should LAFCO determine that the District has not satisfactorily accomplished the improvements in transparency and accountability recommended in this report, a study should be commissioned as a first step toward dissolution. Dissolution findings should be fully vetted and resolved prior to making determinations in accordance with the Government Code.

# 1. Introduction

Harvey M. Rose Associates, LLC is pleased to present this *Audit and Service Review of the El Camino Hospital District* prepared for the Santa Clara County Local Agency Formation Commission (LAFCo). This audit and service review was conducted under authorities granted to the Santa Clara County LAFCo that are contained in California Government Code Section 56000, et seq., known as the Cortese-Knox-Hertzberg Local Government Reorganization Act of 2000 (CKH Act).

## Methodology

The audit portion of the project was conducted in accordance with *United States Government Auditing Standards, 2011 Revision*, as promulgated by the Comptroller General of the United States. The Service Review component was conducted in accordance with the CKH Act and other relevant sections of State law, LAFCo policies, and LAFCo's Service Review Guidelines, as promulgated by the Governor's Office of Planning and Research.

## Scope and Objectives

The scope of the project was designed to provide information to the Santa Clara County LAFCo on required objectives described in the CKH Act, including analysis of the following:

1. Growth and population projections for the affected area.

2. Present and planned capacity of public facilities and adequacy of public services, including infrastructure needs or deficiencies.

3. Financial ability of agencies to provide services.

4. Status of, and opportunities for, shared facilities.

5. Accountability for community service needs, including governmental structure and operational efficiencies.

6. Any other matter related to efficient or effective service delivery, as required by commission policy.

The audit was designed to answer specific questions related to the El Camino Hospital District's governance structure; its financial relationship to the El Camino Hospital Corporation and affiliated non-profit organizations; the financial condition of the District and Corporation; the availability of reserves; the source and use of taxpayer funds used for hospital operations, capital improvements and the acquisition of the Los Gatos Hospital campus; and other related topics. A full listing of these questions can be obtained from the Santa Clara County LAFCo Request for Proposals related to this project.

The Audit and Service Review was conducted between December 12, 2011 and April 30, 2012. At the conclusion of the field work phase of the project, a draft report was produced and exit conferences were held with responsible Santa Clara County LAFCo and District officials for quality assurance purposes and to obtain comments on the report analysis, conclusions and recommendations. A final report was submitted to Santa Clara County LAFCo on May 23, 2012 for public review and comment.

## Project Objectives

Established in 1956 to provide healthcare services to rural populations, the El Camino Hospital District grew to become a major healthcare and hospital service provider in Northern Santa Clara County. Over the years, methods of providing services evolved. In 1992, the El Camino Hospital Corporation was created and major assets of the District were transferred, leased or sold to the Corporation. Thereafter, the District designated the Corporation as the entity responsible for providing direct services to District residents. Beginning in 1997, the District assumed control of the Corporation as its "sole member".

In 2009, the Corporation expanded operations by purchasing the Los Gatos Hospital campus, which is located outside of the District and Sphere of Influence (SOI). This action precipitated the questions that are the subject of this audit and service review. In addition, in 2011, the Santa Clara County Civil Grand Jury criticized the District and Corporation for unclear accountability, lack of financial and organizational transparency, and actions it had independently undertaken to acquire the Los Gatos Hospital campus without first seeking approval from Santa Clara County LAFCo. In light of these concerns, the Santa Clara County LAFCo decided that it wanted to do its own evaluation of these questions.

As a result, the primary objective of the proposed Audit and Service Review was to provide answers to the following two questions:

1. Is the El Camino Hospital District providing services outside of its boundaries?

2. Should the District continue to exist and/or continue to receive public funds or could another entity provide the District's services more efficiently?

This Audit and Service review responds to these questions and provides recommendations to help guide Santa Clara County LAFCo as it makes decisions regarding the El Camino Hospital District.

# 2. El Camino Hospital District and Its Affiliates

The El Camino Hospital District is a political subdivision of the State of California, formed pursuant to the Local Hospital District Law, now known as the Local Health Care District Law, which is codified in Health and Safety Code Sections 32000-32492. According to the California Healthcare Foundation,[1] the intent of the 1945 law was "to give rural, low income areas without ready access to hospital facilities a source of tax dollars that could be used to construct and operate community hospitals and health care institutions, and, in medically underserved areas, to recruit physicians and support their practices."[2]

Today, the El Camino Hospital District is comprised of six legal entities, including the District and five non-profit organizations. The District's financial statements for the Years Ended June 30, 2011, 2010 and 2009, describe the District and its affiliates, as follows:

> El Camino Hospital District is comprised of six (6) entities: El Camino Hospital District (the "District"), El Camino Hospital (the "Hospital"), El Camino Hospital Foundation (the "Foundation", CONCERN: Employee Assistance Center (CONCERN), El Camino Surgery Center ("ECSC"), and Silicon Valley Medical Development, LLC ("SVMD").

According to the financial statements and other miscellaneous documents reviewed for this Audit and Service review:

- The Corporation and three of its four affiliated entities are non-profit organizations, created pursuant to Section 501(c)(3) of the Internal Revenue Code. The fourth affiliated entity, CONCERN, was created pursuant to IRC Section 501(c)(4).
- The District is the "sole member" of the Hospital Corporation.
- The Hospital is the "sole member" of the Foundation and CONCERN.
- ECSC was established as an LLC with the Hospital and a group of physicians as members. However, the Hospital purchased all physician shares of ECSC, LLC on August 31, 2011 and is now the sole owner.
- SVMD was formed in 2008 as a wholly owned subsidiary of the Hospital.

Even though these organizations are recognized as separate legal entities by the State of California, the thread of ownership and control over the activities and finances of these organizations lead directly back to the El Camino Hospital District.

---

[1] According to the *Financial Statements of the California Health Care Foundation and Subsidiary, February 28 2011 and 2010*, the "California Healthcare Foundation . . . is a philanthropic organization established as a tax exempt, nonprofit corporation under Section 501(c)(4) of the Internal Revenue Code and the California Tax Code. The Foundation's primary purpose is to promote the availability of, and access to, quality and affordable health care and related services to the people of California . . ."

[2] April 2006, California Healthcare Foundation by Margaret Taylor, "California's Health Care Districts"

The governance and financial relationships of these organizations are explored more fully in Section 4 of this report. As described in that section, although each of these organizations have been established as separate legal entities, from a financial perspective and when applying various sections of State law that govern the behavior of public entities, the District and the Corporation are considered to be indistinguishable from one another.

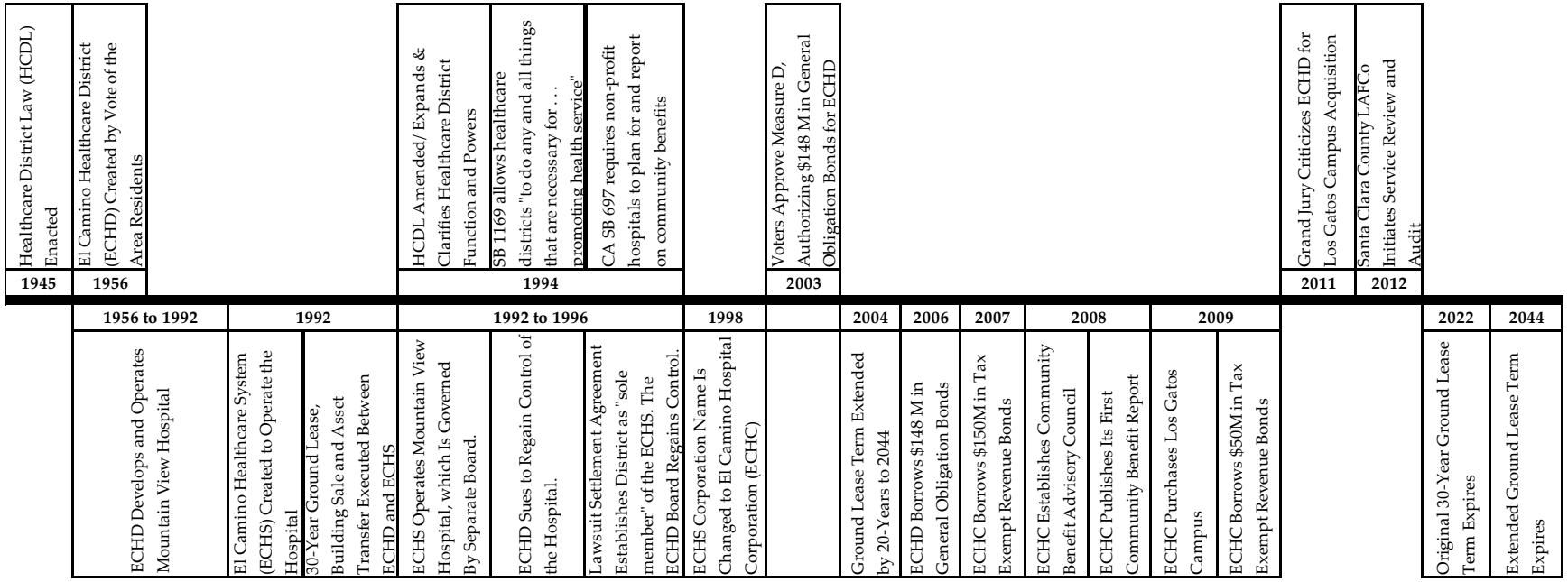
Most notably, when the Corporation was created in 1992, its Board of Directors consisted of a mix of community members as well as District Board members. In 1996, the District prevailed in a lawsuit to regain public control of Corporation activities. Pursuant to the settlement agreement derived from that lawsuit, the District was then established as the Corporation's sole member, all of the District's elected Board members were installed as the Corporation's Board, and the Hospital's Chief Executive Officer (CEO) was added to the Corporation Board as a director. The fact the CEO is hired and may be terminated by the Corporation Board, ensures that the elected District Board of Directors maintains complete control over the Corporation.

As the sole member of the Corporation, the District Board has the ability to alter the Corporation's Board membership and, therefore, maintains control of, and is accountable for, the Hospital Corporation. Even if the boards were not the same, there are other characteristics, such as the District's ability to impose its will, financial benefit and financial burden on the Corporation, which link the boards together and create fiscal dependency.

## Timeline of Key Events

Throughout this report, certain key events help to describe and explain the current relationship between the El Camino Hospital District and the Corporation. Explained more fully in the body of the report, the timeline on the next page provides a visual depiction of the evolving relationship between the two organizations, since the passage of the California Healthcare District Law in 1945 and the creation of the ECHD in 1956, through the term of the Amended Ground Lease through 2044.

## Exhibit 2.1
## 100-Year Timeline of Key Events Affecting El Camino Hospital District and Corporation




Key:

Above the Timeline: Law changes, elections and other external events.

Below the Timeline: Key events and actions taken by the ECHD and/or ECHC.

# 3. Hospital Districts in California

In 1945, in response to the shortage of acute care services in rural areas of the state, the California legislature enacted the Local Hospital District Law, now known as the Local Health Care District Law, which is codified in Health and Safety Code Sections 32000-32492. According to the California Healthcare Foundation, the intent of the law was "to give rural, low income areas without ready access to hospital facilities a source of tax dollars that could be used to construct and operate community hospitals and health care institutions, and, in medically underserved areas, to recruit physicians and support their practices." [1]

The health care district authorizing law has been amended multiple times since its original passage, largely for the purpose of expanding the powers and discretion of the healthcare districts. The law today allows districts wide discretion in how they choose to deliver services. The following key subsections of Health and Safety Code Section 32121 (Powers of local hospital districts), delineate these powers.

> (c) To purchase, receive, have, take, hold, lease, use, and enjoy property of every kind and description within and without the limits of the district, and to control, dispose of, convey, and encumber the same and create a leasehold interest in the same for the benefit of the district.
>
> (i) To do any and all things that an individual might do that are necessary for, and to the advantage of, a health care facility and a nurses' training school, or a child care facility for the benefit of employees of the health care facility or residents of the district.
>
> (j) To establish, maintain, and operate, or provide assistance in the operation of, one or more health facilities or health services, including, but not limited to, outpatient programs, services, and facilities; retirement programs, services, and facilities; chemical dependency programs, services, and facilities; or other health care programs, services, and facilities and activities at any location within or without the district for the benefit of the district and the people served by the district.
>
> (k) To do any and all other acts and things necessary to carry out this division.
>
> (m) To establish, maintain, and operate, or provide assistance in the operation of, free clinics, diagnostic and testing centers, health education programs, wellness and prevention programs, rehabilitation, aftercare, and any other health care services provider, groups, and organizations that are necessary for the maintenance of good physical and mental health in the communities served by the district.
>
> (o) To establish, maintain and carry on its activities through one or more corporations, joint ventures or partnerships for the benefit of the health care district.

As these subsections illustrate, health care districts are authorized to engage in essentially any lawful activity, as long as the activity supports the health care mission in the communities served by the district. Additionally, health care districts may carry out these activities at any location in or outside the district boundaries, as long as the activity is for "the benefit of the district or the people served by the district."

Further, healthcare districts may carry out their missions through a wide variety of organizational structures. Passage of Senate Bill (SB) 1169 in 1994 added regulations governing healthcare districts activity in selling, leasing and transferring assets and establishing alternative operational structures for the furtherance of their missions. These changes are described later in this section.

[1] Margaret Taylor, "California's Health Care Districts," California Healthcare Foundation, April 2006.

As a result of the passage of SB 697 in 1994[2], health care districts are required to prepare and submit community benefit reports to the Office of Statewide Health Planning and Development (OSHPD) annually. According to the declaration of the law, the intent of the requirement is for health care districts to demonstrate how they meet their "social obligation to provide community benefits in the public interest" as a public entity with taxing authority.

## Characteristics of Health Care Districts

As of February, 2012, there were 73 healthcare districts in California[3]. As shown in Table 3.1, of the 73 districts, 43 directly operate a hospital; four directly operate ambulance services; and 15 directly operate other "community-based services", which are typically ambulatory care clinics. The remaining 11 districts, including El Camino Hospital District, have sold or leased their hospitals to non-profit or for-profit organizations, as discussed in more detail in the next section.

**Table 3.1**
**Summary of Healthcare Districts by Type**

| **Total Healthcare Districts in California** | **73** |
|---|---|
| Healthcare Districts directly operating: | 62 |
| *Hospital* | *43* |
| *Ambulance services* | *4* |
| *Other "community-based services"* | *15* |
| Healthcare Districts that sold or leased a hospital to another organization | 11 |

Source: Association of California Healthcare Districts

Of the 73 districts, 31 are designated as rural by the State of California and the remaining 42 are located in more populated areas. The districts are geographically distributed throughout the state, across 38 counties.

According to the most recent information published by the Office of the State Controller[4], 54 healthcare districts received an apportionment of property taxes during the fiscal year that ended June 30, 2010, as shown below in Figure 3.1. These apportionments ranged from a minimum of $102,094 for Muroc Hospital District in Kern County, to a maximum of $27,608,967 for Palomar Pomerado Hospital District in San Diego County.[5] The average property tax

[2] California Health and Safety Code, Sections 127340-127365

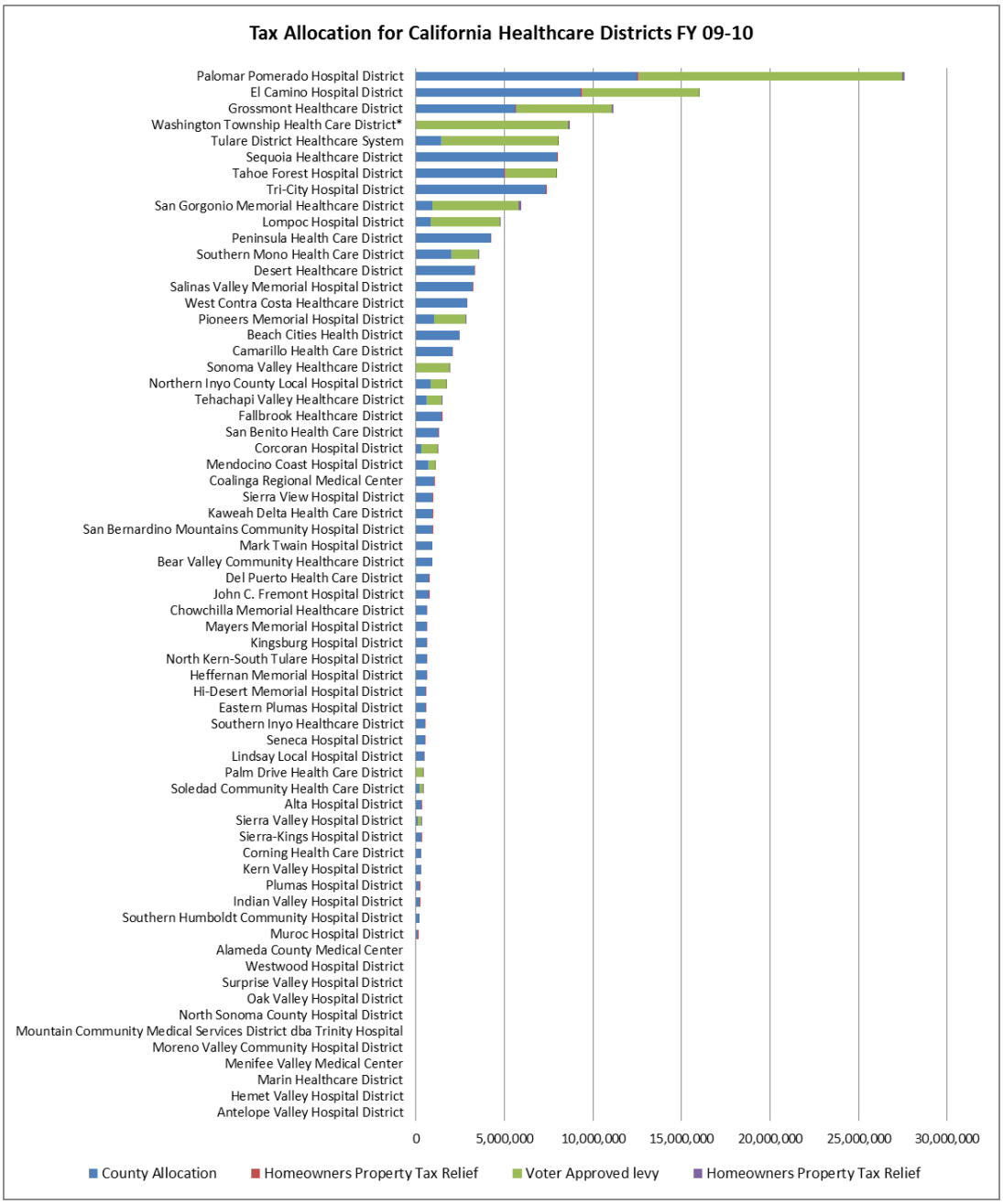
[3] According to the Association of California Healthcare Districts, an additional four organizations are currently registered as a healthcare district with the Secretary of State's Office, but either do not self-identify as a healthcare district (Lindsay Local Hospital District, Sierra Valley Hospital District and Selma Community Hospital) or have filed for bankruptcy and closed but have not yet dissolved as a district (Alta Hospital District).

[4] Special Districts Annual Report, California State Controller, December 13, 2011.

[5] Five districts serve multiple counties and, therefore, receive property tax apportionments from multiple counties. The analysis provided here is based on the aggregate property tax allocations received by each district.

apportionment was $2,390,899, while the median property tax apportionment was $714,133, reflecting the small number of districts receiving a high dollar value property tax apportionment. El Camino Hospital District received $16,016,747 in property tax apportionment monies in FY 2009-10, second only to Palomar Pomerado Hospital District and 144% of the third highest allocation in California. Overall, El Camino Hospital District received property taxes that were 670% of the average for all hospital districts in California and nearly three times the average of the 26 districts receiving over $1.0 million in that year.

**Figure 3.1**




*Source: California State Controller Special Districts Annual Report, FY 2009-10*

According to the Association of California Healthcare Districts, 11 of the 73 healthcare districts operating in California as of February 2012, including El Camino Hospital District, had sold or leased their hospitals to another non-profit or for-profit organization.[6] In 1994, the passage of California Senate Bill 1169 amended the Local Healthcare District Law to change regulations governing transfers of property, conflicts of interest, health care trade secrets and the public meeting act, lease agreements, and sales of property and assets.[7] Subsequently, many healthcare districts chose to reorganize by selling or leasing their hospitals in order to take advantage of the features of the amended law that allowed them to compete with private hospitals and, in some respects, behave more like private hospitals.

ECHD is unique, however, because each of the other ten districts sold or leased their hospitals to well-established, multi-hospital systems, including Sutter Health, St. Joseph Health System, and Catholic Healthcare West. On the other hand, ECHD participated in the creation of a non-profit hospital corporation that was established for the sole purpose of providing the health care services previously provided directly by the District. Although this mission has changed with the purchase of the Los Gatos facility, as discussed in other sections of this report, the governance structure and shared financial management of ECHD and the El Camino Hospital Corporation blur distinctions between the two organizations. In those districts where assets were sold to multi-hospital systems, hospital and district organizations are distinct, with separate governance and financial management structures.

The only exception of the ten other districts that sold or leased their hospitals is Marin Healthcare District. In 1985, Marin Healthcare District leased its hospital to Marin General Hospital Corporation, a private non-profit organization, which soon thereafter entered into an affiliation with California Healthcare Systems. In 1995, California Healthcare Systems merged with Sutter Health, which operated Marin General Hospital for several years. In 2006, a transfer agreement was executed between the District and Sutter Health, beginning the process of transferring control of the Hospital back to the District. In 2010, the District regained full control of the Hospital. However, unlike ECHD, the District board and the non-profit corporation board are composed of entirely different individuals.

