

OFFICE OF THE ATTORNEY GENERAL
STATE OF GEORGIA

IN THE MATTER OF THE LEASE
OF MURRAY MEDICAL CENTER
TO ADVENTIST HEALTH SYSTEM
OF GEORGIA, INC.

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NO. AG 2014-02

REPORT OF FINDINGS

I.

BACKGROUND

MURRAY MEDICAL CENTER

Murray Medical Center (the “Hospital”) is a general acute care hospital licensed for 43 beds. The Hospital is located in Chatsworth, Georgia in Murray County and is operated by the Hospital Authority of Murray County (the “Authority”). The Hospital’s primary service area is Murray County. It operates an emergency room twenty-four hours per day. The facility has twenty-one (21) inpatient rooms, two (2) operating rooms (which are currently not in use), three (3) triage rooms, twelve (12) emergency department rooms, two (2) trauma rooms, and three (3) ICU beds (which are non-operational). The Hospital operates as a community hospital providing emergency and inpatient services including laboratory, imaging, respiratory therapy and limited surgical services.

As proposed, Adventist Health System of Georgia d/b/a Gordon Hospital, a Georgia nonprofit corporation (“AHSG”) located approximately 25 miles from the Hospital, will lease the Hospital from the Authority. AHSG will have an option to purchase¹ the Hospital for fair market value or for the then-owed outstanding debt owed by the Hospital and the Authority,

¹ Although the Lease contains an option for AHSG to purchase the Hospital, the potential exercise of the Option has not been reviewed by the Attorney General through this transaction. The Option requires more than the mere passage of time, and instead, requires that AHSG pay an undetermined fair market value for the Hospital. As a result, review of the potential exercise of such an option is not part of our review here. The parties to this transaction are hereby put on notice that they should contact the Office of the Attorney General prior to the exercise of the option for a determination as to whether the exercise of the option will trigger review under the Hospital Acquisition Act.

whichever is greater. The lease agreement includes all of the assets of the existing Hospital as well as a professional office building and land adjacent to the Hospital.

THE DISPOSITION PROCESS

The Hospital has encountered many difficulties in recent years due to a variety of factors. The Hospital is an aging facility that was constructed in 1949 and, with the exception of the emergency department that was completed in 2005, there have been no major renovations. In addition, many core physicians have left the Hospital in recent years, and therefore, the Hospital has only four (4) primary care and two (2) emergency room physicians on its active and associate roster. The Hospital currently holds less than 20% of the market share in Murray County despite being the only hospital within the county. The most densely populated areas of Murray County are closer to a competing hospital; Hamilton Health Care System, d/b/a Hamilton Medical Center (“Hamilton”). Hamilton is the former leasee² of the Hospital and is located only thirteen (13) miles west of the Hospital.

The record indicates that the Hospital may have been neglected from a management perspective for the past several years, which has resulted in a deterioration of patient volumes, financial performance and community confidence. The Hospital has steadily lost market share over the past six (6) years to Hamilton and Gordon Hospital. In addition, inpatient volume has declined drastically since the affiliation with Hamilton ended. The Hospital has ceased ICU and meaningful surgical care operations. The balance of accounts payable has increased significantly from \$599,000 in 2012 to \$2,465,000 in 2014, with \$1,589,000 of the 2014 balance remaining outstanding for more than 120 days. The record indicates that the Hospital does not operate at the same level of patient satisfaction as other hospitals in Georgia or those across the country.

The Hospital became deeply indebted to Hamilton and was operating at a deficit of approximately \$2 million per year. Prior to the termination of the lease between Hamilton and the Authority, Hamilton expressed its intent to shut-down all of the inpatient beds at the Hospital. The Authority terminated its relationship with Hamilton and took over operations of the Hospital through an “executive management team” from February 2012 to October 2013. In October 2013, due to the financial condition of the Hospital and several operational concerns, the Authority terminated its Chief Executive Officer and began a search for a new management team

² Hamilton leased the Hospital from 1998 to February 2012 and currently holds over 2/3 of the Hospital’s inpatient market share.

or partner. On October 5, 2014, the Authority entered into an interim management agreement with AHSG to manage hospital operations of the Hospital for a management fee of \$60,000 per year.

The Authority did not pursue a formal disposition process, which is the preferred course of action. Instead, the Authority was approached by three potential partners that expressed an interest in the Hospital. Specifically, the Authority discussed potential partnership opportunities with Hamilton, AHSG and Phillip Eastman, a hospital operator. Dr. Randall Richards, Chairman the Authority, provided detailed testimony regarding the Authority's decision to pursue negotiations exclusively with AHSG and forego a formal disposition process. Dr. Richards testified that of these three potential partners, only AHSG planned to maintain the Hospital as an acute care facility,³ and therefore, the Authority elected to pursue discussions only with AHSG.

