DAVID J. CANEPA
SUPERVISOR, FIFTH DISTRICT
COUNTY OF SAN MATEO

September 7, 2022

Attorney General Rob Bonta
1300 "I" Street
Sacramento, CA
95814-2919

Dear Honorable Attorney General Bonta,

I am writing to make you aware that a growing number of community members in my district have come to me with a significant need for representation regarding Sutter Health's use of federal CARES Act dollars. In particular, they believe it is unconscionable, and possibly illegal, that Sutter Health, despite receiving nearly a billion dollars in CARES Act funding, permanently closed the Mack E. Mickelson Center therapy pool, the only warm water rehabilitation facility of its kind in San Mateo County. As you know, the CARES Act was passed by Congress for the express purpose of keeping vital medical and community resources like the Mickelson therapy pool open during the COVID pandemic.

It is not just constituents who have expressed outrage at the closure of this vital facility. Over a dozen local government agencies, including the San Mateo Board of Supervisors, the Sequoia Healthcare District, and ten city councils up and down the Peninsula, have passed resolutions or written letters to Sutter in support of reopening the Mickelson therapy pool.

Sutter has offered varying excuses for closing the pool, including "continued uncertainty surrounding COVID," a "focus on … acute care services," and efforts to be "good stewards of resources." As I will detail below, none of these excuses hold water, especially given that Sutter received federal funds *specifically designed* to save services imperiled by COVID. Additionally, as a not-for-profit charitable hospital organization, Sutter Health is mandated by law to meet the community benefit standard set forth in revenue ruling 69-545.

In this matter, I would appreciate any suggestions you may have as to how we might further our efforts to reach an accommodation with Sutter Health regarding the reopening of this precious community health resource. Crucially, there is no replacement facility available for those who rely upon the benefits of warm water therapy to ease their pain and maintain a decent quality of life—which is why the local community is desperate for the Mickelson therapy pool to reopen.

Despite strenuous efforts to open a dialogue with Sutter regarding the therapy pool—including petitions, protests, and even a multi-million dollar offer from the Peninsula Health Care District to fully fund repairs, retrofitting and operational costs of the pool until a replacement facility can be built—local community members have been unable to gain any traction with Sutter Health. *I personally tried to broker a meeting between Sutter Health and local stakeholders, but the healthcare giant refused.*

It is my understanding that Sutter obtained $853 million through the federal CARES Act program, some of which, based on guidelines that "retrofitting facilities" [to accommodate challenges posed by the COVID-19 pandemic] was one of the approved, reportable uses for CARES act funding, could have been used to prevent

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the closure of the Mickelson therapy pool. I am requesting that your office conduct a probe into Sutter's stewardship of CARES Act funds and whether it has used those funds appropriately.

Following are abbreviated facts of this situation:

1. The Mack E. Mickelson Arthritis and Rehabilitation Center in the City of San Mateo ("Mickelson Center") opened in 1996 to serve the needs of the San Francisco Bay Area Peninsula community.
2. The Mickelson Center was financed *in its entirety* by $4 million in community donations ($7.2 million in today's dollars.)
3. The Mickelson Center's warm water therapy pool was—and remains—the only such facility in San Mateo County that meets ADA requirements. For 25 years, the pool has been a unique, vital resource for community members facing the loss of their physical mobility.
4. The Mickelson Center, including the warm water therapy pool that is its primary feature, was closed to the local community by Sutter Health in March, 2020, ostensibly due to the shelter-in-place COVID mandate.
5. The cost of this closure in terms of human suffering is incalculable, not just because it was the only fully accessible therapeutic pool in San Mateo County, but also because it was a location where individuals and families facing serious, often life-long, mobility challenges could find community and support from others who were experiencing similar challenges.
6. Although Sutter Health has long claimed that COVID restrictions forced—and continue to drive—the closure of the Mickelson Center's therapy pool, the reality is that there *were never any restrictions*. In fact, the pool closure was entirely unnecessary, as "therapeutic pools were exempt from any closures during the peak COVID mandate," according to Helen Godinez, San Mateo County Health supervising environmental health specialist.
7. In June, 2021, with COVID waning, Sutter issued a series of evolving, inconsistent explanations as to why the therapy pool remained closed. It became clear to the local community that the temporary closure was to become permanent, and that COVID was being used as a pretext to withdraw this unique and indispensable medical resource.
8. Frustrated, members of the local community organized to plead with Sutter to reopen the Mickelson Center therapy pool, including launching a Change.org petition signed by nearly 5000 community members. (change.org/save-the-Mickelson-pool)
9. Persistent lobbying by community members has led to formal, institutional support from over a dozen local government agencies, including ten city councils and the San Mateo County Board of Supervisors. (See attached list of supporters.)
10. Additionally, recognizing availability of warm water therapy as a core service necessary to support the health and well-being of the community, the Peninsula Health Care District (PHCD) has offered to fully fund any necessary repairs, remodeling and operational costs of the Mickelson Center pool until a new facility becomes available.
11. As the pool remains closed despite the best efforts of the local citizenry, multitudes of community members who depended upon the Center—senior citizens, rehabilitation patients and disabled persons of every age—remain devastated and are suffering.
12. Sutter's community neglect is not limited to the closure of the Mickelson Center and its therapy pool. Over the past decade, Sutter has cut at least 22 vital programs. (See attached list of program closures.) A significant number of these discontinued programs, such as the Senior Focus Adult Day Program, Phase 3 Cardiac Rehab/Phase 3 Pulmonary Rehab, and the Post Stroke Program, benefitted seniors and the disabled.
13. The current standard for 501(c)(3) tax exemption of a hospital, known as the "community benefit standard," is set forth in Revenue Ruling 69-545, 1969-2 C.B. 117. Of the five factors considered in Rev. Rul. 69-545, which determines whether a hospital has met the community benefit standard, one is whether the hospital's excess funds are generally applied to improvement of facilities, equipment, and patient care, and advancement of medical training, education, and research.
14. In short, not-for-profit hospitals such as Sutter Health are charged with investing the excess of revenue over expenses in such a way as to benefit the health and well-being of the communities they serve.

