STATE OF ILLINOIS
HEALTH FACILITIES AND SERVICES REVIEW BOARD

525 WEST JEFFERSON ST. • SPRINGFIELD, ILLINOIS 62761 • (217) 782-3516 • FAX: 217) 785-4111

DOCKET ITEM:	BOARD MEETING:	EXEMPTION NUMBER:
C-01	November 12, 2014	E-018-014
EXEMPTION APPLICANT(S): OSF Healthcare System, Mendota Community Hospital		
FACILITY NAME and LOCATION: Mendota Community Hospital, Mendota, Illinois		

PROJECT DESCRIPTION: OSF Healthcare System and Mendota Community Hospital, both Illinois not-for-profit corporations seek approval for an affiliation among OSF Healthcare System and Mendota Community Hospital. The estimated fair market value of the Mendota Community Hospital is $39.923 million. **The anticipated project completion date is June 30, 2015.**

EXECUTIVE SUMMARY

PROJECT DESCRIPTION:

- OSF Healthcare System and Mendota Community Hospital, both Illinois not-for-profit corporations seek approval for an affiliation among OSF Healthcare System and Mendota Community Hospital. The estimated fair market value of the Mendota Community Hospital is $39.923 million. **The anticipated project completion date is June 30, 2015.**

WHY THE PROJECT IS BEFORE THE STATE BOARD:

- The applicants are proposing a change of ownership under the exemption rules promulgated by the State Board. (77 IAC 1130.520) An exemption does **NOT** require evidence of the **NEED** for the service.
- 20 ILCS 3960/6 (b) states "*The State Board shall establish by regulation the procedures and requirements regarding issuance of exemptions. An exemption* ***shall be approved*** *when information required by the Board by rule is submitted.*"

EXEMPTION REQUIREMENTS:

To meet the requirements of the change of ownership the applicants must affirm the following;

- that the categories of service and number of beds as reflected in the Inventory of Health Care Facilities will not substantially change for at least 12 months following the project's completion date;
- that no adverse action has been taken against the applicant by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois against any health care facility owned or operated by the applicant, directly or indirectly, within three years preceding the filing of the application;
- proof that the applicant has sufficient funds to finance the acquisition and to operate the facility for a period of 36 months
- that the applicant intends to maintain ownership and control of the facility for a minimum of three years;
- that any projects for which permits have been issued have been completed or will be completed or altered in accordance with the provisions of this Section;
- that the facility will not adopt a more restrictive charity care policy than the policy that was in effect one year prior to the transaction. The hospital must provide affirmation that the compliant charity care policy will remain in effect for a two-year period,
- that failure to complete the project in accordance with the applicable provisions of Section 1130.500(d) no later than 24 months from the date of exemption approval (or by a later date established by HFSRB upon a finding that the project has proceeded with due diligence) and failure to comply with the material change requirements of this Section will invalidate the exemption.

The applicants have met the requirements of the State Board

STATE BOARD STAFF REPORT
CHANGE OF OWNERSHIP EXEMPTION

I. The Exemption Application

OSF Healthcare System and Mendota Community Hospital, both Illinois not-for-profit corporations seek approval for an affiliation among OSF Healthcare System and Mendota Community Hospital. The estimated fair market value of the Mendota Community Hospital is $39.923 million. **The anticipated project completion date is June 30, 2015.**

The Illinois Health Facilities Planning Act defines a change of ownership as

> ". . . a change in the person who has ownership or control of a health care facility's physical plant and capital assets. A change in ownership is indicated by the following transactions: sale, transfer, acquisition, lease, and change of sponsorship or other means of transferring control."

No public hearing was requested and no letters of opposition were received by the State Board Staff. Letters of support were received from the following:

- State Representative Frank Maulino
- State Senator Susan Rezin
- Michael A. Hall, Mayor, City of Earlville
- David A. Scholl, M.D.
- Eric G. Anderson, General Manager, Northern Partners Coop
- Timothy J. McConville, President/CEO First State Bank
- J. Leonard and Marilyn Schaller
- Connie J. Bontz, CTFA Vice President & Trust Officer, Midland Bank
- Richard Nora, M.D.
- Rayanne M. Sestor, Mendota Area Senior Services, Inc.
- Emily J. McConville, City of Mendota Economic Development Director
- David W. Boelk, Mayor City of Mendota
- Matthew B. Carroll, President & CEO, Black Brothers Co.

II. The Facility

Mendota Community Hospital is a 25-bed Critical Access Hospital (CAH) located at 1401 East 12th Street, Mendota, Illinois in Health Service Area II and Health Planning Area C-02. HSA II includes the Illinois Counties of Bureau, Fulton, Henderson, Knox, LaSalle, Marshall, McDonough, Peoria, Putnam, Stark, Tazewell, Warren, and Woodford. Planning Area C-2 includes LaSalle, Bureau, and Putnam Counties; Stark County Townships of Elmira and Osceola. The table below identifies the other hospitals in HSA II, their location, their planning area and total number of beds.

