

NEW ISSUE – BOOK-ENTRY ONLY**RATING**

Standard & Poor's: AA-
See "RATING" herein

In the opinion of Norton Rose Fulbright US LLP, Los Angeles, California, Bond Counsel, under existing statutes, regulations, rulings and court decisions, and subject to the matters described in "TAX MATTERS" herein, interest on the Series 2016 Bonds is excluded pursuant to section 103(a) of the Internal Revenue Code of 1986 from the gross income of the owners thereof for federal income tax purposes and is not included in the federal alternative minimum tax for individuals or, except as described herein, corporations. It is also the opinion of Bond Counsel that under existing law interest on the Series 2016 Bonds is exempt from personal income taxes of the State of California. See "TAX MATTERS" herein, including a discussion of the federal alternative minimum tax consequences for corporations.

\$5,680,000*

**MENDOCINO COAST HEALTH CARE DISTRICT
(MENDOCINO COUNTY, CALIFORNIA)
INSURED HEALTH FACILITY REFUNDING REVENUE BONDS
SERIES 2016**

Dated: Date of Issuance

Due: February 1, as shown herein

The above-referenced bonds (the "Series 2016 Bonds") will be issued by the Mendocino Coast Health Care District (the "District"), a public entity under the laws of the State of California (the "State"), as fully registered bonds in minimum denominations of \$5,000 or any integral multiple thereof of single maturities, pursuant to a resolution of the governing body of the District and an Indenture, dated as of July 1, 2016 (the "Indenture"), between the District and The Bank of New York Mellon Trust Company, N.A., as trustee (the "Trustee"), authorizing the Series 2016 Bonds. Interest on the Series 2016 Bonds is payable on each February 1 and August 1, commencing February 1, 2017, to the persons appearing as registered owners on the registration books kept by the Trustee as of the 15th day of the month immediately preceding each interest payment date. The Series 2016 Bonds will be registered in the name of Cede & Co., as nominee for The Depository Trust Company, New York, New York ("DTC"), as securities depository for the Series 2016 Bonds. Purchasers of the Series 2016 Bonds will not receive physical delivery of Bond certificates. The principal or redemption price of and interest on the Series 2016 Bonds are payable by wire transfer to DTC, which, in turn, is to remit such principal, redemption price or interest to DTC Participants for subsequent disbursements to the owners of the Series 2016 Bonds, as more fully discussed herein. See "APPENDIX F-BOOK-ENTRY SYSTEM" herein. Capitalized terms used on this cover and not defined herein shall have the meanings given to them in the Indenture or the Regulatory Agreement, as applicable.

The Series 2016 Bonds will be limited obligations of the District and will be secured under the provisions of the Indenture and will be equally and ratably payable from Gross Revenues (as defined in the Indenture) and certain funds held under the Indenture. Pursuant to the California Constitution Article XVI, Section 4, and California Health and Safety Code, Division 107, Part 6, Chapter I, payment of the principal of and interest on the Series 2016 Bonds will be insured by the Office of Statewide Health Planning and Development of the State of California, and all debentures issued in payment of any claims under such insurance will be fully and unconditionally guaranteed by the State. See "CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM" herein.

The Series 2016 Bonds are subject to optional, mandatory and extraordinary optional redemption prior to their respective maturities, as described herein. See "THE SERIES 2016 BONDS – Redemption" herein.

Proceeds derived from the sale of the Series 2016 Bonds, together with certain available funds of the District, will be used to: (i) refund, on a current basis, all of the District's outstanding Mendocino Coast Health Care District Insured Health Facility Refunding Revenue Bonds, Series 1996 (the "Series 1996 Bonds"), and all or a portion of the Mendocino Coast Health Care District Insured Health Facility Revenue Bonds, Series 2010 (the "Series 2010 Bonds") and refund, on an advance basis, a portion of the District's outstanding Mendocino Coast Health Care District Insured Health Facility Revenue Bonds, Series 2009 (the "Series 2009 Bonds"); (ii) fund a Bond Reserve Account established under the Indenture; and (iii) pay the expenses incurred in connection with the issuance of the Series 2016 Bonds, including the insurance premium payable to the Office. The Series 2016 Bonds will be issued on a parity with the District's Series 1996 Bonds, the Series 2009 Bonds and the Series 2010 Bonds, which will remain outstanding following the issuance of the Series 2016 Bonds.