Dr. Richards further testified that maintaining a Hospital with inpatient beds and ambulatory services in the community was the Authority's primary focus. The proposed lease with AHSG meets the Authority's goals of maintaining ownership of the Hospital and maintaining an acute care hospital for the community. Dr. Richards testified that the Authority felt the lease with AHSG was the "best" and "only alternative" for the community to maintain its Hospital.

THE PROPOSED TRANSACTION

The proposed lease transaction is preceded by several related agreements and events. On September 29, 2014, the Authority executed a promissory note in favor of AHSG for \$5,111,939, the proceeds of which were made available to the Authority to repay the outstanding balance due under its promissory note with Hamilton.⁴ AHSG also executed a promissory note on September 29, 2014, in favor of the Authority for \$700,000 with the funds to be used for the operational expenses of the Hospital incurred during AHSG's management of the Hospital pursuant to the Management Services Agreement. On October 5, 2014, AHSG began managing the Hospital under the Management Agreement which provides for a management fee of \$60,000 per year.

³ Dr. Richards testified that Hamilton expressed a desire to primarily use the Hospital as a psychiatric facility, and Mr. Eastman expressed his intent to use the facility as an adult daycare facility.

⁴ The promissory note with Hamilton was executed by the Authority on January 31, 2012, in favor of Hamilton in the principal amount of \$5,893,200.

AHSG has also agreed to loan the Hospital various used medical equipment and other personal property for use in the Hospital's daily operations on an interest-free basis.

Under the terms of the transaction, AHSG will lease the existing Hospital from the Authority for a period of five (5) years⁵ with an option to renew the lease for one additional five-year term. The Lease Agreement includes all of the assets of the existing Hospital as well as a professional office building and land adjacent to the Hospital. As part of the consideration for the transaction, AHSG will forgive the \$700,000 operating loan provided to the Authority prior to the transaction. During each of the five years of the initial term of the Lease, Murray County will provide \$1.2 million⁶ for use for capital expenditures at the Hospital. In exchange for that commitment, the Hospital Authority will receive a credit of \$1.2 million per year toward the promissory note with AHSG. The Lease Agreement provides AHSG with an Option to acquire the Hospital during the initial and renewal lease term at the greater of fair market value or for the then outstanding debt owed by the Hospital and the Authority. AHSG will also operate the professional office building, and during the initial term of the lease, AHSG will turn over any sums collected from tenants of the building to the Authority for use in repaying the outstanding balance of the accounts payable of the Hospital which was incurred prior to the lease transaction. As part of the lease transaction, AHSG has also committed to hire at least 70% of the full time employees of the Hospital.

In short, the Authority will receive approximately \$6.0 million in rent during the initial five year term, forgiveness of an operational loan of \$700,000, forgiveness of the \$5.1 million promissory note in exchange for annual capital contributions from Murray County of \$1.2 million, rent from the professional office building to repay the outstanding payables which currently amount to approximately \$2.4 million, and the interest-free use of used medical equipment and furniture with an estimated value of between \$600,000 to \$1.5 million.

⁵ The annual fixed rent is based on the greater of the fair market value use of the existing facilities or the annual bond payments due under the Revenue Anticipation Certificates, excluding any sum that may be attributable to acceleration or other default of the Authority. The annual rent is currently estimated to be \$6.0 million for the initial five-year term based on the present value of the annual bond payments.

⁶ The Authority will retain ownership of any assets acquired for the Hospital.

FINANCIAL ANALYSIS

Under O.C.G.A. § 31-7-406(6), a transaction involving the acquisition or disposition of the assets of a nonprofit hospital to a nonprofit entity requires the Attorney General to make a determination as to whether the seller “will receive an enforceable commitment for fair and reasonable community benefits for its assets.”

The Authority and AHSG jointly engaged Deloitte Financial Advisory Services to assess the anticipated community benefit resulting from the transaction. Deloitte Financial Advisory Services reviewed the transaction under O.C.G.A. § 31-7-406(6), which requires that the seller or lessor in a disposition of a nonprofit hospital to another nonprofit corporation “will receive an enforceable commitment for fair and reasonable community benefits for its assets,” as discussed in the following valuation analysis.

VALUATION ANALYSIS

Deloitte Financial Advisory Services was jointly engaged by the Authority and AHSG to perform a fair market value analysis of the proposed Lease Agreement as of June 2014 and to perform an analysis of the Management Services Agreement. Deloitte employed a standard of fair market value defined as:

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, both parties having reasonable knowledge of relevant facts.