TABLE ONE Hospitals located in the HSA II Service Area			
Facility	**City**	**Planning Area**	**Beds**
Advocate Eureka Hospital	Eureka	C-01	25
Hopedale Hospital	Hopedale	C-01	25
Kindred Hospital	Peoria	C-01	50
Methodist Medical Center	Peoria	C-01	329
OSF St. Francis Medical Center	Peoria	C-01	609
Pekin Memorial Hospital	Pekin	C-01	98
Proctor Community Hospital	Peoria	C-01	233
Illinois Valley Community Hospital	Peru	C-02	65
OSF St. Elizabeth Medical Center	Ottawa	C-02	97
Perry Memorial Hospital	Princeton	C-02	25
St. Margaret's Hospital	Spring Valley	C-02	69
St. Mary Hospital	Streator	C-02	97
Galesburg Cottage Hospital	Galesburg	C-03	173
OSF Holy Family Medical Center	Monmouth	C-03	23
St. Mary Medical Center	Galesburg	C-03	90
Graham Hospital	Canton	C-04	87
McDonough District Hospital	Macomb	C-04	48

In April of 2009 the State Board approved as **Permit #08-106** the discontinuation of a 38 bed hospital and the establishment of a 25 bed hospital in Mendota, Illinois at a cost of approximately $33.8 million. The project has been completed.

The Hospital entered into a mortgage agreement dated December 1, 2009, for the construction of a replacement facility. The terms of the agreement allow for borrowings up to $34,220,000 at a fixed interest rate of 6.14 percent. The balance outstanding as of March 31, 2014 and 2013, was $32,533,388 and $33,171,639, respectively. The mortgage is due in monthly installments of $223,436 which began on January 1, 2012, and must be paid in full by December 2036. The mortgage is insured by HUD under Section 242 of the *National Housing Act.*

TABLE TWO Financial Performance Mendota Community Hospital		
Financial Performance	**FY 2014**	**FY 2013**
Net Patient Service Revenue	$32,310,061	$29,560,524
Other Revenue	$949,758	$1,127,976
Total Revenue	$33,259,819	$30,668,500
Expenses	$35,156,061	$34,640,253
Operating Income (loss)	-$1,896,242	-$3,951,753
Other Income	$184,590	$1,275,219
Deficiency of Revenues over Expenses	-$1,646,663	-$3,621,500
Cash	$1,173,503	$544,005
Current Assets	$6,086,679	$6,627,296
Total Assets	$46,993,908	$50,809,287
Current Liabilities	$4,798,409	$5,462,841

TABLE TWO Financial Performance Mendota Community Hospital		
Financial Performance	**FY 2014**	**FY 2013**
Long Term Debt	$33,145,121	$34,649,449
Net Assets	$9,050,378	$10,696,997
Operating Margin	-5.87%	-13.37%
Net Margin	-5.10%	-12.25%
Charity Care Expense	$711,000	$863,000
Charity Care as % of Net Patient Revenue	2.2%	2.9%
EBIDA	$4,160,219	$2,172,005
EBIDA %	12.88%	7.35%
Days Cash on Hand	13.6	6.4
Unrestricted cash and investments/total long term debt	3.54%	1.57%
Average Age of Plant	4	3.2
Information taken from FY 2014 Audited Financial Statements Mendota Community Hospital		

III. The Applicant

OSF Healthcare System ("OSF") is owned and operated by **The Sisters of the Third Order of St. Francis**, Peoria, Illinois. **OSF Healthcare System** consists of seven acute care facilities in Illinois, and one long-term care facility (OSF Saint Clare Home, Peoria Heights-98 beds). The seven acute care hospitals are listed below.

TABLE THREE OSF Healthcare System Hospitals		
Facilities	**City**	**Beds**
OSF Saint Anthony Medical Center	Rockford	254
OSF Saint James – John W. Albrecht Medical Center	Pontiac	42
OSF Saint Elizabeth Medical Center	Ottawa	97
OSF St. Joseph Medical Center	Bloomington	149
OSF Saint Francis Medical Center	Peoria	609
OSF St. Mary Medical Center	Galesburg	90
OSF Holy Family Medical Center	Monmouth	23

Below is the financial information provided by the applicants for OSF Healthcare System.

