



## **Proposal for the New Sonoma Valley Hospital**

Prepared for: Sonoma Valley Health Care Coalition

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## EXECUTIVE SUMMARY

Cirrus Health and The Cirrus Group (the Cirrus Companies) propose to build a new Sonoma Valley Hospital to replace the existing hospital owned and operated by the Sonoma Valley Hospital District. The new hospital will be organized to function as a Community Hospital providing basic 24/7 Emergency Room services as well as offering all services currently provided by the district hospital and more.

Cirrus Health will actively recruit new doctors to the community and invite physicians to participate in the governance and ownership of the new hospital and enhance the level, quality and safety of the services provided. ***The ability to own and govern the hospital will significantly enhance the ability to recruit high quality physicians to the Sonoma community.***

Cirrus Health will also seek local community members to participate on the fiduciary governing board for the Hospital. We expect the Governing Board to consist of 5 physicians, 3 Cirrus Health appointees and at least 2 members of the Sonoma community.

The financial pro formas included in this submission assume all existing Emergency Room and hospital inpatient and outpatient services and volumes (primarily non-procedural, medicine based services) will continue to be provided in the new Sonoma Valley Hospital. The viability of the hospital depends upon growing the level of inpatient and outpatient volume in other services sought by the Sonoma market population, who currently are seeking their hospital care in other communities.

In a time when many small district hospitals in California are in crisis, Cirrus Health offers Sonoma Valley unique operational innovations and non-public financial backing not available to typical district hospitals including: expanded market outreach ability, physician ownership opportunities, enhanced physician recruitment and retention programs, ability to provide advanced health care services typically unaffordable to small district hospitals and state of the art quality of care and patient safety programs.

The new Sonoma Valley Hospital will be located adjacent to the proposed Sonoma Medical Spa (SMS; refer to Exhibits A1 and A2). SMS will be financially independent from the new hospital. Service agreements will be established between the new hospital and SMS which will create a revenue stream currently unavailable to the existing hospital. SMS will provide diagnostic, rehabilitation, wellness, fitness and diet training services to local, regional, and destination-seeking patients. SMS doctors will prescribe medical imaging procedures, lab work and other services for SMS patients to the new Sonoma Valley Hospital. For the purposes of establishing a baseline financial pro forma for the new hospital, expected revenues from this source have not been included in the financial projections.

The Cirrus Companies seek NO direct tax support for the operation of the hospital or the construction and operation of the medical office and other health care facilities we anticipate bringing to the community.

We believe a privately funded, majority physician-owned hospital offers many unique benefits to the community and supports the long term existence of quality health care in Sonoma Valley. This proposal removes many of the variables upon which a publicly financed hospital model must be based, including the requirement for three separate voter initiatives and a 67% majority approval of the primary General Obligation bond.

Cirrus Health looks forward to becoming part of the community with a view to being *The Community Hospital*. This hospital will meet the needs of all Sonoma Valley residents and visitors who need access to emergent, acute and scheduled hospital inpatient and outpatient services, without regard to the ability to pay, and provide High Quality, High Safety and High Patient and Physician Service.

## **OWNERSHIP AND MANAGEMENT ASSUMPTIONS**

Cirrus Health is proposing to construct and operate a new community hospital for the Sonoma Valley. Cirrus Health anticipates offering 70% of the ownership in the hospital to local physicians and surgeons, who as a condition to ownership, must participate on the Active Medical Staff of the hospital. Ownership in the hospital will be optional; medical staff physicians who elect not to own will still be permitted to treat their patients in Sonoma. Cirrus Health will maintain a 30% ownership in the facility and provide all necessary services and support associated with running a full-service community hospital. Cirrus Health will assume responsibility for managing Sonoma Valley Hospital once syndicated. Cirrus Health anticipates working with existing Sonoma Valley Hospital employees and their knowledge and skill sets to create a smoother transition from one facility to the next.

The Cirrus Group LLC, a commonly controlled affiliate of Cirrus Health, will be the General Partner of the hospital development. Equity capital for the development will most likely come from Cirrus Group's strategic partner Health Care Property Investors, Inc. (HCPI). HCPI is the largest, in terms of market capitalization, of the healthcare Real Estate Investment Trusts in the country. Our debt capital will be procured in the institutional capital markets. Once construction is underway, Cirrus Group will open the opportunity for individual physicians to invest as a minority partner in the real estate of the hospital. The Cirrus Health-run hospital will become a tenant of The Cirrus Group's property, and Cirrus Group will be responsible as the managing entity of the site.

