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Funding Health Care for Uninsured Adults

Issue

How will San Mateo County (County) be able to secure funding for the health care of uninsured adults?

Background

A previous San Mateo County Civil Grand Jury (2006-2007) found that: “Indigent and charity care growth is a national issue as medical costs increase and fewer people can afford medical insurance. San Mateo County is no exception. Indigent and charity care within the County is provided almost exclusively by the San Mateo Medical Center (SMMC). Contributions from the County General Fund for indigent and charity care have grown from \$42 million in fiscal year 2001-2002 to a budgeted \$70 million in fiscal year 2006-2007. The total County budget grew 39% over the five-year period, while the General Fund contributions to the SMMC grew 68%. However, the percentage of the SMMC budget which comes from the County General Fund has remained roughly constant. If growth in County income does not keep pace with the increase in the cost of indigent health care, then other County services will be impacted.”¹

The current Civil Grand Jury (2007-2008) continued to review the County’s efforts to provide health care for indigent and uninsured adults.

In response to the County’s policy to provide for indigent and charity health care from sources outside the County’s budget, the County Board of Supervisors formed the Blue Ribbon Task Force (BRTF) in the summer of 2006. The BRTF was charged with developing a health care coverage plan for a targeted group of approximately 40,000 uninsured adults residing in the County. The income ceiling for the target group has been set at 400% of the Federal Poverty Level in order to reflect the County’s high cost of living.

The BRTF consists of 37 members² representing public and private medical providers, elected officials, labor, legal and religious leaders from within the County; it is co-chaired by two

¹ <http://www.sanmateocourt.org/grandjury/2006/reports/IndigentHlthCareinSMCFinal.pdf>

² http://www.co.sanmateo.ca.us/vgn/images/portal/cit_609/28/27/1029569905preliminary_recommendations_to_bos.pdf.

Appendix A: Roster of Members

members of the Board of Supervisors. The BRTF plan is based on studies provided by a broad range of local, state, and national experts in the fields of health care delivery, financing, public health and existing health care models.

Adults eligible for coverage must be County residents aged 19-64 who earn an annual income of \$68,680 or less, which is 400% of the Federal Poverty Level for a family of three.³ The targeted group includes many who earn too much to qualify for Medi-Cal, Healthy Families⁴ or WELL⁵ programs, but not enough to afford health insurance.

The BRTF has established a pilot program to provide services to uninsured adults. The pilot program covers those whose income is at or below 200% of the Federal Poverty Level. The program is currently funded by a \$7.5 million yearly California (State) grant for a total of three years.⁶ This pilot program was named the San Mateo Access and Care for Everyone Program (San Mateo ACE). The enrollment target for the San Mateo ACE program was 2,100 participants. As of February 2008, the program was operating with approximately 1,800 participants receiving health care services. This patient group will be followed closely. Their experience is expected by the BRTF to shed light on the anticipated efficiency and effectiveness of the plan, and hopefully, help to establish the coverage criteria for health care of the 40,000 uninsured.

The Health Plan of San Mateo (HPSM) serves as the Third Party Administrator for the San Mateo ACE Program, and HPSM is also expected to administer the County's full-scale consolidated program in the future. HPSM is governed by the San Mateo Health Commission. The Commission is made up of community advocates, a physician, a pharmacist, and elected officials that serve on the San Mateo County Board of Supervisors.⁷ HPSM was launched in 1987 to demonstrate how a locally administered managed health care plan could improve access and service delivery for the County's Medi-Cal beneficiaries, by making available a network of primary care physicians, regional hospitals, pharmacies, and other health care providers. Currently, HPSM operates in a fashion similar to that of a preferred provider organization (PPO) and pays fees comparable to those paid by Medicare.

The ultimate goal of the BRTF is to provide health care for the 40,000 uninsured in San Mateo County. It is anticipated that the ongoing program cost will be \$100 million annually. There is currently no guaranteed funding source beyond the three-year State grant, which supports the San Mateo ACE Program. To cover a portion of the future costs, the BRTF recommends that enrollees pay from \$0 to \$100/month, depending on income, as an individual contribution to coverage. Assuming that the average enrollee pays \$50/month, 40,000 enrollees would contribute \$24 million annually; an additional \$76 million would still be needed to meet the program's projected \$100 million budget. The BRTF believes a potential source of such funding could be the non-profit private hospitals and health care districts.

³ <http://aspe.hhs.gov/poverty/07fedreg.htm>

⁴ <http://www.hpsm.org/Members.aspx?DocID=228>

⁵ <http://www.sanmateocourt.org/grandjury/2006/reports/IndigentHlthCareinSMCFinal.pdf>, p. 4

⁶ The State has distributed federal/state Medi-Cal resources structured through a Medi-Cal hospital waiver.

⁷ <http://www.hpsm.org/AboutUs.aspx>

Investigation

The Civil Grand Jury interviewed representatives from the Blue Ribbon Task Force, Peninsula Health Care District (PHCD), Sequoia Healthcare District (SHD), Health Plan of San Mateo (HPSM), Health Management Associates (HMA), Local Agency Formation Commission (LAFCO), and members of the San Mateo County Board of Supervisors. The Grand Jury also reviewed documents provided by these organizations and documents from outside sources.

Findings

The Grand Jury finds that:

- 1) The Blue Ribbon Task Force has recommended that all current County-sponsored programs for uninsured adults, such as WELL and ACE, be consolidated into the San Mateo ACE Program.
- 2) A yearly expenditure of approximately \$100 million will be needed to meet all of the goals set out by the BRTF, which includes funding that the County will continue to direct to meeting the healthcare needs of the indigent. The County, the Health Plan of San Mateo and Ravenswood Family Health Center competed to receive a State funding award of \$7.5 million per year for three years that has enabled the launch of the Blue Ribbon Task Force Pilot Program, called San Mateo ACE. Other new funding sources have not yet been determined.
- 3) The Blue Ribbon Task Force's proposed funding structure is built on a principle of shared responsibility among individuals, employers and the community. Explored sources include:
 - increased contributions from the county's private non-profit hospitals
 - contributions from the two health care districts
 - monthly payment by enrollees
- 4) The Blue Ribbon Task Force has also analyzed funding sources that require voter approval:
 - tax or fee on employers
 - sales tax increase
 - parcel tax
- 5) The six private non-profit hospitals in San Mateo County (Kaiser-Permanente Redwood City and South San Francisco, Seton Daly City and Moss Beach, Mills Peninsula Burlingame, Sequoia Hospital Redwood City) participate in HPSM and play different

roles in serving the uninsured. Non-profit hospitals are required by IRS code Section 501(c)(3) to provide “community benefit” in order to retain their tax-exempt status. In July 2007, the IRS noted that: “The lack of consistency or uniformity in classifying and reporting uncompensated care and various types of community benefit often makes it difficult to assess whether a hospital is in compliance with current law.”⁸

- 6) The County’s health care needs are also served by another private non-profit organization: Palo Alto Medical Foundation (PAMF), which currently operates clinics in Redwood City and Redwood Shores, has committed to building a new campus in San Carlos. PAMF already provides some care for HPSM members.
- 7) By March 2008, two private providers had agreed to support the BRTF plan by increasing care for HPSM members:
 - Kaiser had agreed to accept up to 360 pregnancies per year for prenatal care and delivery at Kaiser Redwood City.
 - PAMF had agreed to increase its quota from 500 to 1,500 patients.
- 8) Additionally, San Mateo County has two health care districts, Peninsula Health Care District (PHCD) and Sequoia Healthcare District (SHD). PHCD receives approximately \$3.8 million annually, and SHD receives approximately \$6.9 million from property tax monies. PHCD has approximately \$34 million in reserves and SHD has approximately \$69 million in reserves.⁹ These two health care districts have distributed a percentage of their annual tax income through their grant process, which is not coordinated with any other health care plan or organization. There is now a countywide program (San Mateo ACE) through which distribution of these tax monies could be coordinated rather than continuing with the current ad hoc method of distribution by grants.
- 9) While HPSM has been able to recruit enough providers for its current membership, some access gaps exist. HPSM has been paying these providers at or above Medi-Cal rates.¹⁰ HPSM is concerned that a reduction of state and federal funding may impair its ability to continue paying its current rates and/or attract new providers, which would be necessary to achieve coverage expansion.
- 10) By May 2008, enrollment of more than 3,000 patients in the San Mateo ACE pilot program had exceeded the target of 2,100. The Blue Ribbon Task Force will regularly review the effects of the San Mateo ACE program.

⁸ <http://www.irs.gov/newsroom/article/0,,id=172416,00.html>

⁹ <http://www.peninsulahealthcaredistrict.org/pdfs/annualfinancials.pdf>

http://www.sequoiahealthcaredistrict.com/sequoia_healthcare_bfs_07.pdf

¹⁰ <http://www.hpsm.org/Documents/Providers/Provider%20Manual%20Full%20Copy%202008.pdf>

pp.48-50. HPSM pays as much as 133% of Medi-Cal rates (June 2008).

Conclusions

The Grand Jury commends the County Board of Supervisors and its Blue Ribbon Task Force for their efforts to plan and design health care coverage for the uninsured adults in San Mateo County. The BRTF has developed an ambitious, comprehensive, and well researched approach to provide health care to the County's uninsured adults.

The Grand Jury concludes that the BRTF has identified potential funding sources to cover the estimated \$100 million annual cost of their plan, but has no firm commitments for funding. However, if all of the hospitals and health care district's participants adopt the BRTF's recommendations, if enrolled patients contribute up to \$100/month for their coverage, and if grant distributions are used to meet the goals of the BRTF, a significant portion of the needed funds can be realized. The Board of Supervisors could also go to the voters for an increase in sales and/or parcel taxes for additional funding.

The availability of providers is of concern if HPSM cannot continue to pay fees at current levels.

Recommendations

The San Mateo County Civil Grand Jury recommends that the:

1. San Mateo County Board of Supervisors encourage the Health Plan of San Mateo to:
 - Continue to pay fees at current levels in order to retain and attract providers. If funds are limited, consider paying higher rates to providers in critically needed specialties.
 - Use all available options (County resolution, support of state and federal legislation) to encourage the six private non-profit hospitals in San Mateo County (Kaiser-Permanente Redwood City and South San Francisco, Seton Daly City and Moss Beach, Mills Peninsula Burlingame, Sequoia Hospital Redwood City) to give significant and ongoing financial contribution and operational support to the San Mateo Access and Care for Everyone Program.
2. Sequoia Healthcare District and Peninsula Health Care District:
 - Enter into a formal agreement to support the San Mateo Access and Care for Everyone Program.
 - Re-evaluate the need for substantial financial reserves, since the health care districts no longer have hospitals to manage or maintain.

