File #: 19-1048, **Version:** 1

Recommendation to authorize City Manager, or designee, to execute all documents necessary for a Lease Agreement with MWN Community Hospital, a California limited liability company, for the operation and potential development of City-owned property, located at 1720 Termino Avenue, 1760 Termino Avenue, and 4111 East Wilton Street, including the provision of an acute care hospital, for a period of 45 years, with the option of two 10-year extensions;

Amend the grant deed restriction to allow a for-profit health care organization to operate an acute care hospital, and allow for non-acute care health services upon the occurrence of certain conditions at the Subject Property; and

Authorize City Manager to reimburse Tenant up to $1,000,000 per year on an annual basis for the first five years, and up to $2,000,000 per year on an annual basis for years 6 through 15 of the Lease, to assist with seismic retrofit construction costs of the hospital facility. (District 4)

On March 22, 2011, the City Council authorized the execution of Lease No. 32175 with Long Beach Memorial Medical Center (MemorialCare) for the use of the City-owned property located at 1720 Termino Avenue, 1760 Termino Avenue, and 4111 E. Wilton Street (Subject Property) for the operation of an acute care hospital and other health care services. The Subject Property includes approximately 8.7 acres of land with multiple facilities and medical office buildings.

On March 5, 2018, MemorialCare formally notified the City of its decision to terminate its lease agreement for the Subject Property effective July 3, 2018. Shortly after, the City Council directed the City Manager to conduct a targeted process to identify potential operators with the demonstrated ability to operate a general acute care facility, including an emergency department with basic support services, at the Subject Property. The City received five non-binding proposals from potential operators and received further direction from the City Council to conduct due diligence that included extensive review of the operational, engineering, and financial plans for the Subject Property. The City Council subsequently approved an Exclusive Negotiating Agreement with Molina, Wu, Network, LLC (Tenant) for a period of up to 180 days to allow the parties (i) to negotiate the terms of a ground lease for the proposed development of the Subject Property (ii) to complete construction plans and pursue the extension of the State-established deadline for seismic compliance and (iii) to negotiate general terms and conditions of an interim lease agreement.

On March 12, 2019, the City Council authorized the City Manager to execute a short-term lease (Interim Lease) with the Tenant for the Subject Property and to execute a Letter of Intent related to the development of a long-term replacement lease between the City and Tenant. During the term of the Interim Lease, the Tenant worked with the City to submit seismic compliance plans to the Office of Statewide Hospital Planning and Development (OSHPD), submitted an application for hospital licensing to the California State Department of Public Health (CDPH), and began preparing the Subject Property for State inspections required for opening an acute care hospital. As part of the Interim Lease, the City is obligated to provide up to $1,000,000 reimbursement for costs incurred by Tenant should successful negotiation or approval of a long-term replacement lease not occur.

After extensive collaboration between the City and Tenant, City staff recommends the proposed Lease as the best opportunity to achieve the City Council's direction to reopen an acute care hospital on the Subject Property. The Lease has the following major terms and provisions:

- Landlord: City of Long Beach

- Tenant: MWN Community Hospital LLC, a California limited liability company.

- Address: 1720 Termino Avenue (Hospital), 1760 Termino Avenue (physician's medical building), and 4111 E. Wilton Street (MRI Center).

- Use: At a minimum, the use of Subject Property will include an acute care hospital and other health care facilities, including a medical office building and other health and/or wellness-related uses, and emergency and urgent care services. As long as the City's Sexual Assault Response Team ("SART") is in existence, the Tenant will continue to sublease a portion of the Subject Property to SART, upon terms and conditions similar to those contained in the current sublease with SART.

- Length of Term: The term of the Lease will begin on October 15, 2019 (Effective Date), and expire 45 years after the date on which a hospital license is issued to the Tenant by the applicable State regulatory agency and Tenant opens the hospital (Opening Date). The Tenant will have the option of two 10-year extensions.

- Rent: Rent will be one dollar per year. Beginning on the Opening Date, and continuing annually, in arrears, until the fifth anniversary of the Opening Date. The Tenant will pay to Landlord as additional rent, an amount equal to 20 percent of hospital net revenue.

- Maintenance: Landlord will have no responsibility to perform the improvement, repair or maintenance of the Subject Property, or any part thereof (including, but not limited to, seismic upgrades or work required by any legislation relating to earthquake retrofitting). The Tenant will, at the Tenant's sole cost, improve and repair the Premises as necessary, and maintain the Premises, including all improvements, fixtures, USTs and equipment, in good repair, in a clean, orderly and safe operating condition, and in substantial compliance with applicable laws, rules, regulations, permits, and licenses.

