DRAFT REPORT

MARK TWAIN MEDICAL CENTER

VALUATION DATE: JANUARY 18, 2018
DISTRIBUTION DATE: JANUARY 20, 2018



VMG HEALTH
WE VALUE HEALTHCARE

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MARK TWAIN MEDICAL CENTER

SECTION I – ENGAGEMENT & TRANSACTION OVERVIEW

MARK TWAIN MEDICAL CENTER

ENGAGEMENT OVERVIEW

VMG HEALTH
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Engagement Overview

Value Management Group, LLC d/b/a VMG Health ("VMG") has been engaged by Archer Norris, PLC ("Archer Norris") in connection with its representation of Mark Twain Health Care District (the "District" or the "Landlord") to provide a third party, independent fair market value ("FMV") analysis pertaining to certain terms of a potential transaction involving the District.

Specifically, the California Health and Safety Code specifies certain powers afforded to Hospital Districts (and thus these powers are applicable to Mark Twain Medical District). Specifically, Power 32121 establishes that "Each local district shall have and may exercise the following powers":

Section (p) (1):

- *To transfer, at fair market value, any part of its assets to one or more corporations to operate and maintain the assets. A transfer pursuant to this paragraph shall be deemed to be at fair market value if an independent consultant, with expertise in methods of appraisal and valuation and in accordance with applicable governmental and industry standards for appraisal and valuation, determines that fair and reasonable consideration is to be received by the district for the transferred district assets. Before the district transfers, pursuant to this paragraph, 50 percent or more of the district's assets to one or more corporations, in sum or by increment, the elected board shall, by resolution, submit to the voters of the district a measure proposing the transfer. The measure shall be placed on the ballot of a special election held upon the request of the district or the ballot of the next regularly scheduled election occurring at least 88 days after the resolution of the board. If a majority of the voters voting on the measure vote in its favor, the transfer shall be approved. The campaign disclosure requirements applicable to local measures provided under Chapter 4 (commencing with Section 84100) of Title 9 of the Government Code shall apply to this election.*

In accordance with the requirements stated in Section (p) (1) above, and the terms and consideration amounts specified in the final draft term Sheet dated January 18, 2018 (the "Draft Term Sheet"), VMG has been asked to provide the following to the District:

I. Determination of Fair Market Value Rent associated with the Real Property and Personal Property to be leased to Mark Twain Medical Center ("MTMC", or the "Hospital", or the "Tenant") by the District;

II. Review of the rate of return utilized to calculate the lease payment on District Acquisition Cost in excess of $8.0 million; &

III. Determination of the Fair Market Value of the 49.0% interest in MTMC purchased from the District.

Engagement Overview

VMG's report is intended for use solely by Archer Norris and the District and only for the indicated purpose. Furthermore, the result of our analysis should not be construed as a fairness opinion or investment recommendation. The term FMV means the price at which property would change hands between a willing buyer and willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell and both parties having reasonable knowledge of the relevant facts.

VMG has not taken any steps in auditing the financials statements provided. We have relied upon the representation that the latest financial statements are accurate and represent the financial and operational assets of MTMC in a reasonable manner. The obligation of VMG is solely a corporate obligation, and no officer, principal, director, employee, agent, shareholder, or controlling person shall be subjected to any personal liability whatsoever to any person or entity, nor will any such claim be asserted by or on behalf of any other party to this agreement or any person relying on the opinion. In reaching our final conclusion with respect to the FMV, we considered the factors set forth in Revenue Ruling 59-60, 1959-1, C.b. 237, including:

- The nature of the business and the history of the enterprise from its inception;
- The economic outlook in general and the condition and outlook of the specific industry in particular;
- The book value of the stock and the financial condition of the enterprise;
- The earning capacity of the enterprise;
- The dividend-paying capacity of the enterprise;
- Whether or not the enterprise has goodwill or other intangible value;
- Prior sales of the stock and the size of the block of stock to be valued; and
- The market price of stock of corporations engaged in the same or a similar line of business, having their stocks actively traded on an exchange or over-the-counter market.