TABLE FOUR OSF Healthcare System (2)			
Financial Performance	**2013**	**2012**	**2011**
Net patient revenue	$1,910,851	$1,817,000	$1,787,360
Total operating revenue	$1,994,993	$1,895,976	$1,865,985
Total operating Expenses	$2,004,367	$1,857,743	$1,845,357
Operating income	-$9,374	$38,233	$20,628
Operating margin (%)	-0.47%	2.02%	1.11%

TABLE FOUR OSF Healthcare System (2)			
Financial Performance	**2013**	**2012**	**2011**
Net non-operating income	$39,121	$45,982	$37,542
Excess income	$29,747	$84,215	$58,170
Excess Margin	1.46%	4.34%	3.06%
EBIDA margin (%)	7.71%	10.59%	10.19%
Net available for debt service	$156,921	$205,633	$193,955
Maximum annual debt service	$57,741	$57,741	$57,741
Maximum annual debt service coverage	2.72%	3.56%	3.36%
Operating lease-adjusted coverage (x)	1.92	2.4	2.33
Liquidity and financial flexibility			
Unrestricted cash and investments	$1,019,550	$832,423	$759,738
Unrestricted days' cash on hand	194.5	171.4	158
Unrestricted cash and investments/total long term debt (3)	115.70%	93.90%	89.10%
Average age of plant (years)	12.2	14.3	11.8
Capital Expenditures/depreciation and amortization	127.60%	110.80%	90.80%
Debt and Liabilities			
Total long-term debt	$881,390	$886,139	$853,089
Long-term debt/ capitalization	47.80%	54.20%	55.10%
Contingent liabilities	$293,320	$294,070	$280,945
Contingent liabilities /total long term debt	33.30%	33.20%	32.90%
Debt Burden (1)	2.84%	2.97%	3.03%
Defined Benefit plan funded status	65.19%	51.23%	56.76%

(1) cost of servicing debt
(2) Information from Standard and Poor’s
(3) Cash and Investments/total long term debt means> 100% means amount of cash in excess of total long term debt

IV. The Proposed Transaction

Upon State Board approval Mendota Community Hospital (“MCH”) will be reorganized to provide that OSF Healthcare System (“OSF”) will become the sole member of MCH with full rights and powers. The proposed affiliation will result in a change in membership or sponsorship of a not-for-profit corporation that is the licensed entity and a change of 50% or more of the voting members of a not-for-profit corporation's board of directors that controls a health care facility's operations, license, certification and physical plant and assets.

The agreement states *“The moral teachings of the Roman Catholic Church, including the Ethical and Religious Directives for Catholic Health Care Services. as amended from time to time, promulgated by the United States Conference of Catholic Bishops, as interpreted and applied by OSF ("Ethical and Religious Directives"), and the Code of Canon Law of the Roman Catholic Church ("Canon Law") shall govern without exception the conduct by Mendota Community Hospital of their businesses following Closing.”*

As part of the agreement there will be a modification of the HUD Financing for the new hospital which requires (i) finalization of an Interest Rate Reduction Loan Modification to reflect modification in interest rate and prepayment provisions of the HUD Financing to OSF's reasonable satisfaction, and (ii) preliminary approval from the U.S Department of Housing and Urban Development for an Application for Transfer of Physical Assets to permit OSF to become the sole member of MCH; and (b) HUD approval of the Management Agreement.

Mendota Community Hospital will continue to be a licensed hospital and owner of the site and will be operated as a division of OSF and will, upon closing, begin operating under an assumed name approved by the OSF Board. The Fair Market Value (FMV) of the transaction has been determined to be $39,923 million, based on the documentation attached at the end of this report. The transaction acquisition price is $0.00.

Among the **anticipated benefits** of the merger *is local residents will experience is greater access to integrated primary, secondary, and advanced tertiary health care services. Achieving excellence in clinical innovations, services, quality, costs and outcomes have also been identified as goals of both organizations.*

Individuals who are Mendota Community Hospital employees on the transaction closing date will become employees of OSF. The affiliation **will not affect or change the medical staff status or clinical privileges** held by members of Mendota Community Hospital medical staff. However, the medical staff bylaws will be amended to insure compliance with the Ethical and Religious Directives for Catholic Health Care Services. The employment agreements of all physicians presently employed by Mendota Community Hospital will be honored. Patient records will remain intact.

The applicants:

1. Attest that the Inventory of Health Care Facilities of Mendota Community Hospital will not substantially change for at least 12 months following the project's completion date;

2. Certify that no adverse action has been taken against the applicant by the federal government, licensing or certifying bodies, or any other agency of the State of Illinois against any health care facility owned or operated by the applicant, directly or indirectly, within three years preceding the filing of the application;

3. Affirm that the applicant intends to maintain ownership and control of the facility for a minimum of three years;

4. Affirm that any projects for which permits have been issued have been completed or will be completed or altered in accordance with the provisions of this Section;

5. Affirm that the facility will not adopt a more restrictive charity care policy than the policy that was in effect one year prior to the transaction. The hospital must provide affirmation that the compliant charity care policy will remain in effect for a two-year period, following the change of ownership transaction; and

V. Attached to this report is the valuation analysis performed by Alvarez & Marsal Valuation Services, LLC**.**

Ownership, Management and General Information

ADMINISTRATOR NAME:	Judy Christiansen
ADMINSTRATOR PHONE	815-539-1464
OWNERSHIP:	Mendota Community Hospital
OPERATOR:	Mendota Community Hospital
MANAGEMENT:	Not for Profit Corporation (Not Church-R
CERTIFICATION:	Critical Access Hospital
FACILITY DESIGNATION:	General Hospital
ADDRESS	1401 E. 12th Street

