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Dear District Member,

Thank you for your input as we continue the process of determining the future of the Peninsula Medical Center and the Peninsula Health Care District. Although this process is not yet complete, we have solicited and received an abundance of information from the public and qualified consultants assisting us in various fields. This work will help us chart a course for the future of health care in this District. This edition of our newsletter will summarize our study over the past few months.

Before detailing our findings, first let us remind you of our goals for this District:

- To build a new state-of-the-art medical campus for the community that includes basic emergency service at minimal taxpayer expense
- Ensure adequate beds and services to satisfy community needs
- Secure the commitment of a long-term health care organization to operate the hospital

At this time, the Peninsula Health Care District is not compliant with SB 1953, a law enacted by the California legislature to establish stricter earthquake safety standards for California hospitals in the future. The new standards must be met by 2013. Two independent engineering studies were conducted to determine how to best meet the newly passed safety standards.

It has been concluded that because extensive retrofitting of the original hospital would be required, the best way to achieve the new standards will be to build a new hospital on undeveloped portions of the District property. In doing this, we will ensure that the facility will be able to operate continuously during the lengthy construction period and the District will have a new state-of-the-art facility at nearly the same cost as retrofitting the existing hospital.

Mills-Peninsula Health Services (MPHS), a subsidiary of Sutter Health and the operator of the Peninsula Medical Center, has submitted a formal proposal to finance and build a new facility at their expense and enter into a 50-year lease for \$1 a year. While the initial cost of construction will be paid for by MPHS/Sutter, the proposal calls for District support of capital improvements made in years 26 through 50 of the lease to be reimbursed at book value upon the conclusion of the lease.

The remainder of this newsletter will detail much of the information obtained over the past several months from the expert consultants we engaged to help us understand the current proposal and all of its implications. This information was presented in a series of special District meetings held expressly for the purpose of presenting our findings to the public and soliciting feedback on the subject. To view the proposal in its entirety, you can visit www.mills-peninsula.org or contact Mills-Peninsula at 650-696-5400.

Thank you for your time, participation and patience as we move to protect this community and to place the future of health care in this District on solid footing.

PHCD District Board

After initial presentations on the condition of the existing hospital and the need for a new facility, the District established three preliminary goals:

- To build a new state-of-the-art medical campus for the community that includes basic emergency service at minimal taxpayer expense
- Ensure adequate beds and services to satisfy community needs
- Secure the commitment of a long-term health care organization to operate the hospital

MPHS/Sutter submitted a proposal that they felt would achieve the above goals. As a result, the District Board established a public process to review the submitted proposal. During this process, the District sought expert advice to help them analyze the proposal and identify areas of concern.

In order to gain public input on the matter, the District hosted a series of special public meetings detailing the many different components of the proposal.

The District’s process thus far has identified a number of areas that need further clarification before the District can take action, including:

- A better contingency plan that will allow the District to better weather a worst-case scenario
- Greater financial commitment and/or protections from the operator to ensure the District will have the resources to buy back the facility at the close of the lease
- Obtain a greater level of District oversight than currently exists by revising the concept of “core services” and how they are protected

After this period of negotiation, currently underway, the District will present the newly negotiated proposal to the public and solicit their input before taking further Board action.



Rendering provided by Mills-Peninsula Health Services

Architectural Analysis

MPHS/Sutter’s proposal called for a greater use of District land and a larger hospital than was initially proposed. This raised concerns among the Board and public that the gift of land was too great and that the new facility would be excessive.

As a result, the District hired Thistlethwaite Architectural Group – an award-winning, full-service firm specializing in design and land use plans for medical and health care facilities – to conduct an independent review of the hospital land use and parking plans of the submitted proposal.

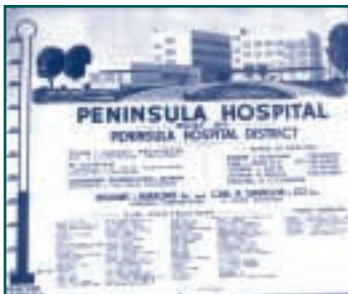
Thistlethwaite determined that Mills-Peninsula’s new hospital proposal “used sound planning and designing principles” and that it is “practical” and “an appropriate design for the community it serves.” Additionally, Thistlethwaite stated that the initial plan presented by MPHS/Sutter requiring less land (approximately 13 acres)

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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.