## Affiliations with Non-Profit Entities

Many health care districts and hospitals in California are affiliated with non-profit entities, such as charitable foundations or physician employee groups. In addition to the hospital corporation, ECHD includes the El Camino Hospital Foundation, the CONCERN Employee Assistance Program, the El Camino Surgery Center, LLC, and the Silicon Valley Medical Development, LLC as component units in its financial statements, meaning that these entities are financially

[6] This does not include Redbud Healthcare District, which sold its hospital to Adventist Health in 1997. The hospital currently has no connection to the District.

[7] "California's Health Care Districts," prepared for the California Healthcare Foundation by Margaret Taylor, April 2006.

linked or dependent upon the hospital.[8] The financial relationships between these affiliated organizations are described in more detail in Sections 3 and 5 of this report.

Each of the eight health care districts in California that received more than $5 million in property tax allocations in FY10[9] were affiliated with a non-profit charitable foundation. By contrast, only half of the ten health care districts that had leased or sold their hospitals to a private entity appear to operate a foundation. However, most of those districts offer grant programs directly to the community and not through a third party entity, such as a foundation.

## Community Benefit Comparisons

California Health and Safety Code Sections 127340-127365 require private not-for-profit hospitals to plan for and report on the actual provision of community benefits. Each year, hospitals must submit a community benefits report to the Office of Statewide Health Planning and Development (OSHPD), delineating the actual resources contributed toward community benefits programs during the previous year, and presenting the hospital's plan for community benefits programs in the upcoming fiscal year.

As discussed in Section 5, in 2008 the El Camino Hospital Corporation established a Community Benefit Advisory Council as part of an effort to increase community benefits that it provides. According to its 2011 Community Benefit Report[10], the El Camino Hospital provided a total of $54,798,440 of community benefit in FY 2011, $5,039,698 of which was funded directly with District resources, as shown below in Tables 3.2 and 3.3.

**Table 3.2**
**Total Community Benefit Provided by El Camino Hospital in FY 2011**

| | |
|---|---|
| **Government-sponsored health care (unreimbursed Medi-Cal care)** | **$23,639,790** |
| **Subsidized health services funded through hospital operations** | **$20,616,112** |
| Financial and in-kind contributions | $4,002,154 |
| **Traditional charity care funded through hospital operations** | **$2,772,576** |
| Community Health Improvement Services | $1,857,998 |
| Health professions education funded through hospital operations | $1,171,764 |
| Clinical research funded through hospital operations | $402,216 |
| Community benefit operations funded through hospital operations | $185,830 |
| **Government-sponsored health care (means-tested programs)** | **$150,000** |
| **Total Community Benefit, FY 2011** | **$54,798,440** |

Source: El Camino Hospital 2011 Community Benefit Report, unaudited financial data

[8] The Governmental Accounting Standards Board (GASB) Statement No. 14 technical summary states, "The definition of the reporting entity is based primarily on the notion of financial accountability" and describes the conditions under which financial accountability may be established.

[9] The FY 2009-10 data is the most recent available from the California State Controller.

[10] El Camino Community Benefit Report, July 2010 – June 2011.

As shown in Table 3.2, the vast majority of El Camino Hospital's reported community benefit represents the unreimbursed portion of costs for care provided to Medi-Cal and other uninsured or underinsured recipients, other subsidized health services and charity care (shaded rows in Table 3.2), all of which are quantified using industry standard ratios of costs to charges. While the provision of unreimbursed care is considered a community benefit by State and federal guidelines, these costs are usually accounted for by expected net revenue formulas that result from payer contracts, and are part of the hospital budgeting of its net income (total charges less contractual adjustments) for their expected payer mix. In other words, anticipated losses from providing unreimbursed care are typically recovered from other payers. The remaining categories of community benefit, including financial and in-kind contributions, community health improvement services, education and research, amounted to less than $8 million in 2011. Of this amount, approximately $5 million, or approximately two-thirds, was funded by the District.

The portion of the Hospital's FY 2011 total community benefit of $5,039,698 that was funded by the District, is delineated by category in Table 3.3, below.

**Table 3.3**
**Portion of Community Benefits Funded by the District in FY 2011**

| | |
|---|---|
| Community health improvement services (community health education, community-based clinical services, health care support services) provided at Mountain view location – includes Partners for Community Health (PCH) programs | $1,603,074 |
| Financial and in-kind contributions (cash donations, grants, sponsorships) provided at Mountain View location – includes PCH programs | $3,361,624 |
| Government-sponsored health care (means-tested programs) provided at Mountain View location – includes Healthy Kids, a PCH program | $75,000 |
| **Total District-funded Community Benefit in FY 2011** | **$5,039,698** |

Source: El Camino Hospital 2011 Community Benefit Report unaudited financial data available on website. Report includes detailed as well as summary data.

According the District's financial statements, this contribution is funded entirely by the District's property tax revenue apportionment (see Section 5). In total, the District received $15,793,000 in property taxes during FY 2011, $6,643,000 of which was levied for debt service used to finance improvements to the Mountain View Hospital, $3,368,000 of which was designated to support unspecified capital projects, and the remainder which was designated to support the community benefit program[11].

Due to the following factors, it is not possible to provide a comprehensive State-wide comparison of community benefits provided by healthcare districts. First, small, rural and non-acute hospitals are exempt from the community benefit reporting requirement, which means that a sizable portion of healthcare district hospitals are exempt and do not produce a report. Second,

[11] The amount of District funded community benefit shown in the Hospital's Community Benefit Report ($5,039,698) differs from that reported in the District's audited financial statements ($5,782,000). The difference is attributable to financial reporting and timing differences.

according to OSHPD, several hospitals are delinquent in meeting the reporting requirement. In addition, while some hospitals that are operated by larger health systems provide community benefit reports, data is not disaggregated by individual hospital.

Accordingly, four of the ten healthcare districts that have sold or leased their hospitals to other entities do not produce a community benefit report[12]. Of the remaining six that produce a community benefit report, five do not produce annual financial reports of their own and are instead included on a combined basis in their "parent" health system's financial statements. Therefore, precise comparisons with El Camino Hospital District cannot be made.

Nonetheless, Table 3.4 below shows the community benefit expenses as a percentage of total operating expenses reported by El Camino Hospital and each of the six other district hospitals that produce a community benefit report and are operated by a non-district entity. The most recent available financial statements were used for each hospital (either 2010 or 2011). Three categories of community benefits are presented: (1) the subtotal of uncompensated care, charity care, and other subsidized health care services, (2) the subtotal of all other reported community benefits, including cash and in-kind donations, education, and research, and (3) the total reported community benefit[13]. The operating organization's system-wide community benefit information is shown below each "subsidiary" hospital.

For example, Mark Twain Hospital and Sequoia Hospital are operated by Catholic Healthcare West (CHW) and while each hospital has its own community benefit report, neither hospital has its own financial report. The table shows the individual hospitals' reported community benefit expense, but not overall expense. In order to understand its community benefit investment as a percentage of overall expenses, the Catholic Healthcare West system-wide data is shown below Mark Twain and Sequoia Hospitals. As Table 3.4 on the next page shows, El Camino Hospital's reported proportional community benefit expense is within the range of community benefit investment made by the other five hospital district organizations that report such information. El Camino Hospital reports that 8.2 percent of total operating expenses represent uncompensated/charity care community benefits, while the other five hospitals report uncompensated/charity care community benefits that range between 6.7 percent to 9.3 percent of total operating expenses. For all other types of community benefits (including cash, in-kind donations, education and research), El Camino spends 1.3 percent of total operating expenses, while the other five range from 0.7 percent to 2.4 percent. On an aggregate basis, El Camino Hospital reports a slightly higher proportion of community benefit at 9.5 percent of total operating expenses, with the other five ranging from 7.9 to 9.3 percent.

In addition to comparisons with other hospitals performing services for health care districts, an analysis was conducted to compare El Camino Hospital with other hospitals within the County. However, many of these hospitals do not produce community benefit reports. Therefore, since the major portion of reported community benefits are comprised of contributions to Government Sponsored Health Care and Charity Care, this analysis compared total Medi-Cal Inpatient Days as a percentage of Total Inpatient Days for El Camino and other area hospitals.

[12] Fallbrook, Desert, Mt. Diablo, and Peninsula.
[13] Not including unreimbursed Medicare , which was not consistently reported.

**Table 3.4**
**Community Benefits Reported by Healthcare District Hospitals**
**That Have Sold or Leased Hospitals to Another Entity**

| Healthcare District Name | Hospital Name (affiliations shown in parentheses) | Fiscal Year | Operating Expenses | Uncompensated/ Charity Care | Uncompensated/ Charity Care as % of Operating Expenses | Other Community Benefits | Other Community Benefits as % of Operating Expenses | Total Community Benefit* | Total Community Benefit* as % of Operating Expenses |
|---|---|---|---|---|---|---|---|---|---|
| El Camino | El Camino Hospital | 2011 | 577,102,000 | 47,178,478 | 8.2% | 7,619,962 | 1.3% | 54,798,440 | 9.5% |
| Marin | Marin General Hospital | 2010 | 318,900,333 | 25,673,633 | 9.3% | 3,984,098 | 1.2% | 29,657,731 | 9.3% |
| Eden Township | Eden Medical Center (Sutter) | 2010 | (see Sutter) | 25,730,000 | (see Sutter) | 2,295,000 | (see Sutter) | 28,025,000 | (see Sutter) |
| | Sutter | 2010 | 8,431,000,000 | 625,000,000 | 7.4% | 126,000,000 | 1.5% | 751,000,000 | 8.9% |
| Mark Twain | Mark Twain Hospital (CHW) | 2010 | (see CHW) | 2,933,195 | (see CHW) | 159,806 | (see CHW) | 3,093,001 | (see CHW) |
| Sequoia | Sequoia Hospital (CHW) | 2010 | (see CHW) | 6,433,824 | (see CHW) | 1,794,795 | (see CHW) | 8,228,619 | (see CHW) |
| | Catholic Healthcare West "CHW" | 2011 | 10,367,804,000 | 698,902,000 | 6.7% | 248,150,000 | 2.4% | 947,052,000 | 9.1% |
| Petaluma | Petaluma Valley Hospital (St. Joseph) | 2010 | (see St. Joseph) | 9,065,000 | (see St. Joseph) | 15,000 | (see St. Joseph) | 9,080,000 | (see St. Joseph) |
| | St. Joseph | 2011 | 4,031,603,000 | 288,834,000 | 7.2% | 30,088,000 | 0.7% | 318,922,000 | 7.9% |
| Grossmont | Grossmont Hospital (Sharp) | 2010 | unavailable | 81,625,224 | unknown | 2,369,048 | unknown | 83,994,272 | unknown |
| Mount Diablo | John Muir Medical Center (John Muir Health) | 2010 | unavailable | 24,212,000 | unknown | 15,025,000 | unknown | 39,237,000 | unknown |
| Fallbrook | Fallbrook Hospital | No Community Benefit Report Produced | | | | | | | |
| Desert | Desert Regional Medical Center (Tenet) | No Community Benefit Report Produced | | | | | | | |
| Peninsula | Mills-Peninsula (Sutter) | No Community Benefit Report Produced | | | | | | | |

*Source: Community benefit reports filed with OSHPD and hospital financial statements.*

As shown in Table 3.5 on the next page, approximately six percent of ECH inpatient hospital days represented Medi-Cal days at El Camino Hospital, while other area hospitals reported between two percent and 21 percent of inpatient hospital days as Medi-Cal days (excluding Santa Clara Valley Medical Center, which is the County hospital).

**Table 3.5**
**Medi-Cal Inpatient Days as a Percentage of Total Days**
**Santa Clara County Hospitals**

| Facility | Medi-Cal Days | Total Days | % Medi-Cal Days |
|---|---|---|---|
| KAISER FOUNDATION HOSPITAL - SANTA CLARA | 1,778 | 88,874 | 2% |
| KAISER FOUNDATION HOSPITAL - SAN JOSE | 1,446 | 50,285 | 3% |
| **EL CAMINO HOSPITAL** | **4,832** | **79,939** | **6%** |
| GOOD SAMARITAN HOSPITAL- SAN JOSE | 6,783 | 82,942 | 8% |
| STANFORD UNIVERSITY HOSPITAL | 18,200 | 134,394 | 14% |
| O'CONNOR HOSPITAL | 11,463 | 59,098 | 19% |
| REGIONAL MEDICAL CENTER OF SAN JOSE | 11,608 | 56,433 | 21% |
| ST. LOUISE REGIONAL HOSPITAL | 2,617 | 12,496 | 21% |
| SANTA CLARA VALLEY MEDICAL CENTER | 62,801 | 123,551 | 51% |
| **Grand Total** | **121,528** | **688,712** | **18%** |

*Source: OSHPD "Hospital Summary Individual Disclosure Report", Financial and Utilization Data by Payer*

Therefore, when analyzing a significant surrogate measure of community benefit provided by hospitals within the County, ECHD provides a lower percentage of Medi-Cal patient days than all but the Kaiser Foundation hospitals in the County and only one-half to one-third of the services that are provided to this population by Stanford University Hospital and O'Connor Hospital.

# Findings and Conclusions

The original intent for the creation of healthcare districts in California was "to give rural, low income areas without ready access to hospital facilities a source of tax dollars that could be used to construct and operate community hospitals and health care institutions, and, in medically underserved areas, to recruit physicians and support their practices."[14] Based on the El Camino Hospital organization's status in the Santa Clara County healthcare community and the unremarkable level of community benefit contributed to District residents by both the District and Corporation, it is clear that the original intent of the law (i.e., to provide "low income areas" with ready access to "hospital facilities" or to provide health care in "medically underserved areas") is no longer applicable to the El Camino Hospital District.

El Camino Healthcare District (ECHD) is one of eleven healthcare districts that have sold or leased a hospital to a private corporation. ECHD is unique among these districts because the other ten sold or leased their hospitals to larger multi-hospital systems[15].

[14] "California's Health Care Districts," prepared for the California Healthcare Foundation by Margaret Taylor, April 2006.
[15] In 2010, Marin Healthcare District regained full control of Marin General Hospital.

ECHD receives the second highest amount of property taxes of any healthcare district in the State, two-thirds of which is spent on capital contributions and debt service and one-third of which is spent on community benefits. The El Camino Hospital community benefit contributions are within the range reported by other hospital district service providers throughout the State, including major, multi-hospital organizations. Within Santa Clara County, El Camino Hospital provides a lower percentage of Medi-Cal Inpatient Days than many area hospitals at six percent, while others provide as much as 21 percent (excluding Santa Clara Valley Medical Center, which is a public hospital).

Overall, although receiving more property taxes than all but one other healthcare district in the State, community benefit contributions of ECHD do not distinguish it from other healthcare districts in the State or hospital operations within the County.

# 4. Audit of the El Camino Hospital District

## El Camino Hospital District and Its Component Units

The El Camino Hospital District (ECHD) is one entity from a financial perspective. In the District's financial statements, the reporting entity is comprised of the primary government ("District"); as well as several non-profit organizations, including the El Camino Hospital Corporation ("Corporation"), the El Camino Hospital Foundation ("Foundation"), and other smaller entities. In other words, for financial reporting purposes, the El Camino Hospital District is a single consolidated organization that includes multiple component units.

Government structure in California is complex, varying in services that are provided, the manner in which services are provided, the relationships with other governmental and non-governmental entities, and legal structure. However, Generally Accepted Accounting Principles (GAAP) provide authoritative guidelines that are used by certified public accountants (CPAs) and other finance professionals when defining governments as financial reporting entities. In essence, substance over legal form is paramount to ensure that an entity is fairly and accurately presenting financial information in accordance with GAAP.

The Government Finance Officers Association (GFOA) of the United States and Canada publishes practical guidance for use by accounting and auditing professionals regarding the implementation of GAAP. GFOA's principal guidance document, known in the CPA profession as the "Blue Book", states:

> "GAAP direct those who prepare financial statements to look beyond the legal barriers that separate these various units to define each government's financial reporting entity in a way that fully reflects the *financial accountability* of the government's elected officials."[1]

Thus, in addition to the primary government, additional entities should be incorporated into financial reports, if established criteria are met, as discussed in detail below. These additional entities are referred to as component units.

Regardless of legal status, the financial activities and balances of component units are either "blended" with the primary government, if their activities are an integral part of the primary government; or presented "discretely" (e.g. separately) from, but with the primary government, if the component unit functions independently of the primary government. For ECHD, the District's independent financial auditors have consolidated the financial data and information of five blended component units with the primary government (i.e., the El Camino Hospital District). Thus, the activities and balances of the Corporation, the Foundation, and the other affiliated entities are construed to be an integral part of the activities and balances of ECHD and are thus reported in the District's financial statements, as required by GAAP.

[1] Gauthier, Stephen J., Government Finance Officers Association, *Governmental Accounting, Auditing, and Financial Reporting*, 2001, page 51.

## Component Unit Criteria

By definition, component units are separate legal entities from the primary government entity. If they were not separate entities, their activities and balances would be indistinguishable from the primary government. According to GAAP, when establishing whether an entity is a component unit of a primary government, the entity must meet one of the three criteria shown below:

- The entity's governing board is appointed or controlled by the primary government;
- The entity is fiscally dependent on the primary government; or,
- The exclusion of the entity would lead to misleading financial reporting.

Because the El Camino Hospital District Board members all serve as Board members of the El Camino Hospital Corporation and comprise a voting majority of the Corporation's Board[2], the Corporation meets the definition of a component unit. As the GFOA notes, "membership on dual boards is considered to be the functional equivalent of board appointment."[3]

Of historical note, when the Corporation was initially created in 1992, its Board of Directors consisted of a mix of community members as well as District Board members. As of December 31, 1992, the District transferred or sold $256.6 million in assets and $81.1 million in liabilities to the Corporation, totaling $175.5 million in net assets. However, in 1996, the District prevailed in a lawsuit to regain public control of Corporation activities.

Pursuant to the subsequent settlement agreement, the District was established as the Corporation's sole member, which then reinstated the District's elected Board members as the Corporation's Board and added the Hospital's Chief Executive Officer (CEO) as an "ex officio" director. The CEO is hired, and may be terminated by the Hospital Board. As the sole member of the Corporation, the District Board retains the ability to alter the Corporation's Board membership and, therefore, maintains control of, and is accountable for, the Hospital Corporation.

Even if the boards were not the same, there are other characteristics, such as the District's ability to impose its will, financial benefit and financial burden on the Corporation, which link the boards together and create fiscal dependency. Further, the original Articles of Organization for the Hospital Corporation and subsequent amendments stipulate that net assets of the Corporation revert back to the District upon dissolution of the Corporation or termination of the ground lease between the two organizations.

While financial reporting presumes that entities continue indefinitely, and therefore such a reversion clause does not necessarily indicate financial benefit from a financial reporting standpoint, in the context of the larger discussion of authority and accountability, the financial

[2] As described in this section, the Corporation Chief Executive Officer (CEO) serves as an ex officio member of the Corporation Board.

[3] Gauthier, Stephen J., Government Finance Officers Association, *Governmental Accounting, Auditing, and Financial Reporting*, 2001, page 56.

benefits and burdens of this relationship are clear. Further, it is these characteristics of financial benefit and burden that link the other, smaller affiliated entities to the District, albeit indirectly through the Corporation.

## Importance of Fair Presentation

The purpose of GAAP is to provide a framework to ensure that users of financial statements are provided consistent, accurate and complete financial data and information. To this end, it is critical that financial statements provide a fair presentation of an entity's financial activities and status. Circumstances can arise wherein the failure to report a legally separate entity's activities would result in incomplete, if not misleading, financial statements.

For El Camino Hospital District, the District sold or transferred almost all of its assets and liabilities to the Corporation in 1992. Subsequently, a portion of the financing and debt of the new Hospital during the last decade is also accounted for and reported in the District's discrete financial records and accounts, while the assets are accounted for and reported in the Corporation's discrete financial records and accounts, pursuant to the First Amendment to the Ground Lease Agreement effective November 3, 2004. Accordingly, the District reflects a significant liability of $144.9 million in bonds payable in its financial statements as of June 30, 2011, but no correlated assets. Because there are no assets recorded to offset the debt, net assets for the District, as a discrete entity, are negative $110.4 million. Clearly, to fully understand the finances of the District, users of the financial statements must be presented with the data and information that brings these two components together. Further, to fully communicate the financial accountability structure, it is necessary for the financial statements to disclose that the District and its elected Board of Directors are accountable for the District and its entities, including the construction and financing of the new hospital. The El Camino Hospital District and the El Camino Hospital Corporation, in compliance with this generally accepted accounting principle, have consolidated financial statements.

## Financial Accounting System and Segregation of Funds

While the consolidated financial statements combine the financial activities and balances of the El Camino Hospital District and its component units, the individual activities and balances of these affiliated entities are segregated in supplemental schedules that are included in the annual financial report. These audited financial schedules for the fiscal year ending June 30, 2011 are appended to this Section as Exhibit 4.1.

The El Camino Hospital District uses a proprietary financial accounting system to account for the financial activities and balances of all of its entities, rather than a traditional government accounting system that is based on fund accounting. The financial accounting system uses a series of accounts to capture data and information and is used to segregate the different entities and their respective financial activities and balances.

As can be seen in Exhibit 4.1, a separate balance sheet, as well as income statement, or statement of revenues, expenses, and changes in net assets, is presented for the El Camino Hospital District as the primary government, as well as for each of the other five affiliated entities, including the

El Camino Hospital Corporation, the El Camino Hospital Foundation, CONCERN (employee assistance program), the El Camino Surgery Center, and Silicon Valley Medical Development, LLC. These schedules provide a significant amount of disaggregated data and information for these entities. From these schedules, a user of financial information can determine that, while operating revenues derived from patient services are earned primarily by the Corporation and the Surgery Center, property tax revenues are accounted for separately in the primary government's income statement. However, this data and information is presented at a high-level. Obtaining financial data and information that is typically reflected in governmental environments is not readily available in the District's or the Corporations public documents. Financial data and information at a more granular level, such as the line-item use of property tax revenues and budget variances, assists in ensuring that public funds are appropriately accounted for and used.