APPENDIX: Information Sources

Blue Ribbon Task Force Website:

http://www.co.sanmateo.ca.us/smc/departement/home/0,,1954_5352214_779075443,00.html

Health Plan of San Mateo website:

<http://www.hpsm.org/>

Health Care Management Associates, Assessment of Strategic Priorities for San Mateo Health Services, January 2, 2008

http://www.co.sanmateo.ca.us/vgn/images/portal/cit_609/19/40/1254436701hlth_mgt_assoc_report_2008.pdf

Palo Alto Medical Foundation website:

<http://www.pamf.org/home.cfm>

The Wall Street Journal, Friday, April 4, 2008, Vol. CCLI NO. 79, “Nonprofit Hospitals, Once For the Poor, Strike It Rich”, John Carreyrou and Barbara Martinez

CA State Health and Safety Code Statues

§127300-127365

§128740

Resolution No. 1003, Resolution of the Local Agency Formation Commission of the County of San Mateo Making Determinations Pursuant To Government Code Sections 56430 and 56425 And Amending The Spheres Of Influence Of The Peninsula Health Care District And Sequoia Health Care District, May 16, 2007.

Report & Recommended Determinations-Municipal Service Review and Sphere of Influence Review Sequoia & Peninsula Health Care Districts; Martha Poyatos, Executive Officer; May 4, 2007.

2006-2007 San Mateo County Grand Jury; Indigent Health Care In San Mateo County;

<http://www.sanmateocourt.org/grandjury/2006/reports/IndigentHlthCareinSMC>



170 Alameda de las Pulgas
Redwood City, CA 94062

650-367-5708 Phone
650-482-6056 Fax

July 24, 2008

Hon. Joseph Scott
Judge, San Mateo Superior Court
Hall of Justice
400 County Center
Redwood City, CA 94063-1655

Re: Grand Jury Report Re: Funding Health Care for Uninsured Adults

Dear Judge Scott:

I am responding to the Grand Jury Report attached to your letter of June 30, 2008 regarding the funding of health care for uninsured adults in San Mateo County.

On behalf of Sequoia Healthcare District (the "District"), we respectfully disagree with the Grand Jury's recommendations and give the reasons for this conclusion.

As a preliminary matter, the Grand Jury's facts are outdated. The District's assets and reserves are substantially overstated in the report. The Grand Jury lists the assets as \$69 million, but in December 2007 the District entered into a development agreement with Catholic Healthcare West for the construction of the new Sequoia Hospital building and transferred \$50 million in cash to an escrow for this purpose. The District also transferred to CHW, a medical office building worth approximately \$14 million. The District is still responsible for paying the balance of its total \$75 million contribution under the development agreement. As a result, the District's assets are closer to \$22 million than \$69 million. This was communicated to the Grand Jury via email but was not included in their report.

As you will appreciate, there are many demands on today's healthcare system and not enough resources to meet all of the needs. The District has an obligation to address the healthcare concerns of all District residents. Our primary commitment is ensuring the continued viability and high quality of Sequoia Hospital. We are meeting that objective by devoting the lion's share of our assets to the hospital modernization project and by contributions to the Sequoia Hospital Foundation, which are used to support new technology for the hospital. Last year, the District contributed \$1,500,000 to the Foundation.

In addition to ongoing support for Sequoia Hospital, the District uses its tax revenues on major programs that fill specific gaps in the healthcare system. These programs include:

<input type="checkbox"/> San Mateo Medical Center's Fair Oaks Clinic	\$1,660,350
<input type="checkbox"/> Children's Health Initiative	1,350,000
<input type="checkbox"/> Baccalaureate Nursing Program	980,908
<input type="checkbox"/> Samaritan House Clinic	500,000

The District also operates the HeartSafe program, which places external defibrillators in public places and provides training and community awareness. Three lives already have been saved through the use of these devices.

Finally, The District oversees its community grants program. This program makes smaller, targeted grants to community organizations to promote wellness for seniors and children and to assist agencies in planning for continued service in case of disaster.

At present, the District is engaged in a strategic planning process. Our consultants have studied healthcare needs and trends within our District and interviewed many key leaders in the community. The preliminary results were presented to the District Board and the public in a meeting on July 16. Overall, the consultants concluded that our constituency is very satisfied with the way our Board has chosen to allocate its resources and wants the District to take an even more active leadership role. The District's support for wellness and prevention programs and for the management of chronic illness were identified as key components of a plan to reduce the community's dependence on expensive treatment in traditional hospital settings.

Against this successful background, we cannot accept the Grand Jury's recommendation that the District's reserves and tax revenues be allocated to the ACE program. In the first place, ACE is merely a pilot program with limited, short-term funding. There is no guarantee that the program will continue beyond its current three-year demonstration funding or that an expanded program will be supported by employers, enrollees, and other healthcare providers. With an annual cost of \$100 million, ACE will need many funding sources beyond Sequoia Healthcare District and Peninsula Health Care District.

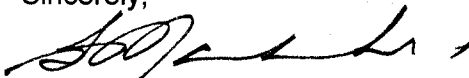
Second, fully allocating the annual tax revenues of the District to ACE would mean the elimination of the other worthy programs supported by the District. Unless and until ACE is able to serve the needs of all uninsured residents, free and low-cost options like those provided by Samaritan House and the Fair Oaks Clinic are essential. And, the shortage of nurses (and primary care physicians and other professionals) cannot be ignored. If the District eliminated its funding of these programs, how would the resulting gaps in service be filled?

We continue to believe that successful programs can be designed through collaboration and cooperation, like the Children's Health Initiative. This program is well-conceived, targeted, and adequately funded by the County and the two districts. At some point in the future, the Blue Ribbon Task Force may begin to achieve consensus on how to design, implement, and fund an insurance program for adults. But at present, with a staggering annual cost and no real funding commitments, it would be premature for the District to commit a large portion of its resources in that direction.

In summary, our Board believes that its use of annual tax revenues to support Sequoia Hospital and to fill gaps in the healthcare system is the wisest course. At present, this course has the support of our community and the Board expects to remain on it for the foreseeable future. We will continue to reassess our spending priorities as the needs of our residents change.

I hope that this adequately explains our reasons for not accepting the Grand Jury's recommendation that the District's reserves and revenues be committed to the ACE program.

Sincerely,



Dev Mahadevan
Interim Executive Director

Copy to: Board of Directors, Sequoia Healthcare District
Mark Hudak, District Counsel
Cheryl Fama, Peninsula Health Care District

Peninsula Health Care District

BOARD OF DIRECTORS RESPONSE TO THE 2007-2008 CIVIL GRAND JURY REPORT “FUNDING HEALTH CARE FOR UNINSURED ADULTS”

Grand Jury Report Filed: June 30, 2008
District Response Filed: September 03, 2008

The Peninsula Health Care District (PHCD) Board of Directors commends the Civil Grand Jury's continued work on the important and complex issue of funding access to healthcare for the uninsured adult residents of San Mateo County. The growing numbers of residents in need impacts not only the health of individuals and provider organizations, but the County as a whole. Effective, sustainable solutions can and will be developed through private and public partnerships throughout this County. The PHCD Board is committed to collaborating and contributing to actions that will ensure access to health education and services for all residents.

RESPONSE TO FINDINGS:

The PHCD Board disagrees with a number of findings and conclusions in the report. The specific areas of disagreement are:

- 1) The magnitude of impact on the financial operating performance of San Mateo Medical Center (SMMC) attributed to indigent care.
- 2) The amount of assets and reserves reported for the Sequoia Health Care District.
- 3) The characterization of both districts' grant processes as lacking coordination with any other health care plan or organization.
- 4) The inference that district boards can delegate authority for distributing health district tax monies.
- 5) The absence of any information or demonstrated understanding of the financial obligations of the districts to their hospitals.

1. Impact of Indigent Care on SMMC's Operating Performance: The Grand Jury referenced its 2006-2007 report on Indigent Care in the opening "Background" statement in its 2007-2008 report. The earlier report noted that SMMC's draw on the County's General Fund increased by \$28M from FY '02 to FY '07, or 68%, *due to the cost of providing indigent and charity care*. The PHCD 2007 response to that conclusion cautioned about reaching conclusions related to the cost of indigent care without looking more fully at the overall operating expenses of SMMC. In part, the PHCD response commented that:

"The report focused on dollars spent rather than patients served. To fully analyze indigent care as a part of SMMC's operating costs, it would be important to know how many indigent patients are new to the system versus repeat admissions or visits, the cost per admission, cost per day of hospital care, cost per episode of illness, etc."

The PHCD Board's position then and now is that to effectively determine the impact of the cost of indigent care one must analyze a number of hospital operating indicators to determine actual drivers of the costs of care at SMMC, in general and specifically for indigent patients, and then must compare these costs and outcomes to comparable hospital providers. The PHCD's 2007 response goes on to note that \$22M of SMMC's FY '06 operating deficit, or 37% of its draw on the County General Fund, was for "non-indigent care". That fact further supported the need to look at the broader cost structure of SMMC, which is exactly what Dr. Sang-Ick Chang has done.

According to a July 2008 article published in the Daily Journal, "In the eight months since announcing a \$5M budget deficit, the San Mateo Medical Center eradicated all but \$59,000 through a combination of hiring freezes, increased revenue and fewer in-patient days....Based on the unaudited financial reports, the previous deficit is virtually gone".

Dr. Sang-Ick Chang and his staff are to be commended for a phenomenal operating turnaround. This performance affirms the PHCD's position that skyrocketing operating costs must be thoroughly analyzed before drawing conclusions about the proportion of these costs ascribed to caring for the indigent, uninsured.

2. Sequoia Health District (SHD) Assets and Reserves: Earlier this year, SHD announced a major financial commitment to the rebuilding of Sequoia Hospital and therefore the Grand Jury report information is out of date. The PHCD Board will not comment further on this as it is more appropriate that SHD provide the updated detail.

3. The statement that Districts' grant processes are "... not coordinated with any other health plan or organization" is inaccurate. Both districts have a well-defined process for determining community health priorities, setting grant budgets, and collaborating with community organizations in administering grants and tracking the investments' impact on the health of the community.

The PHCD Board reviews its community health care initiatives annually and strives to optimize both the amounts and the impact of its contributions. The FY 2008 budget of \$2M for service agreements and grants was directly tied to the Board's 10-month, '06-'07 strategic planning process. Based on more than 20 one-on-one interviews with community leaders, five public town hall meetings, and data collected from a broad range of published sources, the Board developed its Strategic Plan, set its funding priorities and then carried out its FY 2008 grants program. To further assist the Board's grants process, an Ad Hoc Service Agreement Committee was convened and included Board members, as well as, community-members-at-large. Site visits were made to every organization that received funding. The priorities and grants awarded by the PHCD Board in FY 2008 are summarized below.

Access to Primary Care:	\$990,000
Children's Health Initiative	
Samaritan House	

Wise & Wellness Clinics	
Adult Outpatient/At Risk Senior Services:	\$430,000
Alzheimer Day Program	
JFCS In-home Services	
Falls Prevention Program (In home)	
Ombudsman Services	
Stroke Awareness Campaign	
Youth at Risk:	\$105,000
Youth Mentors	
Substance Abuse	
Millbrae After School Healthy Snacks	
Family/Nutrition:	\$125,000
Family wellness/Parenting classes	
Childhood Obesity	
Crisis Hot Line	
Workforce Training:	\$350,000
CSM Nursing Program	
RN Student Forgivable Loans	
TOTAL	\$2,000,000

It is important to recognize that while the PHCD does not contribute directly to SMMC for indigent care, the funding provided to the organizations cited above ***directly contributes to access, prevention, and community-based services for our residents, many of whom are indigent and uninsured.***

To help the Board set its FY 2009 community health priorities and budget, Dr. Scott Morrow, the County’s Health Officer, was invited to present the County’s 2008 Community Assessment findings at the PHCD Board’s April 24, 2008 regular meeting. This supplemented the Board’s awareness of current needs and trends as gleaned from PHCD leadership participation on the Blue Ribbon Task Force on Adult Coverage Expansion, the Healthy San Mateo Collaborative, the Hospital Consortium of San Mateo, and other community activities. In May, the Board approved \$2M for community service agreements in its budget for FY 2009.