### **Proposed Site**

The proposed hospital location is the Northwest corner of the 8<sup>th</sup> Street East and Napa Road intersection in Sonoma, California. The +/- 22.22 acre site is controlled by Cirrus Health through renewable options. A complete schedule and project entitlement, design and construction plan for this site is provided in Exhibit B of this document. The hospital gross building area and room capacity will ultimately be based upon the existing services being provided by the current hospital, and the service lines that Cirrus plans to add to the hospital. While no service currently being offered by Sonoma Valley Hospital will be cut, Cirrus is considering relocating some services out of the hospital and into an adjacent Medical Office Building or Skilled Nursing Facility/Long Term Acute Care facility, or other appropriate health care facility, with a particular focus on improving the quality of clinical care, in a more efficient cost structure and setting. The size of each of these buildings will be directly determined through a formal programming process coordinated with the District Board, by anticipated volumes. Current facility size projections and conceptual site plans are depicted in Exhibits A1 and A2.

### **Relationship with the Sonoma Medical Spa**

The new Sonoma Valley Hospital will be located adjacent to the proposed Sonoma Medical Spa (refer to Exhibits A1 and A2). SMS will be financially independent from the new hospital. Service agreements will be established between the new hospital and SMS which will create a revenue stream not currently available to the existing hospital. SMS will provide diagnostic, rehabilitation, wellness, fitness and diet training services to local, regional, and destination-seeking patients. SMS doctors will prescribe medical imaging procedures, lab work and other services for SMS patients to the new Sonoma Valley Hospital. For the purposes of establishing a

baseline financial pro forma for the new hospital, expected revenues from this source have not been included in the financial projections.

**Near and Long Term Time Line and Financial Plan**

Upon completion of the site annexation to the Urban Growth Boundary and Sphere of Influence, OSHPD review will take anywhere from 12 to 18 months, with construction of the facility itself lasting 18 months. A full entitlement timeline is attached as Exhibit B, and full real estate financing details are available within Exhibit G. In addition to the financial data projected in the Financial Exhibit, Cirrus Group expects to spend an additional \$200,000 in standard legal, survey, and environmental costs prior to the start of construction.

## **MARKET ANALYSIS AND PROJECTED UTILIZATION**

### **A Hospital Open to All**

Cirrus Health has incorporated existing hospital market share and volumes into all projections and assumptions. The hospital developed and owned by Cirrus and the physicians will be open to all individuals, regardless of the ability to pay. Cirrus fully expects to provide every service the hospital currently provides, and anticipates incorporating new services that are currently unavailable in the community.

### **Physician Recruitment**

The key to providing new service lines is the ability to recruit new, young physicians to Sonoma Valley Hospital. Cirrus believes, from personal contact and conversations, that both local and neighboring physicians would be attracted to practice in and own part of Sonoma Valley Hospital. To date Cirrus has contacted 59 individual physicians and two 20+ physician group practices. A large majority of these physicians have expressed interest in the hospital ownership opportunities and practicing in Sonoma. We intend to provide a collection of approximately 40 signed Letters of Interest from these physicians to the Coalition within the next ten days. Should these physicians participate, Cirrus will effectively more than double the staff of physicians currently practicing at Sonoma Valley Hospital. The contacted physicians have expressed interest in specifically utilizing the physician ownership opportunity, and many physicians are interested in allowing their patients the option of surgery or other procedures near their families and community. Cirrus has a detailed marketing plan and timeline in place, specifying 25 additional physicians in local markets to contact, as well as the documentation in place to begin printing for partnership discussion. This timeline can be implemented immediately upon selection by the Coalition.

Market areas Cirrus expects to draw from heavily include Novato, Santa Rosa and South Marin; Cirrus expects to draw more lightly but still significantly from Napa and North Contra Costa Counties. It is reasonable to assume that should Cirrus issue an offering memorandum to the targeted physician recruits, a significant majority would choose to participate in a hospital that allows them ownership and governance over their practice environment. Both specialists and primary care physicians are needed, have been contacted, and are expected to participate.