The Corporation serves as the manager and administrator, not only for the Hospital as a nonprofit public benefit corporation, but also for the District, the Foundation, and the additional affiliated entities. Accordingly, all financial transactions and activities occur through the accounts and records of the Hospital. Thus, as will be seen below, the District's resources predominately are transferred to the Hospital for expenditure rather than being reflected directly in the District's discrete financial statements. Thus, it is difficult to discern the details of the transfers and ensure whether the funds were spent on intended purposes from the audited financial statements alone. For this data and information, one must review individual transactions and accounts provided by internal system reports, which is discussed in more detail later in this Section.

## District Governance Structure and Public Accountability

The District is governed by a five member elected Board of Directors. As a government entity in California, the District Board is subject to disclosure laws that require open meetings, except in matters involving personnel, public security, pending litigation, labor negotiations or real property negotiations.[4]

Known as the Ralph M. Brown Act, Section 54950 et seq. of the California Government Code extends these requirements to private or non-profit corporations or entities if:

a. It is created by a legislative body to exercise authority that may be delegated to the private corporation or entity §54952(c)(1)(A);

b. If a legislative body provides some funding to the private corporation or entity and appoints one of its members to serve as a voting member of the entity's board of directors §54952(c)(1)(B).[5]

The Hospital Corporation meets all three of the tests included in the two citations, as follows.

[4] California Government Code § 54956.6, § 54956.8, § 54956.9 and § 54957.

[5] Ibid.

- The Ground Lease between the District and the Corporation stipulates that the Corporation, "shall occupy and use the properties and the improvements thereon for operating and maintaining a community hospital, for providing related health care services, or for the provision of such ancillary or other health care uses as may benefit the communities served by the Tenant and the *Landlord* (emphasis added)."[6] The Management Services Agreement between the District and the Corporation, effective January 1, 1993, describe specific responsibilities of the Corporation in Article 1, *Corporation's Duties,* requiring, "1.1(a) Performance of those activities that are relevant to the operations of the District and directed by the District's Board." Accordingly, the District has delegated a substantial portion of its responsibilities to the Corporation, meeting the test described in Government Code §54952(c)(1)(A).
- As discussed in detail, above, the District transferred or sold approximately $256.6 million in assets and $81.1 million in liabilities to the Corporation in 1992, totaling net assets of $175.5 million, and received cash compensation of $31.6 million. In addition, the District contributes approximately $15.8 million in property taxes annually to pay debt service for the Mountain View campus and support the Hospital's capital expenditures and community benefit program. Thus, providing substantial funding and meeting the first of the two tests required by Government Code §54952(c)(1)(B).
- The Corporation Bylaws state that "The Corporation shall have one voting Member: El Camino Hospital District, a political subdivision of the State of California (the "Member"). The Corporation shall have no other voting members."[7] This meets the second test under Government Code §54952(c)(1)(B).

Therefore, in addition to meeting the tests for being a consolidated financial reporting entity, described previously, the Corporation also appears to meet all three tests described in the two citations from the Brown Act. Since the ECHD Board also serves as the Corporation Board, these two separate legal entities have the same requirements and effectively function identically for purposes of public disclosure and open meetings.

[6] Ground Lease Agreement Between El Camino Hospital District and El Camino Healthcare System Dated: December 17, 1992, Article I, Section 1.2, *Guidelines for Use*

[7] Amended and Restated Bylaws of El Camino Hospital Adopted December 7, 2005, Article II, Section 2.3

# Financial Assessment and Condition

The financial condition of the El Camino Hospital District, the Corporation and the five non-profit affiliated entities ("District and its entities") is good to excellent, as well as stable. Overall, key financial indicators demonstrate that the District and its entities are performing well and were in a relatively strong financial position as of June 30, 2011. For FY 2011-12, the financial condition of the District and its entities is expected to strengthen based on a detailed financial status update presented to the Corporation Board of Directors on February 8, 2012.

## Financial Status as of June 30, 2011

Net assets for the District and its entities totaled $805.4 million as of June 30, 2011, which is an $83.3 million, or 11.5 percent increase from net assets held as of June 30, 2010 and a $335.8 million, or 71.5 percent increase from June 30, 2006. Interestingly, despite the significant asset acquisition over this five year period and an increase in investment in capital assets of 71.9 percent, unrestricted net assets have also significantly increased by 71.6 percent.

**Table 4.1**
**Consolidated Financial Metrics (In thousands)**
**For the Five Fiscal Years Ending June 30, 2011**

| | June 30, | | | | | July 1, |
|---|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 |
| Net Assets: | | | | | | |
| Invested in Capital Assets | $355,469 | $374,598 | $ 314,571 | $198,162 | $282,667 | $206,837 |
| Restricted | 9,812 | 5,302 | 8,166 | 7,001 | 201,812 | 6,173 |
| Unrestricted | 440,070 | 342,178 | 362,670 | 424,342 | 63,879 | 256,492 |
| Total Net Assets | 805,351 | 722,078 | 685,407 | 629,505 | 548,358 | 469,502 |
| Available Cash and Investments* | 408,703 | 285,317 | 396,526 | 500,733 | 356,306 | 252,797 |
| Annual Operating Revenues | 622,640 | 554,793 | 508,846 | 460,952 | 409,960 | |
| Annual Operating Expenses | 577,102 | 550,991 | 461,351 | 407,817 | 364,268 | |
| Net Non-Operating Revenue (Expenses) | 37,735 | 32,869 | 8,407 | 28,012 | 33,164 | |
| * As reported by the District in the Management Discussion and Analysis section (unaudited). | | | | | | |

*Source: Report of Independent Auditors and Consolidated Financial Statements with Supplemental Information for El Camino Hospital District for the respective fiscal years.*

As can be seen in Table 4.1, both revenues and expenses have increased over the last five years. Operating revenues have increased $212.7 million, or 51.8 percent, whereas operating expenses have increase $212.8 million or 58.4 percent since FY 2006-07. However, the increase in operating revenues in the last year was 12.2 percent as compared to 4.7 percent increase in operating expenses, showing an ability to contain costs and improved financial performance. Non-operating revenues are comprised of various components as detailed in Exhibit 4.1. These

revenues and expenses include, but are not limited to, property tax revenues, interest expense, and restricted gifts, grants, and bequests from donors. In total, non-operating revenues and expenses are significant, comprising $37.7 million, or 45.3 percent of the $83.3 million increase in net assets in FY 2010-11. Property taxes and investment income (on idle cash balances) represent the major portions of this non-operating revenue, amounting to $15.8 million and $18.6 million (net of interest expense), respectively.

Further, the District and its entities maintain a substantial amount of cash and short-term investments, ensuring a high degree of liquidity. Best practices according to the GFOA prescribe, and Bond covenants require the Hospital enterprise to maintain at least 60 days of cash on hand to meet on-going operating requirements. However, the Corporation had approximately 291 days of cash on-hand as of December 31, 2011 and averaged 250 days last fiscal year, which is substantially greater than the Hospital's benchmarks. These average days of cash on hand do not reflect cash and short-term investments held by the District's other entities, which was approximately $26.1 million as of June 30, 2011.

*Moody's Investors Service Downgrade*

Moody's Investors Service downgraded the Corporation's revenue bond rating from A1 to A2 in May 2011 and cited two primary reasons for the downgrade. Moody's noted significant turnover in executive management along with a significant deterioration in FY 2009-10 operating performance and cash balances due to the Mountain View Hospital rebuild and the Los Gatos Hospital purchase. Moody's noted that it viewed the Los Gatos Hospital purchase as "a fundamental modification of the *District's* core operating strategy" (emphasis added), but also added that the District and its entities FY 2010-11 financial performance was projected to improve. Moody's therefore classified the District and its entities as stable.

In its rating of the Corporation' revenue bonds, Moody's assesses the District and its entities' financial status, not just the financial accounts and records of the Corporation. Indeed, Moody's noted in its notice of the downgrade that, while property tax revenues used for general obligation bonds and for capital expenditures are excluded from operating revenues, property tax revenues available for operations are considered operating revenues of the Hospital.

## Outlook for Fiscal Year 2011-12

District management uses a variety of financial indicators to report on financial status to the Boards of Directors of both the District and the Corporation. These indicators include measures of earnings and operating profitability, liquidity, and debt coverage capacity. For the first six months of FY 2011-12, management reports that all of their key indicators are positive and reflect a strong financial position relative to targets, except for accounts receivable collections. The following Table 4.2 contains these key indicators as of December 31, 2011 as reported to the Boards of Directors by management.

As can be seen in Table 4.2, key financial indicators with the exception of Days in Accounts Receivable are positive relative to Corporation targets as well as the benchmark of Standard and Poor's A+ rating for nonprofit hospitals. The Debt Service Coverage Ratio and Debt to

Capitalization Ratio targets are required to be met pursuant to the Corporation's bond covenants and, as shown in the table, these targets are greatly exceeded. As compared to the prior fiscal year, Total Profit Margin has decreased from 10.6 percent to 8.3 percent, still a strong performance and greater than the Hospital's targets.

## Table 4.2
## Key Financial Indicators
## For the Six Months Ending December 31, 2011

| | Year To Date | Target | S&P A+ Hospitals | Fiscal Year 2010-11 |
|---|---|---|---|---|
| Operating Margin | 9.4% | 7.6% | 3.8% | 7.9% |
| Total Profit Margin | 8.3% | 7.5% | 6.0% | 10.6% |
| EBITDA* | 18.8% | 17.3% | 12.9% | 16.6% |
| Days of Cash | 291 | 260 | 229 | 250 |
| Debt Service Coverage Ratio | 7.4 | 1.2 | n/a | 7.0 |
| Debt to Capitalization | 17.0% | 37.5% | 30.9% | 18.9% |
| Days in Accounts Receivable | 51.3 | 50.0 | 45.3 | 50.1 |
| * Earnings Before Interest, Taxes, Depreciation and Ammortization. | | | | |

*Source: Summary of Financial Operations, Fiscal Year 2012 – Period 6, 7/1/2011 to 12/31/2011, as presented to the Board of Directors on February 8, 2012.*

Days in Accounts Receivable are a measure of an entity's ability to collect receivables and directly impacts cash flow. Given the Corporation's strong cash position, this measure is not signifying financial distress, but rather a measure of internal administrative performance. Management believes that 51.3 days is within a normal range and not an area of concern.

While the District and the Corporation maintains some reserve policies, they are not comprehensive. It should also be noted that in the FY 2011-12 budget, additional funds were set aside for contingencies totaling $8.3 million. This is in addition to modest reserves being maintained for the following:

*District*

- Capital outlay reserve funded by restricted property tax revenues and totaling $6.2 million as of June 30, 2011;
- Capital asset replacement reserve funded at 130 percent of annual depreciation expense totaling approximately $3.1 million as of June 30, 2011;

*Corporation*

- Operating reserve equal to 60 days of operating expenses totaling $101.6 million as of June 30, 2011;
- Capital asset replacement reserve funded at 130 percent of annual depreciation expense totaling approximately $37.4 million as of June 30, 2011;
- Catastrophic loss reserve funded from the Federal Emergency Management Agency reimbursements received after the Loma Prieta earthquake in 1989 totaling $11.8 million as of June 30, 2011;
- Community benefit reserve funded by unrestricted property tax revenues transferred to the Corporation and totaling $4.7 million as of June 30, 2011;
- Malpractice reserve funded based on annual actuarial studies totaling $2.3 million, as of June 30, 2011;

*Other Reserves*

- Board-designated reserve held by the Foundation totaling $13.3 million as of June 30, 2011; and
- Board-designated reserve held by CONCERN: Employee Assistance Program totaling $1.0 million as of June 30, 2011.

# Financial Benefits Related to Standing as a Public Sector Entity

## Property Tax Share

The El Camino Hospital District, as a political subdivision of the State of California, receives property taxes levied upon property owners within District boundaries. The levying and apportionment of these taxes are governed by California Revenue and Taxation Code and conducted by the Santa Clara County Assessor, Tax Collector, and Controller. Property tax revenues received by the District are as follows:

One Percent Ad Valorem Property Tax – The District receives a portion of the one percent ad valorem property tax that is levied in Santa Clara County and within District boundaries. Pursuant to Proposition 13 in 1978 and subsequent modifications to the California Revenue and Taxation Code and Government Code, this revenue source is allocated in an amount that is restricted for capital expenditure and an amount that is unrestricted and may be used to meet the general goals and objectives of the District. The District calculates the restricted and unrestricted property tax allocations pursuant to the Gann Appropriations Limit (GAL) and supporting law, which limits appropriations, but excludes qualifying capital expenditures from the limit.[8]

[8] There is a legal debate as to whether the GAL applies to California healthcare districts, due to conflicting California State code sections. Some healthcare districts apply the Limit while others do not. Ultimately, an opinion from the State Attorney General will be required or the Legislature will need to clarify the law.

Debt Service on General Obligation Bonds – Voters in the District approved Measure D in November 2003 which authorized $148.0 million in general obligation bonds to assist in financing the construction of the new Mountain View Hospital pursuant to the Hospital Seismic Safety Act of 1994. The annual debt service requirements of the general obligation bonds are met by an additional property tax levied on the property owners within District boundaries.

The District accounts for these property tax revenues using its chart of accounts described in the previous section and which allows for the District to segregate not only the revenues and expenses of the District, but also the assets and liabilities of the District. Table 4.3 details $75.1 million in property tax revenues received over the last five years.

## Table 4.3
## Property Tax Revenues (In thousands)
## For the Five Fiscal Years Ending June 30, 2011

| | Fiscal Year | | | | | Five Year |
|---|---|---|---|---|---|---|
| | 2010-11 | 2009-10 | 2008-09 | 2007-08 | 2006-07 | Total |
| One Percent Ad Valorem | | | | | | |
| Restricted for Capital Use | $ 3,368 | $ 2,830 | $ 3,510 | $ 3,207 | $ 3,046 | $ 15,961 |
| Unrestricted | 5,782 | 5,858 | 5,732 | 5,403 | 4,935 | 27,710 |
| General Obligation Bonds Debt Service | 6,643 | 6,920 | 6,658 | 6,181 | 5,041 | 31,443 |
| Totals | $ 15,793 | $ 15,608 | $ 15,900 | $ 14,792 | $ 13,022 | $ 75,115 |

*Source: Report of Independent Auditors and Consolidated Financial Statements with Supplemental Information for El Camino Hospital District for fiscal year 2008-09 through 2010-11 and reports and records provided by management for FY 2006-07 and FY 2007-08.*

As noted in the District's Consolidated Financial Statements, property taxes which are levied annually are intended to finance the District's activities within the fiscal year of the levy. However, historically, the District Board has not routinely appropriated available property tax revenues as part of the budget process. Rather, the funds accumulated over time and then were transferred to the Corporation as needed. Table 4.4 presents the use of District revenues, primarily property tax revenues and related interest earnings, for the last five fiscal years.[9] Analysis of data available for this report, suggests that the District may have violated sections of the California Health and Safety Code that require voter approval in the event 50 percent or more of the net assets are transferred to a non-profit hospital. During this period, $40.5 million was transferred to the Corporation, which exceeded the threshold of $29.6 million based on total net assets of $59.1 million in that period. When adjusting for the portion of the net assets that may have represented bond proceeds, approximately 63.9 percent of net assets were transferred, far exceeding the 50 percent threshold established in the law.

[9] In addition to property tax revenues and associated uses, the District also records miscellaneous revenues and expenses, including approximately $80,000 ground lease revenue from the Corporation and funded depreciation expense on assets maintained on the District's books such as the YMCA facility.

The District maintains that it is exempt from the Health and Safety Code provision that requires voter approval prior to transferring more than 50% of net assets to the Corporation, due to actions taken in 1992. It is the District's opinion that by adopting a resolution of intent to develop a business plan for an integrated delivery system, prior to the date the law requiring voter approval was enacted, the District is exempt from the Health and Safety Code provisions that require voter approval prior to any asset transfer. Without the legislative history it is unclear why the Legislature would exempt the District from such an important provision.

As can be seen in the table, the District transferred surplus cash to the Corporation of nearly $40.5 million in FY 2006-07 and $12.5 million in FY 2008-09 to assist in financing the construction of the new Mountain View Hospital. Additional transfers for capital expenditures were made in three of the last five fiscal years and totaled approximately $21.2 million. The District also had approximately $6.2 million in funds earmarked for capital expenditures as of June 30, 2011, which had accumulated from restricted property tax revenues over the last two years (not reflected in Table 4.4). These funds are held as a reserve by the District and not transferred to the Corporation until the capital expenditure is approved by the District Board.

## Table 4.4
## Property Tax Uses (In thousands)
## For the Five Fiscal Years Ending June 30, 2011

| | Fiscal Year | | | | | Five Year |
|---|---|---|---|---|---|---|
| | 2010-11 | 2009-10 | 2008-09 | 2007-08 | 2006-07 | Total |
| Debt Service | | | | | | |
| Interest Payments | $ 4,897 | $ 4,859 | $ 4,655 | $ 98 | $ 3,205 | $ 17,714 |
| Principal Reduction | 1,384 | 1,223 | 726 | 1,813 | - | 5,146 |
| Community Benefits Transfer | 2,025 | 5,731 | 5,403 | - | 500 | 13,659 |
| Capital Expense Transfer | - | 12,458 | 6,253 | - | 2,479 | 21,190 |
| Surplus Cash Transfer | - | - | 12,000 | - | 40,468 | 52,468 |
| Totals | $ 8,306 | $ 24,271 | $ 29,037 | $ 1,911 | $ 46,652 | $ 110,177 |

*Source: Various reports and records provided by District and Hospital management for all fiscal years.*

As shown, during the past five years, $110.2 million in property taxes collected by the El Camino Hospital District and other non-operating revenue (e.g., investment income) have been used very specifically to support El Camino Hospital – Mountain View, as follows:

- Approximately $22.9 million, or 20.7%, has been used to repay debt incurred for the rebuild of the El Camino Hospital Mountain View campus.
- Approximately $21.2 million, or 19.2%, has been used to fund miscellaneous capital improvements at the El Camino Hospital Mountain View campus.

- Approximately $13.7 million, or 12.4%, has been contributed to El Camino Hospital Corporation and its affiliates to support its Community Benefit Program, used primarily for community health education, clinical services and clinical support services.
- Approximately $52.5 million, or 47.6%, has been transferred to the El Camino Hospital Corporation as surplus cash (see Table 4.4), contributing to the Corporation's ability to accumulate over $440 million in surplus net assets during this period and acquire the Los Gatos Hospital campus for approximately $53.7 million.

In 2008, the Corporation Board established the Community Benefits Advisory Council which was tasked with developing a community grants program to expend property tax revenues and other hospital resources to benefit the community. As can be seen in the table, transfers to the Corporation in amounts commensurate with annual unrestricted property tax revenues began in FY 2008-09. These funds are held by the Corporation on reserve and accrue interest earnings until expended.

It does not appear that these funds are appropriated during the annual budget process. Rather, the enabling Board resolution requires the transfer of these funds to the Corporation at year end. The legislation states:

> "On an annual basis, the Community Benefits Advisory Council will provide to the District a recap of expenditures from the transfers made by the District to support the unmet health care needs of the community. Monies remaining in the fund will be available for subsequent years."[10]

Thus, it appears that the District Board of Directors does not directly appropriate these funds to specific community benefit programs, but rather delegates that authority to the *Corporation's* Community Benefits Advisory Council and only receives a report-back of the different programs funded. There is no systematic reporting to the District Board of Directors of expenditure status by the programs or achievement of any performance metrics to ensure effective oversight of these funds or the purposes for which they were appropriated. However, management tracks and monitors these funds internally by using its chart of accounts and, as of June 30, 2011, approximately $4.7 million of these funds, while earmarked, had not been expended by the Corporation.

As previously noted, the Corporation maintains an accounting system that tracks and monitors the receipt and use of property tax revenues. However, historically, those resources have not been systematically appropriated in a public forum or at a level of detail that is appropriate for holding the District and/or the Corporation's Board accountable for its use. Table 4.4 above was developed using a variety of internal and public documents, including (1) the audited annual financial report, (2) internal operating statements, statements of cash flow, and system reports of transaction detail, (3) fiscal policy, and (4) additional documentation and explanations from management.

[10] Resolution of the Board of Directors of the El Camino Hospital District to Establish Annual Funding of El Camino Hospital's Community Benefit Programs and Services, Resolution 2008-2.

Further, in FY 2008-09, the District and Corporation boards made considerable policy decisions: the District, to fund the rebuild of Mountain View Hospital; and the Corporation, to purchase the Los Gatos Hospital. To achieve these objectives, the boards also made policy decisions regarding the financing of these acquisitions with a combination of cash and debt issuance. If the Los Gatos Hospital purchase totaling $53.7 million had not occurred, the Corporation would have had additional cash resources available and would have not necessarily needed to use District resources or the issuance of an additional $50.0 million in revenue bonds. As already noted, the Moody's downgrade resulted in part from concern regarding the district and its entities' cash position. Thus, while there is not a direct expenditure of District funds on the Los Gatos Hospital purchase, there is certainly a direct impact on Corporation resources available for the purchase.

## Public Debt Financing

The District and its entities have used public debt financing to pay for the construction of the Mountain View Hospital. Public debt financing through the issuance of municipal bonds is advantageous to governmental agencies and not-for-profit organizations because the tax-exempt status makes the cost of borrowing less by reducing interest expense.

The District and its entities used two different mechanisms to obtain financing for the project:

- General obligation bonds totaling $148.0 million issued by the District, as a political subdivision of the State of California, and approved by more than two-thirds of District voters. The principal and interest on these bonds are to be repaid from property taxes levied within District boundaries.
- Revenue bonds totaling $200.0 million issued by the Corporation as a nonprofit public benefit corporation with tax-exempt status pursuant to Internal Revenue Service (IRS) code section 501(c)(3), of which $150.0 million was issued in 2007 and $50.0 million was issued in 2009.

