

Peninsula Health Care District

Mills-Peninsula Health Services Proposal Real Estate Study Session

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Mary Smitheram-Sheldon, Managing Director
Sedway Group

PENINSULA HEALTH CARE DISTRICT BOARD'S GOALS

The Peninsula Health Care District Board has two overriding goals:

1. Fulfill its obligation to provide for the District's health care needs; and
2. Preserve and enhance its asset base to promote its ability to meet future obligations, even under "worst case" scenarios.

Essential to the first goal is the need for a new seismically safe hospital, consistent with the requirements of SB 1953.

Mills-Peninsula Health Services' (MPHS) proposal is one way of achieving this goal.

MILLS-PENINSULA HEALTH SERVICES JANUARY 2003 PROPOSAL

Key real estate terms include:

- ❑ Ground lease of District-owned land for 50 years at \$1 per year.
- ❑ Assumed continued ownership of MPHS-owned land ("Front Lawn"/Blood Bank and 1515 Trousdale). Ownership of the "Front Lawn" would not revert to the District until the end of the new ground lease. This means that the District would have only a recorded right to reversion of ownership of the land under the new hospital and administrative/physician office building during the term of the new ground lease.
- ❑ Unless extended at the end of the 50-year ground lease, the land and buildings will be transferred back to the District and all of MPHS' rights terminate. However, the District will be obligated to reimburse MPHS for the remaining book value of District-approved capital improvements, restorations, and repairs made during the last 25 years of the lease. This increases the District's obligations to reimburse MPHS for capital improvements made in the out years of the lease, from the last 15 years of the lease as specified in the 2000 Term Sheet to the last 25 years.
- ❑ Payment to District of 50 percent of the market value of 1720 El Camino Real, which will remain under MPHS ownership.

MILLS-PENINSULA HEALTH SERVICES JANUARY 2003 PROPOSAL – CONTINUED

Key Terms, continued:

- Return of two small medical office buildings to the District (1600 Trousdale and 1848-50 El Camino Real).
- Provides MPHS the ability to mortgage its rights in the land and buildings as part of its obligated group financing.

Issue:

- The January 2003 proposal leaves the District with limited means of generating the financial reserves it may need to meet future contingencies.

COMPARISON OF CURRENT SITUATION, PROPOSAL, AND GENERIC MARKET TRANSACTION

	Current Situation		2003 Proposal		Generic Market Transaction
	District	MPHS	District	MPHS	
Existing Hospital Site (14.67 acres)	Fee ownership – leased though 1/31/2015 at \$1.786 million per year*	Leased site and building through 1/31/2015 at \$1.786 million per year*	Ground lease at \$1 per year	Leasehold at \$1 per year	Ground lease with annual payments based on market value of the land and a market-based rate of return, or sale of the property
Front Lawn and 1515 Trousdale (9.84 acres total)	Reversion rights to Front Lawn in 2015	Fee ownership, but Front Lawn reverts to District in 2015		Fee ownership with reversion to District in 50 years	
Marco Polo Lot (0.88 acres)	Reversion rights in 2015	Fee ownership, but reverts to District in 2015	Ground lease at \$1 per year	Leasehold at \$1 per year	
Small Medical Office Buildings		Fee ownership	Receives fee ownership in 2 buildings and 50% of the market value of 1720 El Camino Real	Retains fee ownership of 1720 El Camino Real, but pays District 50% of market value	
Reversion	Pays MPHS market value of all alterations, additions, or improvements exclusive of those made in lieu of rent		Receives land and buildings but must reimburse MPHS for book value of District-approved renovations and repairs in final 25 years of lease		Ground lessor receives all property (including improvements) at end of lease

* Rent may be in the form of capital improvements and acquisitions.

PRELIMINARY ORDER OF MAGNITUDE OF REAL ESTATE 2003 PROPOSAL AND GENERIC MARKET TRANSACTION

The figures below are preliminary estimates based upon a variety of assumptions and issues and are subject to change. More current information is expected to be received and certain aspects require clarification.