Therefore, we submit that the PHCD’s grant process is well coordinated with other community health plan and service organizations, ties directly to the San Mateo health priorities as identified and supported by statistically valid research methodologies (the 2008 Community Assessment), and contributes to the health care provided the indigent and uninsured in the County.

4. The PHCD tax funds cannot legally be delegated to another entity for distribution. In section 8 of the report, the Grand Jury suggested that district funds could be “distributed by San Mateo ACE.” This cannot be done under the legal strictures by which the District operates. The District Board must make all determinations concerning the disposition of its tax revenues.

5. Incomplete and inaccurate understanding of the PHCD and Peninsula Medical Center relationship. Failure to document any understanding of PHCD's financial obligations for Peninsula Medical Center and the requirements covered in its 2006 50-year Master Lease Agreement with Mills-Peninsula Health Services is a major shortcoming of this report that undermines the feasibility of the Grand Jury's recommendations relative to the District. These obligations are discussed under "Response to Recommendations" below.

GRAND JURY RECOMMENDATIONS FOR THE HEALTH CARE DISTRICTS

Recommendation 1: Enter into a formal agreement to support the San Mateo Access and Care for Everyone (ACE) Program.

District Response: *This recommendation will not be implemented at this time.*

ACE is a pilot program-with laudable goals and objectives, one of which is to help establish coverage criteria for uninsured adults. It is still in its 3-year study phase, still recruiting patients to reach the desired enrollment of 2100, and clearly not fully tested. It would be premature, if not irresponsible, for the PHCD Board to "formally agree" to support a program in such an early stage of development. In support this position, we respectfully refer the Grand Jury to its own 2006-2007 Report on Indigent Health Care, specifically recommendation #4:

*"Withhold implementation of any Blue Ribbon Task Force recommendation until the full financial implications, including impacts on other County programs, are well developed and understood. If any such recommendation is adopted, consideration should be given to its implementation initially as a pilot program so that **no long-term commitment is made before its financial feasibility is established**".*

The PHCD does want to recognize the leadership of the Health Plan of San Mateo (HPSM) and go on record as supporting this organization as a good choice to administer the ACE Program. It has a commendable track record of cost-effective third party administration that will serve well ACE or any other such program going forward. PHCD has supported the HPSM and the Children's Health Initiative for many years and most recently has been a grant funder of the HPSM's new Latino Childhood Obesity Program.

Recommendation 2: Re-evaluate the need for substantial financial reserves, since the health care districts no longer have hospitals to manage or maintain.

District Response: *The re-evaluation of the need for financial reserves has been fully implemented. This was done in direct response to the financial and service obligations delineated in the 50-year Master Lease Agreement between PHCD and Mills-Peninsula Health Services/Sutter that was resoundingly supported by 92% of voters in the August 2006 special election for Ballot Measure V.*

The PHCD Board's legislative mandate today is the same as it was when formed in 1947: to assure the availability of Peninsula Hospital and other health care services for the community. This is carried out by the publicly elected PHCD Board through a partnership with Mills-Peninsula Health Services/Sutter Health, investments into services that address health needs and workforce shortages, and careful stewardship of financial resources.

As referenced earlier, the PHCD Board engaged in a thorough strategic planning process immediately following the passage of Measure V. Verite Consulting was retained to assist the Board in its deliberations. Keith Hearle and J. Michael Watt, the two principals of Verite, are nationally recognized health care and health care financing experts. The five public Town Hall sessions were conducted between December 6, 2006 and April 30, 2007 and the results of Verite's detailed financial analysis were presented and discussed. This detailed analysis was deemed essential by the Board to help it develop a financial policy that would achieve balance between building needed reserves and making a meaningful impact on improving the health of the communities it serves. The financial obligations, assumptions, analysis, and options were openly discussed in the Town Hall meetings and presented again at the Board's regular Meeting in August 2007- this time to reaffirm financial assumptions, directors' understanding of the proposed models, as well as, the proposed policy options. These recommendations, the product of 12 months of deliberation, were then incorporated into the Board's Financial Policy that was passed by Board Resolution on December 13, 2007.

Simply stated, the PHCD's financial obligations are:

- To buy back the hospital at "Fair Market Value" if MPHS/Sutter defaults on its obligations under the lease, referred to as "Paramount Default" in the Master Agreement.
- To maintain more than just the "book value" of the facility and equipment at the time of default because the MPHS working capital would not belong to the PHCD and therefore, PHCD would need a minimum of 2-3 months cash for operating expenses.
- To reimburse MPHS at the end of the lease for such capital spending, as was agreed to by the District Board, during the last 25 years of the lease for assets that still have book value.
- To fund core services needed by the community in the event that MPHS can demonstrate a financial hardship to provide such services.

The Board and its consultants thoroughly tested different levels of savings vs. current spending and carefully weighed the impact these spending formulas had on long term reserve building and current community healthcare needs. Based on the District's long and short term obligations, financial analysis, feedback from the public and community leaders, and selection of a preferred model to achieve its goals, the Board determined that it must:

- **Accumulate roughly \$500M (in 2010 dollars) in reserves by the end of the lease**

- **Maintain a “debt to capitalization ratio” that will not exceed 50%.** (E.g. Debt of \$250M and a Board fund of \$250M to achieve the \$500M needed.)
- **Budget each year to spend on operations an amount up to 10% of the prior year-end Board Fund balance.** (E.g. If the Board Fund balance is \$36M, the operating expense budget cannot exceed \$3.6M.)

The following documents are attached to this response and demonstrate the thoroughness and quality of this important Board work.

Attachment A: Town Hall presentation slides from 1/25/07

Attachment B: Town Hall presentation slides from 4/30/07

Attachment C: Board Meeting presentation slides from 8/23/07

Attachment D: Verite’s summary and recommendations letter, 12/03/07

Attachment E: The Board Resolution setting the PHCD financial policy, 12/13/07

In conclusion, the PHCD Board remains committed to carrying out its mandate and will continue to work collaboratively with San Mateo County community leaders in forging a plan of action that will achieve our mutual goals.

PHCD’s Vision: That all residents of the District enjoy optimal health through education, prevention, and access to needed health care services.

Peninsula Health Care District

**Strategic Plan Development
Meeting #3**

January 25, 2007

ATTACHMENT A



1201 PENNSYLVANIA AVE NW, 5TH FL., WASHINGTON, D.C. 20004

“Paramount Default” by MPHS could occur at any time after the New Facility opens for operation

- “Paramount Defaults” include:
 - Payment default under the Sutter Health Master Indenture, yielding a lien on the New Facility
 - MPHS files for dissolution
 - Sutter Health or MPHS become insolvent
 - MPHS expresses in writing its repudiation of its obligation to operate the New Facility
 - MPHS is “unable” to operate the New Facility
 - Sustained closure of substantially all of the New Facility
 - Note: Force Majeure events may not cause “Paramount Default”
- The District has one year to pay MPHS the Fair Market Value of the Improvements and Non-Removable Equipment

“Taking back the hospital” would require funds for additional needs as well

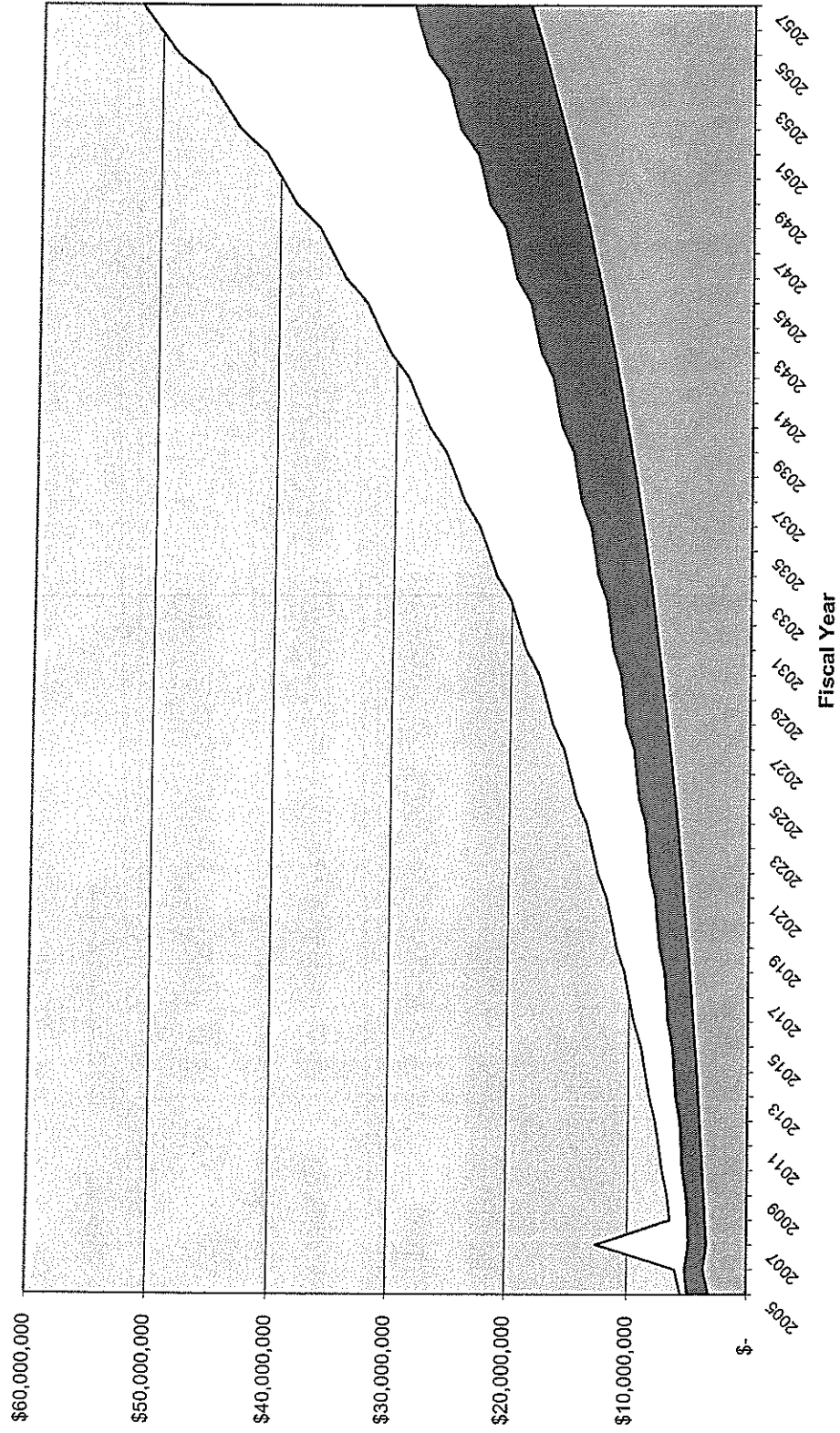
- Amounts factored into prior analyses:
 - Fair Market Value of the Improvements and Non-Removable Equipment
 - Book Value of “Post-Term” assets acquired by MPHS in the last 25 years of the lease
- Additional resource requirements:
 - Funds to purchase moveable equipment (beds, computers,...)
 - Working capital for hospital operation
 - Cash reserves for the hospital
 - Funds during the lease term to preserve “core services”