The details regarding each debt issuance are shown in the table on the next page.

The revenue bonds were issued on behalf of the Corporation by the Santa Clara County Financing Authority, which benefits the Corporation due to ease of access to public financing. However, other than the El Camino Hospital issuances in 2007 and 2009, the Santa Clara County Financing Authority typically does not serve as such a conduit to financing for nonprofit public benefit corporations.

As noted previously, the capital assets, e.g. the Hospital facility and related equipment, have been transferred to the accounts and records of the Corporation pursuant to the First Amendment to Ground Lease Agreement effective November 3, 2004. Upon termination of the lease or dissolution of the Corporation, the related assets and liabilities will revert to the District. While the District is not liable for payment of principal and interest on the revenue bonds, if the Corporation were dissolved prior to 2044, when the final payments are due, presumably the District would assume or resolve any outstanding debt liabilities pursuant to the reversion clause in the Articles of Organization for Hospital Corporation.

# Table 4.5
## Summary of El Camino Hospital District and Corporation Debt

| Borrowing Entity | Type and Purpose | | Original Issue | 6/30/2011 Balance | 2012 | | | Last Payment Due |
|---|---|---|---|---|---|---|---|---|
| | | | | | Principal Due | Interest Due | Total Due | |
| ECH District | 2006 General Obligation Bonds | MV Hospital Replacement | 148,000,000 | 143,805,000 | 1,525,000 | 5,014,000 | 6,539,000 | 8/1/2040 |
| ECH Corp. | 2007 Revenue Bonds | MV Hospital Replacement (Note 1) | 147,525,000 | | | | | 2/1/2041 |
| ECH Corp. | 2009 Revenue Bonds | MV Hospital Replacement (Note 1) | 50,000,000 | | | | | 2/1/2044 |
| (Note 2) | Total Revenue Bonds | | 197,525,000 | 189,675,000 | 52,725,000 | 9,208,000 | 61,933,000 | |

Note 1: Although the 2007 and 2009 Revenue Bonds were designated for the Mountain View Hospital Replacement project, other major capital projects during this time period included the purchase of Los Gatos Hospital, renovations to surgery recovery areas at the Los Gatos Hospital and the acquisition of a physician office building adjacent to the Mountain View campus.

Note 2: The Principal Due on the Corporation Revenue Bonds declines from $52.7M in 2012 to $2.9M in 2013 because the Hospital's Letter of Credit on the $50,000,000 in 2009 Revenue Bonds expires on April 1, 2012. In this situation, accounting rules require the entire amount to of the debt to be shown as a current liability.

# Computation and Assignment of Community Benefits

An underlying question regarding the mission of the District and the Corporation is the degree to which they provide benefits to the taxpayers of ECHD. Certainly, having hospital and health care services located in the community is the primary benefit, discussed extensively in the Service Review section of this report. However, in addition to these services, public and non-profit hospitals are also expected to contribute to the community in other ways.

## California Law Requirements

California's Local Health Care District Law does not contain specific requirements for the provision or reporting of community benefits beyond the broad mandate to provide services for the "maintenance of good physical and mental health in the communities served by the district."[11]

However, legislation passed by the California legislature in 1994, Senate Bill 697[12], requires private not-for-profit hospitals to plan for and report on the provision of community benefits. The primary reason for establishing the community benefit reporting requirement is provided in the text of the law itself:

> "Private not-for-profit hospitals meet certain needs of their communities through the provision of essential health care and other services. Public recognition of their unique status has led to favorable tax treatment by the government. In exchange, nonprofit hospitals assume a social obligation to provide community benefits in the public interest."[13]

The community benefit law requires private not-for-profit hospitals in California to:

a) Conduct a community needs assessment every three years;

b) Develop a community benefit plan in consultation with the community;

c) Annually submit a copy of its plan to the Office of Statewide Health Planning and Development (OSHPD).

d) Develop a community benefit plan in consultation with the community; and

e) Annually submit a copy of its plan to the Office of Statewide Health Planning and Development (OSHPD).

[11] Sections 127350 (d), 127355 (a)-(c)

[12] Ibid

[13] Ibid

SB 697 defines "community benefit" as "a hospital's activities that are intended to address community needs and priorities primarily through disease prevention and improvement of health status, including, but not limited to, any of the following:

- Health care services, rendered to vulnerable populations, including, but not limited to, charity care and the unreimbursed cost of providing services to the uninsured, underinsured, and those eligible for Medi-Cal, Medicare, California Children's Services Program, or county indigent programs.
- The unreimbursed cost of services included in subdivision (d) of Section 127340.
- Financial or in-kind support of public health programs.
- Donation of funds, property, or other resources that contribute to a community priority.
- Health care cost containment.
- Enhancement of access to health care or related services that contribute to a healthier community.
- Services offered without regard to financial return because they meet a community need in the service area of the hospital, and other services including health promotion, health education, prevention, and social services.
- Food, shelter, clothing, education, transportation, and other goods or services that help maintain a person's health.

Based on these qualifying community benefit activities, OSHPD requires hospitals to describe in their community benefit plans the activities that the hospital has undertaken in order to address community needs within its mission and financial capacity. SB 697 requires hospitals, "to the extent practicable, assign and report the economic value of community benefits provided in furtherance of its plan." Plans must include (a) mechanisms to evaluate the plan's effectiveness, (b) measurable objectives to be achieved within specified timeframes, and (c) community benefits categorized into the following framework[14]:

(1) Medical care services;

(2) Other benefits for vulnerable populations;

(3) Other benefits for the broader community;

(4) Health research, education, and training programs; and

(5) Non-quantifiable benefits.

Community benefit plans are due to OSHPD 150 days after the end of the hospital's fiscal year. Hospitals under the common control of a single corporation or another entity may file a

[14] Ibid

consolidated report. Certain types of hospitals are exempt from the community benefit reporting requirement, including children's hospitals that do not receive direct payment for services, designated small and rural hospitals, public hospitals including county, district, and the University of California, and other specific hospitals.[15]

## Non-Profit 501(c)(3) Requirements

The Internal Revenue Service (IRS) does not specifically list hospitals as organizations that are exempt under section 501(c)(3) or specially define exempt purposes to include the promotion of health[16]. However, the IRS recognizes that non-profit hospitals may qualify for exemption as a charitable organization. IRS code section 501(c)(3) identifies the qualifying purposes of tax exempt organizations, as follows:

> "charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term *charitable* is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency."[17]

The IRS requirements for obtaining 501(c)(3) charitable status appear to provide substantial latitude in the manner in which an organization may demonstrate its charitable purpose. The application for exemption (Form 1023) requires applicants to identify their charitable status by type (i.e., church, school, hospital, etc.) and complete a separate schedule specific to that type of organization. Schedule C, for hospitals and medical research organizations, asks several yes or no questions, including whether the organization serves Medicaid and Medicare patients; operates an emergency room; maintains a policy regarding service to patients without an ability to pay; allocates a portion of services for charity patients; and several other questions. However, none of the questions require reporting of number or proportions of "charity" cases.

The questions in Schedule C of the application for tax exempt status reflect the "Community Benefit Standard" established in the IRS Revenue Rulings for the determination of charitable status of hospitals. According to Revenue Rulings 69-545 and 83-157, the Community Benefit Standard includes the following five factors:

a) Whether the governing body of the hospital is composed of independent members of the community;

b) Whether medical staff privileges in the hospital are available to all qualified physicians in the area, consistent with the size and nature of the facilities;

---

[15] OSHPD website: http://www.oshpd.ca.gov/HID/SubmitData/CommunityBenefit/FAQ.html

[16] "Hospital Compliance Project Interim Report," Internal Revenue Service, July 19, 2007.

[17] Internal Revenue Service website, *Exempt Purposes - Internal Revenue Code Section 501(c)(3)*, found at http://www.irs.gov/charities/charitable/article/0,,id=175418,00.html

c) Whether the hospital operates a full-time emergency room open to all regardless of ability to pay;

d) Whether the hospital otherwise admits as patients those able to pay for care, either themselves or through third-party payers such as private health insurance or government programs such as Medicare; and

e) Whether the hospital's excess funds are generally applied to expansion and replacement of existing facilities and equipment, amortization of indebtedness, improvement in patient care, and medical training, education, and research.

The IRS states that "the absence of these factors or the presence of other factors will not necessarily be determinative. Likewise, the courts have held in numerous cases that community benefit is a flexible standard based on the totality of the circumstances and that a hospital need not demonstrate every factor to be exempt."[18]

In remarks summarizing the Community Benefit Standard, IRS Commissioner for Tax Exempt and Government Entities Steven T. Miller stated "a hospital must demonstrate that it provides benefits to a class of persons broad enough to benefit the community, and it must show that it is operated to serve a public rather than private interest. In a nutshell, that is the standard – a hospital must show that it benefits the community and the public by promoting the health of that community."[19]

## Rationale for Community Benefit Assignment

While the provision and reporting of community benefits for health care districts is broadly defined in State law, the requirements for non-profit corporations are more explicit. However, even these requirements leave non-profit corporations with broad discretion regarding the components of community benefits and how they are defined.

As discussed in Section 3, the El Camino Hospital District and the El Camino Hospital Corporation comply with these broadly defined requirements, and reported approximately $54.8 million in community benefits in its 2011 Community Benefit Report. As explained in that section, $5.1 million of this amount is funded directly by the District with property taxes with the remainder funded from other sources through the Corporation and affiliated non-profit entities.

In addition, of the total $54.8 million community benefit contribution, $47.2 million, or 86.1 percent represents the unreimbursed portion of the cost of care provided to Medi-Cal recipients, other subsidized health services and charity care. While classified as allowable community benefits within both federal and State law, it is important to recognize that the unreimbursed cost of services provided to vulnerable populations is a typical expense of hospitals generally and

[18] "Hospital Compliance Project Interim Report," Internal Revenue Service, July 19, 2007.

[19] "Charitable Hospitals: Modern Trends, Obligations and Challenges," Full Text of Remarks of Steven T. Miller, Commissioner, Tax Exempt and Government Entities, Internal Revenue Service, Before the Office of the Attorney General of Texas, January 12, 2009.

non-profit hospitals specifically, and is considered when such hospitals develop their rate structures and reimbursement strategies.

Further, as discussed in Section 3, El Camino Hospital does not distinguish itself as providing extraordinary levels of unsubsidized medical care to vulnerable populations in the County. We make this assertion based on (1) a comparison with other hospital districts in the State, which shows that El Camino hospital falls within the range of community benefit contributions made by hospitals that provide services in other districts; and (2) the amount of care provided to Medi-Cal patients relative to other hospitals within the County of Santa Clara, which shows that El Camino Hospital is the third lowest provider of such services in the County.

LAFCo should seriously consider these factors, in light of the financial data and analysis presented in this section. This data and analysis demonstrates the strong financial position of the Corporation, which held approximately $440 million in net unrestricted assets as of June 30, 2011, built from substantial annual operating surpluses; and, the significant ongoing contributions which the Corporation receives from the District, including over $110 million in property taxes over the last five years.

The District and the Corporation are one consolidated entity that generally combine community benefit contributions. However, the District was unable to demonstrate that District taxpayers receive a substantially greater share of community benefits than non-District residents, despite the fact that the taxpayers of the District have underwritten the operations of the Corporation and affiliated non-profit organizations through the initial transfer of hospital assets, property tax contributions, access to low-cost debt financing and other mechanisms, such as below market rent on the ground lease.. As will be discussed in Section 6 of this report, an estimated 60 percent of emergency room services are provided to persons who reside within the District and SOI, and 40 percent are provided to persons who reside outside of the SOI. For inpatient services, no more than 50 percent of inpatient services are provided to persons who reside within the District and SOI. Although District residents provide 100% of the tax support provided to El Camino Hospital, they receive a disproportionately lower percentage of the community benefits that are provided by the District and Hospital.

# Findings and Statements of Determination

The District and Corporation are one consolidated entity from a governance and financial perspective. Generally Accepted Accounting Principles (GAAP) direct the consolidation for financial reporting because the District, Corporation and other affiliated entities meet very specific criteria. The Corporation also meets very specific criteria detailed in State law, which requires compliance with disclosure laws and open meetings, as if the Corporation were a public agency. Additionally, a 1996 restructuring that resulted from a lawsuit defined the District as the sole member of the Corporation and effectively ensured public control of Corporation net assets and activities going forward. While the District and Corporation have strived in recent years to make a greater delineation between the two organizations, ultimately the authority and accountability of both District and Corporation Boards of Directors stem from members serving as elected public officials presiding over a political subdivision of the State of California.

The Corporation is well served by this relationship, accruing benefits typically reserved for public agencies, including the levying and use of property tax, as well as access to municipal financing. Further, at its initiation in 1992, the Corporation received approximately $175.5 million in net assets from the District. Subsequently, the Corporation's strong financial health is better than it would otherwise be and is strengthening, with $440 million in unrestricted net assets as of June 30, 2011. Further, the Corporation continues to receive financial support from the District, exceeding $15.5 million annually for the Corporation's Community Benefits Program and for debt service on the Corporation's Mountain View Hospital.

It is clear that the activities of each entity are directly linked to the resources of the other. Accordingly, the assignment of community benefits, through provision of services to the underserved and through provision of services to District residents, is fundamental to the mission of both the District and the Hospital. While the provision of services to the underserved as community benefits are proportionate to other hospital districts in the State, it appears to be lower than many hospitals within Santa Clara County based on a review of Medi-Cal inpatient days. Further, significant hospital services, including 40 percent of emergency services and 50 percent of inpatient services are provided to residents outside of the District's sphere of influence. Ultimately, the Local Agency Formation Commission will decide if this service level and associated community benefits are acceptable.

The following findings respond to the specific questions posed by the Santa Clara County LAFCo for the Audit portion of the study:

1. ***Did/does ECHD fund the purchase, operations, or maintenance of the Los Gatos Hospital or other facilities located outside of the District boundaries?***

   The ECHD did not directly fund the purchase, operations or maintenance of the $53.7 million Los Gatos Hospital. However, the Corporation was able to generate sufficient net assets and cash balances to fund the Los Gatos Hospital acquisition due, in part, to: (a) the funding of debt service for a portion of the Mountain View campus rebuild, as well as capital improvements at the Mountain View campus, with annual property tax contributions from the District; (b) the transfer of excess property taxes from the District to the Corporation, amounting to approximately $52.5 million over the last five fiscal years; and, (c) access to and the use of tax exempt debt financing through the District and the County of Santa Clara as a 501(c)(3) non-profit Corporation.

2. ***Does ECHD contribute revenue to El Camino Hospital Corporation, which in turn purchased the hospital in Los Gatos or other facilities located outside of the District? If so, what is the purpose of the contributions and how are the funds accounted for?***

   The ECHD contributes revenue to the Corporation each fiscal year, amounting to approximately $110.2 million between FY 2006-07 and FY 2010-11. Of this amount, (a) $21.2 million (19.2%) was used to fund capital improvements at the Mountain View campus; (b) $17.7 million (16.1%) was used to pay principal and interest on debt used to fund renovations at the Mountain View campus; (c) $13.7 million (12.4%) was used to fund community benefits; and, (d) $52.5 million (47.6%) in surplus cash was transferred to the

Corporation for renovations at the Mountain View campus. These surplus cash transfers may have exceeded the 50 percent threshold established by law, and contributed to the $440.1 million in Unrestricted Net Assets being held by the District, Corporation and affiliated non-profit entities as of June 30, 2011. The funds are accounted for separately in the consolidated financial accounting system maintained by the Corporation.

***3. Is there a contractual relationship between the District and the El Camino Hospital Corporation? Does the District have an equity interest in the assets of the Corporation? If so, how much? If not, who owns the assets of the Corporation?***

The contractual relationship between the District and the Corporation is defined by:

- The 1992 Asset Transfer Agreement;
- The 1992 Building Sale Agreement;
- The 1992 Ground Lease and First Amendment; and,
- The 1992 Management Services Agreement.

Per the Articles of Organization for the Corporation, and subsequent amendments, the net assets of the Corporation revert back to the District upon corporate dissolution or termination of the lease. However, asset disposition is unclear should the District dissolve and the Corporation continues prior to lease termination.

***4. Does the District separately account for the receipt and expenditure of property tax revenues in a separate fund, or are such revenues commingled with other ECHD revenues?***

All of the District's revenues, including property tax, interest earnings, and lease payments are separately accounted for in the financial system and reported in the annual financial report. With the exception of debt service, the District's resources are transferred to the Corporation for expenditure, but are tracked and monitored through the use of separate accounts.

***5. Are the ECHD's funds commingled with the Corporation's Funds?***

No. While District funds are generally transferred to the Corporation for expenditure, they are separately tracked and monitored using separate account coding in the financial system. Therefore, District funds are not "commingled" with the Corporation's funds.

***6. What measures should ECHD take to establish transparency in the relationship between the ECHD and the El Camino Hospital Corporation?***

The District and the Corporation should establish enhanced budgetary reporting and controls on a cash or accrual basis in order to better reflect the use of District resources. This should include detailed reporting of transfers between entities as well as debt service requirements.

***7. What measures should ECHD take to be more accountable to the public/community that it serves?***

Budgetary and financial information should be reported on a component unit level (i.e., separate budgets and financial reports for the District, Corporation and each of the five non-profit entities). These budgets should provide character level detail and be reviewed, discussed and adopted by the respective boards at public hearings.

***8. What are ECHD's current revenue sources and amounts, including proceeds from various bonds and for what purpose are the revenues and bond proceeds used?***

Primary District revenues include property taxes, interest revenue and lease revenue on the Mountain View land. Proceeds from the sale of the bonds were transferred to the Corporation in prior years for expenditure on the Mountain View expansion and renovation. The District's revenues are used for debt service, transfers to the Corporation for capital acquisition and community benefit grants. See response to Question 1, above; tables 4.3 and 4.4; and, Exhibit 4.1 for a fuller explanation.

***9. What is the extent and purpose of ECHD's reserves?***

The District maintains reserves for (a) restricted property tax revenues received but not expended for capital acquisition; and, (b) capital asset replacement, based on accumulated depreciation of existing assets. The Corporation, as the primary operating entity, maintains additional reserves, including a reserve of District funds transferred for community benefit grant programs that have not been expended.

***10. What is an appropriate/adequate amount of reserves? Does the District have any policies on amount and use of reserves?***

All reserves presently maintained by the District and the Corporation are conservative and not excessive. While the District and the Corporation have established limited policies and procedures on reserves, including an operating reserve and capital assets replacement reserves, a number of reserves that are maintained do not have formal policies and procedures or appear to be reviewed or authorized by either of the Boards in a systematic manner. The District should seek guidance from the Government Finance Officers' Association (GFOA) and the Corporation should seek guidance from industry groups to develop reserve policies based on best practices.

***11. Does ECHD have a role in governance/monitoring of hospital services provided by the El Camino Hospital Corporation?***

Yes. The District and Corporation maintain almost identical governing boards, which include identical voting members, so that decision-making is almost indistinguishable between entities. In addition, pursuant to the Corporation Articles of Organization and subsequent amendments, the District is the "sole member" of the Corporation. Essentially, from a governance standpoint, the District and the Corporation are the same entity.

***12. What is ECHD's role and responsibility at the end of the lease agreement between the ECHD and the El Camino Hospital Corporation, as it relates to the assumption of assets and liabilities of the Corporation?***

At the end of the lease agreement in the year 2044, the Amended Agreement states that the related buildings, fixtures, and improvements revert back to the District. Unstated is the disposition of any retained earnings or the transfer of other assets and liabilities. However, per the Articles of Incorporation and subsequent amendments, upon dissolution of the Corporation, all assets and liabilities (i.e., net assets, including retained earnings) would revert back to the District.