There are three approaches typically considered in valuation: the income approach, the market approach, and the cost approach. The income approach is based on the concept that the value of a business or asset is dependent upon the amount and timing of cash flows. Under the market approach, value is derived through a comparison of the transaction prices of similar assets trading in the marketplace, typically involving transfers of 100% ownership interests or valuations related to publicly-traded guideline companies. The cost approach, or the net asset value method, relies on the concept that the value of an asset should not exceed the cost to reproduce or replace it, less any physical, functional and economic obsolescence.

In its valuation analysis, Deloitte considered the market and income approaches to determine whether the proposed lease agreement is within the range of fair market value. Deloitte did not consider the cost approach due to the requirements under the proposed Lease Agreement that AHSG continue to operate the hospital as an acute care hospital. The cost

approach may result in a higher valuation in situations where the hospital owner was able to convert or repurpose the hospital facility, which was impermissible in this transaction. Under the income approach, Deloitte indicated a range of value of \$0 to \$1.8 million. Under the market approach, Deloitte concluded the potential value of the hospital to be \$2.1 to \$3.9 million. Deloitte determined a value range for the consideration to the Authority of \$6.7 million to \$11.8 million. Jimmy Peterson, Principal at Deloitte, testified at the public hearing. Deloitte concluded that the proposed transaction is within or above the range of fair market value. Deloitte additionally concluded that the management agreement is consistent with fair market value.

The Attorney General was assisted by the firm of Ernst & Young, LLP (“EY”) in the review of Deloitte’s valuation. The Attorney General engaged EY to provide valuation advisory services, but not to provide a separate community benefit analysis, valuation or fairness opinion. Bridget Bourgeois, a Partner at EY, testified at the public hearing.

EY performed sensitivity analyses of Deloitte’s discounted cash flow method under the income approach by applying a normalized working capital level of 4.0% to 8.0% and discount rates ranging from 7.0% to 11.0%. EY’s calculations resulted in a value range of \$67 thousand to \$4.3 million. Additionally, EY applied a terminal growth rate of 3.0% to 4.0% and discount rates ranging from 7.0% to 11.0%, which resulted in a range of value of \$0 to \$3.6 million.

EY conducted market research and analyzed valuation multiples observed for hospital transactions and publicly-traded hospitals and compared them to Deloitte’s concluded value range under the market approach. EY observed that Deloitte’s implied valuation multiples fell towards the low end of the minimum to first quartile range of revenue and EBITDA multiples. EY also observed that Deloitte’s implied revenue and EBITDA multiples were below the low end of the observed range of the guideline public company multiples. EY further observed this was consistent with the poor profitability level of the hospital and the relatively long assumed turnaround period.

EY also performed sensitivity analyses by changing certain assumptions in Deloitte’s valuation of the consideration to the parties. EY observed that Deloitte’s projections of Murray County’s capital expenditure commitment may total approximately \$2.6 million over five (5) years rather than \$6 million over five (5) years as stipulated in the proposed Lease Agreement. EY further performed a sensitivity analysis on Deloitte’s present value calculations of rent

payments. After replacing the discount rate of 4.5% based on Baa corporate bond yields with a discount rate of 3.38% based on A-rated bond, EY calculated a lease payment value of approximately \$6.3 million compared to Deloitte's calculation of \$6 million. EY made adjustments to the consideration to be received by both parties, which resulted in an indicated range of value of \$6.7 million to \$12.1 million to the Authority and \$2.1 million to \$9.9 million to AHSG. Comparatively, Deloitte's analysis resulted in range of value of \$6.7 million to \$11.8 million to the Authority and \$2.1 million to \$9.9 million to AHSG.

Based on the information EY received, they concluded that Deloitte used commonly employed valuation methods and techniques in its fair market valuation of the hospital and the proposed Lease Agreement.

PUBLIC COMMENT

The public hearing was held on January 29th, at 5:00 p.m. in Murray County, Georgia, at the Courthouse Annex Conference Room, 121 North 4th Avenue, Chatsworth, Georgia 30705. Seven (7) persons made comments at the public hearing. All were in favor of the transaction.

Following the public hearing, the record was held open until the close of business on February 3, 2015, for any further public comment. This Office did not receive any written comments after the hearing. Counsel for the Authority and AHSG were requested to inform the undersigned in writing by the close of business on February 3, 2015, as to whether their respective clients intended to proceed with the proposed transaction as structured or modify the proposed transaction in some respect. On February 3, 2015, counsel for both parties submitted a joint letter stating that their clients wish to proceed with the transaction as proposed.