CITY: Mendota COUNTY: LaSalle County

Patients by Race

White	96.2%
Black	0.7%
American Indian	0.0%
Asian	0.2%
Hawaiian/ Pacific	0.0%
Unknown	2.9%

Patients by Ethnicity

Hispanic or Latino:	3.8%
Not Hispanic or Latino:	96.2%
Unknown:	0.0%

IDPH Number:	5819
HPA	C-02
HSA	2

Facility Utilization Data by Category of Service

Clinical Service	Authorized CON Beds 12/31/2013	Peak Beds Setup and Staffed	Peak Census	Admissions	Inpatient Days	Observation Days	Average Length of Stay	Average Daily Census	CON Occupancy Rate %	Staffed Bed Occupancy Rate %
Medical/Surgical	21	21	21	695	2,444	788	4.7	8.9	42.2	42.2
0-14 Years				*5*	*9*					
15-44 Years				*54*	*127*					
45-64 Years				*130*	*372*					
65-74 Years				*135*	*496*					
75 Years +				*371*	*1,440*					
Pediatric	0	0	0	0	0	0	0.0	0.0	0.0	0.0
Intensive Care	4	4	4	62	102	61	2.6	0.4	11.2	11.2
Direct Admission				*54*	*93*					
Transfers				*8*	*9*					
Obstetric/Gynecology	0	0	0	0	0	0	0.0	0.0	0.0	0.0
Maternity				*0*	*0*					
Clean Gynecology				*0*	*0*					
Neonatal	0	0	0	0	0	0	0.0	0.0	0.0	0.0
Long Term Care	0	0	0	0	0	0	0.0	0.0	0.0	0.0
Swing Beds			6	151	1,306		8.6	3.6		
Acute Mental Illness	0	0	0	0	0	0	0.0	0.0	0.0	0.0
Rehabilitation	0	0	0	0	0	0	0.0	0.0	0.0	0.0
Long-Term Acute Care	0	0	0	0	0	0	0.0	0.0	0.0	0.0
Dedcated Observation	*0*					*0*				
Facility Utilization	**25**			**900**	**3,852**	**849**	**5.2**	**12.9**	**51.5**	

(Includes ICU Direct Admissions Only)

Inpatients and Outpatients Served by Payor Source

	Medicare	Medicaid	Other Public	Private Insurance	Private Pay	Charity Care	Totals
Inpatients	**77.0%**	**3.8%**	**0.0%**	**16.6%**	**0.2%**	**2.4%**	
	693	34	0	149	2	22	**900**
Outpatients	**47.0%**	**11.7%**	**0.0%**	**38.0%**	**2.2%**	**1.1%**	
	20570	5129	0	16617	970	482	**43,768**

Financial Year Reported: 4/1/2012 *to* 3/31/2013

Inpatient and Outpatient Net Revenue by Payor Source

	Medicare	Medicaid	Other Public	Private Insurance	Private Pay	Totals	Charity Care Expense
Inpatient Revenue ($)	**77.0%**	**1.2%**	**0.0%**	**20.1%**	**1.7%**	**100.0%**	
	5,359,083	86,314	0	1,398,609	120,354	6,964,360	246,656
Outpatient Revenue ($)	**41.5%**	**4.3%**	**0.0%**	**52.7%**	**1.5%**	**100.0%**	
	9,376,866	980,047	0	11,901,443	337,808	22,596,164	458,031

Total Charity Care Expense
704,687

Total Charity Care as % of Net Revenue
2.4%

Birthing Data

Number of Total Births:	0
Number of Live Births:	0
Birthing Rooms:	0
Labor Rooms:	0
Delivery Rooms:	0
Labor-Delivery-Recovery Rooms:	0
Labor-Delivery-Recovery-Postpartum Rooms:	0
C-Section Rooms:	0
CSections Performed:	0

Newborn Nursery Utilization

	Level I	Level II	Level II+
Beds	0	0	0
Patient Days	0	0	0
Total Newborn Patient Days			**0**

Laboratory Studies

Inpatient Studies	9,293
Outpatient Studies	56,616
Studies Performed Under Contract	8,912

