

PHCD Peninsula Health Care District

FALL 2004

NEWSLETTER FOR PHCD

NO. 3

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Dear District Member,

Thank you for your continued interest and input as we work to meet the health care needs of our community for the next fifty years. The last year has been an exciting and challenging time as we have continued our negotiations with Mills-Peninsula Health Services (MPHS) in order to move forward with our hospital rebuild and protect the interests of this District and its members.

As you may remember, when we began this effort five years ago, we had three primary objectives:

- To build a new seismically-safe, state-of-the-art medical campus for the community that provides a wide-range of services, including basic emergency treatment, at minimal taxpayer expense
- Ensure adequate bed capacity to fulfill community need
- Obtain the long-term commitment of an experienced and financially-secure health care organization to operate the hospital

After more than three years of study, Board and community meetings, we have reached a tentative agreement with Mills-Peninsula Health Services, outlined in a Letter of Intent. This edition of the newsletter will describe the key points addressed by this Letter of Intent, negotiated by the District's Ad Hoc Negotiating Committee and representatives from MPHS. The new Letter addresses the situations, challenges, and needs brought to light by our expert consultants and public input. As a result of these efforts, the current proposal better reflects the needs and goals of the District than what was presented to you last December.

If approved, the new proposal will ensure that the entire 26-acre site would be owned by the public through the District and would allow MPHS, the current operator, to build and own a new, privately-funded \$420 million seismically-safe hospital on District land at no expense to the taxpayer. MPHS will also lease 21 acres of the 26-acre District owned site for \$1.5 million per year for 50 years. Upon completion of the 50-year lease, the new facility will be transferred back to the District.

Under the terms of the new relationship with MPHS, the District will also obtain a greater degree of general oversight of the medical campus. Additionally, the District would retain approximately 5 acres of land for the potential development of a non-competing medical use on the site.

As we continue to reach a final agreement with MPHS, there are still a number of steps that must be taken. Before the District Board approves the new agreement, the public will review and comment on the proposal in a series of special Board meetings. After District Board approval, the final agreement will be decided on by the voters.

To review the Letter of Intent or to learn more about the Peninsula Health Care District, we invite you to visit our website at: www.peninsulahealthcaredistrict.org. We look forward to your participation as we move towards securing a final agreement that will allow us to rebuild this facility and better serve our community.

PHCD District Board

Donald E. Newman
Chairman

Lola Thompson
Secretary

Tobin Schneider
Boardmember

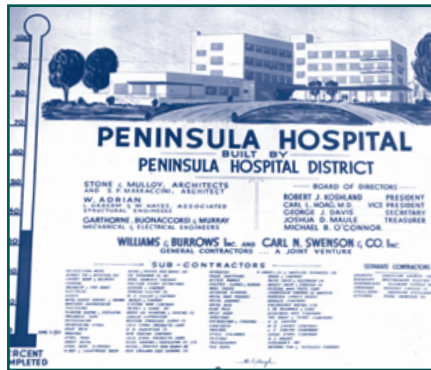
Terilyn Hanko
Vice Chairman

Susan Smith
Treasurer

Where We Stand

In California, many cities were faced with a greater need for medical treatment services following the return of soldiers from World War II. In order to address this need, the state enacted the Local Hospital District Act (later named the Health Care District Act), which allowed regions to form the first special Districts in order to build new hospitals and provide health care programs to meet the changing needs of their communities.

The Peninsula Health Care District was created by the voters of northern San Mateo County in 1947 to establish a tax base and develop and open a new community hospital. Under the direction of a five member board, the District opened Peninsula Hospital



in Burlingame in 1954. The hospital, which was renamed Peninsula Hospital and Medical Center, merged with San Mateo-based Mills Memorial Hospital in 1985 in order to expand the scope and access to health care services throughout the community. This merger transferred management control of both hospitals to Mills-Peninsula Health Services (MPHS).

