

Submission to the California Attorney General
Notice of Proposed Asset Purchase Agreement and Transfer of Health Facility
Via Christi Health System, Seller
And
St. Rose Hospital, Buyer

1. **DESCRIPTION OF THE TRANSACTION**

a. *A full description of the proposed agreement and transaction.*

Hayward Sisters Hospital, Inc., a California non-profit public benefit corporation is the owner and operator of St. Rose Hospital in Hayward, California. Hayward Sisters Hospital, Inc. dba St. Rose Hospital is a member of the Via Christi Health System of Wichita, Kansas. Via Christi Health System is sponsored by the Sisters of St. Joseph of Wichita, Kansas and the Sisters of the Sorrowful Mother of Broken Arrow, Oklahoma. St. Rose Hospital is the only hospital in California sponsored by the Via Christi Health System.

Because the hospital serves as the primary safety-net provider in Central and Southern Alameda County, it has suffered serious financial shortfalls. The System's position is that the hospital owes the System in excess of \$30 million. In addition to the debt, the impact of mandated staffing ratios, seismic retrofitting expenses and the distance from the rest of the System facilities and services, the Via Christi Health System has been attempting to divest of the hospital for the past four years.

Via Christi Health System engaged Cain Brothers, a health care investment banking and consulting firm, to market the hospital. Their efforts failed to produce a single offer for the hospital.

In the fall of 2002, the System contracted with Ponder & Company of Chicago, Illinois to again actively market the hospital. After aggressively marketing the hospital, Ponder was able to identify one organization that was willing to submit a letter of intent.

Provident Foundation, Inc., of Baton Rouge, Louisiana submitted a letter of intent. The CEO of Provident, Mr. Steve Hicks, proposed to acquire the hospital through a highly leveraged buyout. Mr. Hicks' proposal was strongly supported by the System. Initially, Mr. Hicks had proposed to joint venture the acquisition with Children's Hospital in Oakland, however, Children's Hospital elected not to participate.

During discussion with the local hospital board, individual directors raised concerns about the sustainability of the hospital under the ownership of Provident. These concerns included Provident's lack of capital to invest in the hospital's infrastructure, their lack of experience in managing an acute care hospital, their corporate organization's lack of management resources, and the fact that they are located in Baton Rouge.

After considerable review and discussion, the consensus of the hospital board was to reject the Provident proposal. The board then requested that the System grant the hospital board the opportunity to present a proposal to transfer control from the System to the local board and the community (see Schedule CC).

The initial plan outlined a transaction whereby the control of Hayward Sisters Hospital would be transferred from the Via Christi Health System to the local corporation. It was anticipated that the financing would be through the Cal-Mortgage Program and the hospital engaged Cain Brothers to facilitate the financing process. The hospital also engaged a variety of financial and health care consultants to assist in completing all requirements of the Cal-Mortgage application process. After originally supporting the hospital's application, the staff of Cal-Mortgage declined to accept it. They indicated that they would support a new application if it included a request for funds specifically related to meeting the seismic retrofitting requirements of SB 1953.

As a result of this setback, alternate lenders were identified. After extensive evaluation, GMAC was selected as the commercial lender. The plan is to secure a \$25.0 million commitment from GMAC for a three-year term. Upon membership transfer, \$18.0 million is to be repaid Via Christi. Via Christi has agreed to a subordinated note for the remaining \$4.2 million, payable in three years. If restrictive covenants are satisfied, the hospital may have access to the remaining \$7.0 million in order to meet pressing capital needs.

b. *A complete copy of all proposed written agreements or contracts to be entered into by the applicant and the transferee that relate to or effectuate any part of the proposed transaction.*

1. Asset Purchase Agreement – See Schedule A
2. Letter of Intent – See Schedule B

c. *A statement of all of the reasons the Board of Directors of applicant believes that the proposed agreement or transaction is either necessary or desirable.*

It is very important to understand that the local board's decision to move forward with this transaction was made with great reluctance. This was not an opportunity that they sought out, rather the board seized the only available opportunity to save the hospital.