**EL CAMINO HOSPITAL DISTRICT**
**CONSOLIDATING SCHEDULE – BALANCE SHEET**
**June 30, 2011**
**(In Thousands)**

| | El Camino Hospital District | El Camino Hospital | El Camino Hospital Foundation | CONCERN | Surgery Center | Silicon Valley Medical Development | Eliminations Increase (Decrease) | El Camino Hospital District and Affiliates |
|---|---|---|---|---|---|---|---|---|
| ASSETS | | | | | | | | |
| Current assets | | | | | | | | |
| Cash and cash equivalents | $ 51 | $ 39,783 | $ 68 | $ 500 | $ 1,175 | $ 411 | $ - | $ 41,988 |
| Short-term investments | 5,872 | 136,374 | 2,215 | 9,585 | - | - | - | 154,046 |
| Current portion of board designated, restricted funds and trusteed assets | 6,199 | 2,675 | - | - | - | - | - | 8,874 |
| Patient accounts receivable, net of allowances for doubtful accounts of $8,021 | - | 80,398 | - | 422 | 695 | - | - | 81,515 |
| Prepaid expenses and other current assets | - | 19,174 | - | 189 | 514 | 47 | (2,232) | 17,692 |
| Notes receivable, current | 1,964 | - | - | - | 59 | - | (10) | 2,013 |
| Total current assets | 14,086 | 278,404 | 2,283 | 10,696 | 2,443 | 458 | (2,242) | 306,128 |
| Non-current cash and investments - less current portion | | | | | | | | |
| Board-designated funds | 3,072 | 195,241 | 13,289 | 1,013 | - | - | - | 212,615 |
| Restricted funds | - | 4 | - | 50 | - | - | - | 54 |
| Funds held by trustee | 6,380 | 6,710 | - | - | - | - | - | 13,090 |
| | 9,452 | 201,955 | 13,289 | 1,063 | - | - | - | 225,759 |
| Capital assets, net | 12,024 | 678,576 | - | 286 | 615 | - | (323) | 691,178 |
| Pledges receivable | - | - | 3,756 | - | - | - | - | 3,756 |
| Prepaid pension | - | 24,239 | - | - | - | - | - | 24,239 |
| Investment in health care affiliates | - | 19,059 | - | - | - | - | (575) | 18,484 |
| Other assets | 1,512 | 5,205 | - | - | - | - | - | 6,717 |
| Total assets | $ 37,074 | $ 1,207,438 | $ 19,328 | $ 12,045 | $ 3,058 | $ 458 | $ (3,140) | $ 1,276,261 |

**EL CAMINO HOSPITAL DISTRICT**
**CONSOLIDATING SCHEDULE – BALANCE SHEET**
**June 30, 2011**
**(In Thousands)**

| | El Camino Hospital District | El Camino Hospital | El Camino Hospital Foundation | CONCERN | Surgery Center | Silicon Valley Medical Development | Eliminations Increase (Decrease) | El Camino Hospital District and Affiliates |
|---|---|---|---|---|---|---|---|---|
| LIABILITIES AND NET ASSETS | | | | | | | | |
| Current liabilities | | | | | | | | |
| Current portion capital lease obligations | $ - | $ 5,663 | $ - | $ - | $ - | $ - | $ - | $ 5,663 |
| Accounts payable and accrued expenses | - | 18,867 | - | 498 | 574 | 239 | (658) | 19,520 |
| Salaries, wages, and related liabilities | - | 38,629 | - | 612 | 520 | 107 | - | 39,868 |
| Other current liabilities | 2,573 | 8,623 | 956 | 1,116 | - | - | (1,584) | 11,684 |
| Estimated third-party payor settlements | - | 10,476 | - | - | - | - | - | 10,476 |
| Current portion of bonds payable | 1,707 | 52,903 | - | - | - | - | - | 54,610 |
| Total current liabilities | 4,280 | 135,161 | 956 | 2,226 | 1,094 | 346 | (2,242) | 141,821 |
| Capital lease obligations, net of current portion | - | 10,190 | - | - | - | - | - | 10,190 |
| Bonds payable, net of current portion | 143,169 | 137,559 | - | - | - | - | - | 280,728 |
| Other long-term obligations | - | 8,064 | - | - | - | - | - | 8,064 |
| Workers' compensation, net of current portion | - | 15,572 | - | - | - | - | - | 15,572 |
| Postretirement medical benefits, net of current portion | - | 14,535 | - | - | - | - | - | 14,535 |
| Total liabilities | 147,449 | 321,081 | 956 | 2,226 | 1,094 | 346 | (2,242) | 470,910 |
| Net assets | | | | | | | | |
| Invested in capital assets, net of related debt | (120,273) | 475,164 | - | 286 | 615 | - | (323) | 355,469 |
| Restricted - expendable | - | - | 5,250 | - | - | - | - | 5,250 |
| Resticted - nonexpendable | - | - | 1,941 | 50 | - | - | 2,571 | 4,562 |
| Unrestricted | 9,898 | 411,193 | 11,181 | 9,483 | 1,349 | 112 | (3,146) | 440,070 |
| Total net assets | (110,375) | 886,357 | 18,372 | 9,819 | 1,964 | 112 | (898) | 805,351 |
| Total liabilities and net assets | $ 37,074 | $ 1,207,438 | $ 19,328 | $ 12,045 | $ 3,058 | $ 458 | $ (3,140) | $ 1,276,261 |

**EL CAMINO HOSPITAL DISTRICT**
**CONSOLIDATING SCHEDULE – STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**
**Year Ended June 30, 2011**
**(In Thousands)**

| | El Camino Hospital District | El Camino Hospital | El Camino Hospital Foundation | CONCERN | Surgery Center | Silicon Valley Medical Development | Eliminations Increase (Decrease) | El Camino Hospital District and Affiliates |
|---|---|---|---|---|---|---|---|---|
| Operating revenues | | | | | | | | |
| Net patient service revenue (net of provision for bad debts of $31,400 in 2011) | $ - | $ 595,144 | $ - | $ - | $ 8,481 | $ - | $ - | $ 603,625 |
| Other revenue | 80 | 12,241 | 13 | 8,268 | 6 | - | (1,593) | 19,015 |
| Total operating revenues | 80 | 607,385 | 13 | 8,268 | 8,487 | - | (1,593) | 622,640 |
| Operating expenses | | | | | | | | |
| Salaries, wages and benefits | - | 300,226 | 1,224 | 2,502 | 3,521 | 458 | (224) | 307,707 |
| Professional fees and purchased services | 13 | 95,044 | 1,702 | 3,329 | 1,109 | 442 | (253) | 101,386 |
| Supplies | - | 86,885 | 15 | - | 1,859 | 2 | - | 88,761 |
| Depreciation and amortization | 180 | 49,287 | - | 90 | 385 | - | - | 49,942 |
| Rent and utilities | - | 12,902 | 52 | 198 | 510 | - | (633) | 13,029 |
| Other | - | 15,509 | 228 | 212 | 328 | - | - | 16,277 |
| Total operating expenses | 193 | 559,853 | 3,221 | 6,331 | 7,712 | 902 | (1,110) | 577,102 |
| Income (loss) from operations | (113) | 47,532 | (3,208) | 1,937 | 775 | (902) | (483) | 45,538 |
| Nonoperating revenues (expenses): | | | | | | | | |
| Investment income, net | 69 | 21,490 | 1,659 | 338 | (12) | - | - | 23,544 |
| Property tax revenue | | | | | | | | |
| Designated for community benefit programs | 5,782 | - | - | - | - | - | - | 5,782 |
| Designated for capital expenditures | 3,368 | - | - | - | - | - | - | 3,368 |
| Levied for debt service | 6,643 | - | - | - | - | - | - | 6,643 |
| General Obligation Bond interest expense | (4,897) | - | - | - | - | - | - | (4,897) |
| Restricted gifts, grants and bequests, and other | - | - | 5,527 | - | - | - | 2,476 | 8,003 |
| Unrealized gain (loss) on interest rate swap | - | 1,364 | - | - | - | - | - | 1,364 |
| Other, net | (11) | (5,357) | 671 | (1,167) | (1,314) | 1,004 | 102 | (6,072) |
| Total nonoperating revenues and (expenses) | 10,954 | 17,497 | 7,857 | (829) | (1,326) | 1,004 | 2,578 | 37,735 |
| Excess (deficit) of revenues over expenses before capital grants, contributions, and additions to permanent endowments | 10,841 | 65,029 | 4,649 | 1,108 | (551) | 102 | 2,095 | 83,273 |
| Capital transfers | (94) | 506 | (412) | - | - | - | - | - |
| Increase (decrease) in net assets | 10,747 | 65,535 | 4,237 | 1,108 | (551) | 102 | 2,095 | 83,273 |
| Total net assets, beginning of year | (121,122) | 820,822 | 14,135 | 8,711 | 2,515 | 10 | (2,993) | 722,078 |
| Total net assets, end of year | $ (110,375) | $ 886,357 | $ 18,372 | $ 9,819 | $ 1,964 | $ 112 | $ (898) | $ 805,351 |

# 5. El Camino Hospital District Service Review

As stated in Santa Clara County LAFCo's Service Review Policies, municipal service reviews "are intended to serve as a tool to help LAFCo, the public and other agencies better understand the public service structure and evaluate options for the provision of efficient and effective public services." Based on the information provided through the Service Review process, LAFCo may choose to initiate boundary changes or take other actions to reorganize services based on the service profile, sphere of influence (SOI) and other considerations.

The Cortese Knox Hertzberg Local Government Reorganization Act of 2000[1] (CKH Act) requires LAFCo to conduct a municipal service review prior to defining a new SOI, updating an existing SOI or modifying boundaries. The CKH Act requires a LAFCo to "include in the area designated for service review the county, the region, the sub-region, or any other geographic area as is appropriate for an analysis of the service or services to be reviewed, and shall prepare a written statement of its determinations with respect to each of the following:

(1) Growth and population projections for the affected area.

(2) Present and planned capacity of public facilities and adequacy of public services, including infrastructure needs or deficiencies.

(3) Financial ability of agencies to provide services.

(4) Status of, and opportunities for, shared facilities.

(5) Accountability for community service needs, including governmental structure and operational efficiencies.

(6) Any other matter related to efficient or effective service delivery, as required by commission policy.

Service reviews must be conducted by LAFCo every five years. The last Service Review of the El Camino Hospital District was completed in October 2007 and the current service review must be completed prior to January 1, 2013. This section of the report provides a general discussion of the service area boundaries, sphere of influence and populations served by the El Camino Hospital District; as well as analysis of service review data that may be considered by the LAFCo Board in accordance with the objectives of the process.

[1] California Government Code Sections 56000-57550.

## Health Care District Service Area Boundaries

Local health care districts are distinct from other types of special districts because they are permitted to serve individuals residing both inside and outside of the boundaries of the district. Throughout the Health and Safety Code sections that apply to health care districts,[2] broad service permissions are provided that allow activities for the "benefit of the employees of the health care facility or residents of the district"; "for the benefit of the district and the people served by the district"; and, "in the communities served by the district." This emphasis on populations or communities "served" by a district, rather than populations residing within the boundaries of the district, have generally been interpreted to allow health care districts to extend their influence well beyond jurisdictional boundaries.

For example, Health and Safety Code Section 32121(j) allows health care districts "to establish, maintain, and operate, or provide assistance in the operation of one or more health facilities or health services…at any location within or without the district for the benefit of the district and the people served by the district." Unlike water or sewer districts, which are restricted to providing services at permanent physical addresses, this broad language (i.e., "people served by the district") does not restrict services to a specific territory and, instead, allows health care districts to serve individuals who reside outside of the district boundaries and in other parts of the region, state, or even nation.

# Profile of El Camino Hospital Corporation Services

El Camino Hospital is a full service acute care hospital located on a 41-acre campus in Mountain View, California. The campus in Mountain View includes the main hospital, the Women's Hospital, the El Camino Surgery Center, the Breast Health Center, the Oak Dialysis Center, the CyberKnife Center, the Cancer Center in the Melchor Pavilion, the Taft Center for Clinical Research, and the Genomic Medicine Institute. El Camino Hospital Corporation (ECHC) also owns the El Camino Surgery Center, LLC, and Silicon Valley Medical Development, LLC, and has 50 percent ownership of Pathways HomeCare and Hospice.

The El Camino Hospital Mountain View campus is licensed for 374 General Acute Care beds and 25 Psychiatric beds, for a total of 399 beds, based on data available from the California Office of Statewide Health Planning and Development (OSHPD). Ninety-nine of the licensed 374 general acute care beds of located in the old hospital tower and are not available for use and will be deleted from the license as of December 31, 2012, per Senate Bill1953.

The table on the next page displays the number of licensed beds and patient days for the ECH Mountain View hospital, and calculates the average daily census and percent utilization by unit. As shown in the table, El Camino Hospital had an average daily census of approximately 193.8 patients in 2010, the year of the most recent available information. General Acute Care utilization (defined as percent occupancy of licensed beds) was 46.3 percent (or 60.8 percent without the unavailable 99 beds), with the highest utilization in Perinatal (Obstetric) at 65.2 percent and Intensive Care at 77.8 percent. The Hospital's Acute Psychiatric unit had a utilization rate of 82.8 percent.

[2] California Health and Safety Code, Section 32000, et seq., also known as the Local Health Care District Law.

**Table 5.1**
**El Camino Hospital Inpatient Capacity and Utilization by Unit - 2010**

| Unit | Licensed Beds | Patient Days | Average Daily Census | Percent Utilization |
|---|---|---|---|---|
| Medical/Surgical | 180 | 41,490 | 113.7 | 63.2 |
| Perinatal (Obstetric) | 44 | 10,458 | 28.7 | 65.2 |
| Pediatric | 7 | 123 | 0.3 | 4.3 |
| Intensive Care | 24 | 6,836 | 18.7 | 77.9 |
| Neonatal ICU | 30 | 4,297 | 11.8 | 39.3 |
| **General Acute Care** | **285** | **63,204** | **173.2** | **60.8** |
| Acute Psychiatric | 25 | 7,542 | 20.7 | 82.8 |
| **Total Beds** | **310** | **70,746** | **193.8** | **62.5** |

*Note: The table reflects a 99 licensed medical/surgical beds reduction, scheduled to take effect in 2012.*

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

The El Camino Hospital Emergency Department has a "basic" level designation with 28 emergency medical treatment stations. In 2010, the ECH Emergency Department had a total of 40,877 patient visits. The Mountain View campus also has ten operating rooms, with two licensed for cardiac surgery. These operating rooms generated over 6,000 surgical procedures in 2010. Two cardiac catheterization laboratories provided 1,625 diagnostic and therapeutic catheterization procedures in that same year. The utilization data for each major service is provided in Table 5.2, below.

**Table 5.2**
**El Camino Hospital Mountain View - General Utilization Statistics - 2010**

| Type | Volume |
|---|---|
| General Acute Discharges | 15,244 |
| Psychiatric Discharges | 994 |
| Total Inpatient Discharges | 16,238 |
| Total Emergency Department Visits | 40,877 |
| Inpatient Surgery | 4,384 |
| Ooutpatient Surgery | 1,751 |
| Total Live Births | 4,139 |
| Cardiac Surgery | 231 |
| Cardiac Catheterization (Diagnostic and Therapeutic) | 1,625 |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

## Present Utilization and Capacity by Service

*Countywide and El Camino Hospital Medical-Surgical and ICU/CCU Beds*

Within Santa Clara County there were a total of 2,041 Medical-Surgical and 379 Intensive care Unit/Cardiac Care Unit (ICU/CCU) beds in 2010, with a 65.0 percent and a 63.9 percent average occupancy rate in the year. While the intensive care beds at the Mountain View campus of ECH may have been near maximum capacity in that year, there is sufficient capacity in the County overall. Based on the 2010 data, at a target 85 percent occupancy rate, there are an additional 291 Medical-Surgical beds and 80 ICU/CCU beds available in Santa Clara County (including underutilized bed capacity at the El Camino Hospital Mountain View campus. Data for each hospital is shown in Table 5.3, below.

**Table 5.3**
**Santa Clara County Medical-Surgical and ICU/CCU**
**Licensed Beds, Average Census and Occupancy by Hospital - 2010**

| | IP Medical/Surgical | | | | ICU/CCU Services | | | |
|---|---|---|---|---|---|---|---|---|
| Facility | Licensed Beds | Patient Days | Avg Daily Census | Occupancy | Licensed Beds | Patient Days | Avg Daily Census | Occupancy |
| EL CAMINO HOSPITAL | 180 | 41,490 | 113.7 | 63.2% | 24 | 6,836 | 18.7 | 78.0% |
| EL CAMINO HOSPITAL LOS GATOS | 82 | 7,863 | 21.5 | 26.3% | 15 | 1,331 | 3.6 | 24.3% |
| GOOD SAMARITAN HOSPITAL-SAN JOSE | 152 | 40,334 | 110.5 | 72.7% | 43 | 9,868 | 27.0 | 62.9% |
| KAISER FND HOSP - SAN JOSE | 175 | 39,776 | 109.0 | 62.3% | 24 | 4,814 | 13.2 | 55.0% |
| KAISER FND HOSP - SANTA CLARA | 185 | 57,825 | 158.4 | 85.6% | 38 | 8,255 | 22.6 | 59.5% |
| LCP CHILDRENS HOSP. AT STANFORD | 35 | 8,287 | 22.7 | 64.9% | 44 | 11,896 | 32.6 | 74.1% |
| OCONNOR HOSPITAL - SAN JOSE | 210 | 32,650 | 89.5 | 42.6% | 22 | 5,047 | 13.8 | 62.9% |
| REGIONAL MEDICAL OF SAN JOSE | 150 | 43,340 | 118.7 | 79.2% | 34 | 9,084 | 24.9 | 73.2% |
| SANTA CLARA VALLEY MEDICAL CENTER | 234 | 71,876 | 196.9 | 84.2% | 52 | 10,943 | 30.0 | 57.7% |
| ST. LOUISE REGIONAL HOSPITAL | 48 | 9,322 | 25.5 | 53.2% | 8 | 1,624 | 4.4 | 55.6% |
| STANFORD HOSPITAL | 491 | 107,936 | 295.7 | 60.2% | 75 | 18,739 | 51.3 | 68.5% |
| **Grand Total** | **1,942** | **460,699** | **1262.2** | **65.0%** | **379** | **88,437** | **242.3** | **63.9%** |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

*Countywide and El Camino Hospital Obstetrics and Neonatal Intensive Care Unit Beds*

Within Santa Clara County there were a total of 440 Obstetrics and 256 Neonatal Intensive Care Unit (NICU) beds in 2010, with a 42.3 percent and a 57.1 percent average occupancy rate in the year. At 65.1 percent occupancy, El Camino Hospital had a higher rate of utilization than all other hospitals in the County, which averaged 42.3 percent overall (including El Camino Hospital - Mountain View). NICU occupancy was near the average for the County. Based on the 2010 data, at a target 85 percent occupancy rate, there are an additional 188 Obstetrics beds and 72 NICU beds available in Santa Clara County (including underutilized bed capacity at the El Camino Hospital Mountain View campus). Data for each hospital is shown in Table 5.4, below.

**Table 5.4**
**Santa Clara County Obstetrics and NICU**
**Licensed Beds, Average Census and Occupancy by Hospital - 2010**

| | Obstetrics | | | | | NICU | | | |
|---|---|---|---|---|---|---|---|---|---|
| Facility | Licensed Beds | Patient Days | Avg Daily Census | Occupancy | | Licensed Beds | Patient Days | Avg Daily Census | Occupancy |
| EL CAMINO HOSPITAL | 44 | 10,458 | 28.7 | 65.1% | | 20 | 4,297 | 11.8 | 58.9% |
| EL CAMINO HOSPITAL LOS GATOS | 14 | 1,277 | 3.5 | 25.0% | | 2 | 404 | 1.1 | 55.3% |
| GOOD SAMARITAN HOSPITAL-SAN JOSE | 69 | 8,937 | 24.5 | 35.5% | | 51 | 10,876 | 29.8 | 58.4% |
| KAISER FND HOSP - SAN JOSE | 31 | 4,381 | 12.0 | 38.7% | | 12 | 1,314 | 3.6 | 30.0% |
| KAISER FND HOSP - SANTA CLARA | 52 | 10,395 | 28.5 | 54.8% | | 26 | 6,002 | 16.4 | 63.2% |
| LCP / STANFORD | 32 | 8,287 | 22.7 | 71.0% | | 89 | 22,359 | 61.3 | 68.8% |
| OCONNOR HOSPITAL - SAN JOSE | 65 | 8,439 | 23.1 | 35.6% | | 10 | 1,665 | 4.6 | 45.6% |
| REGIONAL MEDICAL OF SAN JOSE | 37 | 1,165 | 3.2 | 8.6% | | 6 | 264 | 0.7 | 12.1% |
| SANTA CLARA VALLEY MEDICAL CENTER | 80 | 12,870 | 35.3 | 44.1% | | 40 | 6,146 | 16.8 | 42.1% |
| ST. LOUISE REGIONAL HOSPITAL | 16 | 1,645 | 4.5 | 28.2% | | - | - | 0.0 | 0.0% |
| **Grand Total** | **440** | **67,854** | **185.9** | **42.3%** | | **256** | **53,327** | **146.1** | **57.1%** |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

On a Countywide basis, El Camino Hospital provides about 9.4 percent of total inpatient services. For Medical/Surgical (9.0%), ICU/CCU (7.7%) and NICU (8.1%), the Hospital provides a lower proportion of services than the 9.4 percent overall. For Obstetrics, the Hospital provides 15.4 percent of the services in the County. The Hospital has 9.4% of the total licensed beds in the County and 9.5% percent of excess capacity in the County, excluding beds that are becoming unlicensed at the end of 2012. This is displayed in the table, below.

**Table 5.5**
**Countywide Comparison of Capacity and Utilization**

| | Average Daily Census | | |
|---|---|---|---|
| **Hospital Unit** | **County-wide** | **ECH-MV** | **Percent** |
| Medical /Surgical | 1,262.2 | 113.7 | 9.0% |
| ICU / CCU | 242.3 | 18.7 | 7.7% |
| Perinatal (Obstetric) | 185.9 | 28.7 | 15.4% |
| NICU | 146.1 | 11.8 | 8.1% |
| **Total Acute ADC** | 1,836.5 | 172.9 | 9.4% |
| Licensed Acute Beds | 3,017.0 | 285.0 | 9.4% |
| **Excess Capacity / (Deficiency)** | **1,180.5** | **112.1** | **9.5%** |
| **Percent Utilization** | **60.9%** | **60.7%** | |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

*Emergency Services*

El Camino Hospital (Mountain View) has 28 Emergency Department stations, or about 12% of total available emergency department stations in Santa Clara County. In 2010, the Mountain View campus had 40,877 Emergency Department visits, equating to an average of 1,460 visits per station during the year. El Camino Hospital also publishes average estimated wait times at

their two emergency departments that range between eight and 40 minutes (based on random sampling conducted between 8AM and 10PM on various days in February 2012).

Emergency departments with lower average acuity visits, such as the Santa Clara Valley Medical Center (SCVMC) facility, tend to have significantly higher visit rates per station and also have lower admission rates to total visits.[3] El Camino Hospital - Los Gatos and the St. Louis Regional Hospital had zero hours on diversion, which suggests some capacity remaining in the county's emergency departments. Table 5.6 displays emergency room activity in the county.