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for the facility was unworkable and that the revisions to that plan (currently considered) are realistic.

Thistlethwaite identified a 5.3-acre parcel, of the 26-acre site, that was requested in the proposal, though not required to accomplish the proposed design. MPHS/Sutter believe that surface parking on that parcel may reduce the need for a garage structure. The District is currently studying other health care related uses of that property to make the determination of the best possible use while also considering the impact on neighboring properties.

Thistlethwaite detailed several issues that would require further study by the planning agency that included the location of the hospital, parking issues, helipad location, traffic, entrances and patient accommodations. Of particular interest were the access issues regarding the service entrance on El Camino Real and the emergency and regular entrances on Trousdale.

The proposed access points, as well as the entire submitted plan, will be reviewed by the Burlingame Planning Department. The Planning Department has the responsibility to ensure that the design plans are consistent with City building codes and have minimum impact on the surrounding community.

Additionally, the FAA will review and make a recommendation regarding flight path issues to the Burlingame Planning Commission, who will consider that matter.

Although the design appears reasonable, the Planning Department will study the plans in-depth and may negotiate alterations to aspects of the design and/or plan. The District Board will review any actions taken by the Burlingame Planning Department before final Board action is taken on the submitted and/or revised proposal.

New Hospital Financing

The District contracted G.L. Hicks Financial to advise the Board on facility construction financing and the terms, conditions and limits of bond debt. Hicks Financial is an investment banking firm located in Sacramento that specializes in providing investment banking and financial services to health care districts and non-profit hospital providers. They studied the full-range of options available in order to obtain the best financing mechanism to use to replace the Peninsula hospital.

Hicks' analysis identified that the current proposal put forth by MPHS/Sutter would rely on an obligated group structure. Simply put, the debt undertaken to finance this facility would be shared by a number of facilities throughout the Sutter network.

Hicks also determined that MPHS/Sutter backing would provide the District with an operator which has solid interim financial results, improving operations and debt service coverage and a strong market position with its 30-hospital system. Although the benefits far outweigh the challenges, the hospital does face a balance sheet weakness in light of rating level and potential difficulty in funding \$3.5 billion worth of improvements to hospitals in their network over the next 10 years.

The report also identified two additional possible funding mechanisms. The possibilities are:

- Sutter, or some other third-party operator, finances the construction of the facilities

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1979

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

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.

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- General Obligation Bonds (GO Bonds) are passed by the Board as well as by two-thirds of the voters in the District

Sutter financing:

Hicks determined this option requires no taxpayer support over the first 25 years of the lease and has the benefit of MPHS/Sutter’s strong credit to fund future facility improvements. However, it does require that the District pay for Board approved capital improvements from year 26 onward, payable at lease end at the book value of the approved improvements.

Hicks also noted that if Sutter Health defaulted on its debt obligation, the District would need to purchase the facility at fair market value at the time of default. Otherwise, the District would lose control of the building until the reversion at the end of the 50 years or until it could afford to purchase the facility.

GO Bonds:

In this scenario, the District would issue bonds to finance the hospital facility and property owners in the District would be assessed property taxes to repay the debt. This would require two-thirds voter approval and obligates property owners in the District unless a third-party backing was negotiated.

GO Bond with third-party backing:

Much like the General Obligation Bonds scenario above, the District would issue bonds to finance the hospital facility after two-thirds voter approval. However, the

District would then have the commitment from a third-party to pay off the bond debt. As long as the District collects payments equal to or in excess of the debt owed by the issuance of the bonds, the property owners in the District are not assessed property taxes. If at any time the third-party payments do not equal at least the debt due, then property owners in the District would be assessed property taxes in the amount necessary to cover the debt. This option would require cooperation from a third-party to ensure that District property owners would not be taxed.

One major limitation to this funding mechanism would be that General Obligation Bonds bring limitations on a district’s issuance of debt by Health and Safety Codes. These codes would restrict the District from making certain purchases with Bond money that are unrelated to the construction of the facility, but are important to the operation of a hospital, such as medical equipment.