In March of 2002, the Via Christi Health System informed the hospital board that Via Christi would no longer advance any additional capital to the hospital. Via Christi's position was that the hospital had to meet all of its organizational and operational obligations from the existing hospital revenue stream. Failure to sustain operations would lead to closure of the hospital and the loss of health care resources in Central and Southern Alameda County.

There exists today a window of opportunity to strengthen the hospital's ability to expand services, maintain existing essential services, and to build a strong financial base

for the future. This application is necessary in order to maintain the viability of the hospital and because there are no other viable alternatives.

The proposed transaction is desirable because it represents the best alternative for the community, the hospital medical staff and employees, as well as Alameda County and the State of California.

2. FAIR MARKET VALUE

a. *Estimated market value of all cash, property, stocks, notes, assumption or forgiveness of debt, and any other thing of value that the applicant would receive for each health facility covered by the proposed agreement or transaction.*

Please see the valuation prepared by the Camden Group – Schedule C.

b. *The estimated market value of each health facility to be sold or transferred by the applicant under the proposed agreement or transaction.*

Please see the valuation prepared by the Camden Group – Schedule C.

c.d. *A description of the methods used by the applicant to determine the market value of any assets involved in the proposed agreement or transaction. This description shall include a description of the efforts made by the applicant to sell or transfer each health facility that is the subject of the proposed agreement or transaction.*

Reports, analysis, requests for proposal, and any other documents that refer to relate to valuation of any assets involved in the agreement or transaction.

A description of the methods used by The Camden Group is included in their report.

Summary – The appraisal would give creditors some assurance that the sale of land following forfeiture could cover the loan. While the local board is willing to assume the operating risks of St. Rose Hospital, including seismic requirements, they would also like some assurance that the hospital will be able to avoid closure. Since selling the hospital allows Via Christi to walk away from the challenges of operating a safety-net hospital, significant capital needs including seismic requirements, and the very high costs associated with a potential closure, hospital trustee, Sherman Balch, shared in an email sent to Via Christi (Schedule E), that a one dollar purchase price would be reasonable. In a follow up phone call, Via Christi informed Michael Mahoney, President of St. Rose Hospital, that this offer, in their opinion, was entirely unreasonable. Subsequently, the hospital board submitted a signed offer for \$10.0 million dated February 15, 2005 (Schedule E).

In response to this offer, Via Christi representatives requested a special board meeting held on March 3, 2005. The St. Rose Hospital board was informed that their offer of \$10.0 million was unacceptable. Via Christi presented information, from their perspective, which indicated the hospital owed \$32.0 million. However, Via Christi

shared they would be willing to accept \$28.0 million. Anything less than \$28.0 million and they would continue to look for another buyer. To date, a five-year search, with the assistance of Cain Brothers and the Ponder Group, yielded no one willing to invest more than \$3.0 million of their own money. Instead, the one written offer would have financed over \$30.0 million of the purchase by saddling the hospital with debt it could not afford.

The assessment of the local board, following a comprehensive review of detailed financial projections, was that the hospital could not sustain \$30.0 million in debt for the purchase price, alone, especially in light of significant capital needs which must also be funded. A purchase price at this level would greatly endanger the sustainability of St. Rose. In such a transaction – even if the hospital were to eventually close – the local board is wary that the new parent corporation could profit handsomely on “the deal” itself and on the assessment of significant management fees. After protracted attempts to negotiate a sustainable purchase price, the local board reluctantly made the counter-offer of \$22.22 million reflected in the enclosed asset purchase agreement and letter of intent. The local board was also concerned that further negotiations – while not likely to yield a more sustainable price – could hinder the hospital’s pursuit of critical, strategic opportunities.

Background – As *the* safety net provider for the lower half of Alameda County, 45% of St. Rose Hospital’s admissions are either Medi-Cal patients or uninsured. This is three times higher than the Via Christi Health System average and makes St. Rose a very unattractive acquisition target. St. Rose Hospital has always maintained costs well below marketplace averages. Four years ago, Via Christi hired Cain Brothers to solicit organizations that might be interested in acquiring St. Rose Hospital. None were interested. Over the past three years, Via Christi has contracted with the Ponder Group of Chicago to perform a similar search. Via Christi also made concerted efforts to align St. Rose with other faith-based organizations, including offering to “write-off” \$10.0 million of existing debt. This offer was not accepted.