Organ Transplantation

Kidney:	0
Heart:	0
Lung:	0
Heart/Lung:	0
Pancreas:	0
Liver:	0
Total:	**0**

Surgery and Operating Room Utilization

Surgical Specialty	Operating Rooms				Surgical Cases		Surgical Hours			Hours per Case	
	Inpatient	Outpatient	Combined	Total	Inpatient	Outpatient	Inpatient	Outpatient	Total Hours	Inpatient	Outpatient
Cardiovascular	0	0	0	0	0	0	0	0	0	0.0	0.0
Dermatology	0	0	0	0	0	0	0	0	0	0.0	0.0
General	0	0	3	3	195	742	767	2179	2946	3.9	2.9
Gastroenterology	0	0	0	0	0	0	0	0	0	0.0	0.0
Neurology	0	0	0	0	0	0	0	0	0	0.0	0.0
OB/Gynecology	0	0	0	0	0	0	0	0	0	0.0	0.0
Oral/Maxillofacial	0	0	0	0	0	0	0	0	0	0.0	0.0
Ophthalmology	0	0	0	0	0	0	0	0	0	0.0	0.0
Orthopedic	0	0	0	0	0	0	0	0	0	0.0	0.0
Otolaryngology	0	0	0	0	0	0	0	0	0	0.0	0.0
Plastic Surgery	0	0	0	0	0	0	0	0	0	0.0	0.0
Podiatry	0	0	0	0	0	0	0	0	0	0.0	0.0
Thoracic	0	0	0	0	0	0	0	0	0	0.0	0.0
Urology	0	0	0	0	0	0	0	0	0	0.0	0.0
Totals	**0**	**0**	**3**	**3**	**195**	**742**	**767**	**2179**	**2946**	**3.9**	**2.9**

SURGICAL RECOVERY STATIONS Stage 1 Recovery Stations 4 Stage 2 Recovery Stations 0

Dedicated and Non-Dedicated Procedure Room Utilzation

Procedure Type	Procedure Rooms				Surgical Cases		Surgical Hours			Hours per Case	
	Inpatient	Outpatient	Combined	Total	Inpatient	Outpatient	Inpatient	Outpatient	Total Hours	Inpatient	Outpatient
Gastrointestinal	0	0	0	0	0	0	0	0	0	0.0	0.0
Laser Eye Procedures	0	0	0	0	0	0	0	0	0	0.0	0.0
Pain Management	0	0	0	0	0	0	0	0	0	0.0	0.0
Cystoscopy	0	0	0	0	0	0	0	0	0	0.0	0.0
Multipurpose Non-Dedicated Rooms											
General Surgery	0	0	3	3	195	742	767	2179	2946	3.9	2.9
	0	0	0	0	0	0	0	0	0	0.0	0.0
	0	0	0	0	0	0	0	0	0	0.0	0.0

Emergency/Trauma Care

Certified Trauma Center		No
Level of Trauma Service	**Level 1**	**Level 2**
	(Not Answered)	Not Answered
Operating Rooms Dedicated for Trauma Care		0
Number of Trauma Visits:		0
Patients Admitted from Trauma		0
Emergency Service Type:		Stand-By
Number of Emergency Room Stations		6
Persons Treated by Emergency Services:		6,247
Patients Admitted from Emergency:		504
Total ED Visits (Emergency+Trauma):		**6,247**

Free-Standing Emergency Center

Beds in Free-Standing Centers	0
Patient Visits in Free-Standing Centers	0
Hospital Admissions from Free-Standing Center	0

Outpatient Service Data

Total Outpatient Visits	**43,768**
Outpatient Visits at the Hospital/ Campus:	43,768
Outpatient Visits Offsite/off campus	0

Cardiac Catheterization Labs

Total Cath Labs (Dedicated+Nondedicated labs):	**0**
Cath Labs used for Angiography procedures	0
Dedicated Diagnostic Catheterization Lab	0
Dedicated Interventional Catheterization Labs	0
Dedicated EP Catheterization Labs	0

Cardiac Catheterization Utilization

Total Cardiac Cath Procedures:	**0**
Diagnostic Catheterizations (0-14)	0
Diagnostic Catheterizations (15+)	0
Interventional Catheterizations (0-14):	0
Interventional Catheterization (15+)	0
EP Catheterizations (15+)	0

Cardiac Surgery Data

Total Cardiac Surgery Cases:	**0**
Pediatric (0 - 14 Years):	0
Adult (15 Years and Older):	0
Coronary Artery Bypass Grafts (CABGs) performed of total Cardiac Cases :	0

Diagnostic/Interventional Equipment	Owned	Contract	Examinations Inpatient	Outpt	Contract
General Radiography/Fluoroscopy	6	0	586	7,512	0
Nuclear Medicine	0	1	0	0	446
Mammography	1	0	0	0	1,433
Ultrasound	1	1	143	1,332	527
Angiography	0	0			
Diagnostic Angiography			0	0	0
Interventional Angiography			0	0	0
Positron Emission Tomography (PET)	0	0	0	0	0
Computerized Axial Tomography (CAT)	1	0	156	2,399	0
Magnetic Resonance Imaging	1	0	46	759	0

Therapeutic Equipment	Owned	Contract	Therapies/ Treatments
Lithotripsy	0	0	0
Linear Accelerator	0	0	0
Image Guided Rad Therapy			0
Intensity Modulated Rad Thrp			0
High Dose Brachytherapy	0	0	0
Proton Beam Therapy	0	0	0
Gamma Knife	0	0	0
Cyber knife	0	0	0

Source: 2013 Annual Hospital Questionnaire, Illinois Department of Public Health, Health Systems Development.