We re-worked and updated the financial analysis to assist the Board with policy development

Variable	Assumption
Tax Revenue	3.5 percent annual growth
Lease Revenue	4.0 percent annual growth (applied at 3-year intervals)
Earnings on Reserves	4.0 percent earnings rate
Direct Services and Grants Expense	Greater of: <ul style="list-style-type: none"> ■ \$2.0 million in 2007, increasing 4.0 percent annually, or ■ Earnings on reserves
Other Expenses	4.0 percent annual growth, plus funds for CEO

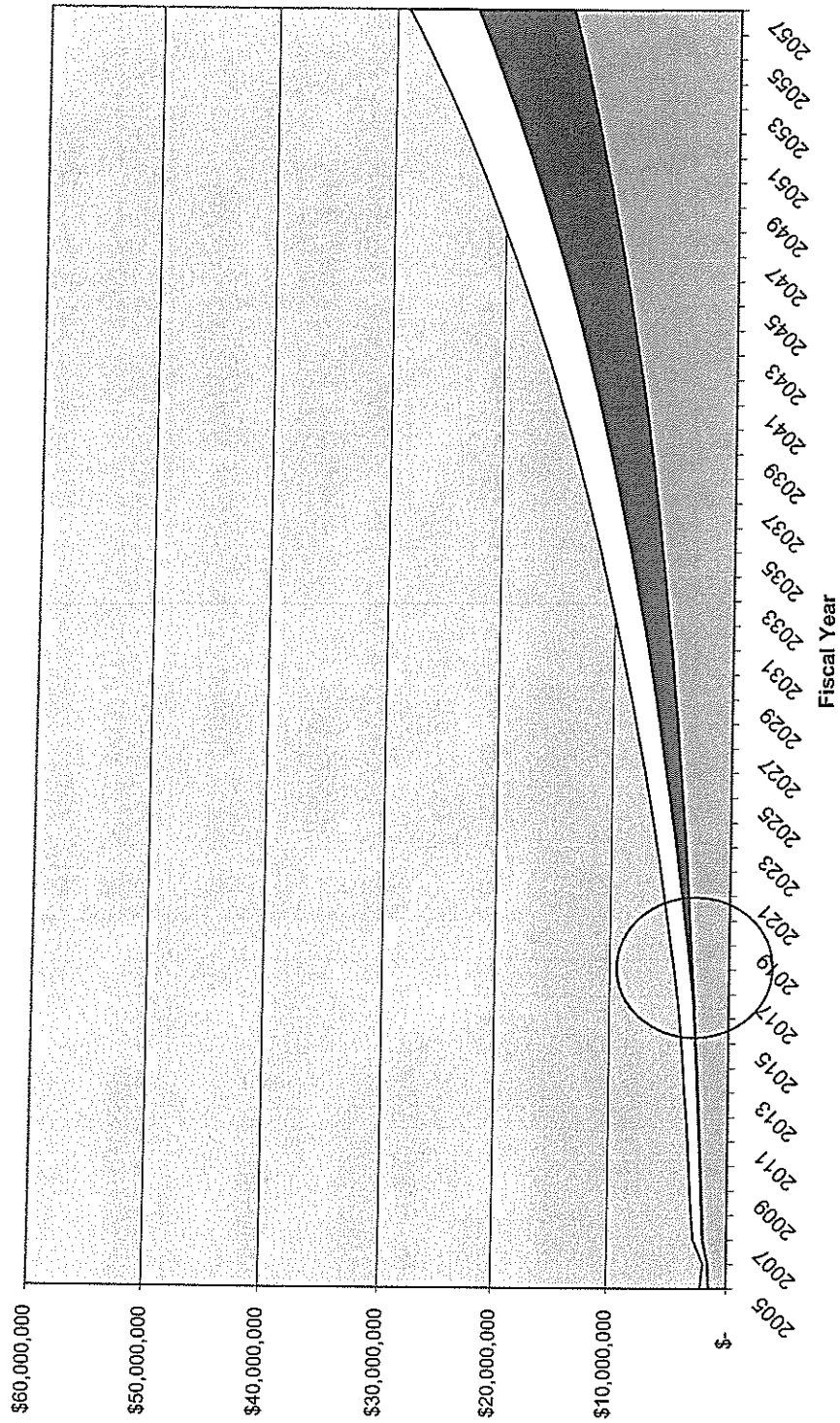
By lease end, interest earnings may become the largest revenue source for the District

Projected PHCD Revenue



Beginning in 2017, interest earnings can help fund additional grants

PHCD Operating Expenses



Direct Services and Grants Expense
 Incremental Services and Grants
 Other Expense

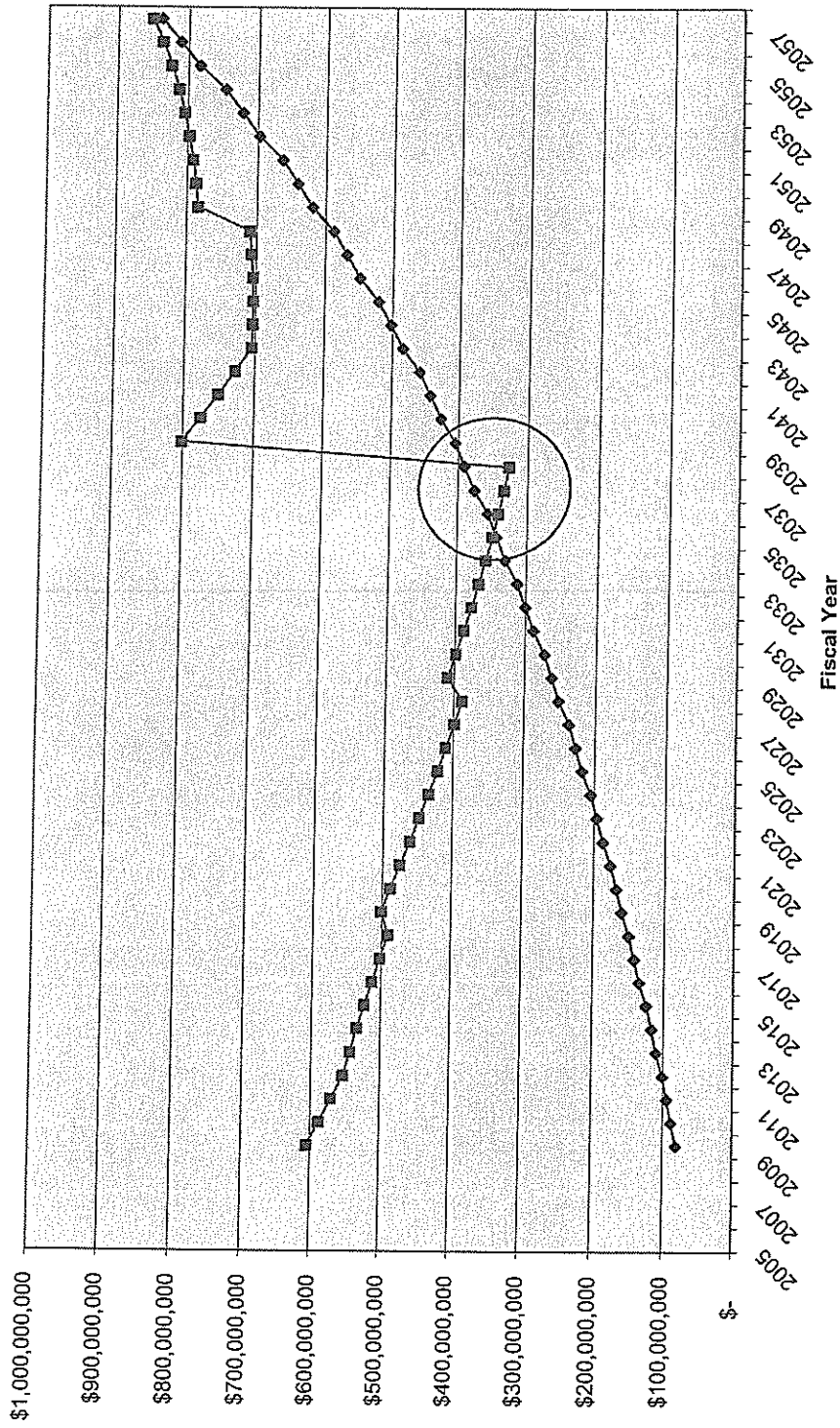


We re-worked and updated the financial analysis to assist the Board with policy development

Variable	Assumption
Value of MPHHS Improvements and Non-Removable Equipment	<ul style="list-style-type: none"> ■ Initial value of \$540 million, declining to almost \$0 over 30 years ■ Value of Post Term Assets based on prior analysis (\$463 million at Year 31)
Cost of Moveable Equipment	<ul style="list-style-type: none"> ■ \$25 million inflated through time
Needed Hospital Cash Balance	<ul style="list-style-type: none"> ■ Net working capital = 45 days of expense ■ Cash reserve = 30 days of expense
Borrowing Capacity	<ul style="list-style-type: none"> ■ Payment = PHCD Net Income / 1.25 (coverage ratio) ■ Bond issue based on Payment with 6% interest rate over 30 years

Under the assumptions, the PHCD would have the resources needed to take over at two critical junctures: when the New Facility is fully depreciated and at lease end