MARK TWAIN MEDICAL CENTER

TRANSACTION OVERVIEW

History of Mark Twain Medical Center

Establishment of the District & MTMC

Mark Twain Health Care District was formed by a vote of the people of Calaveras County in a special election held August 27th, 1946. The political boundaries of the Mark Twain Health Care District are comprised of the entire County of Calaveras. Mark Twain District Hospital was built in 1951 with funding from the Hill-Burton Act.

The District shifted management and operation of Mark Twain District Hospital to Dignity Health ("Dignity") through the establishment of Mark Twain Medical Center (the "Hospital" or "MTMC"), which was organized as a California non-profit corporation and had operations managed by Dignity under the terms of a management services agreement between Dignity and MTMC. Real Property and Personal Property was leased from the District to MTMC under the terms of a Lease Agreement established in 1990 (the "Prior Lease") between the District and MTMC. Unless terminated, the Prior Lease is set to expire after a 30-year term on December 31, 2019. Upon termination of the Prior Lease, the District would be required to purchase MTMC's fixed assets at a defined "District Acquisition Cost" per the Prior Lease.

Draft Term Sheet Overview

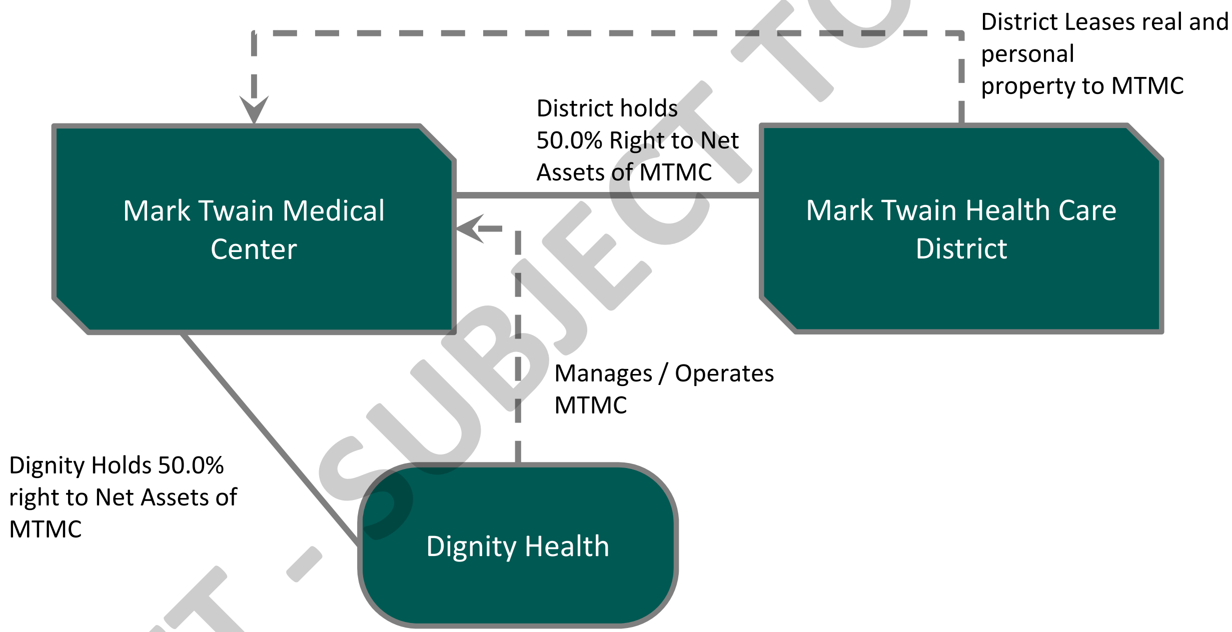
Prior to expiration of the Prior Lease, the District began a process to evaluate future opportunities for the hospital. Ultimately, the Draft Term Sheet currently under consideration was arrived at first through attrition of potential interested investors during the RFP process, and then through negotiations with Dignity to establish the new lease (the "New Lease"). VMG was provided the final Draft Term Sheet which outlines the following terms associated with the New Lease:

- The up-front lease prepayment, the on-going annual lease payment following the prepayment period, the additional lease payment adjustments for certain utilities expenses, and the termination fee payable to the District if Dignity does not renew the lease. Additional detail and lease payment calculations are provided later in this report.