Sutter's fierce opposition to the efforts of community members, our office, and agencies such as PHCD to meet and work together to find a solution to the pool closure currently devastating the community runs contrary to its status as a not-for-profit.

15. Sutter Health's use of excess revenue is no small matter, given that the healthcare giant has been collecting a large nest egg of reserves that had grown to $7.967 billion in net cash, cash equivalents, and short-term investments as of year-end 2020. (See attached financial analysis by G.L. Hicks Financial, LLC.)
16. As you are aware, Sutter Health lost a lawsuit last year for monopolistic behavior. *I question whether Sutter Health is, in fact, meeting the obligations of its not-for-profit status.*
17. Of serious concern is Sutter's claim that it is moving toward focusing primarily on "acute care services" with no apparent consideration for the immense long-term and preventive benefits of rehabilitative and chronic care services such as warm water therapy—long recognized as beneficial by the medical profession, and depended upon by many here on the Peninsula. What is Sutter's obligation to patients when it abruptly closes services it uniquely has provided those patients for a considerable period of time?
18. Sutter often cites offerings such as its Mobile Stroke Unit (MSU), a laudable acute care service to be sure, as the reason it must close facilities like the therapy pool. But the reality is that even with MSU services, stroke still causes long-term disability in nearly half of survivors. *By closing rehabilitation and chronic care services such as the therapy pool, Sutter is condemning stroke survivors and other patients with mobility impairments to a needlessly poor quality of life.*

Warm Water Wellness Inc (WWW) is a nonprofit organization founded by community members to advocate for the reopening of the Mickelson Center therapy pool. Last month, I invited members of their group to join me for a rally in front of the facility. It was very moving to observe how so many former patrons of all ages, many in wheelchairs and with canes and walkers, showed up to make their voices heard.

There is a broad range of information on the subject to be found on the WWW website, warmwaterwellness.org, including the history of the pool, articles and letters to the editor from local media, personal stories from former therapy pool users, and updates on actions taken and tried by this organization. Many WWW board members and organizers are themselves disabled. Their battle has often been compared to that of a David against the Goliath that is Sutter Health.

I agree with the community that Sutter's actions in this matter are unjust and disproportionately affect the most vulnerable in our community. They may also be illegal. Sutter Health's status as a tax-exempt organization should be investigated as well as its compliance with the laws enforced in the Charitable Trusts Section.

As the office charged with protecting charitable assets and donations in California, I hope you will consider stepping in to help advance a resolution to Sutter Health's two-year abandonment of a vital healthcare resource.

I appreciate you taking the time to read our letter, and please do not hesitate to contact me directly if you have any questions regarding the situation at (650) 363-4572.

In friendship,

David J. Canepa

DAVID J. CANEPA
San Mateo County Supervisor

Three enclosures: Mickelson Therapy Pool supporters. List of MPMC closed programs. Sutter Health FY20 Financials/Hicks Report

Reopening the Mickelson therapy pool is supported not only by numerous editorials and articles in local newspapers but also by civic leaders, city and county governments, and various organizations. These include:

San Mateo County Board of Supervisors*
City of Belmont**
City of Burlingame*
City of Colma*
Foster City*
City of Half Moon Bay*
City of Hillsborough*
City of Menlo Park**
City of Millbrae*
City of Pacifica*
City of San Carlos
City of San Mateo*
Sequoia Healthcare District Board of Directors*
Peninsula Health Care District Board of Directors
San Mateo County Central Labor Council*
San Mateo Lions Club
Assemblymember Kevin Mullin
State Senator Josh Becker
San Mateo County Supervisor David Canepa
Belmont Vice Mayor Charles Stone
Half Moon Bay Mayor Robert Brownstone
Hillsborough Mayor Alvin Royse
San Carlos Mayor Sara McDowell
City of San Mateo Senior Citizens Commissioner Ellen Wang
San Mateo County Central Labor Council Executive Director Julie Lind Rupp
Sequoia Healthcare District Director Kimberly Griffin
Pomeroy Recreation & Rehabilitation Center CEO David Dubinsky
Joseph W. Cotchett, Esq.

*Organizations that have passed formal resolutions in support of reopening the Mickelson therapy pool

**Organizations with resolutions on upcoming agendas

DATE: March 31, 222

TO: Michael Shrader

FROM: Cheryl Fama, CEO

RE: MPMC Programs Closed in past 15 years

Per your request, the list that follows represents the programs that were either closed or turned over to another operator by Sutter/Mills-Peninsula Medical Center in the past 15 years. The source of my information is my direct knowledge and input from former MPMC employees. I've listed programs in alphabetical order as I did not have dates of closure on all to make a chronological listing meaningful.