The Provident Foundation Corporation of Baton Rouge, Louisiana emerged as the only company interested in acquiring St. Rose Hospital. Provident’s only healthcare experience, to date, had been the acquisition and subsequent bankruptcy and closure of Granada Hills Hospital in Southern California. Since Provident did not have any available capital, the purchase would have required St. Rose Hospital to assume over \$30.0 million in debt and pay “market value” for the land and other assets. Furthermore, it is likely that this debt would neither qualify for tax-exempt status nor be considered “investment grade.” The Via Christi Health System board was initially in favor of the sale to Provident.

After careful consideration, the St. Rose Hospital board questioned the value added by an out-of-area corporation and whether Provident would be able to meet the financial obligations of the transaction, and recommended that other alternatives be investigated including whether local leadership could put together a similar transaction. The board was very encouraged to learn that a loan from GMAC, if obtained, would enable St. Rose to continue serving the community while retaining control within the local community. (GMAC loan documents – Schedule PP.)

The St. Rose Hospital board believes the acquisition of assets at \$10.0 million (accomplished through a bylaws change giving control to the local board with a simultaneous repayment of \$10.0 million in debt to Via Christi) will allow an opportunity to sustain the mission and operations of the hospital and represents the absolute maximum price the hospital can pay to safely assume responsibility of keeping the hospital open and avoiding a very costly closure.

Measure A funding would almost certainly be discontinued if St. Rose Hospital were sold to any party other than the local board. Similarly, SB 1255 funding for the hospital would be greatly reduced. Earnings before interest and depreciation (EBIDTA) for 2005, excluding Measure A funding, and a large portion of SB 1255 funding, would approximate \$1.3 million. Therefore, a purchase price for the hospital, at five times EBIDTA, would be \$6.5 million.

As a requirement of the Cal-Mortgage application submitted one year ago, a five-year financial projection was prepared by an independent firm, HFS (Schedule OO). One unfavorable development since that time has been a “freeze” in the hospital’s Medi-Cal rate. The effects of making the following three allowances to HFS’s projections are quite significant, as evidenced in the attached projected statement of operations and cash flow (prepared by hospital management): 1) replacing HFS’s projections for “year one” with the actual results of operations over the past year, 2) holding the hospital’s Medi-Cal rate flat in 2006 and 3) increasing capital investment to the level required to compete successfully in any market. As you can see, it will remain very challenging to maintain the mission of St. Rose Hospital even at a \$10.0 million purchase price. These projections were provided to Via Christi along with the local board’s \$10.0 million offer.

1. Correspondence referenced above – Schedule E.
2. The Camden Group Valuation – Schedule C.
3. Wellspring Valuation – Schedule D.

3. **INUREMENT AND SELF-DEALING**

a. *Copies of documents or writings that relate or refer to any personal financial benefit that a proposed affiliation between applicant and the transferee would confer on any officer, director, employee, doctor, medical group or other entity affiliated with applicant or any family member of any such person as identified in Corporations Code section 5227(b)(2).*

Schedule SS.

b. *Identity of each and every officer, trustee or director of applicant (or any family member of such person as identified in Corporations Code section 5227(b)(2) or any affiliate of applicant who or which has any personal financial interest in any company, firm, partnership or business entity (other than salary and directors/trustee fees) currently doing business with applicant, any affiliate of applicant or any affiliate of the transferee.*

Not applicable.

c. *A statement describing how the board of directors of the nonprofit corporations involved in the transaction is complying with the provisions of Health and Safety Code sections 1260 and 1260.1.*

The negotiations of the terms and conditions of the sale of assets of St. Rose Hospital and transfer of the hospital to St. Rose Hospital and the community have been conducted by the Via Christi Health System Board of Directors, executive staff and legal counsel and the St. Rose Hospital Board of Trustees and executive staff with assistance from the financial consulting group of Cain Brothers & Company.