The District is currently anticipated to move forward with the MPHS/Sutter-financed facility with a long-term land lease and is prepared to negotiate, addressing the deficiencies in the current proposal to accomplish the following:

- Build a new state-of-the-art medical campus for the community that includes basic emergency service at minimal taxpayer expense
- Ensure adequate beds and services to satisfy community needs
- Secure commitment of a long-term health care organization to operate the hospital

PHCD Timeline (continued)

1997

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

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.

2002-2003

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 is currently under review by the District Board. The acceptance of this proposal by the District Board would settle the 1997 lawsuit if approved by the voters.



To help the District fully understand the economic issues related to the lease/sale aspects of the potential MPHS/Sutter transactions proposed, the District consulted with the Sedway Group, a San Francisco-based real estate and urban economics firm that specializes in long-term real estate strategies and solutions.

Sedway prepared a report and gave a public presentation that determined the following:

- The District will need to achieve higher lease payments to preserve and enhance its asset base and to improve its ability to meet future obligations, especially under “worst-case” scenarios
- The exact reimbursement obligation to buy back the facility at the end of the 50-year lease could vary greatly depending upon the frequency and extent of capital improvements during the latter years of the lease. However, at the end of the lease, the facility will likely be valued higher than the District’s reimbursement obligation. This would make the purchase price lower than its value, allowing the District to purchase the facility at a discount

- A fair market value exchange of this property would likely yield around \$4 million annually in lease payments
- The proposed exchange being considered is not a fair value market exchange. A fair market exchange would not restrict the use of land to hospital use and the lessee would not be obligated to some of the conditions proposed in the new lease

Sedway’s analysis also identified some factors that influence future value that cannot be controlled (or estimated today) such as:

- Technological Change
- Updated Seismic Codes
- Change in Health Care Industry and Regulatory Environment

District Health Care Summary

In July 2000, the Lewin Group advised the District in their negotiations of health policy issues that partially led to the Letter of Intent entered into with MPHS/Sutter. In July 2003, Lewin gave an updated presentation to the District to address the updated demographic data and the newly presented MPHS/Sutter proposal. The well attended two-hour presentation covered a host of issues dealing with the state of health care in the District, reviewed core service protections and made some suggestions on bolstering those protections.

The concept of “core services” was first recommended to the District by the Lewin Group in 2001. As a result, the MPHS/Sutter submitted proposal included a list of “core services” that were protected from closure throughout the term of the lease. Lewin revisited this concept by applying a new approach developed to high-light important services that meet community needs. Their latest review utilized the following criteria:

- Large size
- High market share overall
- Low levels of out-migration
- High levels of in-migration

- High dependency on the emergency room
- High market share of “special populations”

This exercise led Lewin to recommend considering mental health services to the MPHS/Sutter submitted proposal’s “core services” list.

The services identified as “core” are protected from operator closure with the following contractual language:

“The District shall approve a request by Mills-Peninsula to discontinue a service if Mills-Peninsula can demonstrate any one of the following:

- The service is economically infeasible to Mills-Peninsula because the service’s direct revenue cannot cover the expense for providing that service
- Quality is at risk or compromised because of low volume
- No community need exists for the service or another provider or a new service will meet community need”

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Lewin believes that closure of these services at Peninsula Medical Center, if not addressed elsewhere, would result in a hole in the delivery of health care within the District.

In Lewin’s review of the “core service” protections outlined in the current proposal, Lewin suggested that the contractual language protecting “core services” could be improved with the following suggestions:

- The service is economically infeasible to Mills-Peninsula because the service’s direct revenue cannot cover the expense for providing that service **and MPHS demonstrates it cannot afford to sustain these losses**
- Quality is at risk or compromised because of low volume as **demonstrated by nationally-recognized standards**
- No community need exists for the service or another provider or a new service **demonstrates to the District that it will meet community needs**

This language is important in order to establish appropriate conditions on any closure of services deemed to be “core” to the District. It is equally important that the District allow, under specific circumstances, the ability to close “core” services if:

- They are deemed unnecessary by virtue of the changing technology in the health care field
- They become such a financial burden on the hospital that other services and/or “core” services are in jeopardy of closing
- The quality of the service is not able to meet standards acceptable to the District

Lewin also addressed the District’s desire to establish community standards for the new hospital. This was to alleviate concerns that the hospital, at some time in the future, could possibly change its operations to be something different than a community hospital, such as a Kaiser model.