Acute Rehabilitation Unit
Adult/child/teen Metabolic programs
Aquatics 2000 (independent exercise, group pool classes, physical therapy)
Arthritis Center
Bariatric Program (Weigh to Go)
Cardiac Rehab, PT, & OT at 1875 Trousdale 2018
Community Education (High volume of regularly scheduled lectures and health screenings)
Ease Into Exercise (Class for older adults held at 1720 ECR under Senior Focus umbrella)
Healing Store 2009
Integrative Medicine
Massage Therapy 2009
Outpatient Diabetes Program
Pediatric Unit
Phase 3 Cardiac Rehab/Phase 3 Pulmonary Rehab (closed vs not re-started since COVID?)
Post Physical Therapy (one on one exercise with Exercise Physiologist after PT concluded)
Post Stroke Program (group exercise program with RN and Exercise Physiologist)
Recovery Care Unit (post-surgery)
Renal Dialysis Center (Now operated by DaVita)
Senior Focus 2021
Skilled Nursing (Now Peninsula Post-Acute & Rehab)
Travel Medicine
Watsu 2009 (Aquatic Massage)

G.L. Hicks Financial, LLC

337 S. Palisades Drive
Orem, UT 84097
(801) 225-0731

April 20, 2021

Ms. Cheryl Fama, Chief Executive Officer
Ms. Vickie Yee, Chief Financial Officer
Peninsula Health Care District
1819 Trousdale Drive
Burlingame, CA 94010

Re: Assessment of Sutter Health and Mills-Peninsula Health Services

Dear Ms. Fama and Ms. Yee:

I appreciate the opportunity to again provide financial advisory services to Peninsula Health Care District (the "District") relating to the assessment of Sutter Health ("Sutter") and Mills-Peninsula Health Services ("MPHS" or the "Hospital Corporation") as owner and operator of Mills-Peninsula Medical Center, an approximate 450,000 square foot 241-bed general acute care hospital facility opened in 2011 (the "Hospital"). In this regard, you have expressed the desire to assess the financial stability of Sutter, as sole corporate member of the Hospital Corporation and the likelihood for the continued availability of needed healthcare services to District residents as a result of the continuing financial viability of Sutter and the Hospital Corporation. Unless otherwise noted, when Sutter is referenced in this report it refers to Sutter Health as combined with its affiliates and subsidiaries in its audited financial statements, including its medical and fundraising foundations, clinics and a variety of specialized healthcare organizations.

In conducting my assessment, I have reviewed the following materials relating to Sutter, the Hospital Corporation and the Hospital:

1. The Master Agreement between the District and the Hospital Corporation dated October 17, 2005
2. The District's 2019 Strategic Financial Policy Procedures approved on February 27, 2020
3. Sutter's audited financial statements for the calendar years 2016, 2017, 2018, 2019 and 2020 (dated March 3, 2021)
4. Sutter's $1,989,205,000 Series 2020A Taxable Revenue Bonds, Official Statement, including Appendix A, dated October 22, 2020
5. S&P Global Ratings research report for Sutter, dated December 23, 2019
6. S&P Global Ratings research report for Sutter, dated April 1, 2020
7. S&P Global Ratings credit profile for Sutter, dated October 6, 2020
8. Moody's Investors Service credit opinion report for Sutter, dated October 7, 2020
9. Sutter and MPHS web sites
10. The Corporation's internally prepared operating statements for the calendar years 2018, 2019 and 2020

The following information provides an overview of Sutter, MPHS, the Hospital and provides an assessment of Sutter's financial position, operating performance and overall credit strength as well as a limited assessment of MPHS's operating performance. In addition, a summary is provided of my assessment of risks that may impede Sutter and/or MPHS from fulfilling their obligations to the District pursuant to the Master Agreement between the District and MPHS.

GENERAL OVERVIEW OF THE MASTER AGREEMENT, THE HOSPITAL CORPORATION, AND THE HOSPITAL

On October 17, 2005, the District and MPHS entered into a Master Agreement relating to the lease of land comprising the Hospital site, the construction and operation of the Hospital, among other matters. The Master Agreement incorporates a land lease with a base term of 50 years and requires MPHS to pay the District approximately $2.2 million annually, adjusted for inflation every three years. The Master Agreement and land lease can be renewed for an additional 25 years upon MPHS's request and the District's consent. MPHS has agreed to provide core clinical services at the Hospital during the term of the Master Agreement. MPHS may request financial support from the District for projects or services that benefit the community or target underserved or disadvantaged populations within the District. Upon the request of MPHS, the District must act in good faith in reviewing such requests for financial support, but is not obligated to approve the same. MPHS is required to provide the District with quarterly reports of the operations of the Hospital. Upon the occurrence of certain events of default under the Master Agreement, the District may pursue a variety of remedies which shall not include termination of the Master Agreement unless specified serious defaults occur. Upon termination of the Master Agreement for specified serious defaults or due to the expiration of the Master Agreement, MPHS would be required to transfer ownership and control of the Hospital to the District in accordance with the terms and conditions of the Master Agreement.