No director of St. Rose Hospital (except as stated in Paragraph 3.a. above) will be receiving, directly or indirectly, any salary, compensation, payment, or other form of remuneration from Via Christi Health System following the close of the sale or other transfer of assets.

4. **CHARITABLE USE OF ASSETS**

Under the terms of this transaction, as described in Section 1 above, there will be no net sale proceeds inuring to the hospital after this transaction has been completed. Nevertheless, in the interest of completeness of this application, applicant has included the following documents:

- a. Articles of Incorporation for Hayward Sisters Hospital – Schedule F.
- b. Articles of Incorporation for St. Rose Hospital Foundation – Schedule G.
- c. Articles of Incorporation for St. Rose Medical Building – Schedule H.
- d. Bylaws for Hayward Sisters Hospital 2000 – Schedule I.
- e. Bylaws for Hayward Sisters Hospital 2003 – Schedule J.
- f. Bylaws for Hayward Sisters Hospital 2004 – Schedule K.
- g. Bylaws for St. Rose Hospital Foundation – Schedule L.
- h. Bylaws for St. Rose Medical Building – Schedule M.

5. **IMPACTS ON HEALTH CARE SERVICES**

a. *A copy of the two most recent “community needs assessments” prepared by applicant for any health facility that is the subject of the agreement or transaction.*

1. Assessment for 2001 – Schedule N.
2. Assessment for 2004 – Schedule O.

b. *A description of all charity care provided in the last five years by each health facility that is the subject of the agreement or transaction. This description shall include annual total charity care spending; inpatient, outpatient and emergency room charity care spending; a description of how the amount of charity care spending was calculated; annual charity care inpatient discharges, outpatient visits, and emergency visits; a description of the types of charity care services provided annually; and a description of the policies, procedures, and eligibility requirements for the provision of charity care.*

1. Charity Care and Community Benefits Provided – Schedule P.
2. Charity Care and Self-Pay Discount Policy – Schedule Q.

c. *A description of all services provided by each health facility that is the subject of the agreement or transaction in the past five years to Medi-Cal patients, county indigent patients, and any other class of patients. This description shall include the type of services provided, the payor, and the cost of the services provided.*

1. Current Services – Schedule R.
2. Future Services – Schedule R.
3. 2004/2005 Strategic Plan – Schedule S.
4. Charity Care and Community Benefits Provided – Schedule P.

d. *A description of any community benefit program provided by the health facility during the past five years with an annual cost of at least \$10,000.*

A Five Year Overview - St. Rose Hospital continues to meet the challenges of providing access and continuity of quality healthcare services to Hayward and surrounding communities. With 175 licensed beds, more than 800 employees, and a medical staff of more than 400 physicians, St. Rose is one of the largest employers in Hayward; the sixth largest city in the greater Bay Area. Hospital's services include family birthing, breast imaging, emergency medicine, a very successful hospitalist program, oncology, outpatient surgery, rehabilitation, primary and secondary medicine and surgery, mobile van services, occupational and corporate health, skilled nursing, off-campus pediatric medical and dental clinical services and student health services. The hospital's most recent service enhancement is the newly remodeled Cardiovascular Laboratory. St. Rose is the *only* hospital in Central Alameda County that offers emergency angioplasty, a life-saving non-invasive procedure to diagnose and treat heart disease.

St. Rose Hospital is located in Hayward, one of 14 cities and two unincorporated towns in Alameda County. Alameda County is one of the most ethnically diverse counties of California. People of color represent over 50 percent of the county residents.

Uncompensated Care - St. Rose Hospital provided **\$18.4** million in uncompensated care to low income and uninsured patients during 2004. Of the inpatient admissions at St. Rose, **45%** are Medi-Cal and uninsured patients. Other hospitals serving Central and Southern Alameda County report that low income patients comprise from 1% to 18% of their patient volume. Last year, St. Rose Hospital served over 31,000 patients in the emergency room, of which 7,000 were uninsured and low income.