· Seismic Compliance: Tenant will maintain required State permits to operate an acute care facility. Upon the receipt of State approvals for seismic compliance plan, the Tenant will promptly thereafter begin the seismic work and follow it through to completion.

· Seismic Work Annual Payments: Landlord agrees to reimburse the Tenant for 50 percent of the seismic work costs, not to exceed $25,000,000, in annual payments over a 15 year period. The first five seismic work annual payments will not exceed $1,000,000 each, and remaining seismic work annual payments will not exceed $2,000,000 per year, until the $25,000,000 maximum is reached.

· External Funding: Grant funds secured by Landlord will count as a 50 percent credit against the seismic work annual payments, except that the initial $5,000,000 of external funding secured by Landlord will not count as a credit against the seismic work annual payments cap.

· Landlord Remedies: Following the occurrence of default by the Tenant, Landlord may withhold seismic work annual payments dollar for dollar until the default is cured and/or terminate the Lease and Tenant rights to possession of the Subject Property. Tenant will be entitled to reimbursement of Net Hospital Capital Costs (as defined below) for any default other than bankruptcy.

· Voluntary Termination by Tenant: If the Tenant determines that it is no longer economically feasible to operate at the Subject Property, then the Tenant may issue a written termination notice to the City evidencing its intent to terminate the Lease. In such event, the Tenant will still be entitled to the reimbursement of Net Hospital Capital Costs (as defined below), limited to the value of the Subject Property, or its actual sale price.

· Hospital Capital Costs: Hospital Capital Costs will mean all costs and expenses actually incurred pertaining to the startup and continued operation of the Hospital, only after the Effective Date (expressly excluding any non-Hospital portions of the Subject Property), including, without limitation, (a) all seismic work costs (as reduced by all seismic work annual payments actually received by Tenant), (b) building repair, maintenance and equipment costs, (c) restoration costs in connection with any casualty, (d) all real and personal property taxes, (e) interest on financing incurred by Tenant to secure funds for Hospital Capital Costs, and (f) all Hospital net losses; but expressly excluding (1) costs and expenses exclusively related to any non-Hospital portions of the Subject Property, and (2) non-cash items such as depreciation or amortization.

· Net Hospital Capital Costs: Net Hospital Capital Costs will include all Hospital Capital Costs (as defined above), minus: (a) hospital net profits, and (b) costs and expenses incurred by City on and after the Effective Date (pertaining to the Hospital only).

- Net Hospital Capital Cost Payment: After negotiating the Net Hospital Capital Costs amount (as defined above), City has the right to either: (a) reimburse Lessee, (b) sell the Subject Property on the open market (Market Sale Option described below), or (c) sell the Subject Property directly to Tenant (Tenant Sale Option described below). Under no circumstances will the Net Hospital Cost Payment to Tenant be greater than the sale price of the Subject Property.

- No Recovery of Costs Before the Effective Date: The Lease does not provide for recovery of the City's holding costs (security, utilities, maintenance and insurance) prior to the Effective Date of the Lease, nor does it provide for recovery of any the Tenant costs associated with the Subject Property prior to the Effective Date.

- Restricted Use: If the Subject Property is sold under either the Tenant or Market Sale option, the use is restricted to acute or non-acute health care related purposes.

- Tenant Sale Option: If Landlord elects to exercise the Tenant Sale Option, the purchase price for the Subject Property will be an amount equal to the appraised value of the Subject Property (restricted to acute or non-acute health-care related purposes) minus Net Hospital Capital Costs (as described above). Under no circumstance will the Landlord owe the Tenant more than the appraised value of the Subject Property.

- Market Sale Option: If the Landlord elects the Market Sale Option, the purchase price will be determined by the market sale, restricted to no less than 50 percent of market value, unless the Tenant offers the highest price. Under no circumstance will the Landlord owe the Tenant more than the appraised value or the open market sale value of the Subject Property.

- Staffing: Tenant will make a good faith effort to hire former Community Hospital Long Beach staff impacted by the change in operators who desire to remain at the Subject Property.

- Seismic Construction: Tenant is solely responsible for all construction at the Subject Property, including without limitation all seismic work.

There are significant potential benefits associated with the Lease, such as an acute care hospital, et. al., as well as significant financial impacts and potential risks. The consideration of this Lease by the City Council has three main potential outcomes. The potential costs and implications and risks of each potential outcome are described in the Fiscal Impact section below.

This matter was reviewed by Deputy City Attorney Richard Anthony on October 10, 2019 and by Finance Director John Gross on October 10, 2019.