GENERAL OVERVIEW OF SUTTER HEALTH

Sutter provides fully integrated healthcare services in two geographic areas (Sutter Health Bay Area and Sutter Health Valley Area) primarily in Northern California. It is one of the largest and most successful single state healthcare systems in the country. Sutter operates 30 acute care hospital facilities (approximately 4,200 licensed beds), one free-standing chemical dependency recovery hospital, its own health plan, several out-patient health facilities, and partners with physicians contracted through two medical foundations (approximately 2,500 physicians) and operates numerous other healthcare organizations. Sutter provides bondholders a gross revenue fund pledge and a "joint and several" obligation of its aggregate operating entities within an Obligated Group structure provided pursuant to their Master Trust Indenture (updated in October of 2020). The Obligated Group structure in essence consolidates the revenues of all members of the Obligated Group as security for the repayment of debt obligations under the Master Trust Indenture. Approximately 98% of Sutter's system-wide consolidated revenues are captured within this Obligated Group structure. Sutter currently holds the following bond ratings from Moody's Investors Service (A1 with a negative outlook revised on October 7, 2020), Standard & Poor's (A+ with a stable outlook revised on April 1, 2020) and Fitch (A+ with a negative outlook). All three ratings have recently been downgraded from their prior "Aa3/AA-" rating categories due to underperforming operations driven by a material increase in labor related costs, the effects of several northern California wild-fires, the COVID-19 pandemic, significant capital

costs and related debt issuances over the past several years in order for Sutter to meet earthquake retrofit requirements imposed by SB 1953 at its acute-care facilities.

FINANCIAL POSITION OF SUTTER HEALTH

Sutter recently completed a 20-year seismic upgrade program that has achieved compliance at all of its major acute hospital facilities (as reported in Moody's credit opinion dated October 7, 2020) with respect to SB 1953 that requires its acute-care hospitals to meet more stringent seismic building standards, including a complete rebuild of two San Francisco hospitals in 2018 and 2019, at a total cost of over $2.5 billion. It has accomplished this mandate well ahead of its 2030 deadline while still keeping its debt burden at relatively manageable levels (demonstrated by Sutter's debt to capital ratio as of December 31, 2020, of 34%) and its liquidity still at reasonably strong levels (demonstrated by Sutter's adjusted days cash on hand as of December 31, 2020, of 227 days). Sutter's ongoing investment in its facilities and equipment places Sutter in a strong position with respect to its competitors when it comes to providing state-of-the-art facilities for its medical staff to practice while meeting state mandated seismic requirements (as demonstrated by its 9.6 years average age of plant in 2018 and 2019 as compared with an S&P median ratio of 12.0 for an A+ rating category). Its low leverage and strong liquidity positions are also supported by Sutter's cash to debt ratio as of December 31, 2020, of 173%, and attests to Sutter's success in upgrading its facilities over the past several years while not impairing its balance sheet with an excessive use of debt or a reduction in its unrestricted reserves. Although a total of $4.6 billion in outstanding revenue bond debt appears to be excessive at first glance, the resulting debt to capital and cash to debt ratios indicated above combined with an 88% funding of its defined benefit retirement plan obligations places Sutter at an enviable position for many healthcare providers, small or large. Finally, Sutter's near-term capital budgets are modest in comparison with past year's capital budgets as there are no major capital projects on Sutter's horizon which should reduce future debt levels, leverage ratios and help to preserve reserves and improve current liquidity levels into the future.

However, future challenges await Sutter with the need to reduce the growth of its staffing costs, recover from past and potentially future state mandates to cease providing elective surgeries and procedures for prolonged periods, repay its outstanding long-term debt associated with capital improvements at its health facilities and medical office building leases and reduce its habit of ending up on the losing end of major lawsuits and the related impact this ultimately has on its cash reserves and operations, including the payment of a $575 million recent settlement of a class action lawsuit and compliance with restrictions and oversight measures associated with its past contracting practices.

OPERATING PERFORMANCE OF SUTTER HEALTH

Sutter's operating performance over the past five years has been characterized by increasing revenues (with the exception of a pandemic influenced 2020), but declining operating margins over the past three years (averaging (1.70%) and declining from 1.58% to (2.43%) from 2018 to 2020). Diversification of revenues, its excellent regional market position, a fully integrated health delivery system (both horizontal and vertical) with a large physician base that has been aligned closely with Sutter's acute-care facilities (approximately 5,500 active physicians in total) and a strong management team are some of the more important credit related strengths that Sutter has exhibited over the past several years. Another Sutter credit strength is its ability to

service the repayment of its debt obligations (demonstrated by a debt service coverage ratio of 3.57x and 3.63x in 2019 and 2020, respectively), even during a time of weak operating performance helped by investment earnings derived from the investment of its sizeable cash reserves and contributions from the efforts of community based charitable foundations, along with manageable debt service requirements (even though it doesn't utilize variable rate debt).

OPERATING PERFORMANCE OF MILLS PENINSULA HEALTH SERVICES

MPHS's operating performance over the past three years has been characterized by increasing revenues (with the exception of the pandemic 2020), strong operating margins (averaging 2.8% over the past three calendar years) and consistent positive cash flow that has produced decent excess margins (averaging 3.87% over the past three calendar years) and very strong EBIDA margins (averaging 12.4% over the past three calendar years). Consistency in MPHS's financial performance from year-to-year and its significant contribution to Sutter's obligated group structure (see below analysis) demonstrates MPHS's value and importance within the Sutter system. This consistent and strong operating performance has not been duplicated by many other California healthcare providers over the past three years, including Sutter.