St. Rose Hospital has reached out to the community to provide health care, dental care, access to insurance, and health care education to Hayward and surrounding communities. St. Rose is the only hospital in Alameda County to provide dental services to Medi-Cal and uninsured patients.

Examples of healthcare outreach are as follow:

1. Silva Pediatric Medical and Dental Clinic
10,055 Medical visits in F/Y 03/04
3,023 Dental visits in F/Y 03/04
Assisted 95 families enroll in the Healthy Families insurance program
2. Chabot College Student Health Center
Student treatments at Chabot College in 2003/04
Immunizations 450
Ill visits 600
Physicals 150
Gynecology 270
3. St. Rose Hospital Community Care-A-Van
St. Rose Hospital provides the only school-based health care mobile clinic to Hayward area schools. In 2003/04, the Care-A-Van saw over 730 uninsured/under served students at seven different Hayward area school locations for immunization and health checks. Many of these students have no access to healthcare.
4. St. Rose Hospital Breast Care Center
In 2003/04 over 800 diagnostic breast cancer screening procedures were provided to our low income, uninsured patients.
5. Platinum Senior Program
Offering healthcare education, counseling, and screening to over 220 seniors in the community.
6. Community Health and Wellness Education
In 2003/04, St. Rose Hospital provided 719 classes for the community and seniors. The St. Rose Hospital Health Fair hosted over 3,000 community members, 90 health related organizations and 25 different health screenings last year.
7. Health Insurance Outreach
St. Rose Hospital's Health Insurance Outreach Program was established to address issues in enrollment, utilization and maintenance of health insurance. In 2003/04 financial counselors have assisted over 700 individuals with enrollment process this year.
8. Hayward New Start Tattoo Removal Project
St. Rose Hospital participated in a tattoo removal program to offer gang members the opportunity to change by removing visible gang and drug related tattoos. Participants are selected and assisted back into society by gainful employment and volunteer work. There are 76 active participants currently enrolled in the program.

9. Collaborative Efforts and Community Involvement

Hayward Rotary
 Hayward Chamber of Commerce
 Hayward Health Insurance Task Force
 Health Ministries Outreach
 Local Parishes
 South Hayward Neighborhood Collaborative
 Alameda Alliance for Health/Healthy Families Program
 Alameda County Public Health
 American Cancer Society
 Hayward Unified School District
 Tennyson High School Advisory Board
 Chabot College Foundation Board

1. 2001/2003 Community Benefits Plan – Schedule T.
2. 2003-2004 Community Benefits Plan – Schedule U.

e. *For each health facility that is the subject of the agreement or transaction, all existing staffing plans, policy and procedure manuals, employee handbooks and collective bargaining agreements or similar documents relating to current policies and procedures on staffing for patient care areas; employee input on health quality and staffing issues; and employee wages, salaries, benefits, working conditions and employment protections.*

1. Staffing Policies and Procedures – Schedule V.
2. Employee Handbook – Schedule W.
3. Bargaining Agreement – Teamsters 856-Ancillary – Schedule X.
4. Bargaining Agreement – Teamsters 856-Clerical – Schedule Y.
5. Bargaining Agreement – Operating Engineers 39 – Schedule Z.
6. Human Resources Policy Manual – Schedule QQ.
7. Employee Salaries and Benefits – Schedule AA.

f. *For each health facility that is the subject of the agreement or transaction, all existing documents setting forth any guarantees made by any entity that would be taking over operation or control of the health facility relating to employee job security and retraining, or the continuation of current staffing levels and policies, employee wages, salaries, benefits, working conditions and employment protections.*

The hospital board has committed to maintaining all staffing levels, health care benefits, bargaining agreements and pension plan benefits equal to those presently provided. The health, dental, prescription and vision benefits are in fact already in place and are being administered by California entities. The new pension plan is targeted to be in place by June 1, 2005 (reference Employee Salaries and Benefits – Schedule AA, and Board Minutes – Schedule HH).

g. *A statement describing all material effects that the proposed agreement or transaction may have on delivery of health care services to the community served by each*

facility proposed to be transferred, and a statement of how the proposed transaction will affect the availability and accessibility of health care in the affected communities.