In 1994, the Legislature passed SB 1953, which established stricter earthquake safety standards for acute care hospitals in California by 2013. In response to this new standard, the District enlisted independent engineering

studies to determine the state of Peninsula Hospital and found that the current facility did not meet the new standards. It was determined that building a new hospital on the unused portion of District land would be the best way to meet the new seismic safety requirements.

MPHS became a member of the Sutter Health network in 1996. The following year, the District Board filed a lawsuit against MPHS regarding potential conflicts of interest in the original lease/transfer agreements. At issue were the terms of the lease, the District's oversight rights, and the legality of property transferred to MPHS affiliates in the 1985 agreement.

In 1999, the District Board's negotiations with MPHS began regarding the construction of a new hospital and a revised operating agreement between the two parties. Since that time, the negotiating parties have agreed to the terms to settle the 1997 suit and have worked cooperatively to plan the future of the Peninsula Medical Center and secure a formal settlement. Both PHCD and MPHS have continued to analyze and study various ways by which the construction of a new hospital could be funded and address what clinical services are needed to provide for the community they serve. Those efforts were described in detail in our Winter 2003 Newsletter.

Since that report, we have continued to work towards mutually agreeable solutions, which culminated in Mills-Peninsula Health Services submitting a revised Letter of Intent to the District's Board in September.

To access a copy of the Letter of Intent or to read the Winter 2003 Newsletter, please visit the District's website at www.peninsulahealthcaredistrict.org.

Peninsula Health Care District Timeline

1947

December 2, 1947 - San Mateo County residents voted to create the Peninsula Health Care District, establishing a tax base with a five-member elected board responsible for developing and opening a new hospital in San Mateo County.

1954

March 2, 1954 - After two and a half years of construction, the Peninsula Hospital opened in Burlingame. The new hospital, built primarily through taxpayers' support, provided 153 beds and carried a staff of 275 employees and 100 physicians and surgeons.

1960

Peninsula Hospital changed its name to Peninsula Hospital and Medical Center.

1978

Peninsula established a Cardiovascular Surgery program at the hospital through an affiliation with the University of California, San Francisco.

1979

Peninsula celebrated its 25th anniversary, as well as signed a joint planning agreement with Mills Memorial Hospital in the city of San Mateo.



What the Agreement Provides

The Letter of Intent provides for a number of agreements designed to facilitate the construction and operation of a new privately-funded hospital for the community that will be built on District land. Among these agreements are the resolution of past litigation and numerous provisions placed to protect the public's interests and ensure quality health care for our community, now and in the future.

Transfer of Properties to the District

One of the controversial issues left unresolved from the 1985 agreement was the transfer of District property to MPHS. Twelve years later, these leases and transfers were challenged by the District as being executed under conflict of interest in a 1997 lawsuit. The new Letter of Intent recognizes and resolves this dispute between the District and MPHS by transferring the disputed properties back to the District.

Property Listing

1. 1730 Marco Polo Way
2. 1515 Trousdale Drive (land only)
3. 1600 Trousdale Drive (land only)
4. 1811 Trousdale Drive
5. 1720 El Camino Real (A 50% interest)
6. 1791 El Camino Real (commonly known as Blood Bank & Front Lawn)
7. 1848-50 El Camino Real

The Letter of Intent also states that upon Closing – which includes completion of the approval process, dismissal of all litigation, validation of the Ground Lease, and securing of necessary financing – MPHS would return properties it received in the 1985 agreement back to the ownership of the District with the exception of 1720 El Camino Real, property located across the street from the medical campus site (see list of properties above). With regards to the 1720 El Camino Real site, a medical office building, the District would receive \$6,650,000 from MPHS for the District's 50% interest in the property.

As part of the agreement, MPHS would be granted the right to match any bona fide offer received by the District for the purchase of any of the properties. Sales to third parties would stipulate that they could not compete with any existing or Approved Future Services of MPHS.

Lease Terms Under the New Proposal

The Letter of Intent provides for a series of agreements that would amend the Existing Lease and provide for a long-term commitment from MPHS. These new tentative agreements establish the guiding principles for the restructured relationship between The District and MPHS for the life of the lease, as well as the interim period between voter approval and the opening of the new hospital.