Although only limited information over the past three calendar years was provided for MPHS, this information is none-the-less helpful in evaluating its contribution to Sutter's operations over this period. In particular, MPHS has out-performed Sutter over the past three years in its operating margin (2.80% vs. (1.70%)), in its excess margin (3.87% vs. 0.67%) and in its EBIDA margin (12.40% vs. 7.09%). In addition, when MPHS is compared with the Sutter system, it represents only 5.7% of total beds and only 5.0% of total operating revenues but represents 28.9% of its net income and 8.6% of its earnings before interest, depreciation and amortization (EBIDA), as follows:

(Dollars in Millions)	**2018**	**2019**	**2020**	**Average**
Licensed Beds:				
Sutter	4,200	4,200	4,200	4,200
MPHS	241	241	241	241
Percentage	5.7%	5.7%	5.7%	5.7%
Total Operating Revenues:				
Sutter	$12,697	$13,304	$13,220	$13,074
MPHS	$ 643	$ 677	$ 643	$ 654
Percentage	5.0%	5.0%	4.9%	5.0%
Net Income (Loss):				
Sutter	$(120)	$189	$200	$90
MPHS	$ 30	$ 28	$ 19	$26
Percentage	N/A	14.8%	9.5%	28.9%
Total Available (EBIDA):				
Sutter	$676	$1,084	$1,105	$955
MPHS	$ 88	$ 85	$ 73	$ 82
Percentage	13.0%	7.8%	6.6%	8.6%

PERCEIVED FUTURE RISKS – INTERNAL AND EXTERNAL

The providing of healthcare services in the State of California is a difficult challenge even in good economic times, but can be very challenging in times of economic crisis as has occurred over the past couple years in California due to massive wild-fires, the COVID-19 pandemic and related restrictions on elective surgeries and procedures, combined with state mandated operating and construction requirements without corresponding or sufficient reimbursement support. I believe the present economic climate, for the State of California in particular, and the nation as a whole, is the greatest immediate risk to Sutter's future operations and ultimately to their enviable financial position. Fiscal shortfalls and related problems due in large part to the continuing pandemic, the improved but still low level of reimbursement associated with California's Medi-Cal program, high costs associated with the construction of and improvements to acute care facilities due to OSHPD requirements, increasing staffing issues and related costs combined with Sutter's own continued poor labor relations, and problems stemming from litigation with several of Sutter's partners in the healthcare arena should all be of concern. These and other factors have caused many cities, counties and other public agencies struggling to face significant declines in tax revenues and other sources of revenues combined with the rise in underfunded pension plan obligations seeking either federal support or facing the possibility of filing for Chapter 9 bankruptcy protection in the future. Many local governmental agencies have already looked to Congress for financial support or will undoubtedly soon be seeking some form of government support. In addition, unemployment has increased in almost all sectors of California's economy with many of the most vulnerable in its population taking the greatest hits. Higher unemployment combined with businesses attempting to keep operating costs down will undoubtedly continue to move more employers/employees to high-deductible health plans with more co-payment requirements and higher deductible amounts. In addition, some California businesses have elected to move their businesses to other states that have a more favorable business climate than the state of California. These factors likely will have the impact of constricting revenues, operating margins and cash flow for physicians and healthcare providers alike. As mentioned above, California healthcare providers face significant challenges even during the best of economic times, but when the economy worsens, the challenges only intensify. This economic environment is reflected in all three rating agencies still retaining a negative outlook for the healthcare industry as a whole, that has been in place since early 2020.

Sutter's ongoing contentious relationship with its labor unions has been a difficult situation for many years and will likely continue to be a cause for concern in the future. In fact, Sutter is the only California healthcare system that still does not have a system-wide agreement with CNA, SEIU or any other labor union. Approximately 25% of Sutter employees are represented by collective bargaining units with ongoing union organizing activities at some of Sutter's facilities. The two largest unions representing Sutter employees include the California Nurses Association (CNA) and SEIU United Healthcare Workers West (formerly known as the Service Employees International Union). Sutter's relationship with organized labor will likely not change in the near future due in part to a nursing labor pool that continues to lag behind demand in California and most every other state in the nation. As a consequence, Sutter will likely continue to experience labor disputes and maybe even disruptions.

Several outstanding lawsuits, including a class action lawsuit relating to Sutter's arrangements with health plans, another lawsuit relating to billing and collection activities at a lab outreach program, two US Attorney's Office investigations of the billing activities of its reference lab testing and a separate criminal investigation associated with the lab outreach program and a Department of Justice investigation regarding potential False Claims Act violations, among others, were listed in Sutter's Official Statement dated October 22, 2020. Sutter management states "there can be no assurance that the final resolution of these matters will not have a material adverse impact on Sutter Health's consolidated financial position or results of operations and, therefore, could have a material adverse effect on the Obligated Group, taken as a whole." Although these disclosures of pending litigation are not uncommon in Official Statements associated with the issuance of debt by large healthcare providers, the total number of lawsuits listed by Sutter in this most recent Official Statement are more than I would typically expect to see and I believe is reflective of ongoing issues at Sutter in this area.