The proposed transfer of ownership is expected to have no adverse effects on the availability or accessibility of health care in the service area. It is expected to have a positive effect on service availability. The only negative effect would occur only if this transaction does *not* materialize, in which case the hospital would close.

With a service mix of 45% Medi-Cal and uninsured, St. Rose struggles to serve one of the most diverse and challenging patient populations of any private hospital in the state. Not-for-profit and for-profit health systems alike, with their vast resources and avowed charitable missions, have declined the opportunity to purchase the assets of the hospital and continue efforts to serve low-income patients.

Via Christi Health System, the Kansas-based corporate parent of St. Rose had been unsuccessful in finding a suitable and willing buyer for the hospital. Determined to exit the California health care market and leave behind its unique problems of state mandated seismic retrofitting and minimum staffing ratios, and intense managed care competition, Via Christi had only one viable alternative – to close the hospital and liquidate the physical assets.

Faced with the closure of a critical safety-net hospital as the only alternative, the St. Rose Board of Trustees took up the challenge of formulating a new option by arranging the complicated financing needed to purchase the hospital and continue its charitable mission. Fortuitously, the board was aided by a tremendous boost in 2004 when the voters of Alameda County approved Measure A, an initiative to increase the county sales tax by ½% to support access to critical health care services. St. Rose was the only private, adult hospital in Alameda County to receive a portion of these discretionary funds, which were subsequently matched through the SB 1255 Disproportionate Share Hospital (DSH) program. Incidentally, St. Rose also has the distinction of being the only non-governmental, adult hospital in Alameda County to receive DSH funding. These crucial funds not only helped to enable the financing, but also demonstrated the commitment of the state and county to the future of St. Rose Hospital as an independent, nonprofit organization, serving the health care needs of the community.

The St. Rose Board of Trustees, executive leadership team, and staff are committed to maintaining the mission of the hospital. The needed capital that will be made possible through the transfer of ownership will allow St. Rose to upgrade and expand its services to the local community.

1. Impact of Hospital Closure – Schedule BB.

h. *A description of each measure proposed by the applicant to mitigate or eliminate any potential significant adverse effect on the availability or accessibility of health care services to the affected community that may result from the agreement or transaction.*

As stated in g. above, the proposed transfer of ownership is expected to have no adverse effects on the availability or accessibility of health care in the service area. It is expected to have a positive effect on service availability.

6. POSSIBLE EFFECT ON COMPETITION

a. *For any agreement or transaction for which a Premerger Notification and Report Form is required to be submitted to the Federal Trade Commission under the Hart-Scott-Rodino Anti-Trust Improvement Act of 1976, a brief analysis of the possible effect of any proposed merger or acquisition of each health care facility that is the subject of the agreement or transaction on competition and market share in any relevant product or geographic market.*

Not applicable.

b. *The applicant shall provide the Premerger and Notification form and any attachments thereto as filed with the Federal Trade Commission pursuant to the Hart-Scott-Rodino Anti-Trust Improvement Act of 1976 and 16 C.F.R. Parts 801-803.*

Not applicable.

7. OTHER PUBLIC INTEREST FACTORS

Purchase support letters – Schedule RR.

8. RESOLUTION AND CERTIFICATE

Schedule CC.

9. LIST OF OFFICERS AND DIRECTORS

- a. Hayward Sisters Hospital dba St. Rose Hospital – Schedule DD.
- b. St. Rose Hospital Foundation – Schedule EE.
- c. St. Rose Medical Building – Schedule FF.

10. PUBLIC NOTICE

A description of the Applicant's efforts to inform local government entities, professional staff and employees of the health facility, and the general public of the proposed transaction. This description shall include any comments or reactions to this effort.