II.

FINDINGS

The Hospital Acquisition Act (the "Act") involves a public interest determination in the Attorney General's review of a proposed disposition and acquisition of hospital assets. *See* O.C.G.A. §§ 31-7-400 through 31-7-412; *Sparks v. Hospital Authority of City of Bremen and County of Haralson*, 241 Ga. App. 485 (1999) (physical precedent only). The Act requires a written notice filing and a public hearing "regarding the proposed transaction in the county in which the main campus of the hospital is located." O.C.G.A. §§ 31-7-401, 31-7-405(a). The purpose of the public hearing is "to ensure that the public's interest is protected when the assets of a nonprofit hospital are acquired by an acquiring entity by requiring full disclosure of the

purpose and terms of the transaction and providing an opportunity for local public input.” O.C.G.A. § 31-7-406.

Under the Act, disclosure is linked to whether “appropriate steps have been taken to ensure that the transaction is authorized, to safeguard the value of charitable assets, and to ensure that any proceeds of the transaction are used for appropriate charitable health care purposes.” O.C.G.A. § 31-7-406. The Act identifies thirteen factors that are key considerations in determining whether the appropriate steps have been taken by the parties. *Id.* The thirteen factors are listed in Appendix A to this report.

The thirteen factors set forth in O.C.G.A. § 31-7-406 can be grouped into four categories relating to (a) the exercise of due diligence by the seller (factors number 1, 2, 3, 4 and 8), (b) conflicts of interest (factors number 5 and 13), (c) valuation of the hospital assets (factors number 6, 7 and 10), and (d) the charitable purpose of the proposed transaction (factors number 9, 11 and 12).

The Exercise of Due Diligence by the Seller

Factor number 1 is satisfied, as the disposition of the Hospital is authorized by applicable law. With regard to factor number 2, there has been only one donation to the Hospital which exceeds \$100,000.00. The Hospital received a donation of \$750,000.00 from the City of Chatsworth. The donation was made without restrictions, and therefore, it does not appear that the proposed disposition is inconsistent with the directives of any major donors who have contributed over \$100,000.00.

The due diligence factors number 3 and 4 necessitate review of the process and procedures employed by the Seller “in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition.” O.C.G.A. § 31-7-406(3). The Authority did not conduct a formal process for the solicitation and selection of proposals, which is the preferred approach. However, the Authority provided detailed testimony regarding all of the Authority’s efforts, its current financial distress, its discussions with three potential partners, and the steps it has taken to protect the interests of the Authority in the transaction. Factors 3 and 4 are satisfied.

With regard to factor number 8, there is a management services agreement in place pursuant to which AHSG is providing ongoing management to the Hospital pursuant to an Interim Management Agreement (“Management Agreement”) dated October 5, 2014. Under the

Management Agreement, AHSB will receive \$60,000 per year in exchange for management services. The Agreement defines the responsibilities of the parties and does not, by itself, transfer control of the Hospital to AHSB such that it should have been reviewed under the Act. The terms of the Management Agreement appear reasonable. Therefore, factor number 8 is satisfied.

Conflicts of Interest

The disclosure of any conflict of interest involving the Sellers, the Chief Executive Officer of the Hospital and its expert consultant is to be considered under factor number 5. Conflict of interest certifications, as required by the Act and the notice filing requirements of the Attorney General, have been filed by members of the governing board of the Authority, by the chief executive officer of the Authority and by James Peterson, Principal, for Deloitte. Such certifications do not disclose any impermissible conflicting financial interest in the proposed transaction. With regard to factor number 13, the instant transaction involves the transfer of control of a nonprofit hospital to another nonprofit corporation. Health care providers will not be offered an opportunity to invest or own an interest in the Hospital as part of the transaction or after the transaction. Therefore, factor number 13 is not applicable.

Valuation of the Hospital Assets

The factors numbered 6, 7 and 10 involve a determination of the value of the hospital assets. The Authority should receive an enforceable commitment for fair and reasonable community benefits for its assets. *See* O.C.G.A. § 31-7-406(6). Based on the record, including the analysis conducted by Deloitte on behalf of the Authority and the review by Ernst & Young at the request of the Attorney General as described herein, the Authority will receive an enforceable commitment for fair and reasonable community benefits in exchange for the use of its assets, as required by the Act.