Alvarez & Marsal Valuation Services, LLC
55 West Monroe Street, Suite 4000
Chicago, IL 60603
Phone: +1 312 601 4220
Fax: +1 312 332 4599

October 1, 2014

Mr. Mathew S. Hanley
Director of Strategic Affiliations
OSF HealthCare System
800 N.E. Glen Oak Avenue
Peoria, Illinois 61603

Dear Mr. Hanley:

As requested, Alvarez & Marsal Valuation Services, LLC ("A&M VS") has performed a valuation of Mendota Community Hospital ("Mendota") and certain assets (the "Subject Assets") associated with Mendota as of August 31, 2014 (the "Valuation Date"). It is our understanding that OSF HealthCare System ("OSF") is contemplating a potential affiliation with Mendota (the "Transaction"). Management of OSF ("Management") has requested that A&M VS assist with an assessment of the fair market value[1] and fair value of:

a. the business enterprise of Mendota, an Illinois not for profit corporation, on a going concern basis;
b. the real property owned by Mendota located in Mendota, Illinois, including:
   i. the hospital at 1401 East 12th Street,
   ii. the old hospital property and medical office building located at 1315 Memorial Drive,
   iii. a medical office building located at 1315 Meridan Street,
   iv. a medical office building located at 1404 W. Washington Street, and
   v. Approximately 96.5 acres of farm land identified as parcels 03-20-417-000 and 03-29-204-000;
c. the personal property owned by Mendota at the owned and leased locations; and
d. identified intangible assets associated with the operation of Mendota, if any.

It is our understanding that our work will be used for the purposes of reporting requirements with respect to financial and regulatory reporting regarding the Transaction. The scope of our work was limited to the analyses we deemed appropriate and necessary to prepare our assessment of the fair values ("Opinion") as stated herein.

[1] Fair Market Value is defined as: "The price at which the property would change hands between a willing buyer and a 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." (Treas. Reg. 20.2031-1(b); Rev. Ruling 59-60, 1959 C.B. 237).

Our analyses and report are intended solely for your use as described in our engagement letter dated September 5, 2014. The report may be used only for the purposes described above. Neither the report nor its contents may be referred to or quoted in any registration statement, prospectus, loan or other agreement or document without prior written consent of A&M VS.

Executive Summary

We have considered the prevailing economic and industry environments, the history and nature of Mendota and the expected performance of Mendota as reflected in the prospective financial information ("PFI") and described by Management.

Scope of the Engagement

The scope of our work consisted of the identification, analysis and valuation of the Mendota business enterprise and the Subject Assets which included the following:

- Real Property and Related Assets;
- Personal Property and Related Assets;
- Intangible Assets.

Assets and liabilities not identified above were excluded from the scope of our engagement.

Sources of Information

For the purpose of our analysis, the primary written documents and records provided by Management were as follows:

- Projected financial information;
- Audited and internally prepared historical financial information; and
- Other miscellaneous documents.

The information provided by Management has been assumed, without further independent verification, to correctly represent the results of the actual and/or estimated operations and the financial condition of Mendota.

Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.

The PFI was provided by Management and prepared by Mendota. Management utilized a third party healthcare industry consulting firm to assist them in identifying and making adjustments to the PFI provided by Mendota. A&M VS had discussions with Management regarding the PFI including discussions regarding the basis for expectations of future financial performance. The PFI was also compared to historical trends of Mendota and the performance of selected publicly-traded guideline companies and private guideline transactions.

We have made certain adjustments to the historical information and PFI provided by Management considering the standard of value, the nature of the business and discussions with Management. In particular, we included the payment of corporate income taxes despite the tax exempt status of OSF and Mendota as required by the standard of fair market value. Based on all of the above, we confirmed that the PFI reflects Management's best estimate of the assumptions a hypothetical buyer and seller would use in pricing Mendota and was appropriate for use in our analysis. Our work does not constitute an examination, compilation or an agreed-upon procedures assignment as described in the American Institute of Certified Public Accountants ("AICPA") Professional Standards, Attestation Standards Section 200, Financial Forecasts and Projections.

Standard of Value

Fair value is defined in FASB ASC Section 820-10-35 as "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

ASC 820 provides several key principles of fair value measurement:

- Fair value should reflect an exit price, the price that would be accepted to sell the asset.
- The hypothetical transaction is assumed to be an orderly transaction, not a forced sale.
- The asset (liability) is transferred in an exchange between market participants.
- Fair value should reflect the perspective of a market participant that holds the asset or owes the liability; thus, it would reflect its highest and best use.
- The hypothetical transaction is assumed to occur in the principal or most advantageous market.
- Fair value should not reflect any adjustment for transaction costs, but it may include transportation costs in certain circumstances.
- The highest and best use determines the premise of value, either in-use (in combination with other assets as installed or otherwise configured) or in-exchange (stand-alone).