### **Providing Core Medical Services, Quality, and Innovation**

To project the hospital's core service line statistics, Cirrus started with the existing volumes of all services, procedures, and patients that Sonoma Valley Hospital currently sees. Cirrus further added the procedures and ancillary volume that would reasonably be recruited, a majority of which are scheduled, controlled cases and medical admits. It is unlikely there will be an increase in births and skilled nursing use with any new hospital, above and beyond what is currently there. Overall expectations include a large increase in orthopedic surgery, cardiovascular outpatient procedures, general surgery, podiatry, and other inpatient and outpatient services. For inpatient procedures, Cirrus projects a steady hold on general medicine and an increase of orthopedic surgery, inpatient cardiac admits, and the introduction of bariatric surgery.

Cirrus anticipates these increases will result from the increased physician interest and improved levels of patient care and safety. Both improvements will be a direct effect of Cirrus'

commitment to quality, innovation and access to private capital to provide state-of-the-art medical technology and procedures. Our Group Purchasing Organization will lend additional economies of scale in providing the best medical resources possible to Sonoma, at an organizational discount for the hospital but at a net positive benefit to the community. Our local knowledge of and involvement in Sonoma Valley, Marin and Solano Counties, and other neighboring Bay Area communities will contribute to an increased market share, both for patients and physician recruitment.

### **Commitment to Provide Basic Emergency Room Services**

Cirrus will provide Basic Emergency Room services. Our pro forma Emergency Department visit projections are essentially a replication of what the hospital currently sees. It is unlikely a new hospital will result in higher emergencies.

### **Identification of a Larger Medical Service Area**

Cirrus will operate from a broader service area than the current Sonoma Valley Hospital. To identify the service area population, Cirrus evaluated both internal market data and the OSPHD discharge data for 2005, by zip code. It was determined that Sonoma Valley Hospital carries a 4% market share of Sonoma County, which nearly matches the market share of UCSF. The top providers in Sonoma County are Santa Rosa Memorial Hospital (29%), Kaiser Foundation Hospital (19%), Sutter of Santa Rosa (17%), Petaluma Valley (8%), and SVH (4%). Of the Sonoma Valley Health Care District market (zip codes 95416, 95431, 95433, 95442, 95476), SVH carries a 48% market share. It is determined that the strongest market area consists of the ten-mile radius around Sonoma Valley. It is assumed that if a patient is currently willing to drive ten miles outside of Sonoma, patients will be willing to drive ten miles into Sonoma, and furthermore, it is assumed that patients who are currently leaving Sonoma will be motivated to stay in Sonoma, and the physicians will be prompted to practice at SVH.

Our projections have allowed for a marginal rise, if at all, in total population. Cirrus has also made allowances within projections for the Kaiser Foundation patient population, a majority of which will never be treated at Sonoma Valley. Our projections and assumptions assume 19% of the population uses Kaiser. It is reasonable to assume that for the sicker Kaiser patients, SVH may be a hospital they use, but only periodically. The physicians that Cirrus expects to recruit do not practice at Kaiser, therefore all projections are reasonable and include traditional HMO/PPO/conventional insurance/Medicare patients. At this time, Cirrus expects to have the ability to accept all insurance payors.

Population projections indicate a modest gain of 2-3% is most likely over the next five years, with a negligible change in the child-bearing population. The 65+ population is expected to see the greatest increase as a whole, of 1%. This growth accounts for almost 50% of the total population increase. It therefore is reasonable to assume that healthcare providers and proper service lines will be provided to treat the unique needs of an aging population.

## FINANCIAL PROJECTIONS AND ASSUMPTIONS

Please see complete financial projections and assumptions in Exhibit G

### SONOMA VALLEY HOSPITAL

#### PROFORMA SUMMARY

#### SURGICAL VOLUME SUMMARY (YR 1 PER MONTH):

SPECIALTY	OUTPATIENT	INPATIENT	TOTAL
GASTROENTEROLOGY	83	15	98
PLASTICS	18	5	23
PODIATRY	10	10	20
GENERAL SURGERY	30	24	54
GYN	20	11	31
NEUROSPINE	6	5	11
OPHTHALMOLOGY	13	-	13
ORTHOPEDECS	60	22	82
OTOLARYNGOLOGY (ENT)	7	-	7
BARIATRIC	-	2	2
CARDIOLOGY	30	26	56
UROLOGY	16	8	24
	<b>293</b>	<b>128</b>	<b>421</b>