The Authority is not providing any financing for the transaction. I therefore conclude that factor 7 is inapplicable. As to factor number 10, the Lease Agreement prohibits AHSB from transferring the lease to a third party without the consent of the Authority. AHSB has retained an option to purchase the Hospital during the initial and renewal lease term. In the event that AHSB exercises the Option and subsequently decides to sell the Hospital, AHSB and the Authority have entered into a separate Right of First Refusal Agreement allowing the Authority

to purchase the leasehold interests held by AHSB for the same or equivalent economic terms and conditions as set forth by a third party purchaser. Thus, factor 10 is satisfied.

Charitable Purpose of the Proposed Transaction

With respect to the charitable purpose of the proposed transaction, factor number 9 requires that the disposition proceeds be used for charitable health care purposes consistent with the nonprofit's original purpose. AHSB is a nonprofit corporation. The consideration received by the Authority through the Lease Agreement will be used to pay down the Authority's debt obligations. Therefore, the Lease Agreement is not expected to generate any excess proceeds to the Authority. The other two charitable purpose factors, numbers 11 and 12, concern the purchaser's commitment to provide (a) continued access to affordable care, (b) the range of services historically provided by the seller, (c) health care to the disadvantaged, the uninsured and the underinsured and (d) benefits to the community to promote improved health care.

AHSB has made express contractual commitments in the Lease and Transfer Agreement to maintain the general acute care hospital license of the Hospital and provide emergency services twenty-four hours a day, seven days a week. AHSB will also maintain its status as a participating provider in Medicare and Medicaid. AHSB has also agreed to continue to provide indigent and charity care to the disadvantaged, uninsured and underinsured and to maintain the broader mission of the Adventist Health System. Thus, factor 10 is satisfied.

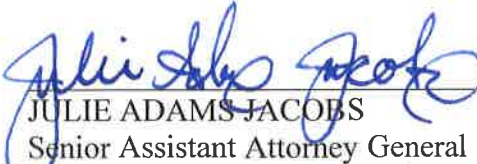
The evidence, taken as a whole, demonstrates an enforceable commitment to improve health care in the community and to assure continued access to affordable care. The record as a whole demonstrates that the Authority has obtained from AHSB an enforceable commitment to provide health care to the disadvantaged, the uninsured and the underinsured and to provide benefits to the community to promote improved health care.

III.

CONCLUSION

Upon review of the public record and in accordance with the Hospital Acquisition Act, the Hearing Officer finds that the public record in this matter discloses that the parties have taken appropriate steps to ensure that the transaction, including the lease and option to purchase pursuant to the Lease and Transfer Agreement, is authorized and that the value of the charitable assets is safeguarded.

This 27TH day of February, 2015.


JULIE ADAMS JACOBS
Senior Assistant Attorney General
Hearing Officer

APPENDIX A

- (1) Whether the disposition is permitted under Chapter 3 of Title 14, the Georgia Nonprofit Corporation Code,' and other laws of Georgia governing nonprofit entities, trusts, or charities;
- (2) Whether the disposition is consistent with the directives of major donors who have contributed over \$100,000.00;
- (3) Whether the governing body of the nonprofit corporation exercised due diligence in deciding to dispose of hospital assets, selecting the acquiring entity, and negotiating the terms and conditions of the disposition;
- (4) The procedures used by the nonprofit corporation in making its decision to dispose of its assets, including whether appropriate expert assistance was used;
- (5) Whether any conflict of interest was disclosed, including, but not limited to, conflicts of interest related to directors or officers of the nonprofit corporation and experts retained by the parties to the transaction;
- (6) Whether the seller or lessor will receive fair value for its assets, including an appropriate control premium for any relinquishment of control or, in the case of a proposed disposition to a not-for-profit entity, will receive an enforceable commitment for fair and reasonable community benefits for its assets;
- (7) Whether charitable assets are placed at unreasonable risk if the transaction is financed in part by the seller or lessor;
- (8) Whether the terms of any management or services contract negotiated in conjunction with the transaction are reasonable;
- (9) Whether any disposition proceeds will be used for appropriate charitable health care purposes consistent with the nonprofit corporation's original purpose or for the support and promotion of health care in the affected community;
- (10) Whether a meaningful right of first refusal to repurchase the assets by a successor nonprofit corporation or foundation has been retained if the acquiring entity subsequently proposes to sell, lease, or transfer the hospital to yet another entity;
- (11) Whether sufficient safeguards are included to assure the affected community continued access to affordable care and to the range of services historically provided by the nonprofit corporation;

- (12) Whether the acquiring entity has made an enforceable commitment to provide health care to the disadvantaged, the uninsured, and the underinsured and to provide benefits to the affected community to promote improved health care; and
- (13) Whether health care providers will be offered the opportunity to invest or own an interest in the acquiring entity or a related party, and whether procedures or safeguards are in place to avoid conflicts of interest in patient referrals.