**Table 5.6**
**Santa Clara County Emergency Department**
**Visits and Admissions by Hospital - 2010**

| Facility | ED Level | Stations | Total ED Visits | Visits / Station | Hours on Diversion | Visits (No Admits) | Visits (Admitted) | % Admitted |
|---|---|---|---|---|---|---|---|---|
| EL CAMINO HOSPITAL | Basic | 28 | 40,877 | 1,460 | 172 | 33,975 | 6,902 | 16.9% |
| EL CAMINO HOSPITAL LOS GATOS | Basic | 10 | 11,398 | 1,140 | - | 10,206 | 1,192 | 10.5% |
| GOOD SAMARITAN HOSPITAL-SAN JOSE | Basic | 25 | 51,447 | 2,058 | 109 | 42,408 | 9,039 | 17.6% |
| KAISER FND HOSP - SAN JOSE | Basic | 28 | 47,319 | 1,690 | 5 | 40,108 | 7,211 | 15.2% |
| KAISER FND HOSP - SANTA CLARA | Basic | 32 | 57,478 | 1,796 | 40 | 48,418 | 9,060 | 15.8% |
| OCONNOR HOSPITAL - SAN JOSE | Basic | 23 | 43,507 | 1,892 | 235 | 36,108 | 7,399 | 17.0% |
| REGIONAL MEDICAL OF SAN JOSE | Basic | 33 | 59,069 | 1,790 | 392 | 50,737 | 8,332 | 14.1% |
| SANTA CLARA VALLEY MEDICAL CENTER | Comprehensive | 24 | 74,754 | 3,115 | 951 | 63,685 | 11,069 | 14.8% |
| ST. LOUISE REGIONAL HOSPITAL | Basic | 8 | 28,077 | 3,510 | - | 25,678 | 2,399 | 8.5% |
| STANFORD HOSPITAL | Basic | 31 | 49,038 | 1,582 | 202 | 39,129 | 9,909 | 20.2% |
| **Grand Total** | | **242** | **462,964** | **1,913** | **2,106** | **390,452** | **72,512** | **15.7%** |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

## Growth and Population Projections

Using data from OSHPD on actual inpatient hospital utilization by age cohort for Santa Clara County, the projected demand for inpatient acute care can be estimated by multiplying population projections for each age cohort times the utilization rate. OSHPD 2010 discharge data indicates that:

- Children under the age of 18 are admitted for acute inpatient care at a rate of approximately 41 discharges per 1,000 population (excluding normal newborn cases);

- Adults between the ages of 18 and 64 are admitted for acute inpatient care at a rate of approximately 65 discharges per 1,000 population;

- Adults age 65 and above are admitted for acute inpatient care at a rate of approximately 216 discharges per 1,000 population, or approximately 3.3 times the rate of adults under the age of 65;

[3] Acuity level is based on a distribution procedure codes for "minor", "low", "moderate" and "severe" classifications. The Santa Clara Valley Medical Center Emergency Department is the only comprehensive emergency department in the County, offering a full range of tertiary emergency care. However, because uninsured patients in the County tend to use the SCVMC Emergency Department for non-emergency urgent care, the average acuity level of the patients and rate of hospital admissions are lower.

- Overall, the rate of acute inpatient care for the entire County population is approximately 78 discharges per 1,000 population.

On an aggregate basis, the Santa Clara County population is expected to grow by approximately 5.0 percent over the next five-year horizon between 2012 and 2017; and, by approximately 7.1 percent over the next seven-year projection horizon between 2012 and 2019. However, these projection rates are not constant by age cohort and an examination of the segregated data illustrates that the rate of growth will differ by age cohort.

This is an important consideration when projecting the rate of growth in acute inpatient care, since persons over the age of 65 are admitted at a rate over three times as high as other adults and more than five times as high as children. This segregation of population projections by age cohort is displayed in the table, below.

**Table 5.7**
**Santa Clara County 5-Year and 7-Year**
**Population Projections by Age Cohort**

| Age Group | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 5 yr % Change | 7 yr % Change |
|---|---|---|---|---|---|---|---|---|---|---|
| 0-17 | 436,535 | 432,100 | 427,710 | 423,365 | 419,064 | 414,806 | 410,592 | 406,421 | -5.0% | -6.9% |
| 18-64 | 1,174,723 | 1,189,807 | 1,205,084 | 1,220,557 | 1,236,230 | 1,252,103 | 1,268,180 | 1,284,464 | 6.6% | 9.3% |
| 65+ | 216,370 | 223,923 | 231,739 | 239,828 | 248,200 | 256,864 | 265,830 | 275,109 | 18.7% | 27.1% |
| **All Pop** | **1,828,573** | **1,846,466** | **1,864,533** | **1,882,777** | **1,901,200** | **1,919,803** | **1,938,588** | **1,957,556** | **5.0%** | **7.1%** |

Therefore, assuming constant utilization rates and population projections by age cohort, Santa Clara County is expected to generate approximately nine percent more inpatient care volume over the next five year period and 13.0 percent more inpatient care volume over the next seven year period. The basis for these projections are shown in the table, below.

**Table 5.8**
**Santa Clara County 5-Year and 7-Year**
**Inpatient Volume Projections by Age Cohort**

| Age Group | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 5 yr % Change | 7 yr % Change |
|---|---|---|---|---|---|---|---|---|---|---|
| 0-17 | 17,776 | 17,596 | 17,417 | 17,240 | 17,065 | 16,891 | 16,720 | 16,550 | -5.0% | -6.9% |
| 18-64 | 76,773 | 77,759 | 78,757 | 79,769 | 80,793 | 81,830 | 82,881 | 83,945 | 6.6% | 9.3% |
| 65+ | 46,704 | 48,335 | 50,022 | 51,768 | 53,575 | 55,445 | 57,381 | 59,384 | 18.7% | 27.1% |
| **All Pop** | **143,266** | **145,702** | **148,210** | **150,792** | **153,449** | **156,184** | **159,000** | **161,898** | **9.0%** | **13.0%** |

*Application of Countywide Projections to the El Camino Hospital District and SOI*

The District and SOI contain about 1/6$^{th}$ of the population of Santa Clara County. Using available population data sorted by zip code, this analysis determined that the overall population growth rate for the District is slightly more than half of the growth rate for the rest of the county. The District and SOI also has a significantly smaller proportion of the population that are seniors aged 65 and above. The results of this analysis are provided in the tables, below.

**Table 5.9**
**El Camino Hospital District and SOI 5-Year and 7-Year**
**Population Projections by Age Cohort**

| Age Group | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 5 yr % Change | 7 yr % Change |
|---|---|---|---|---|---|---|---|---|---|---|
| 0-17 | 67,890 | 68,359 | 68,832 | 69,308 | 69,788 | 70,270 | 70,756 | 71,246 | 3.5% | 4.9% |
| 18-64 | 198,587 | 198,703 | 198,819 | 198,935 | 199,051 | 199,168 | 199,284 | 199,401 | 0.3% | 0.4% |
| 65+ | 42,643 | 43,787 | 44,961 | 46,167 | 47,405 | 48,676 | 49,981 | 51,321 | 14.1% | 20.3% |
| **All Pop** | **309,190** | **310,896** | **312,612** | **314,337** | **316,072** | **317,816** | **319,569** | **321,333** | **2.8%** | **3.9%** |

As seen, using the same methodology as was used for the entire county, the District and SOI are expected to experience a five-year population growth rate of 2.8 percent compared with a Countywide population growth rate of approximately 5.0 percent. Also, as shown below, because of the differences in the populations by age cohort, the area will experience a lower 5.8 percent inpatient volume increase compared with a 9.0 percent inpatient volume increase for the County overall. Over seven years, the District and SOI inpatient volume is projected to increase by approximately 8.3 percent.

**Table 5.10**
**El Camino Hospital District and SOI 5-Year and 7-Year**
**Inpatient Volume Projections by Age Cohort**

| Age Group | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 5 yr % Change | 7 yr % Change |
|---|---|---|---|---|---|---|---|---|---|---|
| 0-17 | 2,765 | 2,784 | 2,803 | 2,822 | 2,842 | 2,861 | 2,881 | 2,901 | 3.5% | 4.9% |
| 18-64 | 12,979 | 12,986 | 12,994 | 13,001 | 13,009 | 13,016 | 13,024 | 13,032 | 0.3% | 0.4% |
| 65+ | 9,205 | 9,452 | 9,705 | 9,965 | 10,233 | 10,507 | 10,789 | 11,078 | 14.1% | 20.3% |
| **All Pop** | **24,948** | **25,221** | **25,502** | **25,789** | **26,083** | **26,385** | **26,694** | **27,011** | **5.8%** | **8.3%** |

With the exception of ICU beds, it is unlikely that this growth in local demand will lead to capacity concerns at the Mountain View hospital in the next five years. In addition, current facility plans under consideration for the Mountain View campus include the possibility of relocating physician offices in the Women's Hospital to make approximately 40,000 square feet available for inpatient use in 2013-2014[4].

# Services Provided by Geography

Nearly all of the El Camino Hospital Corporation services are provided at the two main campuses in Mountain View or Los Gatos. The services provided outside of the El Camino Hospital District and its sphere of influence are the Los Gatos operations and two off-campus dialysis centers located in San Jose. A listing of the facilities owned or leased by the Hospital Corporation; and, a map of the areas served by the two hospital campuses, including the location of the two hospitals and the off-site dialysis centers, are provided below and on the next page.

[4] ECHC Exhibit XXII – "Land Uses and Facility Plans for El Camino Hospital, Nov. 19, 2010 with 2011 Updates"

**Figure 5.1**
**Listing of Properties Used by El Camino Hospital Corporation**[5]

| Name | Street and/or Business Address | City | Land Owner | Building Owner | Leased By | Note |
|---|---|---|---|---|---|---|
| ***Main Campus*** | | | | | | |
| **El Camino Hospital** | 2500 Grant Road | Mountain View | ECHD | ECH | | Main ECH Campus |
| **New Main Hospital** | 2500 Grant Road | Mountain View | ECHD | ECH | | |
| **Old Main Hospital** | 2500 Grant Road | Mountain View | ECHD | ECH | | |
| **YMCA/Park Pavilion** | 2400 Grant Road | Mountain View | ECHD | ECHD | | |
| **Willow Pavilion** | 2480 Grant Road | Mountain View | ECHD | ECH | | |
| **ECH Women's Hospital** | 2485 Hospital Drive | Mountain View | ECHD | ECH | | |
| **Melchor Pavilion** | 2490 Hospital Drive | Mountain View | ECHD | ECH | | |
| **Oak Pavilion** | 2505 Hospital Drive | Mountain View | ECHD | ECH | | |
| **North Drive Parking Garage** | North Drive | Mountain View | ECHD | ECH | | |
| **Higgins Property** | 530 South Drive | Mountain View | ECHD | ECHD | | Road Runners Transportation Service |
| **Radio Surgery Center** | 125 South Drive | Mountain View | ECH | ECH | | Radiation Treatment Facility |
| **Phyllis Property** | 111 El Camino Real | Mountain View | ECHD | N/A | | Vacant Land |
| **Hospital Drive MOB # 2** | 2500 Hospital Drive | Mountain View | ECH | ECH | | Medical Office - Leased |
| **Hospital Drive MOB # 10** | 2500 Hospital Drive | Mountain View | ECH | ECH | | Medical Office - Leased |
| **Hospital Drive MOB # 11** | 2500 Hospital Drive | Mountain View | ECH | ECH | | Medical Office - Leased |
| **Hospital Drive MOB # 12** | 2500 Hospital Drive | Mountain View | ECH | ECH | | Medical Office - Leased |
| **Hospital Drive MOB # 14** | 2500 Hospital Drive | Mountain View | ECH | ECH | | Medical Office - Leased |
| **Cook Property** | 2660 Grant Road | Mountain View | N/A | N/A | ECH | Senior Center / BHS Clinic |
| **Concern Office** | 1503 Grant Road | Mountain View | N/A | N/A | ECH | Employee Assistance Program |
| **Wolfe Properties** | 205 / 285 South Drive | Mountain View | N/A | N/A | ECH | Medical Offices Leased / ECH Facilities |
| ***Off-Campus from Main Mountain View Hospital*** | | | | | | |
| **El Camino Hospital Los Gatos** | 815 Pollard Dr | Los Gatos | ECH | ECH | | Los Gatos Campus |
| **In-Patient Rehab** | 355 Dardanelli Ln | Los Gatos | ECH | ECH | | |
| **Parking Stucture** | | Los Gatos | ECH | ECH | | |
| **555 Knowles Building** | 555 Knowles | Los Gatos | N/A | N/A | ECH | OP Rehab / Offices |
| **825 Pollard Building** | 825 Pollard Dr | Los Gatos | N/A | N/A | ECH | BHS Clinic |
| **Evergreen Dialysis** | 2230 Tully Rd | San Jose | N/A | N/A | ECH | Dialysis Clinic |
| **Rose Garden Dialysis** | 999 W Taylor St | San Jose | N/A | N/A | ECH | Dialysis Clinic |

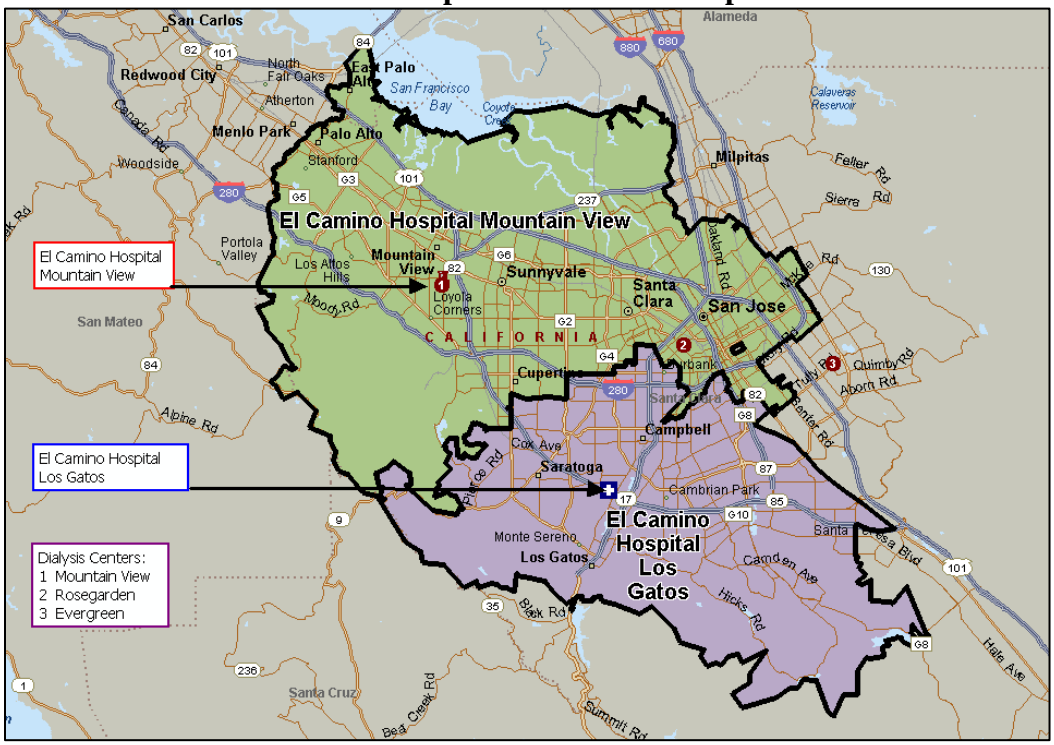
Source: ECHD Exhibit XII: El Camino Hospital Properties, Dec. 23, 2011

As shown, many of the facilities used by the El Camino Hospital Corporation are located outside of the District boundaries and sphere of influence. This creates a dilemma for the District. For example, Although the Corporation is a separate legal entity, as discussed in Section 4, the ECHD is the "sole member" of the El Camino Hospital Corporation. As structured, the elected District Board members sit as the majority of the voting members of the Corporation Board. Therefore, any activities of the Corporation are, by extension, activities of the District. Given this interpretation of the relationship between the two entities, the acquisition and opening of the Los Gatos Hospital extends the range of District services well beyond its current jurisdictional boundaries and sphere of influence.

Further, although providing dialysis services outside of the physical boundaries of the District is consistent with State law [Health and Safety Code § 32121(j)] and with the broader mission of the District and Hospital, the locations of these centers in East San Jose (2230 Tully Road) and Central San Jose (999 West Taylor Street) are notable. The District indicates that these facilities have been in operation for approximately 20-years.

[5] El Camino Hospital District Exhibit XII: El Camino Hospital Properties, December 23, 2011

**Figure 5.1**
**ECH Campus and Services Map**[6]




## District Boundaries and Patient Origin

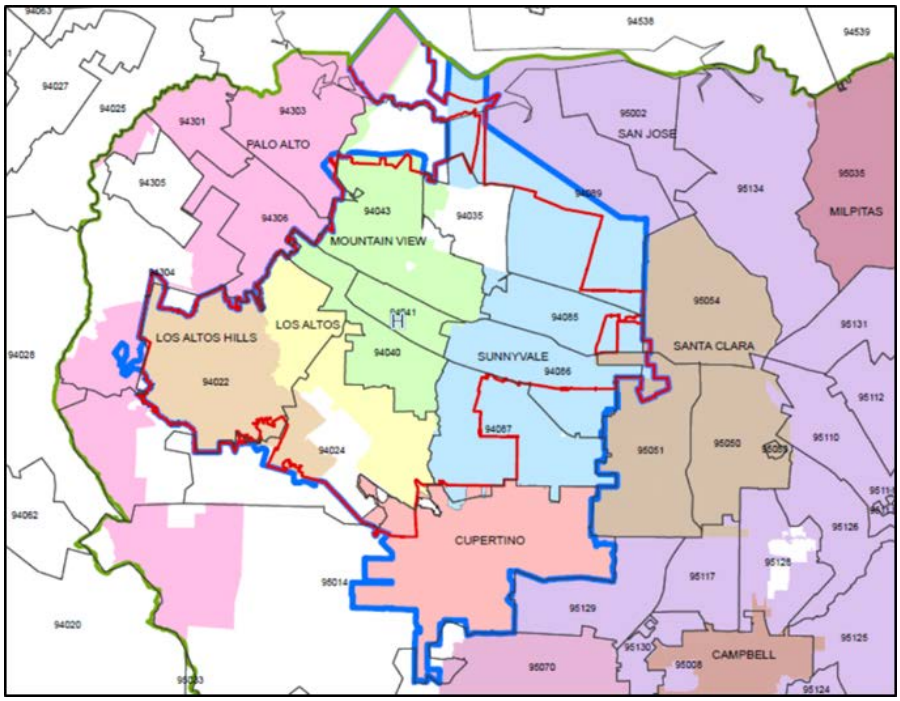
The map included as Figure 5.3 illustrates the boundaries of the El Camino Hospital District as presented by Santa Clara County LAFCo during the Service Review. As shown by the map, LAFCO has recognized that El Camino Hospital provides substantial services beyond its jurisdictional boundaries into areas of Cupertino and Sunnyvale.

As will be demonstrated later in this section, the Mountain View campus of El Camino Hospital draws about 43 percent of its inpatient volume from zip codes that are wholly within the SOI.[7] Including zip codes for all of Cupertino and Sunnyvale yields a catchment of 50 percent of inpatient volume from these areas. Another 38 percent originates from the rest of Santa Clara County, and the remaining 12 percent originates from other counties and beyond. This analysis is displayed in the table on Page 5-12.

[6] ECH Exhibit XXII – Land Uses and Facility Plans for El Camino Hospital, "Facilities Development and Real Estate Plan, Nov. 19, 2010 with 2011 Updates"

[7] Two analyses were conducted to determine the percentage of patients that are drawn from the District and SOI. The first analysis only counted those patients who resided in zip codes areas that were entirely within the District and SOI, showing that 37.5 percent of the patient count resides in the SOI. However, this methodology results in an under-count. The methodology used in the report analysis showing a 50 percent rate includes zip code areas that are partially – but not entirely – in the SOI, which results in an over-count. To be conservative, this second methodology is used in the report and is consistent with the approach used by El Camino Hospital.

**Figure 5.3**
**Santa Clara County LAFCo Map of**
**El Camino Hospital District and Sphere of Influence**




**Map Legend**
Red – District boundary
Blue – Sphere of Influence[8]
Green – Santa Clara County

As further illustrated in Table 5.11, and as discussed more fully later in this section, El Camino Hospital consistently captures about a 40 percent market share within its boundaries and throughout its sphere of influence. Beyond its SOI, market share declines significantly due to the strength of other hospitals in their own local markets.

[8] Includes all of Cupertino and Sunnyvale within the Sphere of Influence, which is inconsistent with the physical description of the area, but which corresponds with recommendations made in the 2007 Service Review and definitions generally used by the El Camino Hospital District.

**Table 5.11**
**El Camino Hospital District Inpatient Catchment**[9]
**Sorted by Zip Code – Calendar Year 2010**

| Catchment Areas | El Camino - Mt. View Case Volume | % of ECH-MV | Cumulative % | Market Share |
|---|---|---|---|---|
| **Within the District** | | | | |
| 94040 Mountain View | 960 | 6% | | 44% |
| 94043 Mountain View | 742 | 4% | | 35% |
| 94024 Los Altos | 693 | 4% | | 50% |
| 94022 Los Altos & Hills | 519 | 3% | | 37% |
| 94085 Sunnyvale | 488 | 3% | | 34% |
| 94041 Mountain View | 361 | 2% | | 40% |
| 94042 Mountain View | 10 | 0% | | 26% |
| 94039 Mountain View | 8 | 0% | | 44% |
| 94023 Los Altos | 6 | 0% | | 14% |
| 94035 Moffett Field | 2 | 0% | | 15% |
| **Within the District** | **3,789** | **22%** | **22%** | **40%** |
| **Partially Outside the District but Within the Sphere of Influence** | | | | |
| 94087 Sunnyvale | 1,548 | 9% | | 43% |
| 94086 Sunnyvale | 1,371 | 8% | | 39% |
| 94089 Sunnyvale | 605 | 4% | | 38% |
| 94088 Sunnyvale | 18 | 0% | | 36% |
| **Partially Outside the District but Within the Sphere of Influence** | **3,542** | **21%** | **43%** | **41%** |
| **Outside the District but Within the Sphere of Influence** | | | | |
| 95014 Cupertino | 1,189 | 7% | | 38% |
| 95015 Cupertino | 10 | 0% | | 20% |
| **Outside the District but Within the Sphere of Influence** | **1,199** | **7%** | **50%** | **38%** |
| Rest of Santa Clara county | 6,339 | 37% | 88% | 4% |
| Rest of California | 1,903 | 11% | 99% | - |
| Out of state or unknown | 176 | 1% | 100% | - |
| **Total** | **16,948** | | | |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

Inpatient catchment for all inpatient services provided by El Camino Hospital Mountain View is visually displayed in the Figure 5.4 map, shown below.