STATEMENT OF URGENCY

Approval of the proposed Lease on October 15, 2019 has been determined to be a necessary condition for the Tenant to meet State hospital licensing requirements. To maintain continuous licensing of the hospital in a suspended status, the Tenant has agreed to complete its State inspection of the hospital by the end of October 2019. Additionally, the Tenant has established a two-week timeframe for hiring and training of hospital staff prior to State inspection, and it must obtain City approval of the Lease before proceeding with the substantial investment necessary to hire staffing and purchase equipment required for State inspection. As such, approval of the proposed Lease by October 15, 2019 is necessary to enable Tenant to meet its obligations thereunder.

The Lease is a complex transaction and there are three potential outcomes from City Council action that are described in this fiscal impact statement.

The Lease is a vehicle that provides the Tenant an incentive to operate an acute care hospital, and also allows the rest of the Subject Property to be used for any medical purpose. The main incentive for Tenant to enter into the Lease is the use of the Subject Property, reimbursement for up to half the seismic retrofit costs, and the possibility of full reimbursement if the Tenant decides, for any reason, to discontinue operations and terminate the Lease. In general, the Lease is intended to minimize the financial risk to the Tenant for the acute care hospital by providing the opportunity for potential revenue from the portions of the Subject Property's non-acute care facilities, and from a nearby proton beam facility. In addition, the Tenant would likely have the ability to purchase the entirety of the Subject Property, subject to a deed restriction for acute or non-acute health care related uses. There is a rent provision for profit sharing, but City income under that provision is not anticipated under normal circumstances.

Neither the City or the Tenant are entitled to recover any costs associated with the Subject Property prior to the Effective Date (October 15, 2019) of the lease.

At the direction of the City Council, tremendous effort and resources have been put into eliminating many difficult hurdles and issues preventing the re-opening of the hospital. Although there are hard costs to the City, as well as significant risks and likely significant additional costs, this is the best Lease that could be negotiated and is the City's best and likely only opportunity to open an acute care hospital on the Subject Property.

The three potential outcomes associated with the Lease: 1) the Lease is approved and continues to term (at least 45 years); 2) the Lease is approved and is terminated at some point; or 3) the Lease is not approved. The table below summarizes the potential costs and likely outcomes under the three identified scenarios.

Summary of Costs and Likely Outcomes Under the Three Possible Outcomes

Outcome 1: Lease Approved (hospital operates)	Outcome 2: Lease Terminated Prior to 45 Years (either before hospital opens or after)	Outcome 3: Lease not Approved
$25 million over 45 years, plus some annual administrative costs that could be $100,000 to $150,000 a year	Up to $25 million, plus some annual administrative costs that could be $100,000 to $150,000 a year, and potentially tens of millions of dollars more for reimbursement of Tenant costs, the reimbursement amount limited to, and likely offset by, the sale of the property. *Note: For several reasons, this is a likely outcome. The acute care hospital may or may not operate after termination.*	$2 million to $2.5 million a year until property can be repurposed or sold *Note: City Council would have to decide next steps and provide direction to staff.*

<u>Outcome 1: Lease Approved and Continues</u>

Under this scenario, the Tenant will open and operate an acute care hospital, and fund the seismic retrofit (with 50% reimbursement from the City) to allow the Hospital to operate into the future. Under those circumstances, the City will benefit from an ongoing acute care hospital. The known City cost and impact is as follows:

- Seismic retrofit reimbursement to Tenant of up to $1,000,000 a year for the first five years and up to $2,000,000 a year for the next ten years. Maximum cost of $25 million.

- City administrative costs of $100,000 to $150,000 a year for monitoring and verifying of net profits and losses.

- Tenant would profit share with the City for first five years for Hospital acute care related activities, but it is unlikely that the City would receive any significant funds.

- Tenant can use the non-acute care portion of the Subject Property for any medical use and can operate this portion of the Subject Property or a proton beam facility without having to share its profits or otherwise provide credit to the City for its net income.

<u>Outcome 2: Lease is approved and subsequently terminated</u>

Under this scenario, which is likely to occur at some point during the Term, the Lease would be terminated at some point in the future by either Tenant or the City. The key reasons for that more likely outcome are:

· Although much work has been done to overcome major obstacles, the opening and ongoing operations of an acute care hospital on the Subject Property still have many issues and potential roadblocks, cost being a lead issue. The Tenant expressly makes no representation that it can open or operate an acute care hospital. The State's regulatory agencies may identify issues that are insurmountable during the current or future hospital licensing and/or seismic construction planning process. These issues may be outside the Tenant's control or current understanding of the Subject Property.

· The true cost of detailed construction plans for the seismic retrofit is not known at this point; therefore, a financial plan to address the seismic retrofit component of the project has not been prepared yet. The $50 million estimate to conduct a seismic retrofit (of which the City would pay half) is a preliminary number based on the conceptual seismic plans prepared by the City's architect and confirmed by the Tenant's consultant. Any unexpected high cost of the retrofit, which is at the Tenant's risk, may cause abandonment of the opening of the Hospital as may any difficulty in the Tenant being able to finance the retrofit costs.