- Consideration to be paid to the District by Dignity in association with modification to the MTMC Articles of Incorporation ("Articles") and Bylaws such that, upon dissolution of MTMC, Dignity would have the right to 99.0% of MTMC's assets remaining after payment of all MTMC debts and liabilities. The current Articles specify Dignity's right to 50.0% of MTMC's assets upon dissolution and the remaining 50.0% is held by the District. Therefore, the consideration proposed in the Draft Term Sheet is for the payment for an additional 49.0% interest in the net assets in MTMC and the change in liquidation rights to Dignity upon termination of the New Lease.

Prior Lease & Current Organizational Structure

In September of 1989 the District agreed to a 30-year lease with St. Joseph's Healthcare Corporation ("St. Joseph's"). St. Joseph's joined Catholic Health Care West during the initial lease term, and Catholic Health Care West later became Dignity. Dignity continues to manage the operations of the Hospital under the terms of a separate management services agreement. The Prior Lease's effective date was January 1, 1990 and was set to expire December 31, 2019. An overview of the current organizational structure is presented in the chart below.



Request For Proposal Process

In August of 2016, the District hired Quorum Health to assess whether the District should operate MTMC as an independent hospital, continue with Dignity as manager, or consider other options. After the report was issued, the District began the Request For Proposal ("RFP") process. It is VMG's understanding that the District openly solicited bids for MTMC under various scenarios. Based on discussions with Management, the four parties that participated in the RFP process were Kaiser Permanente ("Kaiser"), Sutter Health ("Sutter"), Adventist Health System ("Adventist"), and Dignity. Although non-disclosure agreements precluded District Management from sharing additional details, VMG reviewed public press release information to assist with an understanding of the RFP process.

Key Events

- January 1, 1990 Original Lease's Effective Date
- March 24, 2016- "Partnership with Dignity Health evaluated"- *Calveras Enterprise*
- August 25, 2016- Mark Twain Health Care District directors hire Quorum Health to assess whether the district should operate Mark Twain Medical Center as an independent hospital, continue with Dignity as manager, or considered other options- *Calveras Enterprise*
- June 5, 2017- *Quorum report issued*
- July 2017- District Issues Request For Proposal ("RFP")
- July-December 2017- The RFP was communicated to various health systems which included discussions with executive leadership.
- December 8, 2017- Adventist Health decided not to move forward with the RFP process - *Calveras Enterprise*.
- December 11, 2017 Mark Twain hospital district director indicated Dignity Health option is the best – The Union Democrat
- December 13, 2017- District considers independent operation vs. new Dignity Health agreement- *Calveras Enterprise*
- December 20, 2017- VMG engaged by Archer Norris in connection with its representation of the District to provide valuation services.
- December – January 18, 2017 – District and Dignity continue to negotiate terms of New Lease Agreement
- No later than September 30, 2018- Expected Date for Early Termination of the Lease

Although no publicly available information is available regarding any proposed offers by the interested parties discussed above, the above process provided an opportunity for the District's consideration of alternatives to the current organizational structure. Ultimately, the Draft Term Sheet currently under consideration was arrived at first through attrition of potential interested investors during the RFP process, and then through continued negotiations with Dignity to establish the New Lease. It is important to consider that the process to establish the current Draft Term Sheet included consideration from outside parties other than Dignity and was an informed process by the District.

Summary of New Lease Terms

Below is a summary of the Draft Term Sheet provisions associated with the New Lease Agreement between the District (the "Landlord") and MTMC (the "Tenant"). As mentioned previously, VMG was provided a final Draft Term Sheet dated January 18, 2018.