#### PROFORMA SUMMARY OF YEARS ONE THROUGH FIVE

	Pre-open & YEAR				
	1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Surgical Volume	2,989	5,254	5,464	5,683	5,910
Medical Admits	611	1,053	1,074	1,095	1,117
ER Volume	8,329	8,329	8,329	8,329	8,329
<b>TOTAL NET REVENUE</b>	<b>\$ 26,137,989</b>	<b>\$ 44,778,332</b>	<b>\$ 46,452,727</b>	<b>\$ 48,191,763</b>	<b>\$ 49,997,979</b>
<b>EXPENSES</b>					
PERSONNEL COSTS	7,224,248	8,294,946	8,610,607	8,938,572	9,279,326
CONTRACT SERVICES	1,528,804	3,059,948	3,466,747	3,480,002	3,513,722
REPAIRS, MAINTENANCE, OTHER OFFICE EXPENSES	168,357	96,145	98,068	100,029	102,030
PROFESSIONAL FEES	112,000	22,440	22,889	23,347	23,814
COMMUNICATIONS AND IT	430,500	336,600	343,332	350,199	357,203
RENT AND UTILITIES	6,522,921	5,980,289	6,148,988	6,322,533	6,501,066
INSURANCE	488,850	498,627	508,600	518,772	529,147
MEDICAL SUPPLIES	4,996,720	8,223,591	8,388,063	8,555,824	8,726,940
ER EXPENSES	1,424,954	1,801,937	1,837,976	1,874,735	1,912,230
MARKETING	198,800	121,176	123,600	126,072	128,593
TRAVEL AND ENTERTAINMENT	96,800	34,884	35,582	36,293	37,019
DEPRECIATION	3,200,000	3,200,000	3,200,000	3,200,000	3,200,000
INTEREST EXPENSES	1,598,789	1,300,113	973,420	616,081	225,221
INTEREST EXPENSES (WORKING CAPITAL LOAN)	994,377	1,420,631	783,834	68,722	-
OPERATIONAL SUPERVISION	132,000	134,640	137,333	140,079	142,881
BAD DEBT 3% (total revenue)	2,091,039	3,582,267	3,716,218	3,855,341	3,999,838
MANAGEMENT FEE	1,613,279	2,000,000	2,000,000	2,000,000	2,000,000
OTHER (contingency, bank service fees)	61,600	62,424	63,672	64,946	66,245
<b>TOTAL OPERATING EXPENSES</b>	<b>32,884,039</b>	<b>40,170,658</b>	<b>40,458,927</b>	<b>40,281,547</b>	<b>40,745,276</b>
<b>PROFIT / (LOSS)</b>	<b>\$ (6,746,050)</b>	<b>\$ 4,607,674</b>	<b>\$ 5,993,800</b>	<b>\$ 7,910,216</b>	<b>\$ 9,252,703</b>
<b>MARGIN</b>	na	10%	13%	16%	19%

### **Basis of Assumptions**

The data that Cirrus' assumptions are based on are derived from the following sources:

- Centers for Medicare and Medicaid Services
- Claritas
- The National Health Interview Survey
- The National Center for Health Statistics
- Census Bureau
- Office of Statewide Health Planning and Development
- Sonoma Valley Hospital

### **Next Steps**

Upon receipt of this proposal Cirrus proposes to meet with Coalition representatives, HFS and members of the District Board to expand on or clarify the points of this proposal. We believe that more communication, not less, is important at this critical juncture. We would like to develop a working Memorandum of Understanding (MOU) with the Coalition that could be used as a basis for future negotiations. Topics we would like to discuss include but are not limited to: quality of care, continuation of traditional programs including the Hospital Foundation, volunteer programs and the women's health clinic currently in formation, provision of assurances to the community, the future role of the District Board, governance, schedule and possible transition plans.

### **Summary**

Cirrus intends to continue offering care and services provided by the current hospital, but do so in a more efficient, patient-friendly, and expanded environment. Cirrus plans to accept all insurance payors, will accept individuals that cannot pay, and can provide a higher standard of service and patient care to all. It is our goal to work with the Healthcare District in establishing the best hospital possible for the Sonoma Community, and work with the individuals who have invested time, energy and emotion into the welfare of their hospital and community.