Competition from Kaiser Permanente, Dignity Health (part of CommonSpirit Health), Adventist Health, St. Joseph's of Orange and other independent healthcare providers continue to place pressure on its current market share and operating margins.

Unfunded state mandates for California healthcare providers including (i) minimum nurse staffing ratios, (ii) relatively stringent building code requirements overseen by the Office of Statewide Health Planning and Development ("OSHPD"), (iii) an expensive and protracted OSHPD plan check review process and (iv) an underfunded Medicaid (Medi-Cal in California) program are all concerns.

Current volatile investment earnings and in some instances substantial investment losses are problematic and deteriorating values associated with fixed income securities (caused in an increasing interest rate market environment) can lessen past years performance if profits are not continued. These same factors may also require funding increases in defined benefit pension plans and may also reduce contributions from fundraising efforts associated with Sutter operating entities.

From an industry perspective, all three rating agencies revised their outlooks for the healthcare industry from stable to negative in early 2020. These outlook changes by the rating agencies reflect their concerns for the fundamental credit conditions in the healthcare industry in the near future. Many reasons were listed for the recent change to a negative outlook, but the most influential factors appear to be the concern of a prolonged and deep recession caused in large part by the pandemic and related governmental actions taken to stem the loss of life associated with the COVID-19 virus. For Sutter specifically, the rating agencies indicated their concerns about the high cost of living in Sutter's service areas, a strong union presence in the communities served by Sutter, a challenging payer mix, high managed care penetration and unfunded mandates.

CONCLUSION

Although the above-stated potential risks can be significant, Sutter is likely one of the best prepared healthcare systems to survive the ongoing difficulties impacting the California healthcare industry. Although financial information is extremely limited on MPHS, it does

appear as if it continues to perform well when compared with other members of Sutter's Obligated Group. As such, I believe the greatest risks that Sutter will face in the next three to five years will originate from external forces (post-pandemic economic environment and governmental oversight). Sutter is still one of the strongest healthcare systems in California if not nationally; it is well positioned in its chosen markets and well managed. I believe Sutter is positioned to weather the storm that healthcare operators will likely endure over the next three to five years. As such, I believe that Sutter and the Hospital Corporation/MPHS will comply with the Ground Lease, assuming there is no catastrophic economic event that would change the delivery of healthcare in California as we know it today.

I would be pleased to answer any questions that you or any of the District's Board members may have concerning this assessment of Sutter Health and Mills-Peninsula Health Services and I look forward to presenting my findings at your Board meeting on May 11, 2021.

Sincerely,

Gary Hicks
President

SUTTER HEALTH
SUMMARY OF AUDITED FINANCIAL STATEMENTS
(Dollars in Millions)