New Lease Summary of Terms

Term

- Initial Term – 10 Years following Closing of the Prior Lease
- Renewal Provisions – Lease shall automatically renew for four (4) consecutive five (5) year terms for a total of 30 years, unless Tenant: (i) gives notice to prevent such automatic renewal from occurring no later than 36 months in advance of such automatic renewal, and (ii) pays the Termination Fee.
- Termination Fee – Termination Fee equals $10,000 times 360 minus the number of months during the New Lease which the Tenant occupied the lease premises. Termination fee is due and payable within 60 days of Tenant's notice.

Tenant Obligations

- Rent Payment – Fixed (for 30 years) at $100,000 per month.
- Rent Prepayment – The first 60 months (5 years) of rent shall be prepaid to the Landlord at Closing of the New Lease. Beginning in month 61, monthly rent shall be paid the first of each month.
- Additional Monthly Rent – The Monthly Rent Payment shall be the sum of $100,000, plus the excess (if any) of the "District's Acquisition Cost" over $8.0 million, divided into 360 monthly payments, at an interest rate of 8.00%.

Landlord Obligations

- Electric Utilities – Landlord obligation to pay electric utilities of the leased premises. Landlord shall pay such electric utilities for the entire term of the New Lease unless Landlord becomes ineligible to purchase discounted electricity. Should this occur, then at any time after, Landlord may terminate its obligation to pay such electric utilities and monthly rent shall decrease by an amount equal to the Landlord's average monthly electric utility costs at the discounted rate.
- Other Utilities – Landlord obligation to pay natural gas, water/sewer, telephone, other than the main AT&T bill, and non-hazardous non-medical waste removal for the leased premises. Landlord may require Annual Reimbursement from Tenant equal to the amount by which Landlord's cost of such utilities exceeds (a) $300,000 per year ($25,000 per month) during the first 5 years, or (b) at month 61 an annual amount not less than zero as established by the Landlord in its sole discretion.

**The list above is a summary of those terms most relevant to VMG's analysis and does not reflect the full Draft Term Sheet.*

MARK TWAIN MEDICAL CENTER

FAIR MARKET VALUE RECOMMENDATION

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Comparison of Fair Market Value to Proposed Consideration for 49.0% Interest in MTMC

The Draft Term Sheet includes specified consideration of $14.5 million which will be paid to the District by Dignity in consideration of proposed changes to the Articles and Bylaws of MTMC. Specifically, this payment will provide Dignity with a right to 99.0% of the assets of MTMC upon dissolution. Given the current Articles specification that Dignity holds a 50.0% right to these assets, the payment covers the purchase of the right to an incremental 49.0% of the assets of MTMC upon dissolution. These asset values would be adjusted at dissolution for the then current liabilities of MTMC.

VMG performed a Fair Market Value analysis of MTMC at the business enterprise level ("BEV"), as though MTMC were to conduct a hypothetical sale of 100.0% of the equity of the Hospital. This analysis was utilized to determine if the payment of $14.5 million is consistent with Fair Market Value.

Therefore, the BEV was estimated at approximately **$15.8 million** and reflects the value of the operations of MTMC inclusive of all operating assets. Based on a December 31, 2017 balance sheet, adjustments have been applied to the BEV for certain balance sheet items not reflected in the BEV. These adjustments include a reduction for a negative balance of cash & cash equivalents of approximately $3.3 million, addition of a $5.2 million net working capital surplus, and addition of $12.1 million of non-operating assets. The net working capital surplus is calculated based on a normalized level of cash-free net working capital of 10.0% of normalized net operating revenue. The BEV is also reduced for current portion of long-term debt of approximately $699,000 and long-term liabilities of approximately $545,000. The resulting FMV of MTMC, adjusted for non-operating assets and liabilities is approximately $28.6 million and represents the value of 100% of the equity of MTMC.