THE SERIES 2016 BONDS ARE LIMITED OBLIGATIONS OF THE DISTRICT PAYABLE SOLELY FROM GROSS REVENUES AND CERTAIN FUNDS HELD UNDER THE INDENTURE. NEITHER THE FAITH AND CREDIT NOR THE TAX REVENUES RECEIVED BY THE DISTRICT ARE PLEDGED TO THE PAYMENT OF THE PRINCIPAL OR PREMIUM, IF ANY, OR INTEREST ON THE SERIES 2016 BONDS. THE SERIES 2016 BONDS ARE NOT A DEBT OF THE STATE OF CALIFORNIA OR MENDOCINO COUNTY, AND THE STATE AND MENDOCINO COUNTY ARE NOT LIABLE FOR THE PAYMENT THEREOF, EXCEPT THROUGH THE INSURANCE PROGRAM AS DISCUSSED HEREIN.

This cover page contains certain information for general reference only. It is not intended to be a summary of the security or terms of this issue. Investors must read the entire Official Statement to obtain information essential to making an informed investment decision.

The Series 2016 Bonds are offered when, as and if issued and accepted by the Underwriter, subject to the approval as to legality by Norton Rose Fulbright US LLP, Los Angeles, California, Bond Counsel. Certain legal matters will be passed upon for the District by Norton Rose Fulbright US LLP, as Disclosure Counsel, and by John J. Ruprecht, as counsel to the District. Certain legal matters will be passed upon for the Underwriter by Nossaman LLP, Irvine, California. It is anticipated that the Series 2016 Bonds will be available for delivery through the book-entry facilities of DTC on or about July 27, 2016.

William Blair

Dated: July __, 2016

* Preliminary; subject to change.

\$ _____ *

**MENDOCINO COAST HEALTH CARE DISTRICT
(MENDOCINO COUNTY, CALIFORNIA)
INSURED HEALTH FACILITY REFUNDING REVENUE BONDS
SERIES 2016**

MATURITY SCHEDULE

Maturity Date (February 1)	Principal Amount	Interest Rate	Yield	CUSIP [†]
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\$ _____ % Term Bonds due February 1, 20 __, Yield _____ % CUSIP[†] _____

* Preliminary; subject to change.

[†] CUSIP is a registered trademark of the American Bankers Association. CUSIP data herein is provided by CUSIP Global Services, managed by Standard & Poor's Financial Services LLC on behalf of The American Bankers Association. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services. CUSIP numbers have been assigned by an independent company not affiliated with the District and are included solely for the convenience of investors. Neither the District nor the Underwriter is responsible for the selection or uses of these CUSIP numbers, and no representation is made as to their correctness on the Series 2016 Bonds or as included herein. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2016 Bonds as a result of various subsequent actions including, but not limited to, refunding in whole or in part or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Series 2016 Bonds.

MENDOCINO COAST HEALTH CARE DISTRICT

<u>Name</u>	<u>Position</u>
Tom Birdsell	Chair
Kitty Bruning	Vice Chair
Peter Glusker, M.D.	Secretary
Sean Hogan	Treasurer
Vacant	Member

Bob Edwards, Chief Executive Officer
Wade Sturgeon, Chief Financial Officer

DISTRICT COUNSEL

John J. Ruprecht, Esq.

BOND AND DISCLOSURE COUNSEL

Norton Rose Fulbright US LLP
Los Angeles, California

UNDERWRITER

William Blair & Company, LLC
Los Angeles, California

BOND INSURER

Office of Statewide Health Planning and Development
Cal-Mortgage Loan Insurance Division
Sacramento, California

TRUSTEE

The Bank of New York Mellon Trust Company, N.A.

VERIFICATION AGENT

Causey Demgen & Moore P.C.
Denver, Colorado

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The information set forth herein has been obtained from the District and other sources believed to be reliable. This Official Statement is not to be construed as a contract with the purchasers of the Series 2016 Bonds. Estimates and opinions are included and should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions. No dealer, broker, salesperson or any other person has been authorized by the District or the Underwriter to give any information or to make any representations other than those contained in this Official Statement in connection with the offering contained herein and, if given or made, such information or representations must not be relied upon as having been authorized by the District or the Underwriter. This Official Statement does not constitute an offer to sell or solicitation of an offer to buy, nor shall there be any offer or solicitation of such offer or any sale of the Series 2016 Bonds by any person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale of the Series 2016 Bonds made thereafter shall under any circumstances create any implication that there has been no change in the affairs of the District or in any other information contained herein, since the date hereof.