	2003 Proposal		Generic Market Transaction*
	District	MPHS	
Existing Hospital Site (14.67 acres)		\$21.3m (leasehold)	District retains market value of 26 acres (\$51.4m) as MPHS pays market rent of \$4.1 to \$4.6m per year
Front Lawn and 1515 Trousdale (9.84 acres total)		\$20.5m (reversion)	
Marco Polo Lot (0.88 acres)		\$1.1m (leasehold)	
Small Medical Office Buildings	\$11.1m (fee + cash)	\$7.9m (fee/leasehold)	\$18.2m (MPHS fee)
Reversion in 50 years (Land Only)	\$7.7m		
Total	\$18.8m	\$50.8m	\$51.4m District \$18.2m MPHS
Reversion in 50 Years (Hospital)	???		

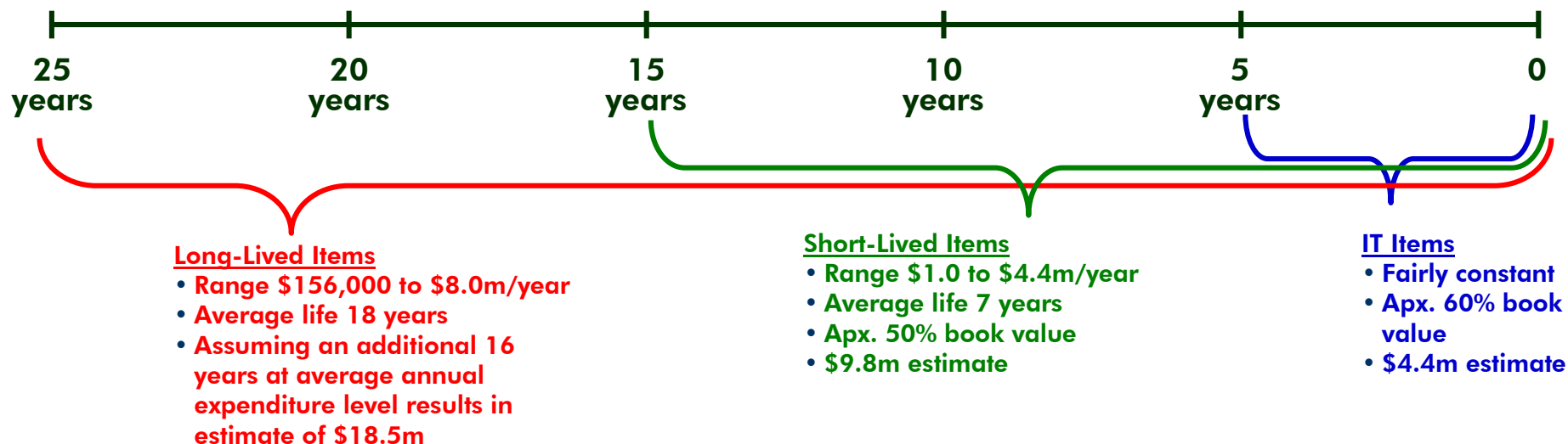
*Market transaction does not reflect the public aspects and goals of the project.

REVERSION OF HOSPITAL IN 50 YEARS

- ❑ The District also receives the hospital building (plus administrative/physician office building and associated parking) at the end of the lease.
- ❑ However, there is a cost associated with this asset, namely the reimbursement for the remaining book value of District-approved capital improvements, restorations, and repairs made during the last 25 years of the lease.
- ❑ While less than the market value of the hospital building, the reimbursement obligation could vary greatly depending upon the frequency and extent of capital replacements during the latter years of the lease. While the District is anticipated to have approval rights for these expenditures, it could be compelled to approve expenditures responding to the following:
 - Building code or seismic code changes;
 - Technological changes; or
 - Health care industry and/or regulatory changes.

HISTORICAL CAPITAL EXPENDITURES (1994-2002)