Lease During Construction of the New Facility

This Interim Lease would supersede the Ground Lease until the new hospital facility opens its doors and provides that previous to, and during, the construction process, the existing hospital facility shall be leased to MPHS for a fee of \$1 per year. Existing maintenance standards would continue to apply during this time.

The new agreement guarantees that the cost of construction and any associated debt would be paid for by MPHS and that Sutter Health would guarantee to back MPHS.

The New Hospital Lease

A new 50-year lease term would begin upon the opening of the new hospital. The annual rental fee charged by the District shall be \$1.5 million, with cost of living adjustments applied every 10 years. If, however, MPHS were to have a negative net operating income, then the payment for that year would be deferred and the District would be owed the principal plus interest accrued at the existing Prime Rate. If the payments were to be deferred for more than five years, MPHS would be in breach of the Ground Lease and subject to the District exercising its right to terminate the lease.

Highlighted Facts

- \$6.65 million payment for 50% interest in medical office building at 1720 El Camino Real
- \$1.5 million annual payment for property rental (Adjusted every 10 years)
- Use of 5-acre parcel at 1730 Marco Polo for health care purposes as the District sees fit
- 25 Clinical Services offered in five specialty areas
- All rooms shall be private (unless otherwise required by treatment)
- No additional private room fee to be charged to Medicare patients

1985

Peninsula (Burlingame) and Mills (San Mateo) hospitals merged to form Mills-Peninsula Hospitals in an effort to expand the scope and quality of services provided to residents. Both Mills and Peninsula continued to operate as full service hospitals.

As part of the consolidation, the District Board leased the Peninsula Medical Center and its land to Mills-Peninsula Health Services, a private non-profit group that assumed management of the hospital. At this time, the District also donated 7 parcels of land to Mills-Peninsula Health Services.

1994

The State of California passed Senate Bill 1953, establishing stricter safety standards for general acute care hospitals, which must be complied with by 2013. Mills-Peninsula and the District did two independent studies, both concluding that the only feasible approach would be to re-build the hospital. Although a retrofit was possible, the cost was prohibitive and there was no guarantee that the hospital could remain open during the retrofit.

1996

Mills-Peninsula joined Sutter Health, a non-profit health system of 27 hospitals in Northern and Central California. The Peninsula campus officially became Peninsula Medical Center and inpatient care was consolidated there. At this point, ICU and inpatient services were eliminated at the Mills Health Center in San Mateo.

The Family Birth Center opened at the Peninsula Medical Center.

1997

The District filed a lawsuit against Mills-Peninsula Health Services for alleged conflict of interest in the original lease.

What the Agreement Provides (continued from page 3)

Capital Improvements to the New Facility During Lease Term

Capital improvements made to the new facility during the initial 25 years of operation would be at the sole responsibility of MPHS. Capital Improvements made during the last 25 years of the lease would need to be made with the District's approval to be eligible for reimbursement from the District, at book value, upon the expiration of the Ground Lease. Three years before the expiration date, the District and MPHS will meet and confer to determine if the District will purchase assets owned by MPHS.

If capital improvements are required due to partial or total destruction of the new facility during the initial 25 years, MPHS will not have a right for reimbursement/refund. If the destruction occurs during the second 25-year period, and if not covered fully by insurance, MPHS would then be eligible for reimbursement/refund at book value upon the expiration of the Ground Lease.

Transfer of the New Facility Upon Expiration of the Ground Lease

After completion of the 50-year lease, MPHS will transfer the New Facility back to the District.

Under a voluntary transfer of control, MPHS shall provide the District, at its request, with a maximum of three years bridge financing to assist with the District's obligation to pay for repairs, restorations, and/or capital improvements to the new hospital. If the transfer is by force, the period of the bridge loan shall be a maximum of one year.