Lewin advised the District that “there are many

examples of entities using quality and volume standards, such as:

- Health Grades rates hospitals based on volume statistics for certain services (cardiac, orthopedics, obstetrics, neurosciences, neurosurgery, pulmonary/respiratory, vascular surgery, and others)
- Leapfrog Safety Initiatives specifies volume standards for certain procedures, particularly high-risk surgery and high-risk births
- The following are other sources of quality data or standards
 - OSHPD
 - Joint Commission on Accreditation of Healthcare Organizations
 - National Quality Forum
 - Foundation for Accountability
 - Agency for Healthcare Research and Quality”

Additionally, the possibility of creating appropriate “hospital standard” that would add language to ensure that MPHS/Sutter maintains “high quality services that are consistent with staffing and other laws, accreditation standards, Medicare conditions of participation, and other customary practices of a first-class community hospital.”

They recommended that the District could create requirements for “competitive rates” where “the District would negotiate an assurance that the New Hospital would (a) participate in any County-public health program, and (b) provide “competitive rates” to any County employee health plan.”

Finally, Lewin suggested that “a final agreement could require that MPHS/Sutter contract with payers unless it can show that a specific contract (accounting for a certain patient care volume) would lose money and that the losses would be so substantial that they would threaten overall performance.”

These suggestions are being further developed by the District’s Negotiating Committee and counsel to utilize in the negotiation sessions.

Proposed Core Services

<p>Acute Care Surgical Intensive Care Diagnostic/ Therapeutic</p>	<p>Newborn Care Obstetrics Laboratory Diagnostic Imaging</p>	<p>Mental Health Care Services*</p> <p><small>*Not included in the MPHS/Sutter proposal but recommended by the Lewin Group</small></p>
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The District is currently anticipating moving forward with the MPHS/Sutter financed facility with the long-term land lease and is prepared to negotiate to address the deficiencies in the current proposal and to assure the following:

- Build a new state-of-the-art medical campus for the community that includes basic emergency services at minimal taxpayer expense
- Ensure adequate beds and services to satisfy community needs
- Secure commitment of a long-term health care organization to operate the hospital

To accomplish this, the District held a review session to recap the many different aspects of the proposal and to solicit any additional public input.

After this review and public input, the Board voted on a proposed list of terms to be spelled out in order for the negotiating committee to bring the proposal to Mills-Peninsula's negotiating team. This resulted in the following list of issues:

Issues Emerging

From Public Forums / Board Discussion / Expert Testimony For District / MPHS Negotiations

1. Explore further protections for the District in the event of natural disasters and "worst-case" scenarios through the exploration of the following provisions:
 - o Increased lease payment amount
 - o Buyout conditions at lease end
 - o Remedies
 - o Nature of Sutter Obligated Group creditors' security interest
 - o Nature of arbitration panel to resolve disputes
2. Clarify and expand where possible the standards for District oversight and service protection. Areas for exploration may include, but not be limited to:
 - o Development of a community hospital standard
 - o Strengthen service closure standards
 - o Establish charity care levels
 - o Expansion of core services list
 - o Medicare private room coverage guarantee

3. Explore additional provisions to protect the District's real property interests that may include but not be limited to:
 - o MOB/Marco Polo lot return or buyout of properties
 - o Return of property followed by subsequent lease (rather than MPHS retained ownership of some)
 - o MPHS assumption of existing (old) bond debt and elimination of unamortized capital reimbursement obligation under existing lease.
4. Provisions to protect the District during the development process that may include, but not be limited to:
 - o District role in future new campus development
 - o Ultimate use of 5.3 acres
5. District approval vis-a-vie Burlingame Planning process
 - o Approval process (relationship in timing to Burlingame permit and CEQA process)
 - o District approvals of any possible Burlingame changes

Adopted by Board of Directors, Peninsula Health Care District, September 18, 2003

After the District reaches a negotiated agreement, the District will host a series of public meetings to educate the public on the updated proposal prior to forwarding it to the Board for action. The Board action will be to accept, reject or to modify the newly revised proposal.



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