	2016	2017	2018	2019	2020	3-Year Average	Median Ratios - 2019 Moody's A3 (38)	Fitch A- (25)	S&P A- (8)
Patient Service Revenues	$ 10,290	$ 10,828	$ 10,957	$ 11,407	$ 10,532	$ 10,965			
Premium Revenues	1,160	1,220	1,383	1,509	1,525	1,472			
Contributions	9	9	6	29	821	285			
Other	414	387	351	359	342	351			
Total Operating Revenues	$ 11,873	$ 12,444	$ 12,697	$ 13,304	$ 13,220	$ 13,074			
Total Operating Expenses	$ 11,496	$ 12,118	$ 12,496	$ 13,852	$ 13,541	$ 13,296			
Income (Loss) from Operations	$ 377	$ 326	$ 201	$ (548)	$ (321)	$ (223)			
Non-Operating Revenues (Expenses):									
Investment Income	23	336	187	246	205	$ 213			
Change in Net Unrealized Gains & (Losses)	229	315	(454)	491	440	159			
Loss on Extinguishment of Debt	(7)	(19)	(54)	-	(202)	(85)			
Net Periodic Postretirement Cost	-	-	-	-	78	26			
Net Income (Loss) Before Noncontrolling Interests	**$ 622**	**$ 958**	**$ (120)**	**$ 189**	**$ 200**	**$ 90**			
Add Depreciation & Amortization Expense	676	655	681	738	747	722			
Add Interest Expense	138	105	115	157	158	143			
Total Available for Debt Service (EBIDA)	***$ 1,436***	***$ 1,718***	***$ 676***	***$ 1,084***	***$ 1,105***	***$ 955***			
Maximum Annual Debt Service	304	304	304	304	304	304			
Debt Service Coverage Ratio	***4.72***	***5.65***	***2.22***	***3.57***	***3.63***	***3.14***	***4.10***	***3.10***	***3.40***
Operating Margin	***3.18%***	***2.62%***	***1.58%***	***-4.12%***	***-2.43%***	***-1.70%***	***1.80%***	***0.90%***	***1.70%***
Excess Margin/Net Income Margin/Total Margin	***5.13%***	***7.32%***	***-0.97%***	***1.35%***	***1.43%***	***0.67%***	***4.60%***	***3.20%***	***3.90%***
Operating Cash Flow Margin/ EBIDA Margin	***11.84%***	***13.12%***	***5.44%***	***7.72%***	***7.93%***	***7.09%***	***8.00%***	***9.10%***	***9.30%***
Net Return on Total Assets	***3.97%***	***5.61%***	***-0.69%***	***1.02%***	***0.98%***	***N/A***	***N/A***	***N/A***	***N/A***
Patient Revenue Margin	***-0.40%***	***-0.58%***	***-1.26%***	***-7.25%***	***-12.31%***	***-6.90%***	***N/A***	***N/A***	***N/A***
Long-term Debt Obligations	$ 4,138	$ 3,972	$ 4,626	$ 4,520	$ 4,601				
Unrestricted (Controlling) Net Assets	*$ 7,946*	*$ 8,965*	*$ 8,530*	*$ 8,705*	*$ 8,741*				
Total Capital	$ 12,084	$ 12,937	$ 13,156	$ 13,225	$ 13,342				
L-T Debt to Capital	***34%***	***31%***	***35%***	***34%***	***34%***		***36%***	***45%***	***47%***
L-T Debt to Equity	***49%***	***42%***	***51%***	***48%***	***49%***		***N/A***	***N/A***	***N/A***
Net Property, Plant & Equipment and CIP	*$ 7,735*	*$ 7,954*	*$ 8,193*	*$ 8,345*	*$ 8,043*				
Licensed Beds	*4,188*	*4,188*	*4,188*	*4,188*	*4,188*				
Net PP&E per Licensed Bed	***$ 1.85***	***$ 1.90***	***$ 1.96***	***$ 1.99***	***$ 1.92***		***N/A***	***N/A***	***N/A***
L-T Debt to Net PP&E	***53%***	***50%***	***56%***	***54%***	***57%***		***N/A***	***N/A***	***N/A***
Total Net Assets	*$ 8,498*	*$ 9,558*	*$ 9,111*	*$ 9,340*	*$ 9,422*				
Total Assets	*$ 15,674*	*$ 17,081*	*$ 17,303*	*$ 18,527*	*$ 20,441*				
Equity to Total Assets	***54%***	***56%***	***53%***	***50%***	***46%***		***N/A***	***N/A***	***N/A***
Total Current Assets	*$ 6,844*	*$ 7,920*	*$ 7,726*	*$ 8,186*	*$ 10,256*				
Total Current Liabilities	*$ 1,952*	*$ 2,457*	*$ 2,276*	*$ 2,894*	*$ 4,065*				
Current Ratio	***3.51***	***3.22***	***3.39***	***2.83***	***2.52***		***1.70***	***N/A***	***N/A***
Cash and Cash Equivalents	$ 426	$ 395	$ 362	$ 505	$ 1,169				
Investments*	*$ 4,870*	*$ 5,811*	*$ 5,969*	*$ 6,845*	*$ 6,798*				
Total Cash, Cash Equivalents and Investments	$ 5,296	$ 6,206	$ 6,331	$ 7,350	$ 7,967				
Daily Cash Requirements	*$ 30*	*$ 31*	*$ 32*	*$ 36*	*$ 35*				
Days Cash on Hand	***179***	***198***	***196***	***205***	***227***		***179***	***175***	***138***
Cash to L-T Debt	***128%***	***156%***	***137%***	***163%***	***173%***		***102%***	***120%***	***101%***
Patient Accounts Receivable	*$ 1,264*	*$ 1,277*	*$ 1,223*	*$ 1,244*	*$ 1,205*				
Days in Accounts Receivable	***40***	***39***	***36***	***35***	***36***		***46***	***45***	***41***

N/A: Not available.

* Excludes $999M in advance Medicare payments, $575M in a legal settlement, $209M in deferred payroll taxes and $400M in outstanding S-T LOC.

Exhibit B

MILLS-PENINSULA HEALTH SERVICES
SUMMARY OF FINANCIAL STATEMENTS
(Dollars in Thousands)

	2018	2019	2020	3-Year Average	Median Ratios - 2019 Moody's A3	Fitch A-	S&P A-	Sutter Health 2020	Sutter Health 3-Year Average
Total Operating Revenues	$ 643,339	$ 676,812	$ 643,181	$ 654,444					
Total Operating Expenses	$ 624,604	$ 649,771	$ 634,000	$ 636,125					
Income from Operations	$ 18,735	$ 27,041	$ 9,181	$ 18,319					
Investment Income & Other Nonoperating Revenues	11,070	1,282	9,593	$ 7,315					
Net Income	**$ 29,805**	**$ 28,323**	**$ 18,774**	**$ 25,634**					
Add Depreciation & Amortization Expense	47,440	45,814	43,638	45,631					
Add Interest Expense	11,141	10,594	10,551	10,762					
Total Available for Debt Service (EBIDA)	***$ 88,386***	***$ 84,731***	***$ 72,963***	***$ 82,027***					
Maximum Annual Debt Service	N/A	N/A	N/A	N/A					
Debt Service Coverage Ratio	***#VALUE!***	***#VALUE!***	***#VALUE!***	***#VALUE!***	***4.10***	***3.10***	***3.40***	***3.63***	***3.14***
Operating Margin *(line 11 / line 8)*	***2.91%***	***4.00%***	***1.43%***	***2.80%***	***1.80%***	***0.90%***	***1.70%***	***-12.31%***	***-6.90%***
Excess Margin *(line 14 / (line 8 + line 12))*	***4.55%***	***4.18%***	***2.88%***	***3.87%***	***4.60%***	***3.20%***	***3.90%***	***1.43%***	***0.67%***
EBIDA Margin *(line 18 / (line 8 + line 12))*	***13.51%***	***12.50%***	***11.18%***	***12.40%***	***8.00%***	***9.10%***	***9.30%***	***-2.43%***	***-1.70%***