Fair market value is defined by Internal Revenue Services as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Many of the underlying concepts and principles of fair market value are similar to those of fair value but there can be differences under certain circumstances. The differences are usually insignificant and unless otherwise noted, our conclusions are the same under both standards herein and are referred to as fair values.

Premise of Value

Fair value is established based on premise of value and underlying analytical approaches appropriate to the facts and circumstances pertaining to the various classes of assets valued. Our valuation assumes that, unless identified otherwise in this report, the highest and best use of the assets will continue to be as a group in the ongoing hospital business. Therefore, we recognized the highest and best use of the assets to be as installed and as used, and we valued the assets under an in-use premise. In the case of the personal property assets, the premise of value in-use includes the additional value related to the freight, tax, installation and other costs that were incurred when the personal property assets were placed into service.

Valuation Approaches

In developing our opinions, we considered three approaches to value for Mendota and the Subject Assets and chose the most appropriate approach or approaches for each. Our conclusions rely on the approaches judged to be most appropriate for the purpose and scope of our analysis, as well as the nature and reliability of the available data. The three approaches to value are summarized as follows:

- **Income Approach**

  The income approach is a way of developing a value indication for a business, tangible or intangible asset or liability using one or more methods that convert anticipated economic benefits or obligations into a present single amount.[2] The discounted cash flow method is a method whereby the present value of future expected net cash flows is calculated using a discount rate.[3]

- **Market Approach**

  The market or sales comparison approach is a general way of estimating the value of a business, security, tangible, or intangible asset using one or more methods that compare the subject to similar investments or assets that have been sold or offered for sale.[4] Sales and offering prices for the comparable investments or assets are adjusted to reflect the difference

[2] AICPA Statement on Standards for Valuation Services No. 1, *Appendix B: International Glossary of Business Valuation Terms*, 45.
[3] Ibid. 43.
[4] *International Glossary of Business Valuation Terms*, 45.

between the investment or asset being valued and the comparable investments or assets, such as historical financial condition and performance, expected economic benefits, time and terms of sale, utility, and physical characteristics. The adjusted prices of the comparable assets provide an indication of value for the subject asset.

- **Cost Approach**

  The cost or asset approach may be viewed as a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capacity of that asset.[5]

Application and Methodology

Business Enterprise Value of Mendota

Both income and market approaches were applied to determine the fair value of the Total Invested Capital ("TIC") Mendota. In particular, we used a discounted cash flow analysis ("DCF") and market-derived multiples of revenue, earnings before interest taxes depreciation and amortization ("EBITDA"). The discounted cash flow analysis was used to determine the enterprise value of Mendota based on the PFI. In addition to the PFI, the discounted cash flow method relies upon a discount rate and a long term growth rate. The discount rate is the rate used to convert the annual cash flows as represented in the PFI into a present value. The appropriate discount rate to estimate enterprise value is the weighted average cost of capital ("WACC") that reflects the required rates of return on debt and equity by the investors in the business.

Our market approach included derivation of market multiples from publicly-traded guideline companies in the hospital management business as well as market multiples observed in private transactions where individual hospitals were acquired. We further defined the observations from private transactions to include only critical access hospitals.

By adding the value of liabilities not considered to be components of invested capital, typically the liabilities being included in Net Working Capital, to our estimate of the Total Invested Capital, we arrive at an estimate of the aggregate fair value of the cumulative Total Assets.

Real Property

As of the date of this letter, three[6] of Mendota's owned assets were under contract for sale or were subject to a Letter of Intent to Purchase. Based on discussions with Mendota's real estate

[5] Ibid, 43.
[6] 1) 1,276+/- SF office building located at 1315 Meriden Street: Sales Contract dated 9/14/14 for $70,500;
2) 2.06+/- acres vacant land at 1315 Memorial Drive: LOI dated 7/1/2014 for $300,000; and

broker as well as our independent research, the contract prices were determined to be reflective of fair value. As such, the fair value of these assets has been recorded at their contract prices.

In order to estimate the value of land for the new hospital site located at 1401 East 12^{th} Street, the remaining vacant land at the old hospital site located at 1315 Memorial Drive, and the land at 1404 Washington Street, we used the sales comparison approach by gathering recent sales transactions of land sales with similar characteristics as the subject land parcels. We then used adjustment grids to make qualitative and quantitative adjustments to arrive to our land value. Mendota was willed approximately 95.6 acres of farm land in 1968. The land is subject to a deed restriction whereby the Hospital cannot sell the land for 99 years and receives rental income in the interim. In order to estimate the value of the farm land we utilized the income approach. The estimated cash flow was projected over the remaining term of the restricted period and discounted back at a market-supported discount rate to estimate the present value of the land under its restricted use.