Medicare Private Room Coverage

The new facility is expected to have all private rooms except where semi-private rooms are felt to assist with treatment (such as mental health). MPHS will not seek additional reimbursement from Medicare patients for any shortfall in payments from Medicare based on private versus shared rooms.

Core Services and Charity Care

During the Interim Period, MPHS shall maintain services required as a general acute care hospital and basic emergency services provider. Upon the opening of the new facility, MPHS shall provide over 25 services in five specialty areas (see Expanded Core Services list) in addition to 24-hour, seven-day-a-week emergency walk-in service.

Charity Care

MPHS will continue to maintain its level of service related to its Charity Care policy and participate in any regional San Mateo County cooperative planning process among hospital providers. Under the new agreement, MPHS would also report annually its Charity Care results for the previous year.

Termination of a Core Service

In order for any service to be removed from the list, MPHS would have to gain the District's approval, be directed to terminate the service by an act of law, or through a hearing process involving the MPHS Board, nursing and professional staff, and the public. If the termination is for solely financial reasons, the District may fund the continuation of the service.

PHCD Timeline (continued)

1999

The District Board began negotiating the terms of a new hospital lease and the construction of a proposed new hospital with Mills-Peninsula.

2000

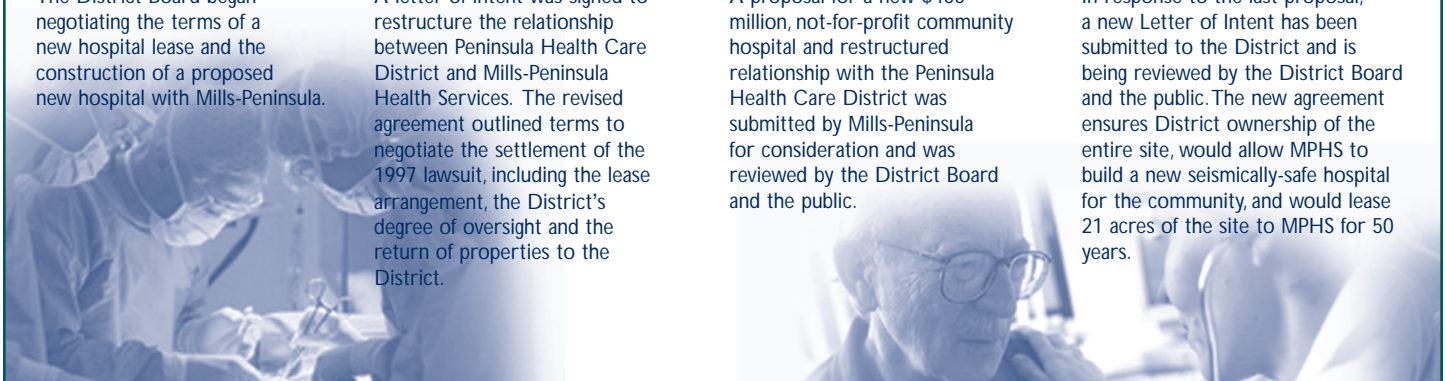
A letter of intent was signed to restructure the relationship between Peninsula Health Care District and Mills-Peninsula Health Services. The revised agreement outlined terms to negotiate the settlement of the 1997 lawsuit, including the lease arrangement, the District's degree of oversight and the return of properties to the District.

2002/03

A proposal for a new \$400 million, not-for-profit community hospital and restructured relationship with the Peninsula Health Care District was submitted by Mills-Peninsula for consideration and was reviewed by the District Board and the public.

2004

In response to the last proposal, a new Letter of Intent has been submitted to the District and is being reviewed by the District Board and the public. The new agreement ensures District ownership of the entire site, would allow MPHS to build a new seismically-safe hospital for the community, and would lease 21 acres of the site to MPHS for 50 years.