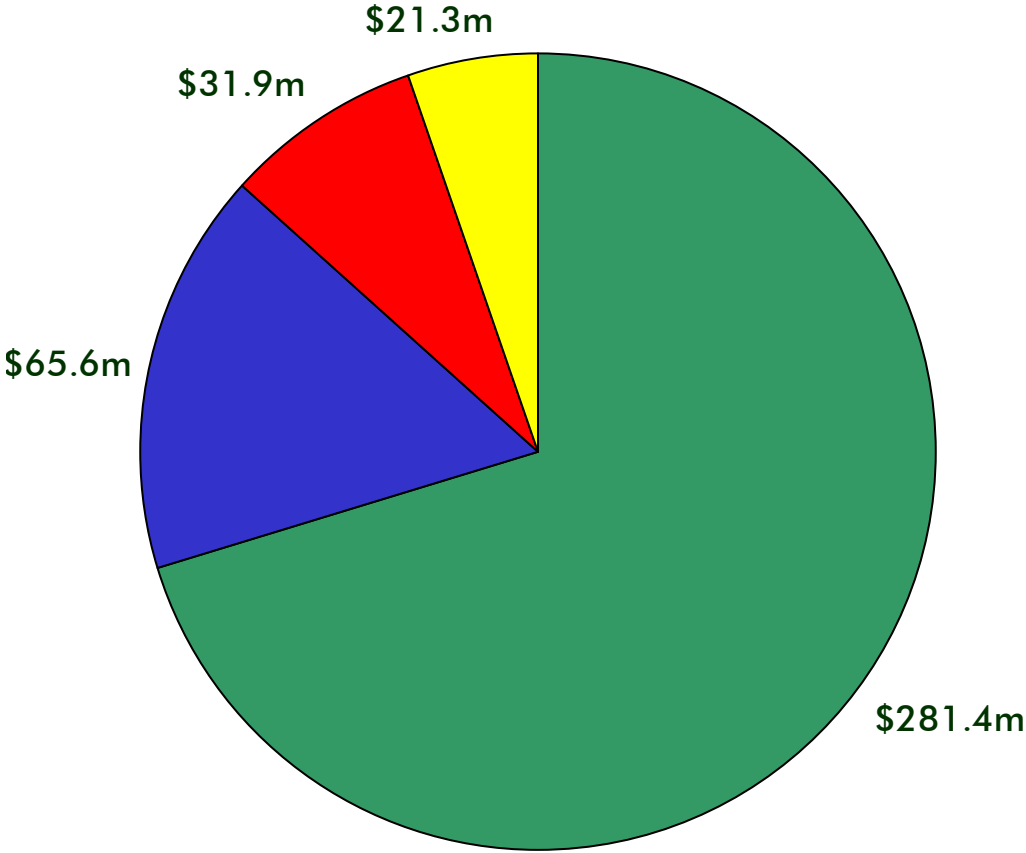
Category	Book Basis		Current Book Value
Long-Lived Items (15-25 years)	\$16.8m	or \$1.9m/year	\$13.0m
Short-Lived Items (<15 years)	\$23.4m	or \$2.6m/year	\$10.1m
Information Technology (65%, 5 years)	\$10.2m	or \$1.1m/year	\$4.4m
Total	\$50.4m	or \$5.6m/year	\$27.5m



Caveats: The above is based on extrapolated historical expenditures, which may not reflect future capital needs. Capital expenditures are not trended.

REVERSION VALUE OF HOSPITAL IN 50 YEARS – CONT.

The \$400m budget does not all go to the hospital building



- ❑ \$65.6m to administrative/physician office building (a portion of which serves the hospital)
- ❑ \$31.9m to site work, demolition, and landscaping
- ❑ \$21.3m to parking garages

■ Hospital Budget
■ Administrative/Physician Office Building
■ Site Work, Demolition, and Landscaping
■ Parking Garages

REVERSION VALUE OF HOSPITAL IN 50 YEARS – CONT.

- ❑ The \$281.4m budget for the hospital consists of \$175.8m in direct costs, (e.g., walls, roof, interior build-out, mechanical equipment, etc.) and \$105.5m in indirect costs, which include medical equipment, IT/communications, and furniture.
- ❑ Many of the items in the hard costs category, as well as the medical equipment, IT/communications, and furniture, will be replaced, repaired, or renovated during the 50-year ground lease. If these occur in the last 25 years of the lease, then the District will be obligated to reimburse MPHS for the undepreciated amount of these items.
- ❑ The more frequent and extensive the repairs, replacements, and renovations, the higher the market value of the hospital at the end of the ground lease, and the greater the District's reimbursement obligation.
- ❑ Therefore, the value in 50 years is very difficult to ascertain as it heavily depends upon the future capital improvement program.
- ❑ There are also factors that influence future value that cannot be controlled (or estimated today):
 - Technological Change
 - Updated Seismic Codes
 - Change in Health Care Industry and Regulatory Environment
- ❑ Regardless of the future value, the effect of discounting reduces the future value to 2.1% in present value terms.