



Santa Cruz Local Agency Formation Commission

Date: October 1, 2025
To: LAFCO Commissioners
From: Joe Serrano, Executive Officer
Subject: **Pajaro Valley Health Care District Apportionment Waiver Request**

SUMMARY OF RECOMMENDATION

State law created LAFCOs to oversee the formation and change of organization for cities and special districts in each county in California. However, the Pajaro Valley Health Care District was formed on February 4, 2022 following the Governor's approval of Senate Bill 418 to address the failing Watsonville Community Hospital, which bypassed the LAFCO process through special legislation. A subsequent bill (Senate Bill 969) was enacted to ensure Santa Cruz LAFCO has full jurisdiction over the newly-formed healthcare district. Subsequently, Santa Cruz LAFCO adopted a coterminous sphere boundary for the healthcare district in January 2023 with a scheduled service and sphere review to be conducted by November 2025. While the healthcare district successfully purchased the Watsonville Community Hospital in November 2024, it is currently facing significant financial concerns. As a result, the healthcare district has requested a waiver of its apportionment payment to LAFCO.

It is recommended that the Commission approve the full apportionment waiver of \$610.17.

EXECUTIVE OFFICER'S REPORT:

Senate Bill 418 was signed into law on February 4, 2022, resulting in the formation of the Pajaro Valley Health Care District¹. The District was formed to provide adequate governmental oversight to the Watsonville Community Hospital, which filed for Chapter 11 bankruptcy on December 21, 2021. A subsequent bill, Senate Bill 969, was also signed into law on July 1, 2022 to clearly outline LAFCO's purview over the newly formed district².

Senate Bill 969 requires LAFCO to develop and determine a sphere of influence for the district within one year of the district's date of formation and conduct a municipal service review regarding the health care provision in the district by December 31, 2025 and by December 31 every five years thereafter. Santa Cruz LAFCO adopted a sphere boundary for the healthcare district on January 4, 2023 as shown in **Attachment 1**. LAFCO is also scheduled to present its first service and sphere review on November 5, 2025.

Financial Concerns

Recent federal policy changes affecting Medicaid (Medi-Cal in California) and Medicare are expected to place additional financial and operational pressure on healthcare districts statewide. Based on LAFCO's understanding, Congress and the Centers for Medicare & Medicaid Services (CMS) have advanced measures that tighten Medicaid eligibility and

¹ Senate Bill 418: https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202120220SB418

² Senate Bill 969: https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220SB969

verification, phased out some pandemic-era flexibilities, and adjusted Medicare reimbursement rates. These actions are projected to reduce federal matching funds, increase administrative workload for eligibility renewals, and shift reimbursement timing and amounts for hospitals serving a high proportion of public program patients.

California's Department of Health Care Services has signaled that the State will work to mitigate coverage losses, but the combination of federal reductions and the State's budget constraints creates uncertainty. Healthcare districts, which already operate with thin margins providing safety-net services, are especially vulnerable to increased uncompensated care if Medi-Cal enrollment declines or renewals lapse. Changes to Medicare payment rules, such as modifications to inpatient and physician fee schedules, may further erode revenue stability and require budget adjustments for the coming fiscal years.

For the Pajaro Valley Health Care District and Watsonville Community Hospital, these federal actions carry heightened risk. The Hospital serves a disproportionately large Medi-Cal and uninsured patient population, so any decrease in federal reimbursements could quickly translate into revenue shortfalls. The district may face higher administrative costs to assist patients with renewals, potential service reductions or deferred capital projects to balance budgets, and greater urgency to secure operational partnerships or supplemental funding.

Apportionment Waiver Request

As previously stated, the healthcare district (as an independent special district) falls under LAFCO's purview and is subject to the statutorily-required allocation payment to LAFCO. The independent special districts' share is determined in proportion to each district's total revenues as a percentage of the combined total district revenues within a county. **Attachment 2** provides the allocation breakdown for each special district under the current Fiscal Year 2025-26 LAFCO Budget. As the table shows, PVHCD is subject to an allocation amount of \$610.17, representing less than a half percent (0.12%) of the total apportionment amount. In light of recent revenue losses, PVHCD has formally requested a waiver of its \$610.17 apportionment payment as it evaluates strategies to reduce expenditures. **Attachment 3** provides a copy of the District's letter to LAFCO.

While LAFCO staff is recommending that the Commission approve the requested allocation waiver, the commission may consider two alternative options: (1) deny the waiver request, or (2) defer payment until the next fiscal year (FY 2026-27) – under this scenario, PVHCD will be required to pay the FY 25-26 amount plus the proposed FY 26-27 amount.

Conclusion

LAFCO staff recommends that the Commission approve Pajaro Valley Health Care District's request to waive its \$610.17 apportionment payment for this fiscal year. Although the amount represents less than half of one percent of the total contributions paid by all special districts, the District's inability to pay even this modest sum is concerning and signals serious financial distress. This issue will be flagged for further analysis in LAFCO's upcoming service and sphere of influence review to evaluate the District's long-term viability and service capacity. Staff also notes that Senate Bill 418, which created PVHCD, requires LAFCO to consider dissolution if the District either sells

Watsonville Community Hospital to another entity or ceases to provide health care services at the facility. Given the recent revenue losses, the District is actively seeking an operational partner - a process that could potentially trigger SB 418's dissolution clause and will require close monitoring by LAFCO.

Respectfully Submitted,



Joe A. Serrano
Executive Officer

Attachments:

1. [PVHCD Sphere Map](#)
2. [FY 2025-26 LAFCO Budget – Allocation Breakdown Table](#)
3. [PVHCD Allocation Waiver Request Letter](#)