Expanded Core Services

The following services will be offered at the new facility:

Intensive Care

Coronary, Medical, Neurosurgical,
Pulmonary, Surgical

Acute Care Services

Geriatric, Medical, Neonatal,
Oncology, Orthopedic, Surgical

Newborn Care Services

Newborn Nursery Care, Premature
Nursery Care

Obstetric Services

Abortion Services/Labor/
Delivery/Post Partum Services

Surgery Services

Dental, General, Gynecological,
Cardiac, Kidney, Neurosurgical,
Ophthalmologic, Orthopedic,
Otolaryngologic, Podiatry, Thoracic,
Urologic, Anesthesia Services

Laboratory Services

(Provided directly or through contract)

Diagnostic Imaging Services

(including invasive cardiology)
(Provided directly
or through contract)

Diagnostic/Therapeutic Services

(Provided directly or through contract)

Mental Health*

*Provided either at the New Facility or at any other location within the District. Does not include substance abuse or rehabilitation services.

Penalties & Enforcement Rights

As a part of the Letter of Intent, MPHS spelled-out the manner in which its promises could be enforced. Three separate time-frames were identified: Pre-Construction, Construction, and After the Start Service Date.

During the Pre-Construction and Construction phases, the District would have three remedies to address any breaches in MPHS's promises or commitments.

They include:

- Monetary or other Equitable remedies for breaches. (Construction plans, the Ground Lease and other Definitive Agreements would remain in effect.)
- Enforcement of Sutter Health's guarantee to replace MPHS if they are unable to perform.
- Release MPHS from its responsibility to perform (through modification of the Interim Lease) and proceed unilaterally with the funding and construction of the new facility after termination of the Ground Lease and Definitive Agreements. Under this scenario, the District would not be able to request relief under either of those circumstances and would be required to reimburse MPHS for its development costs if those plans were substantially utilized by the District.

Once the facility is open (Start Service Date), breaches will be classified as ordinary or paramount. The District, after notice and providing a reasonable opportunity to cure, may enforce MPHS's promises as follows:

- Ordinary Defaults
 - Monetary or other Equitable remedies for breaches. These would be limited to compensatory or actual damages suffered by the District. (The Ground Lease and other Definitive Agreements would remain in effect.)

- Paramount Defaults*
 - The District would have the option to treat the problem as if it was an Ordinary Default or it could declare a default and terminate the Ground Lease, at which time the New Facility would automatically revert to the District.
 - The District would then owe MPHS the fair market value of New Facility.
 - At the request of the District, MPHS would provide up to one year of bridge-financing at the appropriate current rate of interest.

Other Considerations:

Other conditions that must exist previous to the Closing include:

- No other litigation is pending that will impact the Restructured Relationship.
- MPHS's review and satisfaction with the appropriate title policies.
- The District's compliance with the subdivision.
- Map Act regarding leased Premises required to implement the Ground Lease & Definitive Agreements.
- Appropriate warranties & representations by the District and MPHS.

* A Paramount Default is defined as a major incidence, caused by MPHS and/or Sutter Health, which impacts MPHS's ability to perform. That includes: defaults on payments, insolvency, dissolution, refusal/inability to perform, or sustained closure of substantially all of the new facility. Acts of God, third-parties, or anything outside of the control of MPHS/Sutter Health would not apply.

The Approval Process

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Over the past five years, thousands of hours of work have gone into planning a new hospital facility for Peninsula Medical Center. Even with this tremendous effort, there are several more steps that must be taken before the Restructured Relationship (Closing) can be instituted and the agreements can be signed.

These steps include:

- **Multiple Approvals**

Each independent Board of Directors of the Peninsula Health Care District, Mills-Peninsula Health Services and Sutter Health must approve the proposed Restructured Relationship and Definitive Agreements language.

- **Voter Approval**

At MPHS's cost, and with mutual consent, the District will place before the voters a ballot measure seeking approval of the Ground Lease and other Definitive Agreements spelled-out in the Restructured Relationship documents. The measure will require a 50% plus one majority vote in order to pass.

- **Dismissal of Litigation**

The lawsuit filed by the District in 1997 against MPHS will be dismissed, with prejudice*, no later than immediately following Voter Approval.