PHCD Assets Versus Purchase Needs

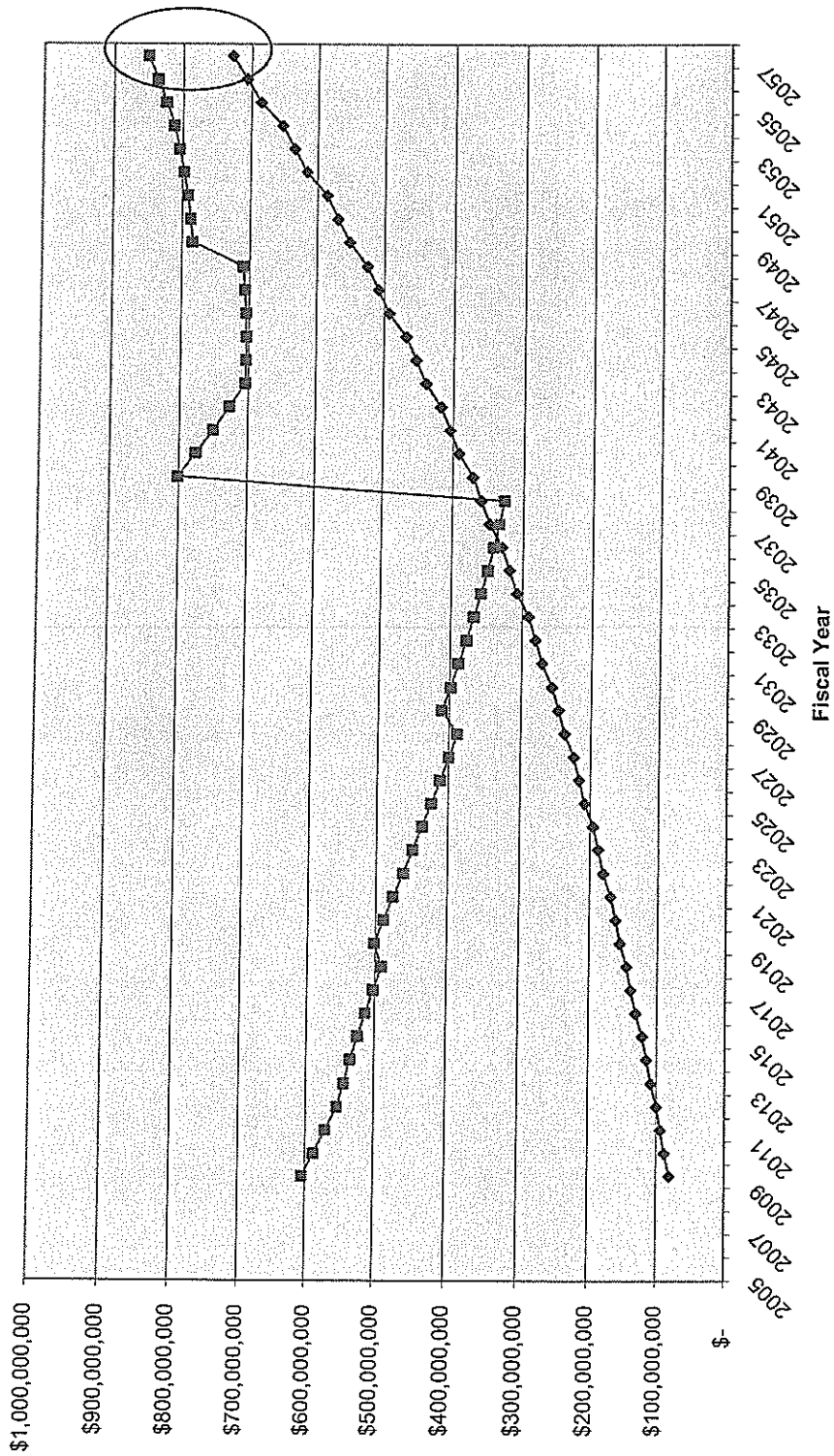


—◆— Cash + Debt Resources —■— Purchase Requirements



The results are highly sensitive (e.g., tax receipts increasing at 3.0 percent annually versus 3.5 percent)

PHCD Assets Versus Purchase Needs



—◆— Cash + Debt Resources —■— Purchase Requirements

“Taking back the hospital” could require a lower amount of resources under certain circumstances

- Assumed in the analysis:
 - PHCD would issue revenue bonds to finance acquiring MPHS assets
 - PHCD’s performance (earnings) would be the principal source of debt repayment, not the hospital
- Factors that would reduce resource needs:
 - PHCD agrees with MPHS (or its successor) to continue the lease beyond 50 years
 - PHCD issues General Obligation or other tax-supported bonds to finance acquiring MPHS assets
 - PHCD would lease the land and the hospital to another partner, with lease payments that exceed the amount associated with the ground lease only
 - A new partner agrees to help PHCD finance acquiring the MPHS assets

The analysis suggests continual monitoring of the lessee and of PHCD resources

- Under the following circumstances, a more conservative stance with respect to the building of long-term reserves may be warranted:
 - Sutter Health becomes less credit-worthy (e.g., Obligated Group debt is downgraded)
 - MPHS is not complying with (any) lease terms
 - The District determines that the probability of District-Issued General Obligation bonds or a new partner are low
 - MPHS requests (or requires) District support to maintain a core service
 - Capital spending at Peninsula Medical Center is greater than projected
 - PHCD revenues and/or reserves are lower than expected (interest earnings, tax revenues, other)

Conclusions: Financial Policy and Reserves

- The analysis supports the following financial policy with respect to direct services and grants:
 - Spend the greater of \$2.0 million in 2007 (with inflation through time), or interest earnings on PHCD reserves
 - If reserves exceed projected levels, then additional grants could be considered
- The above financial policy would reinforce the importance of building reserves
- Decisions in the short-run will significantly affect resources available at critical points during the 50-year lease agreement
- The District should re-assess this financial analysis every year and budget accordingly (perhaps ask the District's Audit Firm to provide annual opinion)
- MPHS and the District will face a significant decision 30 years after the New Facility opens, as another round of capital spending may be necessary
- The District should monitor risk factors associated with "Paramount Default"

Peninsula Health Care District

Strategic Plan Development

Meeting #5

March 21, 2007



1201 PENNSYLVANIA AVE NW, 5TH FL., WASHINGTON, D.C. 20004

- The PHCD needs to balance short-term spending with the longer-term need to preserve resources pursuant to the lease with MPHS
- Why does the District need to build reserves?
 - To assure the community that Peninsula Hospital will continue to operate if there is a "Paramount Default" at any time during the lease, PHCD needs sufficient resources to purchase the MPHS-funded "Improvements" and "Non-Removable Equipment" at Fair Market Value
 - The PHCD also may need resources during the lease term to preserve "core services" at the hospital
 - At the end of the lease, PHCD will need resources:
 - to reimburse MPHS for the Book Value of PHCD-approved capital spending during the last 25 years of the lease
 - for working capital and cash reserves (unless the lease with Sutter is renewed or a different partner organization provides these resources)
 - The hospital will have \$0 working capital when (if) transferred back to the District



The District will need resources at the end of the lease, unless the lease is extended at that time

- In 2003, Sedway Group estimated the possible book value of PHCD-approved investments occurring in the last 25 years of the lease
- This amount, in 2003 dollars was estimated to be \$32.7 million,
 - During the 1994-2002 time frame, MPHS invested \$5.6 million annually in buildings, equipment and information technology
 - The \$32.7 million estimate assumed a similar level of investment (before inflation) at the end of the new lease
- Applying a 5 percent inflation factor yields an estimated book value of PHCD-approved investments at lease end of \$300 million
- The PHCD may need working capital at lease end as well (another \$200 million?)

Annual Inflation Rate	Projected Book Value in 50 Years
0%	\$ 32.72
3.0%	122.60
4.0%	189.77
5.0%	293.18

VERITE HEALTHCARE CONSULTING

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There are risks associated with not building enough reserves; other risks could come from having too much

- Risks of insufficient reserves include:
 - The District could be forced to find a financial or operating partner with resources to help acquire the assets – leading to a loss or substantial dilution of control
 - The District could have difficulty raising sufficient bond proceeds to help acquire assets and help build working capital
 - The District could regain operating responsibility for the hospital without having adequate working capital or with excessive debt
 - When the hospital is returned to the District, the PHCD may not be able to continue supporting its direct services or grantees
 - The District may not be in a position to continue a “core service” that MPHS proposed to terminate
- Risks of excessive reserves include:
 - The PHCD will not be as successful over the lease term in achieving its mission of improving health awareness and health status
 - Continued, growing interest in District resources by others

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After much analysis, two alternative spending policies emerge as most promising

- For the next few years, budget to spend on grants and direct services either:
 - The greater of \$2 million, or investment earnings, or 5 percent of prior, year-end reserves, or
 - The greater of \$2 million or a defined percent of revenue from all sources (including investment earnings), e.g. 40 percent
- Under either policy, an annual review of risks associated with Paramount Default and of projected obligations under the lease will be important, and the policy can be adjusted accordingly
 - Upon approving any capital expenditures during the last 25 years of the lease, assure that assets are set aside to fund the future liability

VERITE HEALTHCARE CONSULTING

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Strategy 1: Spend the greater of \$2 million, or 5 percent of prior year reserves, or all earnings on reserves

Fiscal Year	Beginning Reserves	Total Revenue	Grants and Services	Total Expenses	Ending Reserves
6/30/2007	\$ 24,806,510	\$ 12,564,446	\$ 2,000,000	\$ 2,869,000	\$ 34,501,956
6/30/2008	34,501,956	6,423,522	2,000,000	2,999,760	37,925,718
6/30/2009	37,925,718	6,684,616	2,000,000	3,039,750	41,570,584
6/30/2010	41,570,584	7,146,199	2,078,529	3,159,870	45,556,913
6/30/2011	45,556,913	7,438,647	2,277,846	3,402,440	49,593,120
6/30/2012	49,593,120	7,737,750	2,479,656	3,649,234	53,681,637
6/30/2013	53,681,637	8,254,452	2,684,082	3,900,443	58,035,646
6/30/2014	58,035,646	8,576,084	2,901,782	4,166,798	62,444,932
6/30/2015	62,444,932	8,905,093	3,122,247	4,437,863	66,912,163
6/30/2016	66,912,163	9,478,759	3,345,608	4,713,849	71,677,073
6/30/2017	71,677,073	9,832,878	3,583,854	5,006,824	76,503,127

\$ in Millions	Reserves	Bond Size	Total
10 Years	\$ 76.5	\$ 73.7	\$ 150.2
25 Years	\$ 170.4	\$ 127.8	\$ 298.2
50 Years	\$ 478.1	\$ 302.1	\$ 780.2

Note: Bond size assumes tax revenue (equal to the amount for the year in question) is pledged to debt service.

VERITE HEALTHCARE CONSULTING

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Strategy 1 Scenario: Increase to spending percent of beginning reserves on grants and services

Fiscal Year	Beginning Reserves	Total Revenue	Grants and Services	Total Expenses	Ending Reserves
6/30/2007	\$ 24,806,510	\$ 12,564,446	\$ 2,480,651	\$ 3,349,651	\$ 34,021,305
6/30/2008	34,021,305	6,404,296	3,402,131	4,401,891	36,023,711
6/30/2009	36,023,711	6,608,535	3,602,371	4,642,121	37,990,125
6/30/2010	37,990,125	7,002,981	3,799,012	4,880,353	40,112,752
6/30/2011	40,112,752	7,220,881	4,011,275	5,135,869	42,197,764
6/30/2012	42,197,764	7,441,936	4,219,776	5,389,354	44,250,346
6/30/2013	44,250,346	7,877,201	4,425,035	5,641,395	46,486,151
6/30/2014	46,486,151	8,114,104	4,648,615	5,913,630	48,686,624
6/30/2015	48,686,624	8,354,761	4,868,662	6,184,278	50,857,107
6/30/2016	50,857,107	8,836,557	5,085,711	6,453,951	53,239,712
6/30/2017	53,239,712	9,095,384	5,323,971	6,746,941	55,588,154

\$ in Millions	Reserves	Bond Size	Total
10 Years	\$ 55.6	\$ 73.7	\$ 129.3
25 Years	\$ 99.8	\$ 127.8	\$ 227.7
50 Years	\$ 243.6	\$ 302.1	\$ 545.7

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Strategy 2: spend 40 percent of revenue from all sources on services and grants