SUTTER HEALTH **Exhibit C**
SUMMARY OF AUDITED FINANCIAL STATEMENTS - DEFINED TERMS

Days in Accounts Receivable (days)	(Net patient accounts receivable x 365) / Net patient service revenue
Debt Service Coverage Ratio (x)	Total available for debt service / Actual debt service
Average Age of Plant (years)	Accumulated depreciation / Depreciation expense
Cash on Hand (days)	(Unrestricted cash & investments x 365) / (Total operating expenses - depreciation and amortization expense)
Curent Ratio	Total current assets / Total current liabilities
Excess Margin	(Total operating revenue - total operating expenses + nonoperating income) / (Total operating revenue + nonoperating income)
Total Available for Debt Serivce	Total operating revenue - total operating expenses + nonoperating income + depreciation & amortization expenses + interest expense
Operating Cash Flow Margin	(Total operating revenue - total operating expenses + nonoperating income + depreciation & amortization expenses) / Total operating revenue
Operating Margin	(Total operating revenue - total operating expenses) / Total operating revenue
Long-term Debt-to-Capitalization	Long-term debt / (Long-term debt + unrestricted (controlling) net assets)
Unrestricted Cash and Investments	Unrestricted cash + short-term investments + board designated cash & investments
Cash and Investments to Debt	Unrestricted cash & investments / Long-term debt

Peninsula Health Care District
Assessment of Sutter Health & Mills-Peninsula Health Services

G.L. Hicks Financial
Gary Hicks, President

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Background/Purpose – Master Agreement & Land Lease

- Master Agreement and Land Lease entered into on October 17, 2005
- 50-year term w/ 25-year renewal option upon MPHS request and PHCD consent
- MPHS provides core clinical services (Sec. 3.02)
  - MPHS may request financial support for services
  - Termination of services – economic infeasibility
- MPHS default and paramount default (Sec. 5.01)

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General Overview of Sutter

- Operates 30 Acute Care Hospitals
  - 4,200 licensed acute care beds
- MTI and Obligated Group Structure
  - Revenue Fund pledge w/ joint & several obligation
- All 30 Acute Facilities meet SB 1953 Requirements
- Current ratings are A1 & A+ by M, S&P and F

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Sutter's Key Financial Indicators

- Financial Position (as of 12/31/20)
  - Total Cash & Investments = $8.0 Billion - adjusted
  - Total Outstanding L-T Debt = $4.6 Billion
  - Day's Cash on Hand = 227 days
  - Debt to Capital Ratio = 34%
- Operating Performance (2020 and 3-yr. average)
  - Operating Margin = (2.43%) & (1.70%)
  - Excess Margin = 1.43% & 0.67%
  - EBIDA Margin = 7.93% & 7.09%
  - Debt Service Coverage = 3.63x & 3.14x

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MPHS Key Operating Indicators

- Revenues declined for first time in recent history
- Positive operating margins 2018, 2019 & 2020
- Operating Performance for 2020 & 3-Yr. Average
  - Operating Margin: 1.43% & 2.80%
  - Excess Margin: 2.88% & 3.87%
  - EBIDA Margin: 11.18% & 12.40%
  - Depreciation Expense: $43.6M & $45.6M

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MPHS Comparison w/ Sutter 3-Year Average

- Total Operating Revenues: 5.0%
- Net Income: $90M vs. $26M 28.9%
- Total Available (EBIDA): $955M vs. $82M 8.6%
- Operating Performance MPHS vs. Sutter 3-Yr. Ave.
  - Operating Margin: 2.80% vs. (1.70%)
  - Excess Margin: 3.87% vs. 0.67%
  - EBIDA Margin: 12.40% vs. 7.09%

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Sutter: 2007 Versus 2020

- Declining:
  - Bond Ratings: Aa3, AA- vs. A1, A+ & A+
- Improving:
  - Total Cash & Investments: $3.3B vs. $8.0B
  - Total L-T Debt Outstanding: $2.6B vs. $4.6B
  - Day's Cash on Hand: 173 days vs. 227 days
  - Debt to Capital Ratio: 40% vs. 34%
  - Cash to Debt Ratio: 123% vs. 173%

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Future Risks

- External Factors (uncontrollable):
  - Economic Climate caused by COVID-19 & similar calamities (droughts, earthquakes, fires, etc.)
  - Unfunded State Mandates
  - Strong Competition in Service Areas
- Internal Factors (controllable):
  - Staffing Difficulties & Labor Disputes
  - Ongoing Litigation & Contracting Oversight
  - Continuation of Investment Returns

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Conclusion

- Strong Liquidity and Low Leverage
- Conservative Capital Structure (no derivatives or variable rate debt)
- Strong Market Share in Market Service Areas
- Successfully Integrated Physician Network
- Strong Contracting Leverage due to Size
- One of the Best Positioned Healthcare Systems in California

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