- **Validation**

A validation is a legal procedure through the Superior Court where the District, with MPHS joined as an interested party, presents the proposed Ground Lease and other Definitive Agreements to the public for any legal challenges. If none are raised, or the Court dismisses them, then the agreements are stipulated to be valid.

- **California Environmental Quality Act and Other Regulatory Approvals**

The District will have final approval over the site use and design while MPHS will navigate all planning, environmental, or regulatory approvals related to the construction of the new facility or the demolition of Peninsula Medical Center.

- **Financing**

MPHS must have secured or arranged for the financing necessary to complete construction of the new facility and any related improvements.

Other Considerations:

Other conditions that must exist previous to the Closing include:

- No other litigation is pending that will impact the Restructured Relationship.
- MPHS's review and satisfaction with the appropriate title policies.
- The District's compliance with the Subdivision Map Act regarding leased Premises required to implement the Ground Lease & Definitive Agreements.
- Appropriate warranties & representations by the District and MPHS.

* "With prejudice" means with good cause and the plaintiff (the District) could not bring the same suit up again.

Grants Submission Procedures

Annually, the Peninsula Health Care District reviews the health care needs of the community and allocates grant money, based on need and priority, to non-profit community-based agencies, programs and services such as youth crisis intervention and suicide prevention, senior services, and children's health care initiatives. The PHCD Board would like to thank all applicants who submitted a Letter of Intent for 2005 grants.

We are excited to announce that the following organizations and programs have submitted Letters of Intent:

Samaritan House
Ombudsman Program
YFES Insights Program
YFES Crisis Services Program
Senior Focus Adult Day Health
Senior Focus Wise & Well
Tracey's Place of Hope
Children's Health Initiative
Women's Recovery Association

The District Board will be deliberating on those organizations on the following schedule:

November 24, 2004
Full applications are due

December 16, 2004
Grants will be announced

January 5, 2005
First installment of funds available

For more information on the Peninsula Health Care District's grantmaking policies and procedures, please visit our website at: www.peninsulahealthcaredistrict.org or call us at (650) 696-5450.

Conclusion Summary

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Five years ago, the Peninsula Health Care District began negotiations with Mills-Peninsula Health Services (MPHS) to rebuild the Peninsula Medical Center in order to comply with stricter California seismic safety standards, settle controversial litigation and protect the community's health care needs for the next fifty years. Over the past year, we have worked hard to negotiate a proposal to better meet the needs of this District and address the issues raised by our expert consultants and the public to build a state-of-the-art, privately-financed hospital at no additional cost to the community.

The process took a huge step forward last month with the receipt of a Letter of Intent submitted to the District by MPHS and its parent-company, Sutter Health. The Letter laid out a newly negotiated proposal, which was modified to better reflect the needs and goals of the District and its members than what was presented to you last year.

The agreements provide for a return of the properties to the District that were leased or transferred to MPHS in 1985, the construction of a new hospital facility at no cost to the District, purchase of a 50% interest in the medical office building at 1720 El Camino Real for \$6.65 million, a \$1.5 million annual lease for the land under the new facility, and a commitment to provide over 25 medical services once the new hospital is opened. The letter goes on to detail MPHS's and Sutter Health's commitment to the completion of the project as well as the enforcement rights the District has to protect the interests of the community and the District as the project moves forward.

Although we are nearing the final stretch, a number of steps must be taken before the final plans are put in place, including Board approval of the Letter of Intent and final agreement, voter approval of the actions of the Board, dismissal of litigation between the District and MPHS, and the removal of any Regulatory or Planning Department restrictions.

To view the proposal in its entirety or learn more about the PHCD and its plans for the future, we invite you to visit our website at:

www.peninsulahealthcaredistrict.org.

Upcoming Board Meetings

The PHCD Board meets on the fourth Thursday of each month in the Sierra Rooms of the Peninsula Medical Center in Burlingame. All meetings begin at 5:45 p.m. unless otherwise specified. We welcome your attendance.