In March 2004, St. Rose Hospital implemented a communications plan in response to media inquiries addressing the disaffiliation of Via Christi Health System from St. Rose Hospital. The communications plan consisted of a comprehensive public relations effort targeted at our stakeholders and community to inform them of our future plans, assure them of our sustainability, and to support the strategic initiatives of Via Christi Health System and St. Rose Hospital. The plan was implemented in several

stages over the past 15 months to target key audiences in the form of one-on-one meetings, forums, newspaper articles, television, and radio interviews. Target audiences included board members, employees, physicians, community leaders, government officials, the general public, and specific patient groups.

Public Notices – Schedule GG.

11. MISCELLANEOUS DOCUMENTS

a. *Any board minutes or other documents relating or referring to consideration by the Board of Directors of the applicant and any related entity, or any committee thereof, of the agreement or transaction or of any other possible transaction involving any of the health facilities that are the subject of the agreement or transaction.*

Hospital Board Minutes – Schedule HH.

b. *Copies of all documents relating or referring to the reasons why any potential transferee was excluded from further consideration as a potential transferee for any of the health facilities that are the subject of the agreement or transaction.*

Provident Foundation, Inc. only, as referred to in Section 1. above and in hospital board minutes, Schedule HH.

c. *Copies of all Requests for Proposal sent to any potential transferee, and all responses received thereto.*

Not applicable.

d. *All documents reflecting the deliberative process used by the applicant and any related entity in selecting the transferee as the entity to participate in the proposed agreement or transaction.*

Please reference paragraphs 1., 2.d., and 5.g., and Board Minutes – Schedule HH.

e. *Copies of each Proposal received by the applicant from any potential transferee suggesting the terms of a potential transfer of applicant's health facilities, and any analysis of each such Proposal.*

Not applicable.

f. *The applicant's prior two annual audited financial statements, the applicant's most current unaudited financial statement, business projection data and current capital asset valuation data.*

1. Hayward Sisters Hospital 2002 audited statements – Schedule II.
2. Hayward Sisters Hospital 2003 audited statements – Schedule JJ.
3. Hayward Sisters Hospital 2004 draft audited statements – Schedule KK.
4. Via Christi Health System 2004 audited statements – Schedule LL.

5. Current Interim Internal Financials – Schedule MM.
6. Camden Group Valuation – Schedule C.

g. *Any requests for opinions to the Internal Revenue Service for rulings attendant to this transaction and any Internal Revenue Service responses thereto.*

Internal Revenue Service 501(c)(3) letters for Hayward Sisters Hospital and St. Rose Hospital Foundation, and application for St. Rose Medical Building letter (response not yet received) – Schedule NN.

h. *Pro forma post-transaction balance sheet for the surviving or successor nonprofit corporation.*

Schedule OO is a five-year financial projection prepared by the independent firm of HFS one year ago as part of the hospital's Cal-Mortgage application. Since much has changed over the past year, projections prepared by hospital management – which include updates to HFS' projections – have also been enclosed in Schedule OO. One significant development over the past year has been a "freeze" in the hospital's Medi-Cal rate.

In the updated projections, hospital management replaced HFS' projections for the 12 months ending February 2005 with actual results of operations over the past year. HFS growth factors 2006 thru 2009 have been held constant. Earnings by year were affected as follows:

| Net income (loss) by year | 2005 | 2006 | 2007 | 2008 | 2009 |
|---------------------------------------|--------|--------|------|--------|--------|
| A. HFS original forecast (1 year ago) | \$1.9M | 1.8M | 2.6M | 1.8M | 1.9M |
| B. Pro forma (YTD 2005 as basis) | \$1.4M | (0.0M) | 0.5M | (0.4M) | (0.4M) |

Line B. assumes a 5% increase in Medi-Cal rates each year after 2005.

St. Rose Hospital is projected to achieve operating income in 2005 as the result of writing off \$1.4 million in current year interest expense, pursuant to the letter of intent. Otherwise, the hospital would be in jeopardy of incurring an operating loss in 2005. The write-off of receivables incurred *prior to 2005* will be recorded "below the line" as an "other change" in net assets, or an "extraordinary item," rather than operating income.