Fair Market Value Recommendation	Value
Fair Market Value of the Hospital, Business Enterprise Level	$15,800,000
Plus: Cash and Cash Equivalents and Short term investments	(3,256,000)
Plus: Net Working Capital Surplus	5,229,302
Plus: Non-Operating Assets	12,112,000
Fair Market Value of the Hospital, BEV Adjusted for Non-Operating Assets	29,885,302
Less: Current Portion of Long Term Debt	(699,000)
Less: Long-Term Liabilities	(545,000)
Fair Market Value of the Hospital, BEV Adjusted for Non-Operating Assets and Liabilities	$28,600,000

Comparison of Fair Market Value to Proposed Consideration for 49.0% Interest in MTMC

We have adjusted the value of a 100.0% interest calculated on the previous page to reflect a pro-rata 49.0% interest midpoint value of approximately $14.0 million. The concluded Fair Market Value Range for a 49.0% interest in MTMC is estimated between **$13.2 million and $14.8 million.**

Fair Market Value Recommendation	Value
Fair Market Value of the Hospital, BEV Adjusted for Non-Operating Assets and Liabilities	$28,600,000
Percentage of Interest	49.0%
Fair Market Value of 49% Interest in MTMC (Rounded)	**$14,010,000**

Selected Fair Market Value Range for 49.0% Interest in MTMC (Rounded):		
Low	**Mid**	**High**
$13,200,000	**$14,000,000**	**$14,800,000**

Dignity's Payment to District for the 49% Interest	**14,500,000**

Conclusion – Comparison of Fair Market Value to Proposed Consideration for 49.0% Interest in MTMC

As mentioned above, Dignity is purchasing the 49% interest for $14.5 million as stated in the Draft Term Sheet. **As this consideration amount falls within the Fair Market Value range determined by VMG, it is our opinion that the consideration is consistent with Fair Market Value.**

VMG understands the District may grant $1.0 million from these proceeds to a foundation in support of the Hospital. A potential grant by the District, which is at the sole discretion of the District, is outside this FMV opinion.

Please refer to *Section II* of this report for detail regarding assumptions and methodology used to estimate the Fair Market Value of MTMC at the Business Enterprise Level.

Qualifying Assumptions

Fair Market Value of MTMC and Comparison to Proposed Consideration for a 49.0% Interest

- VMG relied upon data provided by Dignity and the District for historical operational and financial information utilized in the valuation of MTMC. VMG has not independently audited or confirmed the accuracy of the data provided. We are relying on the data as materially true and correct. To the extent that the information provided to VMG is inaccurate, we reserve the right to amend our analysis accordingly.

- VMG estimated the business enterprise value ("BEV") for MTMC by considering three approaches which include the Cost Approach, Market Approach, and Income Approach. Ultimately, we placed equal reliance (33.3%) on the concluded valuation under each of the three methods.

- BEV is inclusive of a normalized level of net working capital, which has been estimated at 10.0% of net operating revenue for MTMC, or $6.0 million. Based on the December 31, 2017 balance sheet, actual working capital was approximately $11.3 million, or 19.0%, resulting in a working capital surplus calculated at $5.2 million.

- VMG understands that MTMC's historical financial statements include allocated corporate overhead by Dignity. These costs are classified as "Purchased Services – Intercompany" and "Purchased Services – Other" in VMG's Restated Historical Income Statements. VMG has not opined as to the Fair Market Value payment for any services provided by Dignity to MTMC.

Proposed Lease Terms and Comparison to Fair Market Value Rent

Fair Market Value Rent Analysis

VMG determined the Fair Market Value Rent associated with the assets to be leased by the District within the following range: $88,646 to $100,884.

This compares to the monthly lease payment in the Draft Term Sheet of $100,000 including utilities (which is prepaid for the first five years). This fixed monthly lease payment is for District Acquisition Costs up to $8.0 million. Further for comparability purposes, this figure must be adjusted for the utility obligations of the District to allow comparison with the Fair Market Value Rent as determined by VMG. Therefore, the component of the monthly lease payment for the assets to be leased by the District is $45,000 during the first five years and $70,000 beginning in Year Six (as the District at its discretion may reduce its non-electrical utility obligation). These amounts are below VMG's determined Fair Market Value Rent. However, other terms by Dignity should be considered, including prepayment of the monthly rent payment and the potential early termination payment. To determine if the proposed lease terms are at Fair Market Value, VMG compared the Fair Market Value Rent to all lease related considerations by Dignity as outlined in the Draft Term Sheet during the first ten years of the lease term. This period was selected as Dignity may not renew the lease after Year 10 but is subject to an early termination payment.