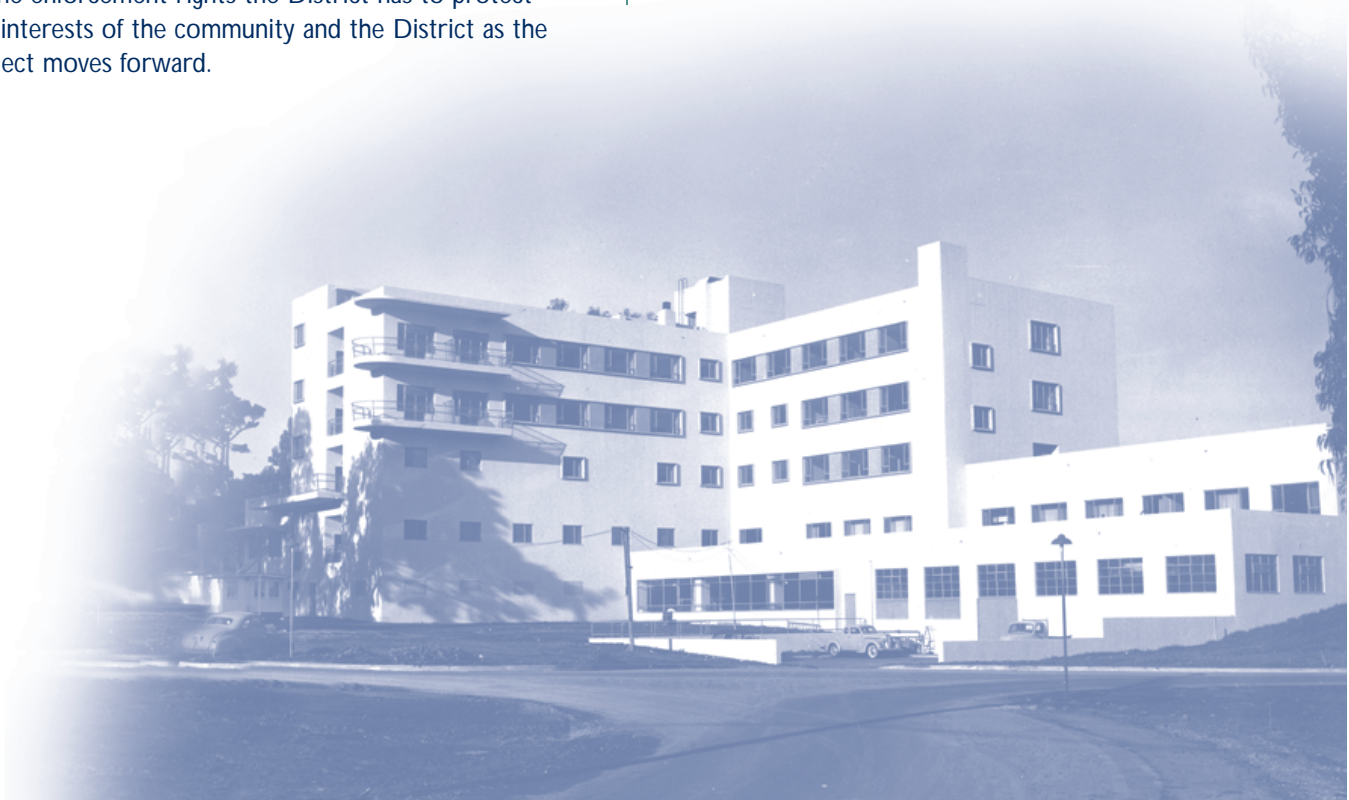
Our next Board meeting is:

Thursday, November 18, 2004

5:45 P.M. in the Sierra Rooms

Peninsula Medical Center in Burlingame

For more information, please visit our website at www.peninsulahealthcaredistrict.org.



Peninsula Health Care District
1783 El Camino Real
Burlingame, CA 94010
Phone: (650) 696-5450
Fax: (650) 696-5336
email: info@peninsulahealthcaredistrict.org
www.peninsulahealthcaredistrict.org



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What's Inside...



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