[9] District geography and El Camino Hospital (Mtn View campus) IP discharges excluding normal newborns for CY2010 as provided by ECH, Dec 23, 2011.

**Figure 5.4**
**Distribution and Saturation of Inpatient Services**
**El Camino Hospital Mountain View by Zip Code**

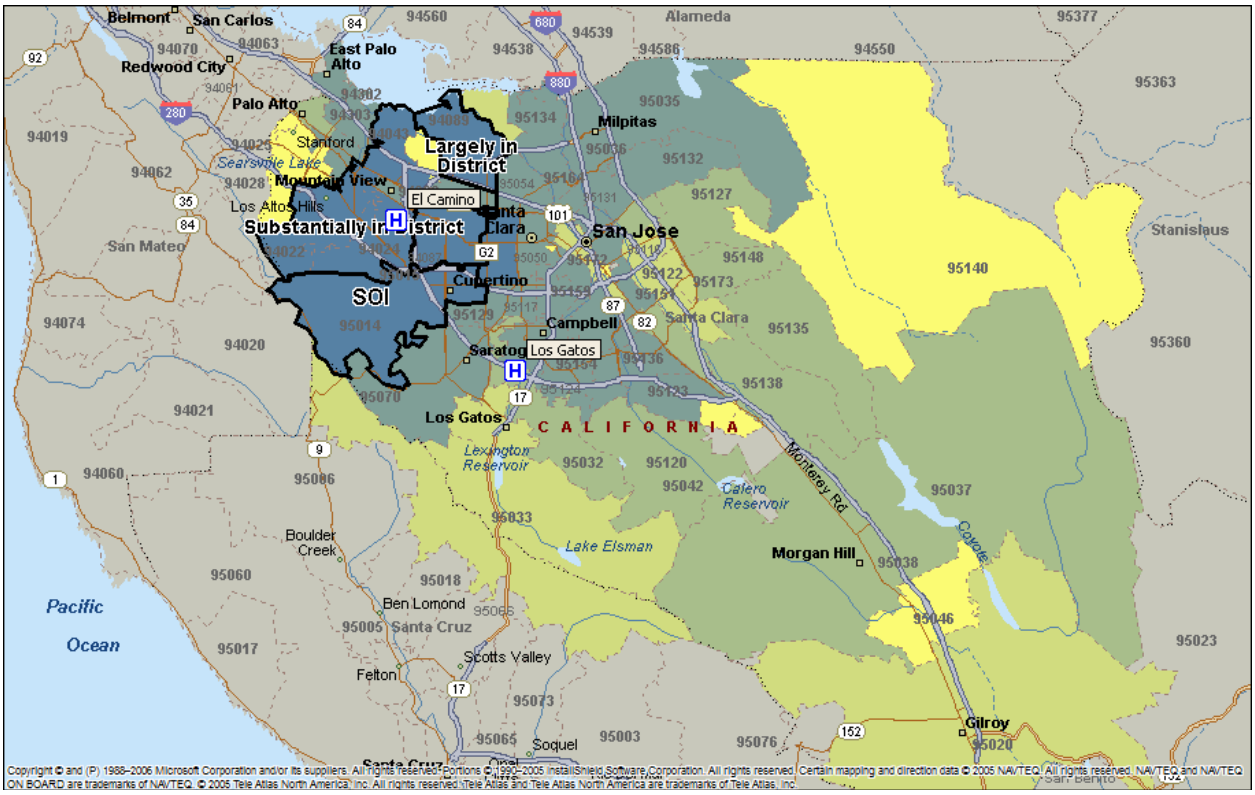



Table 5.12 on the next page provides similar data for emergency room visits. As shown, the Mountain View campus of El Camino Hospital draws about 54 percent of its Emergency Department volume from zip codes that are within the SOI. Expanding the SOI to include all of Cupertino and Sunnyvale yields a catchment of 60 percent of Emergency Department volume from these areas. Another 29 percent originates from the rest of Santa Clara County, and the remaining 11 percent originates from other counties and beyond.

**Table 5.12**
**El Camino Hospital District Emergency Department Catchment**[10]
**Sorted by Zip Code – Calendar Year 2010**

| Catchment Areas | El Camino - Mt. View Visits | % of ECH-MV | Cumulative % |
|---|---|---|---|
| **Within the District** | | | |
| 94040 Mountain View | 3,426 | 8% | |
| 94043 Mountain View | 2,905 | 7% | |
| 94024 Los Altos | 1,844 | 4% | |
| 94085 Sunnyvale | 1,815 | 4% | |
| 94041 Mountain View | 1,366 | 3% | |
| 94022 Los Altos & Hills | 1,270 | 3% | |
| 94042 Mountain View | 43 | 0% | |
| 94039 Mountain View | 30 | 0% | |
| 94023 Los Altos | 15 | 0% | |
| 94035 Moffett Field | 12 | 0% | |
| **Within the District** | **12,726** | **30%** | **30%** |
| **Partially Outside the District but Within the Sphere of Influence** | | | |
| 94086 Sunnyvale | 4,367 | 10% | |
| 94087 Sunnyvale | 3,752 | 9% | |
| 94089 Sunnyvale | 1,705 | 4% | |
| 94088 Sunnyvale | 36 | 0% | |
| **Partially Outside the District but Within the Sphere of Influence** | **9,860** | **23%** | **54%** |
| **Outside the District but Within the Sphere of Influence** | | | |
| 95014 Cupertino | 2,892 | 7% | |
| 94015 Cupertino | 38 | 0% | |
| **Outside the District but Within the Sphere of Influence** | **2,930** | **7%** | **60%** |
| Rest of Santa Clara County | 12,005 | 29% | 89% |
| Rest of California | 4,655 | 11% | 100% |
| Out of state or unknown | - | - | - |
| **Total** | **42,176** | | |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

## Market Share and Patient Flow

The District residents have a high preference for El Camino Hospital (Mountain View campus), with a greater than 40 percent market share from each of the catchment areas within the District and the SOI. Patients in these catchment areas seek about 90% of their inpatient care from within the County, predominantly from El Camino, Stanford, and the two Kaiser facilities. A

[10] District geography and El Camino Hospital (Mtn View campus) ER visits for CY2010 as provided by ECH, Dec 23, 2011.

clear preference for Stanford over Kaiser is apparent in the primary District zip codes, while the zip codes that are partially or wholly outside of the district, but within the SOI, prefer Kaiser over Stanford, as shown in the table, below.

**Table 5.13**
**El Camino Hospital District Market Share**
**Sorted by Zip Code – Calendar Year 2010**

| 2010 - All DRG | Volume | | Market Share | |
|---|---|---|---|---|
| By Hospital System | District | SOI | District | SOI |
| El Camino (Mtn View) | 4,396 | 5,760 | 41% | 42% |
| El Camino (Los Gatos) | - | 1 | 0% | 0% |
| Kaiser (Peninsula/East Bay) | 1,778 | 3,188 | 16% | 23% |
| Stanford / LCPH | 2,661 | 1,539 | 25% | 11% |
| Santa Clara Valley MC | 782 | 1,259 | 7% | 9% |
| Sequoia (CHW) | 255 | 147 | 2% | 1% |
| Good Samaritan | 175 | 618 | 2% | 5% |
| O'Connor | 135 | 422 | 1% | 3% |
| UCSF | 86 | 85 | 1% | 1% |
| Sutter (CPMC, Mills-Peninsula) | 97 | 73 | 1% | 1% |
| Other Santa Clara/San Mateo/ So. Alameda County | 183 | 251 | 2% | 2% |
| Other Outmigration | 285 | 334 | 3% | 2% |

*Source: OSHPD ALIRTS Facility Utilization Statistics, 2010*

While El Camino has lost some market share from the Sphere of Influence zip codes over the last two years (to Kaiser and Stanford), overall its market position has remained stable.

## Patient Flow from Los Gatos

The El Camino Hospital in Mountain View receives some "in-migration" of inpatient volume from the Los Gatos area (defined here as the top 12 zip codes with highest inpatient volume reported from the Los Gatos Hospital in 2008). This in-migration volume totaled 1,972 inpatient cases in FY 2010 (excluding normal newborns, as reported by ECH), or about 5.6 percent of the area's total cases in that year. This volume was the same as that in 2008, when 1,972 discharges was 5.4% share of the volume from the Los Gatos area patients, a slight increase of 0.2% market share points.

Part of this increase is likely due to the reduction in capacity during the change in ownership between 2008-2009, with temporary closure of the Los Gatos facility and the corresponding net decrease in available beds within that area of the County. Overall the El Camino Hospital system of both campuses had a net loss of 0.5 percent of the market share, comprised of a 0.2 percent gain at the Mountain View campus and a 0.5 percent loss at Los Gatos campus.

**Table 5.14**
**Market Share Impact On Area Hospitals from**
**El Camino Hospital Los Gatos Closure – 2008 to 2010**

| Hospital System | Volume | Market Share | Market Share Change 2008-2010 |
|---|---|---|---|
| Good Samaritan | 10,444 | 26.6% | 0.2% |
| Kaiser (Peninsula/East Bay) | 9,916 | 25.2% | 0.4% |
| Santa Clara Valley MC | 5,713 | 14.5% | -0.1% |
| El Camino (Mt. View) | 4,124 | 10.5% | 4.8% |
| O'Connor | 3,998 | 10.2% | -0.3% |
| Stanford/LCPH | 2,248 | 5.7% | 0.3% |
| Sequoia (CHW) | 269 | 0.7% | 0.0% |
| El Camino (Los Gatos) | 28 | 0.1% | -5.5% |
| UCSF | 221 | 0.6% | 0.0% |
| Sutter (CPMC, Mills-Peninsula) | 150 | 0.4% | -0.1% |
| Other Santa Clara/San Mateo/ So. Alameda County | 1,121 | 2.9% | -0.1% |
| Other Outmigration | 1,086 | 2.8% | 0.4% |
| Total | 39,318 | 100% | |

Note: "Los Gatos Market" includes the top 12 zip codes with the highest inpatient volume in the Los Gatos hospital catchment area, comprising 56 percent of total volume at Los Gatos Hospital in 2008.

Source: OSHPD Patient Origin files from 2008 and 2010.

# Findings and Statements of Determinations

Service reviews are intended to serve as a tool to help LAFCo, the public and other agencies better understand the public service structure and evaluate options for the provision of efficient and effective public services. The Service Review conducted of the El Camino Hospital District revealed the following information for consideration by the Santa Clara County LAFCo Board.

- An emphasis in the law on populations or communities "served" by a healthcare district, rather than populations residing within district boundaries, have generally been interpreted to allow health care districts to extend their influence well beyond jurisdictional territory.

**Excess Capacity Even with Projected Population Growth**

- The County of Santa Clara has excess capacity for many services, estimated to be over 291 Medical/Surgical, 80 ICU/CCU, 188 Obstetrics and 72 NICU beds, based on 2010 discharge and licensure data at a target utilization rate of 85 percent.

- El Camino Hospital has a general acute care inpatient utilization rate of 60.7 percent. Although utilization varies by service, the ECH has substantial excess capacity in the Hospital's Medical/Surgical and Neonatal ICU units.

- On a Countywide basis, El Camino Hospital provides about 9.4 percent of total inpatient services. ECH has 9.4 percent of total licensed beds in the County and 9.5 percent of excess capacity, excluding beds that are becoming unlicensed at the end of 2012.

- Given the population profile of Santa Clara County and hospital utilization rates by age cohort, Countywide inpatient hospital demand is expected to increase by between 9.0 percent and 13.0 percent over the next five to seven years. For El Camino Hospital, this growth is expected to increase by between 5.8 percent and 8.3 percent over the same period.

- With the exception of ICU beds, it is unlikely that growth in local demand will lead to capacity concerns at the Mountain View hospital. Excess capacity is likely to remain in most services, since the Hospital is considering a project to relocate physician offices in the Women's Hospital to make approximately 40,000 square feet available for inpatient use.

**Large Proportion of Services Provided to Person Residing Outside of the SOI**

- Unlike water or sewer districts, which are restricted to providing services at permanent physical addresses, Healthcare District law does not restrict services to a specific territory and, instead, allows health care districts to serve individuals who reside outside of the district boundaries and in other areas. With the exception of the Los Gatos Hospital campus and two dialysis centers located in San Jose, all El Camino Hospital District facilities are located within jurisdictional boundaries.

- Approximately 43 percent of inpatient services provided by El Camino Hospital are for persons who reside within the District. Approximately 50 percent are for persons who reside within the SOI that includes all zip code territory within Sunnyvale and Cupertino. Another 38 percent originates from the rest of the County and an additional 12 percent originates from locations outside of the County.

- Approximately 54 percent of El Camino Hospital emergency department services are provided to persons who reside within the District. Approximately 60 percent are for persons who reside within the SOI that includes all zip code territory within Sunnyvale and Cupertino. Another 29 percent of service volume is provided to patients who originate from the rest of the County and an additional 11 percent to those who originate from locations outside of the County.

**Market Share Consistent Across District Boundaries and SOI**

- El Camino Hospital Mountain View captures approximately 40% of the market share within the District and the SOI that includes all zip code territory within Sunnyvale and Cupertino.

- Patients in these catchment areas seek about 90% of their inpatient care from within the County, predominantly from El Camino Hospital Mountain View, Stanford, and the two Kaiser facilities.

- The El Camino Hospital in Mountain View receives some "in-migration" of inpatient volume from the Los Gatos area . This in-migration volume totaled 1,971 cases in FY 2010, or about 5.6 percent of the area's total cases in that year. This share grew slightly from 5.4 percent of the area's volume in FY2008.

The following findings respond to the specific questions posed by the Santa Clara County LAFCo as part of the Service Review:

1. ***Separate and apart from the review of ECHD's role in relation to the Los Gatos Hospital campus, does the ECHD provide any services outside of its boundaries? What is the District's role in the various El Camino Hospital dialysis centers throughout the County?***

   Although the Corporation is a separate legal entity, as discussed in Section 4, the ECHD is the "sole member" of the El Camino Hospital Corporation. As structured, the elected District Board members sit as a quorum of the voting members of the Corporation Board. Therefore, any activities of the Corporation are, by extension, activities of the District.

   The acquisition and opening of the Los Gatos Hospital extends the range of District services beyond its current boundaries and sphere of influence. In addition, even when viewing the activities of El Camino Hospital – Mountain View in isolation, it is clear that a major portion of services are provided to persons who reside outside of the District boundaries and the sphere of influence (see Statement 2, below).

   Providing dialysis services outside of the physical boundaries of the District is consistent with State law [Health and Safety Code § 32121(j)] and with the broader mission of the District and Hospital. However, the location of these centers in East San Jose (2230 Tully Road) and Central San Jose (999 West Taylor Street) presents similar concerns as the acquisition of the Los Gatos Hospital.

2. ***Do the ECHD's current boundaries reflect the population it serves?***

   No. As demonstrated in this report, only 43 percent of the inpatient services provided to residents of zip code areas that are wholly or partially contained within District boundaries. When considering zip code areas that are outside of the District but within the SOI, the proportion of inpatient services received by residents increases to 50 percent. Therefore, approximately half of the services provided by El Camino Hospital – Mountain View are provided to residents of neither the District nor the District's SOI. Although a greater proportion of emergency services are provided to residents of the District and SOI, approximately 40 percent of such services are provided to non-residents that reside in areas throughout the County, State and beyond.

3. ***If the ECHD is providing services outside of its boundaries, should its boundaries be extended to include its service area? If so, how would the affected agencies be impacted by such expansion?***

No. As demonstrated in the report, the El Camino Hospital Mountain View facility consistently has a market share of approximately 40 percent of all inpatient services within the District and sphere of influence. Beyond the SOI, the Hospital's market share drops to only four percent in the rest of the County.

In addition, as demonstrated in Section 4, the District, Corporation and five affiliated non-profit entities have been able to accumulate approximately $440 million in Unrestricted Net Assets as of June 30, 2011. In part, this accumulation of Unrestricted Net Assets and the Corporation's ability to acquire the Los Gatos Hospital have occurred as a result of the significant property tax contributions being made by residents of the current District. By expanding the District boundaries to include the SOI, the property tax base and resulting revenues would increase, adding to the Corporation's ability to either expand deeper into the community or accumulate additional Unrestricted Net Assets. Other local government jurisdictions would lose a portion of their 1% levy, and an additional tax would be imposed on residents within the SOI for ECHD debt service. There would be no clear benefit to residents of an expanded District, if the District boundaries were to be expanded.

***4. What services is the ECHD currently providing? Is El Camino Hospital District currently providing the services for which it was created? Is there a change in ECHD's mission since its creation?***

The ECHD provides services to its residents through the El Camino Hospital Corporation and its affiliates through an array of contracts with the Corporation that include a ground lease for the Mountain View Hospital, and the transfer and sale of assets to the Corporation in exchange for providing services to the ECHD community. As discussed in Section 4 and restated above, although the Corporation is a separate legal entity, the ECHD is the "sole member" of the El Camino Hospital Corporation. As structured, the elected District Board members sit as voting members of the Corporation Board. Therefore, any activities of the Corporation are, by extension, activities of the District.

Given this interpretation of the governance and financial relationship between the District and the Corporation, the decision of the Corporation to acquire Los Gatos Hospital and expand services (including operation of dialysis centers) well beyond the established boundaries of the District represents a significant departure from the original intent of the voters when forming the District in 1956. Further, expanding the Corporation reach in this manner is inconsistent with the intent of California Health and Safety Code § 32121(j), which allows healthcare districts, "to establish, maintain, and operate, or provide assistance in the operation of one or more health facilities or health services…at any location within or without the district *for the benefit of the district and the people served by the district.*" Given the geographical distance of the Los Gatos Hospital to the District, the extent to which the acquisition meets the voters' original intent or the purpose of the State law is questionable.

The following Statements of Determination respond to the requirements of California Government Code Section 56430

1. ***Growth and population projections for the affected area.***

   The District and SOI are expected to experience a five-year population growth rate of 2.8 percent compared with a Countywide population growth rate of approximately 5.0 percent. Also, because of the differences in the populations by age cohort, the District and SOI will experience a lower 5.8 percent inpatient volume increase compared with a 9.0 percent inpatient volume increase for the County overall.

2. ***Present and planned capacity of public facilities and adequacy of public services, including infrastructure needs or deficiencies.***

   With the exception of ICU beds, it is unlikely that growth in local demand will lead to capacity concerns at the Mountain View hospital in the next five years. In addition, current facility plans under consideration for the Mountain View campus include the possibility of relocating physician offices in the Women's Hospital to make approximately 40,000 square feet available for inpatient use in 2013-14

3. ***Financial ability of agency to provide services.***

   The District, Corporation and five affiliated non-profit entities collectively held Unrestricted Net Assets of approximately $440 million as of June 30, 2011, which was 76.3% of annual operating expenses in that year. Of this amount, $408 million was reportedly held in cash and investments. Other financial indicators suggest that the combined organization is in a strong position compared with Standard and Poors (S&P) A+ rated hospitals: (a) the Hospital operating margin is 9.4% vs. 3.8% for the S&P group; (b) the Hospital profit margin is 8.3% compared with 6.0% for the S&P group; and, (c) the Hospital debt to capitalization ratio is 17.0% compared with 30.9% for the S&P group (i.e., for this indicator, a lower percentage suggests better performance). Therefore, the District's financial ability to provide services is strong.

4. ***Status of, and opportunities for, shared facilities.***

   No opportunities for shared facilities were identified during the service review.

5. ***Accountability for community service needs, including governmental structure and operational deficiencies.***

   To improve accountability, the District and the Corporation should establish enhanced budgetary reporting and controls on an accrual basis in order to better reflect the use of District resources. This should include detailed reporting of transfers between entities as well as debt service requirements. In addition, budgetary and financial information should be reported on a component unit level (i.e., separate budgets and financial reports for the District, Corporation and each of the five non-profit entities). These budgets

should provide character level detail and be reviewed, discussed and adopted by the respective boards at public hearings.

The governance structure of the District, the Corporation and the five affiliated non-profit entities blurs the distinctions between the organizations. As the "sole member" of the Corporation, the District is able to directly impose its will, financial benefit and financial burden on the Corporation, which link the boards together and create fiscal dependency. In addition, the Corporation serves as the manager and administrator, not only for the Hospital as a nonprofit public benefit corporation, but also for the District, the Foundation, and the additional affiliated entities. Accordingly, all financial transactions and activities occur through the accounts and records of the Hospital, further blurring distinctions between the entities.

The District should consider changes that would clearly distinguish between the entities for governance and management purposes. This is discussed more fully in Section 6 of this report. In addition, the District should enhance processes for monitoring expenditures for capital improvements and community benefits, through improved budgeting and more transparent financial reporting.

6. ***Any other matter related to effective or efficient service delivery, as required by commission policy.***

   None identified as part of the service review.

The following Statements of Determination respond to the requirements of California Government Code Section 56425

1. ***The present and planned land uses in the area, including agricultural and open space lands.***

   The ECHD has well-developed suburban land use designations without plans for significant changes that would affect the purpose and mission of the District.