Fiscal Year	Beginning Reserves	Total Revenue	Grants and Services	Total Expenses	Ending Reserves
6/30/2007	\$ 24,806,510	\$ 12,564,446	\$ 2,000,000	\$ 2,869,000	\$ 34,501,956
6/30/2008	34,501,956	6,423,522	2,569,409	3,569,169	37,356,309
6/30/2009	37,356,309	6,661,839	2,664,736	3,704,486	40,313,663
6/30/2010	40,313,663	7,095,922	2,838,369	3,919,709	43,489,875
6/30/2011	43,489,875	7,355,966	2,942,386	4,066,980	46,778,861
6/30/2012	46,778,861	7,625,180	3,050,072	4,219,650	50,184,391
6/30/2013	50,184,391	8,114,562	3,245,825	4,462,186	53,836,768
6/30/2014	53,836,768	8,408,128	3,363,251	4,628,267	57,616,629
6/30/2015	57,616,629	8,711,961	3,484,785	4,800,400	61,528,190
6/30/2016	61,528,190	9,263,400	3,705,360	5,073,601	65,717,989
6/30/2017	65,717,989	9,594,515	3,837,806	5,260,776	70,051,728

\$ in Millions	Reserves	Bond Size	Total
10 Years	\$ 70.1	\$ 73.7	\$ 143.8
25 Years	\$ 164.2	\$ 127.8	\$ 292.1
50 Years	\$ 536.2	\$ 302.1	\$ 838.3

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Strategy 2 Scenario: spend 60 percent of revenue from all sources on services and grants

Fiscal Year	Beginning Reserves	Total Revenue	Grants and Services	Total Expenses	Ending Reserves
6/30/2007	\$ 24,806,510	\$ 12,564,446	\$ 2,000,000	\$ 2,869,000	\$ 34,501,956
6/30/2008	34,501,956	6,423,522	3,854,113	4,853,873	36,071,605
6/30/2009	36,071,605	6,610,451	3,966,271	5,006,021	37,676,035
6/30/2010	37,676,035	6,990,417	4,194,250	5,275,591	39,390,861
6/30/2011	39,390,861	7,192,005	4,315,203	5,439,797	41,143,069
6/30/2012	41,143,069	7,399,748	4,439,849	5,609,427	42,933,391
6/30/2013	42,933,391	7,824,522	4,694,713	5,911,074	44,846,839
6/30/2014	44,846,839	8,046,531	4,829,119	6,094,134	46,801,236
6/30/2015	46,801,236	8,279,346	4,967,607	6,283,223	48,797,358
6/30/2016	48,797,358	8,754,167	5,252,500	6,620,741	50,930,784
6/30/2017	50,930,784	9,003,027	5,401,816	6,824,786	53,109,025

\$ in Millions	Reserves	Bond Size	Total
10 Years	\$ 53.1	\$ 73.7	\$ 126.8
25 Years	\$ 97.1	\$ 127.8	\$ 224.9
50 Years	\$ 246.6	\$ 302.1	\$ 548.7



Under the following circumstances, a more conservative stance is warranted

Variables to be monitored:

- Sutter Health becomes less credit-worthy (e.g., Obligated Group debt is downgraded)
- MPHS is not complying with (any) lease terms
- MPHS requests (or requires) District support to maintain a core service
- Capital spending at Peninsula Medical Center is greater than anticipated (either for the current project or in years 25-50 of the lease)
- Capital spending in years just before year 25 of the lease is unusually low
- PHCD earnings, revenues and/or reserves are lower than expected (interest earnings, tax revenues, other)



Peninsula Health Care District

Financial Policy Discussion

August 15, 2007



1201 PENNSYLVANIA AVE NW, 5TH FL., WASHINGTON, D.C. 20004

Financial policy objectives were developed by addressing a series of questions

- Why is establishing an effective financial policy important at this stage of the PHCD's development?
- Why does the District need to build the Board Designated Balance against Paramount Default (Board Fund)?
- What resources are available to the PHCD?
- What are the demands or claims on these resources?
- What financial policy options are available to the District?
- What financial policies are recommended? Why?



Peninsula Health Care District: Preserving the Hospital

■ Current District Resources

- \$34.2 million in the Board Fund
- \$6-7 million in total annual revenue

■ Future Needs (in today's dollars) that suggest the District needs to build reserves

- Fair Market Value of the new hospital: \$540 million
- Estimated Book Value at lease end (in today's dollars): \$74 million (includes working capital the District will need to operate the hospital)
- Supporting core services at the hospital: ?



4

There are risks associated with not having sufficient resources in the Board Fund; other risks could come from having too much

■ If the Board Fund is too low, the District may:

- Not be able to continue a "core service"
- Be unable to preserve the Hospital without an operating partner
- End up with excessive debt
- Have difficulty supporting grants and other direct services when the Hospital is returned

■ If the Board Fund is too high, the District may:

- Not be as successful in achieving its mission of improving health awareness and health status



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“Paramount Default” by MPHS could occur at any time after the New Facility opens for operation

- **“Paramount Default” includes:**
 - Payment default under the Sutter Health Master Indenture, yielding a lien on the New Facility
 - MPHS files for dissolution
 - Sutter Health or MPHS become insolvent
 - MPHS expresses in writing its repudiation of its obligation to operate the New Facility
 - MPHS is “unable” to operate the New Facility
 - Sustained closure of substantially all of the New Facility
 - Note: Force Majeure events may not cause “Paramount Default”
- The District has one year to pay MPHS the Fair Market Value of the Improvements and Non-Removable Equipment



8

The amount that the District should set aside to protect against “Paramount Default” is uncertain

- The probability of Paramount Default will vary depending on numerous variables – and may increase with time:
 - Overall healthcare market/payment conditions
 - Sutter Health’s or MPHS’ financial performance
 - Difference between Fair Market Value (“FMV”) and the hospital’s Book Value near the end of the lease
 - Sutter/MPHS’ commitment to continuing to operate and invest in the hospital
- FMV of the “Improvements” and “Non-Removable Equipment” will vary over the next 50 years
 - Initially, FMV is likely to be close to the capital cost to build the new hospital, or about \$540 million
 - Projections prepared by Gary Hicks suggest the FMV may average about 50 percent of this amount over the lease term (\$220 million)
- Paramount Default may never occur



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Option 1: Total PHCD Expense Budget = 10 percent of prior year-end Board Fund and designated investments

Fiscal Year	Beginning Board Fund	Total Revenue	Total Expenses	Ending Board Fund	% of Revenue Spent	Additions to Board Fund
6/30/2007	\$ 23,906,511	\$ 13,584,691	\$ 2,669,517	\$ 34,241,491	20%	\$ 10,334,980
6/30/2008	34,241,491	7,250,000	3,355,000	38,136,491	46%	3,895,000
6/30/2009	38,136,491	7,570,825	3,813,649	41,893,666	50%	3,757,175
6/30/2010	41,893,666	7,928,603	4,189,367	45,632,903	53%	3,739,237
6/30/2011	45,632,903	8,236,508	4,563,290	49,306,121	55%	3,673,217
6/30/2012	49,306,121	8,544,740	4,930,612	52,920,248	58%	3,614,127
6/30/2013	52,920,248	9,258,823	5,292,025	56,887,046	57%	3,966,798
6/30/2014	56,887,046	9,589,320	5,688,705	60,787,661	59%	3,900,615
6/30/2015	60,787,661	9,920,472	6,078,766	64,629,367	61%	3,841,706
6/30/2016	64,629,367	10,457,465	6,462,937	68,623,895	62%	3,994,528
6/30/2017	68,623,895	10,801,603	6,862,390	72,563,108	64%	3,939,213

\$ in Millions	Board Fund	Bond Size	Total
7/1/2007	\$ 34.2	\$ 58.4	\$ 92.7
10 Years	\$ 72.6	\$ 76.2	\$ 148.8
25 Years	\$ 137.5	\$ 122.3	\$ 259.8
50 Years	\$ 306.5	\$ 256.1	\$ 562.6

Note: The Bond Size analysis assumes PHCD tax revenue is securitized by a bond issue at 5% over 30 years.



Option 2: Total PHCD Expense Budget = Lease + Investment Income (all Property Tax funds allocated to Board Fund)

Fiscal Year	Beginning Board Fund	Total Revenue	Total Expenses	Ending Board Fund	% of Revenue Spent	Additions to Board Fund
6/30/2007	\$ 23,906,511	\$ 13,584,691	\$ 2,669,517	\$ 34,241,491	20%	\$ 10,334,980
6/30/2008	34,241,491	7,250,000	3,355,000	38,136,491	46%	3,895,000
6/30/2009	38,136,491	7,570,825	3,656,825	42,050,491	48%	3,914,000
6/30/2010	42,050,491	7,938,445	3,905,025	46,081,911	49%	4,031,420
6/30/2011	46,081,911	8,258,958	4,106,596	50,234,274	50%	4,152,363
6/30/2012	50,234,274	8,591,147	4,314,214	54,511,207	50%	4,276,933
6/30/2013	54,511,207	9,338,370	4,933,129	58,916,449	53%	4,405,241
6/30/2014	58,916,449	9,690,790	5,153,391	63,453,847	53%	4,537,399
6/30/2015	63,453,847	10,053,782	5,380,261	68,127,368	54%	4,673,521
6/30/2016	68,127,368	10,632,365	5,818,638	72,941,094	55%	4,813,726
6/30/2017	72,941,094	11,017,463	6,059,325	77,899,232	55%	4,958,138

\$ in Millions	Board Fund	Bond Size	Total
7/1/2007	\$ 34.2	\$ 58.4	\$ 92.7
10 Years	\$ 77.9	\$ 76.2	\$ 154.1
25 Years	\$ 172.9	\$ 122.3	\$ 295.2
50 Years	\$ 463.0	\$ 256.1	\$ 719.1



Concluding Observations: Financial Policy and Reserves

- Decisions in the short-run will significantly affect resources available at critical points during the 50-year lease agreement
 - As a result, a more conservative stance to speed the building of the Board Fund may be warranted in the short-run
- The PHCD should conduct an annual review of risks associated with Paramount Default and of its projected obligations under the lease, and adjust financial policy accordingly
- The District should re-assess this financial analysis every year (perhaps ask the District's Audit Firm to provide an annual opinion on the adequacy of the Board Fund)
- Investment management will become increasingly important through time
- The District should monitor risk factors associated with "Paramount Default"
- Upon approving any capital expenditures during the last 25 years of the lease, the District should assure that funds are placed in the Board Fund to fund the future liability

16

Under the following circumstances, a more conservative stance is warranted

Variables to be monitored:

- Sutter Health becomes less credit-worthy (e.g., Obligated Group debt is downgraded)
- MPHS is not complying with (any) lease terms
- MPHS requests (or requires) District support to maintain a core service
- Capital spending at Peninsula Medical Center is greater than anticipated (either for the current project or in years 25-50 of the lease)
- Capital spending in years just before year 25 of the lease is unusually low
- PHCD earnings, revenues and/or the Board Fund balance are lower than expected (interest earnings, tax revenues, other)

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December 3, 2007

Ms. Cheryl Fama
Executive Director
Peninsula Health Care District
1600 Trousdale Drive, Suite 1210
Burlingame, CA 94010

Dear Cheryl:

I thought I'd send you a brief letter that clarifies our recommendations regarding financial policy for the Peninsula Health Care District (PHCD or the District). As you know, we have performed several financial analyses that consider a range of possible financial policies for the management of PHCD resources. This is an important time to codify these policies, because decisions made in the short run will have significant implications for the resources the District will have available over the 50-year term of the lease with Mills Peninsula Health System (MPHS).