The cash flows below represents the initial ten-year lease term at a Fair Market Value Rent within the range estimated by VMG. These rents are on a triple net basis (i.e. excluding utility costs to the landlord). These cash flows were discounted back to a present value using a 10.0% discount rate. This discount rate represents a blend of personal property and real estate concluded return rates. We have not escalated rent in the 10 year projection which is consistent with the Draft Term Sheet. On a present value basis, the sum of the discounted Fair Market Value lease payments is approximately $6.7 million.

Year	1 2019	2 2020	3 2021	4 2022	5 2023	6 2024	7 2025	8 2026	9 2027	10 2028
VMG FMV Lease Payment:										
FMV Monthly Lease Payment - Capital Assets	45,640	45,640	45,640	45,640	45,640	45,640	45,640	45,640	45,640	45,640
FMV Monthly Lease Payment - Real Estate	45,319	45,319	45,319	45,319	45,319	45,319	45,319	45,319	45,319	45,319
Monthly Estimated FMV Lease Payment	90,959	90,959	90,959	90,959	90,959	90,959	90,959	90,959	90,959	90,959
Annual Estimated FMV Lease Payment	1,091,507	1,091,507	1,091,507	1,091,507	1,091,507	1,091,507	1,091,507	1,091,507	1,091,507	1,091,507
Discount Rate / Present Value Factor	0.9091	0.8264	0.7513	0.6830	0.6209	0.5645	0.5132	0.4665	0.4241	0.3855
Present Value of the Discounted FMV Lease Payments	992,279	902,072	820,065	745,514	677,740	616,127	560,115	509,196	462,905	420,823
Sum of Discounted FMV Lease Payments (Rounded)	6,700,000									

Proposed Lease Terms and Comparison to Fair Market Value Rent

Proposed Lease Terms

The cash flows below represents the various lease payment streams as outlined in the Draft Term Sheet over the initial 10 year lease term. As stated earlier, this period was selected as Dignity may not renew the lease after Year 10.

During the first five years, the $100,000 per month of rent or $6,000,000 will be prepaid and immediately received by the District. However, the District will be responsible for $55,000 per month in electric and non-electric utility expenses ($660,000 per year). The utility obligation represents a cash outflow to the District. Beginning in year six, the Tenant is responsible for a reduced utility obligation of $30,000 per month ($360,000 per year). Thus, the District receives a net $70,000 per month or $840,000 per year. At the end of year seven, the landlord is assumed to receive a termination penalty of $2,400,000 (as the termination penalty is based upon the Tenant exiting the lease after year ten but must be paid in year seven). These cash flows were discounted back to a present value using a 10.0% discount rate. On a present value basis, the sum of the discounted lease payments per the DRAFT Term Sheet are approximately $6.7 million which is consistent with the present value of the Fair Market Value lease payments as stated in the prior page.

Year	1 2019	2 2020	3 2021	4 2022	5 2023	6 2024	7 2025	8 2026	9 2027	10 2028
Lease										
Total Monthly Lease Payment to District	-	-	-	-	-	100,000	100,000	100,000	100,000	100,000
- District Utility Obligation	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)	(30,000)	(30,000)	(30,000)	(30,000)	(30,000)
Net Lease Revenue to District (Monthly)	(55,000)	(55,000)	(55,000)	(55,000)	(55,000)	70,000	70,000	70,000	70,000	70,000
Annual Net Lease Revenue to District	(660,000)	(660,000)	(660,000)	(660,000)	(660,000)	840,000	840,000	840,000	840,000	840,000
Termination Fee	-	-	-	-	-	-	2,400,000	-	-	-
Annual Net Lease Revenue to District	(660,000)	(660,000)	(660,000)	(660,000)	(660,000)	840,000	3,240,000	840,000	840,000	840,000
Discount Rate / Present Value Factor	0.9091	0.8264	0.7513	0.6830	0.6209	0.5645	0.5132	0.4665	0.4241	0.3855
Present Value Annual Net Lease Revenue to District	(600,000)	(545,455)	(495,868)	(450,789)	(409,808)	474,158	1,662,632	391,866	356,242	323,856
Present Value of Annual Net Lease Revenue to District	706,836									
Plus: Prepaid Rent for 5 years	6,000,000									
Value of Revenue to District (Rounded)	6,700,000									