· The overall terms of the Lease likely make it financially beneficial for Tenant to terminate the Lease at some point, regardless of whether or not the Hospital is viable.

The costs and implications to the City if the Lease is terminated by Tenant or by the City, for any reason, except bankruptcy, include:

· Seismic retrofit costs paid to date (maximum of $25 million).

· Up to several hundred thousand dollars of costs associated with the termination of the Lease and potential sale of the Subject Property.

· The following additional costs with a limit equal to either the appraised value or the open market value of the Subject Property:

§ Reimbursement for all start-up costs;
§ Reimbursement for Tenant share of any retrofit costs; and,
§ Reimbursement for any cumulative net operating loss (methodology may result in recoverable costs being high and will include retaining of certain Tenant profits).

· Likely sale of the Subject Property by the City either to Tenant or to another third-party to cover the City's obligations to Tenant, or because of Lease requirements. The sale price to Tenant may be the appraised value (less Tenant costs) or the open market sale price (less Tenant costs), which could be any amount if the Tenant is the high bid in an open market sale.

· The acute care hospital may or may not continue to operate after Lease termination.

The City's liability is limited by the appraised value of the Subject Property or the proceeds from its sale. The sale value under the lease termination provisions (land use restriction for medical purposes) may be between $40 million and $90 million, depending on whether the seismic retrofit has been completed. Almost certainly the City would sell the Subject Property to cover costs to reimburse Tenant under the terms and conditions of the Lease. In such a situation, the cost to the City would be a maximum of up to $25 million for the seismic retrofit plus the loss of the Subject Property, and additional hard costs of potentially several hundred thousand dollars related to settlement of the Lease termination.

The Lease provides a financial and property ownership incentive for the Tenant to terminate at some point during the term of the Lease. A mutually agreeable way to eliminate that incentive could not be found while still requiring the Tenant to accept the financial risk of restarting, retrofitting, and ultimately operating an acute care hospital at the Subject Property. The City should expect this outcome, regardless of whether or not the acute care hospital is successful. The acute care hospital may or may not continue to operate after Lease termination, which, would be a decision of the Tenant or future property owner.

<u>Outcome 3: City or Tenant does not approve Lease</u>

If the City does not approve the Lease with Tenant, there are significant cost ramifications for a period of time. As estimated by the Economic Development Department, the City's holding costs for the Subject Property are approximately $2.3 million a year. The City would also be liable to the Tenant for reimbursement of start-up costs up to $1 million. Based on its targeted request for proposal process and subsequent due diligence process in 2018, the Economic Development Department believes the Tenant is likely the only remaining opportunity for an acute care hospital at Subject Property. If the Lease is not approved and a revised Lease cannot be negotiated with Tenant, the City would likely hold the Subject Property for some time until some other use is identified, or the Subject Property is sold. If the Subject Property is sold, the City may net as much as several tens of millions of dollars that could be used for general purposes.

Funding Sources for City Costs

The funding sources for the City costs associated with the proposed Lease are likely as follows:

· <u>Annual Seismic Retrofit Payment</u>: established by the Lease up to $25 million over 15 years with up to $1 million payment for first five years, and an annual payment up to $2 million for another ten years, will be funded from structural General Fund budget by offsetting budget reductions, absent any other identified solution. The City Council has already taken action to allow the $25 million to be an eligible public safety use under

Measure A, with voters having the opportunity to decide on a potential extension of Measure A in March 2020.

· Annual Administration: estimated $100,000 to $150,000 for the administration of the Lease, review of annual reports, and financial audits as needed will be funded from same source as the seismic retrofit.

· Lease Termination Payment: estimated up to $91 million, which reflects the appraised value of the Subject Property if seismic retrofit is completed and the acute care hospital facility successfully completes the State permitting process. The payment is likely much less if termination occurs early when these costs are likely low, the City would likely put the Subject Property up for sale and not have much out of pocket cost for the non-seismic costs.

Other Impacts

If the Lease is executed and the acute care hospital becomes fully operational, there is expected to be property tax revenue (County Assessor estimates not available at this time), and potentially over 250 local jobs associated with this recommendation. Additional use of the Subject Property for alternative medical services may also create property tax and local jobs, sales tax to the City, and other indirect economic benefits for local suppliers.

Approve recommendation.

JOHN KEISLER
DIRECTOR OF ECONOMIC DEVELOPMENT

APPROVED:

THOMAS B. MODICA
ACTING CITY MANAGER