The effects of no Medi-Cal rate increase during 2005 accounts for \$1.0 million of the decrease in annual earnings 2006 thru 2009. An increase in professional fees, mostly anesthesiologist fees, of nearly \$500,000 per year also contributes to the decrease in earnings. Other changes in net assets are also significantly less than HFS' original projections. In the current year, the hospital is recording Alameda County Measure A funding as operating income. HFS included \$2.0 million in Measure A funding, annually, as *non-operating* income. \$600,000 in annual deferred revenue from a partnership with Children's Hospital of Oakland which has not yet been finalized was also included by HFS and foundation contributions are far below the original \$1.0 million annual projection.

Pro Forma earnings 2006 through 2009 if the St. Rose Medi-Cal rate is held flat again in 2006:

| Net income (loss) by year | 2005 | 2006 | 2007 | 2008 | 2009 |
|---|--------|----------|--------|--------|--------|
| C. Pro forma (Medi-Cal rate held flat in '06) | \$1.4M | (\$1.0M) | (0.5M) | (1.4M) | (1.5M) |

The following revisions were also made to HFS original projections :

1. At the request of the St. Rose Hospital board, the annual capital budget (including deferred maintenance) has been increased by \$1.3 million annually to \$3.8 million. We have also reserved \$2.5 million annually toward seismic requirements and addressing the capacity constraints of the existing facility. The “all in” purchase price is comprised largely of two equally significant components:
 - a. The purchase price paid to Via Christi, in addition to
 - b. The significant capital needs of the existing facility
2. The purchase price of \$22.2 million has been revised slightly upward from HFS’ original projection of \$21.5 million.
3. Borrowing has been revised slightly downward from \$26.75 million (per HFS) to \$25.0 million, \$21.5 million in year one and \$3.5 million in year two.
4. Interest expense has been adjusted to reflect GMAC’s higher rate of interest (6.7%) compared to tax-exempt financing in HFS projections (5.6%). Given that market interest rates are far below historical averages, the hospital’s projections also include an allowance that rates will increase 50 basis points in 2006 and again in 2007 (tax-exempt rate would have been “locked in” for 25 years).

Observations:

If the hospital’s Medi-Cal rate is held flat again in 2006, projections indicate:

- a. St. Rose Hospital would incur an operating loss of \$1.0 million in 2006. Achieving operating income is a requirement for both the FHA 242 program and the Cal-Mortgage program. Securing long-term, take-out financing through either program is critical for the future success of the hospital.
- b. The maximum amount of senior debt the hospital can carry (GMAC’s senior debt limit) is reduced to \$22.9 million by the end of 2006 (statement of operations, line 24).
- c. At the end of FY2006, St. Rose would only have \$1.2 million in cash on hand, just enough money to operate the hospital for five days.

Even if the hospital receives a 5% rate increase from Medi-Cal in 2006, the hospital is projected to incur a small operating loss in 2006.

In an attempt to answer the board's question, "at what price does this work," hospital management prepared a sensitivity analysis of various purchase prices (included in Schedule OO). One sensitivity analysis highlights the effect on earnings of various purchase prices assuming St. Rose will receive a 5.0% increase in Medi-Cal rates in 2006. The second sensitivity analysis assumes the hospital's Medi-Cal rates will be held flat again in 2006.

At this point, the hospital's financial advisors assume it is more likely that the hospital will be required to maintain the existing book value of property, plant and equipment rather than "adjusting them down" to the purchase price (if lowered). Therefore, it is not likely depreciation expense would be lowered by a lowered purchase price.

See Schedule OO.

i. *Related party supporting organizations.*

Notwithstanding the fact that there will be no net sale proceeds from the proposed transaction, there exist two separate nonprofit public benefit corporations, which are included in this transaction, that provide financial support to Hayward Sisters Hospital dba St. Rose Hospital and will continue to do so without change following completion of this transaction. Articles, bylaws and a listing of directors for each entity are included in the Schedules.

1. St. Rose Hospital Foundation with net assets of \$1,845,586.
 2. St. Rose Medical Office, Inc. with net assets of \$595,398.
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