Our recommendations are summarized at the end of this letter.

Balancing Priorities

As one expression of the Board's Mission Statement and Strategic Plan, the District's financial policies will need to balance two ongoing, competing priorities:

- building a Board Fund so that the District can meet its responsibilities to preserve Peninsula Hospital both during the term of the lease and at lease end, and
- making a meaningful impact on improving health status in the geographic areas served by District.

Effective financial policies can help manage the trade-offs between building the Board Fund (by saving and investing resources over

time) and providing and supporting community services (by budgeting and spending District revenue from property tax, rental income, and investment earnings).

Why Must the Board Fund Grow?

As we've discussed, the Board Fund must grow through time for several reasons:

- If Sutter/MPHS defaults on its obligations under the lease (otherwise known as "Paramount Default"), then the District can purchase the hospital at "Fair Market Value". If the District does not have sufficient resources to purchase the hospital (through the combined balance accumulated in the Board Fund and through new borrowing), then it will need a financial partner (another health system or hospital company) to participate in financing the acquisition of the hospital from Sutter. **By building the Board Fund, the current and future District Boards will retain all options for the future operation of the Hospital (including being the sole owner/operator of the hospital) and can enter into a transaction to acquire the hospital from a position of strength, thus assuring the hospital remains a vibrant community asset.**

If the Board Fund is too low during or at the end of the lease term, the District could lose control of important decisions about the hospital and its services, because a financial partner would require a certain amount of oversight of its investment. The partner could require contract terms that would remove some of the powers to preserve the community interest that PHCD wields in the current agreement. There is no guarantee that a financial partner would have the same focus on addressing community need within the District, since decisions within multi-hospital systems frequently are influenced by the needs of the system (which may not be well aligned with community need).

For purposes of analysis, it's reasonable to assume that "Fair Market Value" of the hospital in the short run is roughly the

amount being spent to rebuild the facility – roughly \$540 million. “Fair Market Value” to Sutter Health over the lease term will fluctuate – and the actual amount will depend on the valuation method used. Most techniques estimate fair market value based on the ability of the hospital to generate cash flow, or on a multiple of revenue or earnings. In any scenario, the amount of resources needed to pay “Fair Market Value” is well in excess of the current value of the District’s Board Fund¹.

In our analysis, we have assumed that “Fair Market Value” will start at \$540 million, but will average \$220 million over the lease term². The value declines in large part because the number of years available to Sutter Health to earn a cash flow return through the lease also declines as time progresses.

The lease contemplates that “Fair Market Value” would not include any “working capital” on the balance sheet of the hospital at the time a transaction is consummated. As a result (and as discussed more fully below), the District would need more than \$220 million in available resources because if it wants to re-assume operating responsibility for the hospital the District will need working capital to fund operating costs until it can generate and collect its own revenues.

- The District will need funds to acquire the hospital assets at the end of the lease. The lease calls for PHCD to reimburse MPHS for the book value of PHCD-approved capital spending during the last 25 years of the lease. Capital spending will be needed to renovate and potentially replace buildings, to upgrade equipment, and to invest in information technologies. The District commissioned and received an estimate of book value at the end of the lease³. That estimate was \$32.7 million – in 2003 dollars – based on

¹ \$34.2 million at the end of June 2007.

² The \$220 million average is based on analysis prepared by Gary Hicks. The \$220 million figure includes the effect of inflation throughout the lease term.

³ Prepared by The Sedway Group.

the capital spending that occurred to maintain the old Peninsula Hospital buildings and equipment.

The cost of hospital construction and equipment has escalated rapidly in recent years. Inflation accelerated because so many hospitals have been building facilities due to California's seismic regulations and a worldwide spike in the cost of steel and other building materials due to rapid growth in Asia. Applying a conservative, 4 percent annual inflation rate to the \$32.7 million figure and projecting both future capital spending and depreciation amounts yields a projected value of \$190 million at lease end. At 5 percent inflation, the value would be almost \$300 million.

- The District will need more capital than the amount required to pay "Fair Market Value" (in the event of default) or "Book Value" (at lease end), because under the lease agreement, the hospital's "working capital" does not belong to the District. Working capital (typically defined as the difference between current assets and current liabilities) is needed because if (or when) the District assumes responsibility for operations, several types of expenses will need to be paid before revenues can be collected from payers or patients. It's reasonable to assume that the new hospital operator will need 1-2 months of expenses "in the bank" at the moment a transfer of operating responsibility occurs, or the hospital could have difficulty meeting payroll or acquiring the supplies needed for patient care.

Projecting how much working capital might be needed at lease end or in the event of paramount default is hazardous. At the end of its fiscal year 2006, Peninsula Hospital had net working capital of \$30.3 million⁴. This amount can be expected to grow as the hospital's expenses increase over time. At 4 percent inflation, this amount would be slightly over \$215 million at lease end. At 5 percent inflation, the amount would be slightly over \$340 million.

⁴ See Hospital Financial Data at:
<http://www.oshpd.cahwnet.gov/oshpdKEY/FindData.htm>

- Thus, the combined book value and working capital needed at lease end can reasonably be estimated to be about \$400 to \$600 million:
 - \$215 - \$340 million for working capital
 - \$190 - \$300 million for the book value of hospital assets
- The amount needed by the District in the event of “Paramount Default” ranges from
 - **Now:** \$570 million (\$540 million plus \$30.3 million for working capital)
 - **Middle of the Lease:** \$323 million (\$220 million for fair market value plus \$102.6 for working capital based on 5 percent inflation over 25 years)
 - **End of the Lease:** \$340 million (for working capital only)
- There are some other consequences of having a Board Fund that is too low.
 - It is likely that at some point during the lease term, MPHS will approach the District with a request to terminate or materially change a “core service”. If the District has built up the Board Fund, then earnings on (and perhaps capital dollars from the corpus of) that resource will be available to continue programs that the Board may decide truly are needed by the community. If the Board Fund is too low, then it could prove difficult to support and thus preserve one or more core services.
 - If the District has to use all of its Board Fund resources to purchase the hospital either during the lease or at lease end, then it would be difficult or impossible to maintain District-sponsored direct services and/or grants at that time.
 - If/when a transaction occurs, the District has the option to pledge its tax revenue (or other revenues) to a bond issue. If the Board Fund is too low, then the District

could end up with a bond issue that is “too large”. This would make it difficult for the hospital to operate successfully. A reasonable target for how much debt would be prudent is: no more than 50 percent of the overall capital that the District could commit to a transaction. That level of borrowing (in relation to “equity” that would be available in the Board Fund) would provide the District with financial flexibility after reassuming full responsibility for the hospital.

If over time the District commits “too much” revenue to building the Board Fund, the Board would not be as successful in achieving its mission of improving health awareness and health status in the area.

What Target Should the Board Consider?

Recommendation: Our best estimate, after considering all lease terms and the points above, is that the District should set a target of accumulating roughly **\$500 million** by the end of the lease.

Prudent financial management suggests that the District plan to have a “debt to capitalization ratio” that does not exceed 50 percent; in other words, debt of \$250 million and a Board Fund of an equal amount to make up the \$500 million needed. These funds would be used to acquire hospital assets and to fund working capital either during the lease (in the event of paramount default) or at lease end.

What Alternative Strategies Can Be Implemented?

Throughout the strategic planning project, we considered several alternative approaches to building the Board Fund to preserve Peninsula Hospital while also helping the District achieve its mission of improving health awareness and health status among District residents. The options are designed to help guide District budgeting for operating expenses each year, and thus answer the question: how much should the District budget for providing and supporting community services and for its administrative costs?

Three options emerged for assessment – developing a total operating expense budget based on:

- 1) A defined percent of the prior year-end Board Fund balance (e.g., 10 percent of the financial and real-estate assets the Board designates to protect against Paramount Default), or
- 2) A defined percent of revenue from all sources (e.g., 75 percent of the sum of all tax receipts, lease revenue, and investment earnings), or
- 3) Devoting all tax revenue to building the Board Fund, and using lease revenue and investment earnings (only) for budgeted operating expenses.

We developed a financial model to analyze each of the options. That model incorporated numerous assumptions regarding growth in tax revenue, future inflation rates (which affect lease revenue), future earnings rates on investment balances, and interest rates that would govern a future bond issue. The model projects future Bond Fund balances and operating expenses under each of the alternative financial policies throughout the 50-year term of the lease.

The analysis indicates the following:

- 1) Under Option 1, the District would budget to spend for operations 10 percent of the prior year-end Board Fund balance. As a result, the Board Fund could grow to about \$300 million by year 50 of the lease. Tax revenue at that time could support a bond issue of roughly \$250 million, for combined resources of \$550 million.

The total expense budget for the District for fiscal year 2009 under this option would be about \$3.8 million, or 10 percent of the projected \$38.1 million Board Fund balance at June 30, 2008. In fiscal year 2017, the Board's revenues could support a total expense budget of about \$6.9 million.

This option communicates that “only if the Board Fund balance grows can our spending on meeting community needs grow”. It communicates the strongest incentive to building the Board Fund, since that policy is what drives the ability of the District to provide and support community services throughout the lease term.

- 2) Under Option 2, the District would budget to spend for operations 75 percent of revenue from all sources – and 25 percent of revenue would be retained for increasing the Board Fund. As a result, the Board Fund could grow to \$270 million by year 50 of the lease. That amount could be supplemented with a \$250 million bond issue at lease end, for total resources of \$520 million.

The total expense budget for the District for fiscal year 2009 would be \$5.7 million – 75 percent of projected 2009 revenue of \$7.6 million. This represents a significant increase in operating expenses compared to the \$3.4 million budgeted for 2008. In fiscal year 2017, the Board’s revenues could support a total expense budget of about \$7.6 million.

This option is simple to administer and adjust over time. It communicates that each category of revenue – property taxes, lease revenue, and investment earnings, is equivalent and available to increase the Board Fund or for operating expenses as needed.

- 3) If the District devotes all tax revenue to building the Board Fund and uses lease revenue and investment earnings for operating expenses, the Board Fund could grow to over \$460 million by year 50 of the lease. Because tax revenue at that time could support the \$250 million bond issue, the District would have financing capacity of about \$710 million.

Under this option, the total expense budget for the District would be \$3.6 million for fiscal year 2009, and

\$3.9 million in property tax funds for that year would be invested in the Board Fund. In fiscal year 2017, the Board's lease revenues and investment income could support a total expense budget of about \$6.1 million.

This option communicates that property tax funds collected by the District are dedicated to building the Board Fund and thus to preserving Peninsula Hospital. The option likely would lead the District to want the Board Fund invested in income-generating assets, because current programs would depend on those earnings (in addition to lease revenue) for support.

Recommendation: In our opinion, **Option 1** does the best job of aligning incentives by communicating the District's strong interest in building the Board Fund to preserve Peninsula Hospital, while also committing 10 percent of the Fund's prior year balance each year to providing and supporting services that meet community needs.

We note that the Board Fund could grow to exceed the targeted 50% of \$500 million level under each of the options. Each also would require periodic re-evaluation to assure that the District is achieving the desired balance between the two priorities: building the Board Fund and meeting community needs.