Proposed Lease Terms and Comparison to Fair Market Value Rent

Conclusion – Fair Market Value Rent Comparison to Proposed Lease Payments

Based upon the selected Fair Market Value Rent values for the real estate and personal property, as estimated by VMG, the terms as outlined in the Draft Term Sheet are consistent with Fair Market Value.

It should be noted, if Dignity elects to renew the lease after Year 10, it will be responsible for all seismic upgrade costs. Dignity estimates these costs at approximately $11.0 million. The responsibility of Dignity for seismic upgrades more than exceeds any potential lease rate shortfall beyond Year 10.

Proposed Rate of Return for New Purchases and Comparison to Fair Market Value

Archer Norris requested VMG to opine on the 8.0% rate of return utilized to calculate the lease payment for District Acquisition Costs in excess of $8.0 million. VMG understands if District Acquisition Costs are to exceed $8.0 million it would be due to new equipment purchases or additional construction in progress costs. A 10.0% discount rate was utilized in the return analyses on existing equipment and real estate. As mentioned, this discount rate represents a blend of concluded return rates appropriate for the asset classes being leased by Dignity. Any incremental lease payment over $100,000 will relate to new equipment or real estate construction and a lower return rate can be supported.

As mentioned in the Return on Depreciated Costs Analysis, within the acute care real estate sector, 94% of respondents to a CBRE survey indicated capitalization rates between 6.00% and 8.50%. Additionally, per a 4th Quarter 2017 Realty Rates Investor Survey, overall capitalization rates for acute-care facilities range from 5.77% to 16.43% and average 10.55%. It should be noted that overall capitalization rates are typically lower than discount rates.

We also surveyed medical office brokers concerning the interest rate utilized to amortize Tenant improvements. This survey indicated a range of 6.00% to 8.00%. However, the survey was conducted in an urban market and given the rural location of the subject, a higher discount rate would be required.

Based upon this information, we believe the 8% discount rate used to amortize District Amortization Costs in excess of $8.0 million into a lease rate is consistent at Fair Market Value.

Qualifying Assumptions

Fair Market Value Rent Payment and Comparison to Proposed Lease Schedule

- VMG is relying the Draft Term Sheet dated January 18, 2018 and on representations of the District or its representatives regarding interpretation of the Draft Term Sheet. To the extent the Draft Term Sheet changes, the results of our analysis will need to be updated.

- We have limited our analysis to the initial term of the lease (ten years). We have done this due to the uncertainty of the costs to make the subject property seismically compliant. However, we know that the costs will be significant (as much as $11,000,000). It is our understanding that if Dignity exercises the option to renew New Lease, they will be responsible for any seismic upgrades necessary for compliance. This cost incurred for seismic improvements would more than offset any lease payment below Fair Market Value after Year 10.

- In our comparison of Fair Market Value Rent to the proposed payment schedule outlined in the New Lease, we have not considered the value of consideration paid by the District which is associated with termination of the Prior Lease (i.e. District Acquisition Cost). VMG understands this is a required payment to be made by the District and represents a potential cash outflow to the District. Further, VMG understands the expected District Acquisition Cost is estimated to be approximately $8.0 million before any adjustments for new equipment purchases or construction in progress costs. The $8.0 million estimate was utilized to establish the base rent payment of $100,000 and is consistent with VMG's estimated fair market value for the real estate and personal property of MTMC.