2. ***The present and probable need for public facilities and services in the area.***

   The El Camino Hospital Mountain View campus provides a vital healthcare service in the community. A review of population projections for the District and the County, as well as analysis and capacity by major service, indicates that additional healthcare capacity is not required at this time. Overall, the County is using only 60.9 percent of its licensed beds and El Camino Hospital Mountain View is using only 60.7 percent of its licensed beds, suggesting sufficient medical facility capacity in the County and District.

3. ***The present capacity of public facilities and adequacy of public services that the agency provides or is authorized to provide.***

   See Statement Number 2.

***4. The existence of any social or economic communities of interest in the area if the commission determines that they are relevant to the agency.***

The commission did not identify any social or economic communities of interest in the area and none were identified as part of the Service Review.

***5. The nature, location, and extent of any functions or classes of services provided by the existing district.***

Although the District does not directly operate El Camino Hospital, it leases the land, transferred and sold assets, and entered into various agreements with the El Camino Hospital Corporation to operate a hospital on property that it owns in Mountain View. In addition, the District has contributed approximately $110 million to the Corporation in the past five years to pay for debt service related to the rebuilding of the Mountain View hospital, other capital improvements and community benefits.

El Camino Hospital is a full service acute care hospital located on a 41-acre campus in Mountain View, California. The campus in Mountain View includes the main hospital, the Women's Hospital, the El Camino Surgery Center, the Breast Health Center, the Oak Dialysis Center, the CyberKnife Center, the Cancer Center in the Melchor Pavilion, the Taft Center for Clinical Research, and the Genomic Medicine Institute. El Camino Hospital Corporation (ECHC) also owns the El Camino Surgery Center, LLC, and Silicon Valley Medical Development, LLC, and has 50 percent ownership of Pathways HomeCare and Hospice.

El Camino Hospital is licensed for 374 General Acute Care beds and 25 Psychiatric beds, for a total of 399 beds, based on data available from the California Office of Statewide Health Planning and Development (OSHPD). In 2012, the number of medical-surgical beds at the Hospital will be reduced by 99 beds in the old hospital, from 279 to 180 licensed beds. The total inpatient bed capacity of the Hospital will be reduced to 310, including 285 Acute Care and 25 Acute Psychiatric beds.

# 6. Governance and Reorganization Alternatives

As discussed in the Introduction to this report, Santa Clara County LAFCo posed two overriding questions to be answered as part of this service review and audit, as follows:

1. Is the El Camino Hospital District providing services outside of its boundaries?

2. Should the District continue to exist and/or continue to receive public funds or could another entity provide the District's services more efficiently?

*Providing Services Outside of the District Boundaries*

As discussed in Section 5 of this report, only about 50 percent of the inpatient services provided by El Camino Hospital Mountain View are performed for persons residing within the District and the SOI. The balance of services is provided to persons who reside outside of the SOI. This is anticipated in State law, which specifically allows hospital and healthcare districts to perform services outside of established jurisdictional boundaries. However, State law is also silent on the degree to which extra-territorial services are permitted or considered to be reasonable. While the reach of the District services provided through El Camino Hospital Mountain View do not appear to be in violation of the law, it is clear that services are provided in areas that are far outside of the boundaries recognized by Santa Clara County LAFCo.

The matter is further complicated by the El Camino Hospital Corporation's acquisition and opening of the El Camino Hospital Los Gatos campus in the last few years. As discussed extensively in Section 4 of this report, although the Corporation has been organized as a separate legal entity, its governance structure, financial relationship to the District and legal stature as a quasi-public entity conclusively show that the District and the Corporation function as one and the same entity. While the opening of the Los Gatos Hospital may make business sense for the Corporation, that action redefines the mission of the Corporation – and, indirectly, the District – in a manner that is wholly inconsistent with the intended purpose of the District.

Although the Service Review did not find that the El Camino Hospital District is providing services outside of the District in violation of State law, it is clear that the reach of the organization has gone well beyond the territorial boundaries and established sphere of influence (SOI) of the jurisdiction.

*Continued Existence and Receipt of Taxpayer Funds*

As discussed in Section 4, the combined financial statements for the District, the Corporation and other affiliated organizations demonstrate that the combined group of entities is financially strong. As of June 30, 2011, the financial statements indicated that these entities held total net assets of $805 million, of which over $440 million were unrestricted and included $408 million in cash. These unrestricted net assets were equivalent to more than 76 percent of the combined annual operating expenses of the organization, which amounted to $577 million in that year.

The Corporation itself held $886 million in total net assets as of June 30, 2011, of which over $411 million was unrestricted net assets and included $371 million in cash. Notably, the Corporation experienced these significant balances after receiving surplus cash transfers from the District of $52.5 million over the previous five years and spending $53.7 million on the purchase of the Los Gatos Hospital. While the accounting records do not show that any District funds were directly used for the purchase of Los Gatos Hospital, it is clear that asset and cash transfers from the District, as well as access to low cost borrowing through the District and as a non-profit entity, have contributed substantially to the financial success of the organization.

In addition, the combined organization does not distinguish itself by the amount of community benefits that it returns as a result of taxpayer contributions. Certainly, El Camino Hospital Mountain View offers a vital service to the region, providing approximately 9.4 percent of all inpatient services and controlling 15.8 percent of all excess inpatient service capacity within the County. However, the community benefits reported by the District and Corporation merely falls within the range of contributions reported by other California healthcare districts, even though the District receives the second highest apportionment of property taxes in the State. Of the $54.8 million in total community benefit reported by El Camino Hospital in FY 2010-11, the District contributed $5.1 million and the Corporation contributed $49.8 million, of which $47.2 million represented the unreimbursed portion of costs for care provided to Medi-Cal and other uninsured or underinsured recipients, other subsidized health services and charity care. All of these loses are quantified using industry standard ratios of costs to charges and are recovered by the Corporation from charges to insurance companies and other payers. The balance of $2.6 million, or approximately 51.2 percent of the $5.1 million contribution made by the District, represented other community benefits funded by the Corporation.

The balance of property taxes received by the District was used to make principal and interest payments on debt and contribute toward capital improvements at the Mountain View campus. In the last five years, the District spent $110.2 million on El Camino Hospital activities, of which $21.2 million (or 19.2%) was spent on community benefit activities. The District asserts that the $21.2 million expended on community benefits represents the maximum amount permitted by law, due to restrictions imposed by the Gann Appropriations Limit (GAL). However, the legal interpretation of the GAL and its applicability to the District is unsettled.

Further, other indicators of community benefit – such as the number of inpatient days provided to Medi-Cal patients – show that El Camino Hospital does not distinguish itself by providing high levels of service to low income residents. When compared with the eight other hospitals in the County that provide general medical services, El Camino Hospital Mountain View provides the third lowest number of days of service to this population, providing fewer Medi-Cal days of service than all but the two Kaiser Foundation hospitals in the County.

## Analysis of Governance Structure Options for the El Camino Hospital District

The Cortese Knox Hertzberg (CKH) Act grants a LAFCo the right and responsibility to review, and approve or deny a district's official boundary and its Sphere of Influence (SOI). Boundary changes may be initiated by petition of residents / registered voters or by resolution of local affected agencies. LAFCO may also initiate some boundary changes under certain circumstances.

There were six governance structure options identified during this project:

1. Maintain the District's boundaries and take measures to improve governance, transparency and accountability;
2. Modify the District's boundaries and/or SOI;
3. Consolidate the District with another special district;
4. Merge the District with a city;
5. Create a subsidiary District, where a city acts as the ex-officio board of the district; or
6. Dissolve the District, naming a successor agency for the purpose of either "winding up" the affairs of the District or continuing the services of the District.

**Maintain District Boundaries/Improve Governance, Transparency and Accountability**

El Camino Hospital is a well-regarded and successful organization that provides important services to District residents and other persons within the County of Santa Clara. Nonetheless, throughout this report, opportunities that would improve the governance, transparency and accountability of the District have been identified and questions have been raised regarding the level of community benefits being provided to District residents in exchange for substantial property tax dollars that have been contributed to the Corporation over the years.

The audit found that, although they are legally separate entities, there is no functional distinction between District and Corporation governance, management and finances. The audit was unable to draw a clear distinction between Corporation and District net assets that allowed the Corporation to accumulate surplus cash sufficient to acquire Los Gatos Hospital. Without distinct governance and full transparency, public accountability is weakened. With the dissolution of the District, public access and accountability would no longer be a concern.

Under this alternative, El Camino Hospital District would continue operations and receive its apportionment of property taxes for debt service. There would be no change in District boundaries or sphere of influence. However, to avoid future difficulties and questions regarding the appropriateness of property tax contributions to a private Corporation that has extended its service reach well beyond the jurisdictional boundaries of the District, Santa Clara County LAFCo should encourage the El Camino Hospital District Board of Directors to consider the following improvements.

1. The El Camino Hospital District should limit its financial contributions to El Camino Hospital Corporation to payments for principal and interest on debt incurred by the District for the El Camino Hospital Mountain View Rebuild (i.e., a balance of $143.8 million in General Obligation Bonds, discussed in Section 4). In addition, the District should cease all automatic contributions to the El Camino Hospital Corporation to support the Hospital capital improvement program or to be used as a general revenue source. Instead, LAFCo should seek a legal interpretation of the applicability of GAL to the District and, if permitted by law, the District should divert these funds to community benefit programs that more directly benefit the residents of the District. Had this been the practice over the past five years, additional community benefit dollars amounting to approximately $73.7 million would have been available to directly benefit District residents. Should contributions exceed the 50% threshold pursuant to Health and Safety Code 32121 (p)(1), a vote may be required.

2. Cease all automatic payments to the El Camino Hospital Corporation or its affiliates to support the Corporation's community benefit program and divert these funds to other programs that more directly benefit the residents of the District. Under this approach, the District Board should consider establishing a Community Benefit Trust Fund for the purpose of awarding District funded community benefit grants to public and private non-profit organizations that would provide healthcare related services to District residents. While the Corporation and its affiliates should not be barred from receiving community benefit grants from the District, the organizations should be required to compete for dollars along with other providers that might offer services.[1]

3. Implement changes to the budget and financial reporting structure of the District, to provide clear and distinct segregation of budget priorities and reporting of financial activities. The budget process should be restructured to enhance transparency and public accountability, including clear presentation of financial policies, including those related to reserves, as well as projected and actual revenues and expenditures by purpose and program. The budget should report on specific line items financed by the District, including appropriations that support Mountain View hospital debt service, capital improvements (for example, the district should adopt a capital improvement plan), staffing and operations (including compensation paid to District Board members and/or executive staff, other employees and consultants, if any), and community benefit programs by grant category and recipient. In addition, the District Board should routinely appropriate all property taxes and non-operating revenues each fiscal year to prevent accumulation of resources, except in designated reserves or trust funds. A strengthened budget monitoring and reporting system should be established to ensure funds, such as community benefit grants, are being spent in accordance with Board policy.

4. Evaluate current and otherwise necessary professional services agreements with firms or individuals (including the corporation) used by the district for services, to ensure that the

[1] Of the $73.7 million, $21.2 million was restricted for capital use in accordance with the Gann Appropriations Limit. As previously noted, there is debate as to the applicability of the Limit to health care districts. In any event, whether for services or for capital use, the expenditure of property tax revenues should be more directly aligned with property tax payers and residents of the District.

District receives the administrative and legal support necessary to conduct business and differentiates between the two entities. Review and revise the District's code of ethics and conflict of interest policy to ensure that the District avoids circumstances of perceived or actual conflicts of interest.

If the District is not able to implement the suggested reforms within 12 to 18-months, acting as the El Camino Hospital Corporation Board of Directors, the Board should remove the District as the "sole member" of the Corporation and change the membership of the Corporation Board to include majority representation by individuals other than members of the ECHD Board of Directors. This action would result in full control of the Corporation by its Board of Directors and remove the District from its current role in corporate governance. Further, by changing the composition of the Corporation Board, the separation and independence of the two boards would be complete and the actions of the separate boards would be distinct, allowing for greater accountability and transparency.

We believe the separation and independence of the two Boards is an appropriate action due to the purchase and operation of the Los Gatos Hospital campus, which is located outside of the District boundaries and SOI. This fundamental shift in operating and business strategy has moved the Corporation (and by extension, due to Board's role governing both the Corporation and the District) the District away from its principal role as a public entity serving and benefiting District residents. Nonetheless, although we believe separate governance would be the best approach under this alternative, it may be prudent to initially allow the District to attempt reforms before taking the step of requiring modifications to the governance of the two entities.

Adopting these types of reforms would result in the following advantages and disadvantages:

| *Advantages* | *Disadvantages* |
|---|---|
| • Medical services in the District and SOI would continue uninterrupted. | • The Corporation would have the ability to continue expanding services beyond the District's SOI, while using District tax dollars to support its operations. |
| • Taxpayer contributions to the Corporation would continue, ensuring that El Camino Hospital would sustain resources necessary to provide community benefit funds within the community. | • The District and the Corporation could potentially become less distinct and revert to old practices over time, and community benefits could remain unremarkable or decline. |
| • The governance structures of the District and the Corporation would be strengthened and made distinct, and the interests of District residents would be less likely to be compromised by Corporate interests. | |
| • District residents would likely receive increased levels of community benefits from providers other than the Corporation and its affiliates. Establishing a grant award process would ensure that community benefit dollars remain focused within the District. | |

| *Advantages* | *Disadvantages* |
|---|---|
| • Financial and budgetary transparency and public accountability would be enhanced. Systems would be established to ensure that the residents of the District will be able to monitor and influence the use of taxpayer funds in their community. | |
| • Circumstances of perceived or actual conflicts of interest would be lessened. | |

**Modify Boundary and/or Sphere of Influence**

If requested, a LAFCo may modify a district's boundaries by either reducing the amount of assigned territory through detachment or increasing the amount of territory through annexation. When district territory is detached, taxpayers within the removed territory are no longer required to pay taxes to the district. When territory is annexed, the CKH Act, Government Code Section 57330 states that the annexed territory "shall be subject to levying or fixing and collection of any previously authorized taxes, benefit assessments, fees or charges of the … district."

State law requires LAFCo to define and maintain a "sphere of influence" (SOI) for every local government agency within a county. California Government Code Section 56076 defines sphere of influence to mean "a plan for the probable physical boundaries and service area of a local agency, as determined by the [local agency formation] commission." Santa Clara County LAFCo defines "sphere of influence" as "the physical boundary and service area that a local governmental agency is expected to serve."[2] By expanding a SOI there is no financial impact on a district or requirement that taxpayers within the expanded territory pay additional taxes. For hospital districts, therefore, it appears a SOI expansion merely redefines the extraterritorial reach of the jurisdiction for purposes of understanding the size of the "affected area".

Under this alternative, El Camino Hospital District would continue operations and receive its apportionment of property taxes for debt service, community benefits, capital improvements at the Mountain View campus, and general use. If boundaries were expanded, the District would receive more in property tax but would not necessarily provide a greater level of service to District residents. In addition, other local government jurisdictions would lose a portion of their 1% property tax levy, and an additional tax would be imposed on residents within the SOI for ECHD debt service. If the SOI were expanded, there would not be a greater level of service. Accordingly, *there would be no practical benefit from modifying the sphere of influence to better reflect the Hospital's reach.*

| *Advantages* | *Disadvantages* |
|---|---|
| • The boundaries of the District and the SOI would better reflect the Mountain View Hospital Corporation's service reach into surrounding communities. | • The Corporation potentially would have additional resources to locate services outside of the District's SOI, further complicating distinctions between the District and the Corporation. |

[2] Santa Clara County LAFCo website, "Powers of LAFCO"

| *Advantages* | *Disadvantages* |
|---|---|
| | • If the boundaries were expanded, the property tax base and resulting contributions to the District would increase, without necessarily providing significantly more in community benefits to District residents. |
| | • Additional taxpayers, who already have access to Mountain View Hospital services, would have a portion of their base property tax apportioned to the District and would be required to pay an additional levy for debt service, if the boundaries were expanded. |

Consolidate with Another District

Consolidation of a district could occur when there is another district that provides the same or similar functions. Because there is no other district in the County, consolidation *is not a viable reorganization alternative*.

Merge with a City

Merging a district with a city requires that the boundaries of the district be entirely within the City.[3] Since the El Camino Hospital District boundaries extend significantly beyond the boundaries of any single city within its jurisdiction, merger *is not a viable reorganization alternative*.

Create a Subsidiary District

To establish a district as a subsidiary of a city, the city must comprise 70% of the land or include 70% of the registered voters of the district.[4] Therefore, establishing the District as a subsidiary of one of the cities within its jurisdictional boundaries *is not a viable reorganization alternative* since the District's boundaries cover several cities.

Dissolve the District

According to Section 56035 of the California Government Code, "Dissolution" means the "dissolution, disincorporation, extinguishment, and termination of the existence of a district and the cessation of all its corporate powers . . . or for the purpose of winding up the affairs of the district".

If the El Camino Hospital District were to be dissolved, this analysis assumes that the Mountain View hospital would continue to be operated by the Corporation. To accomplish dissolution,

[3] Government Code § 57104.

[4] Government Code § 57105.

Santa Clara County LAFCo would need to make findings regarding the District in accordance with Government Code Section 56881(b), as follows:

(1) Public service costs . . . are likely to be less than or substantially similar to the costs of alternative means of providing service.

(2) A change of organization or reorganization that is authorized by the commission promotes public access and accountability for community services needs and financial resources.

In addition, Santa Clara County LAFCo would need to identify a successor agency to implement the wind-up of the District, in accordance with Government Code Section 57451.

Under this scenario, the District would be dissolved, the successor agency would assume the remaining debt on the General Obligation bonds, and it is assumed the Corporation would continue to operate the hospital, although another health care organization could purchase the facility and assume operations.

Contributions toward community benefits and the transfer of surplus District cash, representing nearly 60 percent of total contributions to the Corporation during the past five years, would clearly represent a decline in hospital income going forward and community benefits could potentially decline, unless the Corporation chose to continue contributing at current or increased levels from other sources of funds. Two other factors related to these transfers should also be recognized by LAFCo:

1. The contributions to community benefits, amounting to 19.2% of the total contributions made by the District, have generally gone toward programs that support the Hospital's general mission of providing healthcare services to the broader region. With dissolution, District residents would no longer be paying taxes to support community benefit services that are presently available to residents and non-residents alike.

2. Similarly, a substantial portion of the transfers (47.6%) have been used for capital improvements at the Hospital, due to factors related to the Gann Appropriation Limit, and have allowed the Corporation to accumulate surplus net assets sufficient to purchase Los Gatos Hospital and expand the Corporation service territory, well outside of the District boundaries and Sphere of Influence. Based on the service review, at most, 43 percent of inpatient services and 54 percent of emergency services are provided to District residents. As with community benefits, District residents would no longer be paying taxes to support the general operations of the Hospital that are presently available to residents and non-residents alike.

Although the total property tax burden would not be reduced for District residents, property tax receipts would be reapportioned to other jurisdictions within the District's tax rate areas, resulting in additional resources for police, fire, schools and other services provided to District residents.

*GC Section 57451 Identifying a Successor Agency for Purposes of Winding Up the District*

In the event of dissolution, Government Code Section 57451 would require Santa Clara County LAFCo to identify a successor agency for purposes of winding up the affairs of the District. The city that contains the greater assessed value of all taxable property within the territory of the dissolved district will be the successor agency pursuant to Government Code § 57451.

Under the Dissolution alternative, Santa Clara County LAFCo would dissolve the District and initiate steps to wind-up the organization. To achieve dissolution, the following issues would need to be resolved:

1. A successor agency would need to be identified.

2. The financial relationship between the District and the Corporation would need to be wound-up, including an equitable settlement for various leases and agreements, and asset and liability disposition.

This report does not contain determinations for dissolution. Should LAFCO determine that the District has not satisfactorily accomplished the improvements in transparency and accountability suggested in this report and recommended below, a study should be commissioned as a first step toward dissolution. Dissolution findings should be fully vetted and resolved prior to deciding whether to initiate dissolution proceedings.

## Recommendations

Therefore, the Santa Clara County LAFCo should:

1. Request the District to implement improvements in governance, transparency and public accountability, consistent with the suggestions made in the subsection of this report entitled, "Maintain District Boundaries/Improve Governance, Transparency and Accountability".

2. If the improvements described in Recommendation 1 cannot be accomplished by the District within 12 to 18 months of acceptance of this report, or if the Corporation continues to purchase property outside of the District boundaries, request that the District Board initiate changes to the governance structure. If such changes are not initiated within six months of the request for the governance change, consider whether to begin actions toward dissolution of the El Camino Hospital District.

The rationale for these recommendations is provided, below:

- El Camino Hospital is a successful organization in a thriving healthcare market, and is an important asset to the community.

- Maintaining the status quo without improvements in governance, transparency and public accountability would result in continued concerns regarding the need for District revenue

contributions to go toward a non-profit public benefit corporation that no longer appears to be in need of taxpayer support.

- Continuation of taxpayer support, without broadening community benefit contributions beyond the Corporation and its affiliates, does not provide assurance that District residents receive an appropriate return on investment. In addition, it creates equity concerns, since approximately 57 percent of all inpatient services and 46 percent of all emergency services are provided to non-District residents, who are not taxed.

- Neither the District nor the Corporation provide remarkable levels of community benefits to District residents, when compared with other healthcare districts in the State and with other hospitals within Santa Clara County.

- Because the District serves as the "sole member" of the Corporation, the acquisition of the Los Gatos Hospital complicates the founding purpose of the District and, by extension, the Corporation. Further, the District made indirect monetary contributions to the Corporation that allowed it to use unrestricted net assets for the Los Gatos Hospital purchase. A more distinct separation of the two entities would ensure greater public accountability.

- The separation of the entities and disposition of assets and liabilities would be complex. Therefore, before embarking on a path toward dissolution, Santa Clara County LAFCo should make an effort to encourage the District to implement suggested reforms.