What Would Trigger Paramount Default?

The lease specifies that any of the following situations would constitute Paramount Default by MPHS/Sutter of their responsibilities under the lease:

- A payment default by Sutter under the Sutter Health Master Indenture, yielding a lien on the new Peninsula Hospital facility
- Sutter Health or MPHS becomes insolvent or files for dissolution

- MPHS expresses in writing its repudiation of its obligation to operate the facility, or is “unable” to operate the hospital
- Sustained closure of substantially all of the facility (other than due to force majeure events).

The likelihood of any of these events occurring may vary significantly over the 50-year life of the lease in response to a variety of local and national health care market forces and federal and state legislative, regulatory and payment policy initiatives. The District should monitor the following indicators of the risk of Paramount Default:

- Sutter Health becomes less credit-worthy (e.g., Obligated Group debt is downgraded)
- MPHS is not complying with (any) lease terms (which could be a leading indicator of financial distress)
- MPHS requests (or requires) District support to maintain a core service (which also could indicate strained finances)
- Capital spending at Peninsula Medical Center is greater than anticipated (either for the current project or in years 25-50 of the lease)
- Capital spending in years just before year 25 of the lease is unusually low (so that spending is deferred until the year that the District becomes obligated to reimburse MPHS for that spending) at lease end

As discussed above, the resources that the District will need to muster in the case of Paramount Default also vary significantly over the life of the lease. For these reasons, we recommend that the District should review annually both the credit-worthiness of Sutter and MPHS (as the best indicator of the risk of Paramount Default) and the District’s obligations under the lease (the Fair Market Value, Net Book Value and working capital requirements discussed above).

Data sources for the review of Sutter Health and MPHS include: bond rating agencies (Standard & Poors or Moodys, which publish ratings for tax exempt healthcare organizations), financial statements and performance reports provided by MPHS to the District, and financial reports available through OSHPD that portray the financial performance of the hospital and of all/any Sutter Health facility. If those documents indicate that the hospital or a majority of Sutter Health facilities are incurring sustained operating losses, risks of default increase. Sutter Health also has a practice of publishing audited financial statements on its corporate website, so those reports also can be reviewed. Examining Sutter-wide debt service coverage ratios, margins, investment reserves, and other metrics would be instructive.

Recommendations Summary

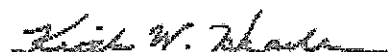
In summary, we recommend that the Board take four actions as integral elements of its financial policy:

- 1) Implement one of the three Financial Strategies described above, toward a target set initially of having \$500 million available (Board Fund + bonds). In particular, we recommend the strategy of setting the operating budget for each fiscal year as 10% of the prior year's Bond Fund balance.
- 2) Conduct an annual review of risks associated with Paramount Default and of projected obligations under the lease, and adjust the financial policy target and financial strategy accordingly
- 3) Assure that investment management expertise is available on an ongoing basis, as the Board Fund grows over time. This will be important not only as a matter of fiduciary responsibility, but also because maintaining growth in the District's funds available for investment in community health improvements increasingly will be driven by investment earnings.

- 4) Monitor risks of paramount default by reviewing annually the types of indicators discussed above.

We would be pleased to answer any questions that you or the Board may have about this analysis of the District's options for balancing its responsibilities for preserving Peninsula Hospital and for investing in improvements in health of the residents of the District. We wish you success in both.

Sincerely,



Keith W. Hearle
President
Keith.Hearle@Veriteconsulting.com

BEFORE THE BOARD OF DIRECTORS OF THE
PENINSULA HEALTH CARE DISTRICT

RESOLUTION TO ESTABLISH SPECIAL BOARD LONG TERM FINANCIAL POLICY TO
IMPLEMENT DISTRICT STRATEGIC PLAN OF 2007 AND ASSURE PRESERVATION OF
PENINSULA HOSPITAL / # 2007 - 01

WHEREAS, following voter adoption of Measure V, in August 2006, and approval thereby of construction of the new Peninsula Hospital, the District Board of Directors began a strategic planning process to address the expanded role of the District as landlord, as well as its role in hospital services oversight, in real estate development and management, as a potential provider of health services, and as a contributor and partner in local healthcare charitable services; and

WHEREAS, the District Board of Directors' strategic planning process focused on the need to identify the healthcare needs of the communities it serves, to determine to what extent these services were being met, and to determine how the District could best assure better health for the residents of the District; and

WHEREAS, to ensure broad public input and key stakeholder involvement in the District's strategic planning process, the Board held five open strategic planning meetings over a six month period, aided by the submission to the Board and public by District consultants of substantial background information, data and findings, and recommendations addressing the present and future status of the health of the community and the current provision of health services from private and governmental sector providers; and

WHEREAS, an integral aspect of the Board's strategic planning process focused on the District's long term role under the Agreements with Mills-Peninsula Health Services and Sutter Health, as approved by the voters, in assuring the preservation and on going operations of the Hospital and its emergency and other core services should the operator default and fail to continue operations; and

WHEREAS, on August 23, 2007, the Board of Directors adopted the 2007 – 2010 Strategic Plan, as presented and documented, and thereupon determined the need to adopt a strategic long term Financial Policy to balance two ongoing, competing priorities identified in the Strategic Plan:

▶ Building a Board Strategic Fund to assure that the District can meet its responsibilities to preserve Peninsula Hospital and certain core services both during the term of the lease and at lease end, and

► Making a meaningful current impact on improving the health status of District residents and meeting critical healthcare needs of the communities served by the District, and

WHEREAS, after further study and public input, and after extensive economic modeling and the receipt of recommendations from the District's strategic planning and financial consultants, the Board has concluded that by building a substantial Board Strategic Fund the current and future Boards will retain all options for the future preservation of the Hospital and its core services, thus assuring that the Hospital remains a viable and effective community health asset.

NOW, THEREFORE, the Board of Directors of the Peninsula Health Care District hereby resolve:

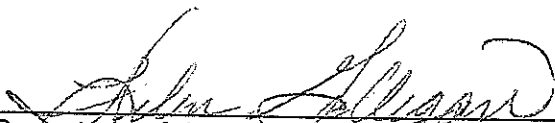
1. That the District Board establish a target of accumulating approximately \$500 million by the end of the lease, and that the District plan to have a "debt to capitalization ratio" that does not exceed 50 percent, e.g., debt of \$250 million and a Board Fund of an equal amount be targeted as the amount needed to acquire Hospital assets and to fund working capital either during the lease (in the event of paramount default under the Agreements) or at lease end.
2. That to meet the above established target, the Board adopt "Option 1" as presented by its strategic and financial consultants in conjunction with the Strategic Plan and thereupon establish a budget policy whereby the Board annually budget for current operations, including community health services, at a sum representing approximately 10 percent of the prior year-end Board Strategic Fund balance (the financial--i.e., cash reserves--and real estate assets the Board designates as its Board Strategic Fund accumulation), with remaining net income devoted to Fund building.
3. That the District conduct an annual (or periodically as deemed prudent) review of risks associated with operations of the Hospital and its operator's viability, along with the District's projected obligations under the lease, and adjust the financial policy target and financial strategy in place accordingly.
4. That the Board and Management assure that investment management expertise is available on an ongoing basis.

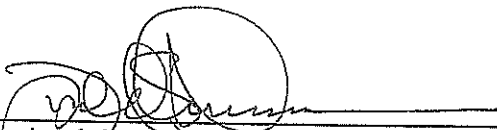
PASSED AND ADOPTED this 13th day of December, 2007, by the following votes:

AYES: 4

NOES: 0

ABSENT: 1


Secretary of the Board of Directors of the
Peninsula Health Care District


Chair of the Board of Directors of the
Peninsula Health Care District



COUNTY OF SAN MATEO
Inter-Departmental Correspondence

County Manager's Office

DATE: August 28, 2008
BOARD MEETING DATE: September 16, 2008
SPECIAL NOTICE: None
VOTE REQUIRED: None

TO: Honorable Board of Supervisors
FROM: John L. Maltbie, County Manager
SUBJECT: 2007-08 Grand Jury Response

RECOMMENDATION

Accept this report containing the County's responses to the following 2007-08 Grand Jury report: Funding Health Care for Uninsured Adults.

VISION ALIGNMENT:

Commitment: Responsive, effective and collaborative government.

Goal 20: Government decisions are based on careful consideration of future impact, rather than temporary relief or immediate gain.

This activity contributes to the goal by ensuring that all Grand Jury findings and recommendations are thoroughly reviewed by the appropriate County departments and that when appropriate, process improvements are made to improve the quality and efficiency of services provided to the public and other agencies.

DISCUSSION

The County is mandated to respond to the Grand Jury within 90 days from the date that reports are filed with the County Clerk and Elected Officials are mandated to respond within 60 days. To that end, attached is the County's response to the Grand Jury report on Funding Health Care for Uninsured Adults, issued on June 30, 2008.

San Mateo County Funding Health Care for Uninsured Adults

Findings:

Staff is in general agreement with the Grand Jury's findings regarding the County and Health Plan of San Mateo (HPSM). However, as outlined below, the County and HPSM's resources are influenced by Federal and State action, which affect issues such as provider reimbursement levels.

Recommendations:

1. The Board of Supervisors should encourage the Health Plan of San Mateo to:

A. Continue to pay fees at current levels in order to retain and attract providers. If funds are limited, consider paying higher rates to providers in critically needed specialties.

Response: Concur. The Health Plan of San Mateo (HPSM), which includes two members of the Board of Supervisors, as part of its governing commission, consistently reviews provider reimbursement levels. HPSM is committed to sustaining provider reimbursement levels to attract and retain providers, in order to ensure appropriate access to healthcare. HPSM has also implemented a robust "Pay for Performance" program that provides incentives for providers to deliver evidence-based services that enhance and promote healthcare quality. HPSM also considers varying payment arrangements for specific areas of client need. HPSM will continue to consider differential reimbursement and other incentives it can provide to encourage participation of critically needed specialties.

Because HPSM resources derive from a mix of federal, state and local funding, it is not always able to maintain payment levels when the State or Federal government passes on reductions in provider payment to HPSM.

B. Use all available options (County resolution, support of state and federal legislation) to encourage the six private non-profit hospitals in San Mateo County (Kaiser-Permanente Redwood City and South San Francisco, Seton Daly City and Moss Beach, Mills Peninsula Burlingame, Sequoia Hospital Redwood City) to give significant and ongoing financial contribution and operational support to the San Mateo Access and Care for Everyone (ACE) Program.

Response: Concur. The County and HPSM are engaged in Health System Redesign initiative that includes engagement of the six nonprofit hospitals in supporting the healthcare needs of the ACE and broader underserved populations. Our initial steps in the development of a "Community Health Network for the Underserved" (CHNU) that includes targeted roles for every

nonprofit hospital in San Mateo County in meeting the needs of the publicly insured and uninsured populations have been well received. The overall goal for the CHNU is to meet the needs of San Mateo County's underserved population with roles that maximize the effectiveness of each delivery system partner and best direct the community's local tax resources devoted to healthcare. Through the development of the CHNU during the 2008-09 fiscal year, the County and HPSM will be better positioned to support underserved populations covered by ACE, Medi-Cal, WELL, Healthy Families, Healthy Kids, and the uninsured.