The cost approach was used to calculate the fair value for building and site improvements. The replacement cost new less depreciation ("RCN-LD") was determined by subtracting accrued depreciation resulting from physical depreciation, functional and external obsolescence from the replacement cost new. Building and site improvement estimates were based on information provided by Management, information acquired during site inspections, discussions with Mendota personnel, and estimates using GIS software. Our cost estimates are based on guidelines provided by *Marshall Valuation Service*. Due to the specialized nature of the subject property, the sales comparison and income approaches were not utilized in estimating the fair value of the subject buildings as vacant and site improvements.

Personal Property and Related Assets

We applied the cost and market approaches to value the personal property and related assets. The income approach was not considered due to the inefficiency of calculating an income stream to each individual personal property and related asset considered in the analysis. Within the cost approach analysis, several techniques are commonly used to facilitate the process of estimating the current replacement or reproduction cost new of the assets. The following methods of the cost approach have been applied within this analysis: trending and direct costing analysis. The historic costs were indexed (using trend factors) to determine the reproduction costs new of the assets. In some situations, additional procedures are appropriate to confirm or adjust the reproduction cost estimates to better reflect replacement costs. The direct replacement costs were researched and quantified by contacting Original Equipment Manufacturers ("OEM")

3) 1.37+/- acres vacant land at 1315 Memorial Drive: Purchase and Sale Agreement dated 6/12/14 for $300,000.

and/or their representatives to determine the cost new today, and from standard pricing media and our data files.

Since the Subject Assets are currently in use and of various age, some deficiency, or loss in value, needs to be deducted in the form of accrued deprecation to arrive at their value. The elements of deprecation to be considered are Physical Deterioration, Functional Obsolescence, and Economic Obsolescence, when applicable. The three forms of deprecation are further described below:

- Physical is a form of depreciation where loss in value or usefulness of a property is due to the using up or expiration of its useful life caused by wear and tear, deterioration, exposure to various elements, physical stresses, and similar factors.

- Functional Obsolescence is a form of depreciation in which the loss in value or usefulness of a property is caused by inefficiencies or inadequacies of the property itself, when compared to a more efficient or less costly replacement property that new technology has developed. Symptoms suggesting the presence of functional obsolescence are excess operating cost, excess construction (excess capital cost), over-capacity, inadequacy, lack of utility, or similar conditions.

- Economic Obsolescence (sometimes called "external obsolescence") is a form of depreciation where the loss in value of a property is caused by factors external to the property. These may include such things as the economics of the industry; availability of financing; loss of material and/or labor sources; passage of new legislation; changes in ordinances; increased cost of raw materials, labor, or utilities (without an offsetting increase in product price); reduced demand for the product; increased competition; inflation or high interest rates; or similar factors.

Summary and Conclusions

Based upon the information provided, discussions with Management and our independent research, as well as the analyses performed and described herein, we have concluded that the fair market value and fair value of the Total Assets of Mendota as of the Valuation Date is approximately $39.923 million.

The conclusions and opinions expressed herein are subject to the *Assumptions and Limiting Conditions* included in the full valuation report. Additional relevant information and analyses considered in our opinions will be retained in our work files and will be available for review upon request. The depth of discussion contained herein is specific to your needs as the client and for the intended use as stated.

If you have any questions regarding the results of the analysis, please contact me at (312) 288-4065.

Very truly yours,

Gary T. Frantzen

Gary T. Frantzen, CFA
Managing Director
Alvarez & Marsal Valuation Services, LLC

OSF HealthCare					Schedule 1
ASC 805 Valuation of Certain Assets Acquired of Mendota Community Hospital					
Summary of Values					Valuation Date: August 31, 2014
US$ in 000s					

	Unadjusted Asset Values	Adjustments	Adjusted Asset Values	Net Book Value
Assets				
Working Capital, Net of Cash	$ 2,633	$ -	$ 2,633	2,633
Property, Plant & Equipment				
Building	27,771	(8,059)	19,711	25,886
Land Improvements	2,060	(598)	1,462	3,986
Land	2,020	-	2,020	1,272
Total Real Property	31,851	(8,657)	3,492	31,145
Personal Property (1)	5,974	(1,734)	4,240	4,629
Total Property, Plant & Equipment	37,825	(10,390)	27,435	35,774
Intangible Assets	-		-	-
Non-Operating Assets				
Other Assets	698	-	698	698
Farm Land Limited As to Use	560	-	560	40
Assets Limited As To Use	3,271	-	3,271	3,271
Total Non-Operating Assets	4,530	-	4,530	4,010
Excess Cash	644	-	644	644
Total Invested Capital	45,631	(10,390)	35,241	43,061
Current Liabilities	4,682	-	4,682	4,682
Total Assets	50,313	(10,390)	39,923	47,742
Premium/(Deficit) to Unadjusted Value	(10,391)			

Footnote:
(1) Adjusted personal property value was based on fair value in exchange.

Attachment 3
Exhibit B
Fair Market Value Summary