The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information, and this Official Statement is not to be construed as the promise or guarantee of the Underwriter.

In connection with the offering of the Series 2016 Bonds, the Underwriter in connection with any reoffering may over-allot or effect transactions which stabilize or maintain the market price of the Series 2016 Bonds at a level above that which might otherwise prevail in the open market. Such stabilizing, if commenced, may be discontinued at any time. The Underwriter in connection with any reoffering may offer and sell the Series 2016 Bonds to certain dealers, institutional investors and others at prices lower than the public offering prices stated on the inside cover page hereof and such public offering prices may be changed from time to time by the Underwriter.

The information set forth herein under the caption "CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM" has been furnished by the Office of Statewide Health Planning and Development of the State of California (the "Office"), and the information set forth herein under the caption "THE SERIES 2016 BONDS - Book-Entry System" and in APPENDIX F hereto has been derived from public information provided by DTC. Such information is believed to be reliable but is not guaranteed as to accuracy or completeness and is not to be construed as a representation by the District. All other information set forth herein has been obtained from the District and other sources that are believed to be reliable. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale of the Series 2016 Bonds made hereunder shall create under any circumstances any indication that there has been no change in the affairs of the District, the Office, or DTC since the date hereof.

This Official Statement, including any supplement or amendment hereto, is intended to be deposited with the Municipal Securities Rulemaking Board through the Electronic Municipal Marketplace Access ("EMMA") website. The District also maintains a website. However, the information presented therein is not part of this Official Statement and should not be relied upon in making investment decisions with respect to the Series 2016 Bonds.

FORWARD-LOOKING STATEMENTS

Certain statements included or incorporated by reference in this Official Statement constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used, such as “plan,” “project,” “expect,” “anticipate,” “intend,” “believe,” “estimate,” “budget” or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The District does not plan to issue any updates or revisions to those forward-looking statements if or when its expectations or events, conditions or circumstances on which such statements are based occur.

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OFFICIAL STATEMENT

\$5,680,000*

**MENDOCINO COAST HEALTH CARE DISTRICT
(MENDOCINO COUNTY, CALIFORNIA)
INSURED HEALTH FACILITY REFUNDING REVENUE BONDS
SERIES 2016**

INTRODUCTION

The following introductory statement is subject in all respects to the more complete information set forth in this Official Statement. The descriptions and summaries of various documents hereinafter set forth do not purport to be comprehensive or definitive and are qualified in their entirety by reference to each document. All capitalized terms used in this Official Statement and not otherwise defined herein have the same meaning as in the Indenture or the Regulatory Agreement (each as defined herein). See “APPENDIX C – SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT” in this Official Statement.

Purpose of this Official Statement

This Official Statement, including the cover page and the Appendices hereto, is provided to furnish information in connection with the sale and delivery of the Mendocino Coast Health Care District (Mendocino County, California) Insured Health Facility Refunding Revenue Bonds, Series 2016 (the “Series 2016 Bonds”), in the original aggregate principal amount of \$5,680,000*. The Series 2016 Bonds will be issued by the Mendocino Coast Health Care District (the “District”) pursuant to and secured by an Indenture, dated as of July 1, 2016 (the “Indenture”), between the District and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”).

The District

The District is a public entity under the laws of the State of California (the “State”) formed by a vote of the District’s constituents on January 17, 1967, and is operated as a local health care district pursuant to California Health & Safety Code Section 3200, et seq. The District is exempt from federal taxation under Section 115 of the Internal Revenue Code of 1986, as amended (the “Code”). The District owns and operates the Mendocino Coast District Hospital (the “Hospital”), a 25-bed acute care facility licensed by the State of California Department of Public Health. The Hospital has been designated as a critical access hospital. The Hospital provides a variety of primary care, support and prevention services and is approximately a fifty-minute drive from the next closest hospital. For information about the District, see “APPENDIX A – INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT,” and “APPENDIX B – AUDITED FINANCIAL STATEMENTS OF THE DISTRICT FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND 2015” in this Official Statement.

Insurance of the Series 2016 Bonds by the Office

In accordance with the California Health Facility Construction Loan Insurance Law, Chapter 1 of Part 6 of Division 107 of the California Health and Safety Code (the “Insurance Law”), the District will enter into a Contract of Insurance, dated as of July 1, 2016 (the “Contract of Insurance”), with the Office of Statewide Health Planning and Development of the State of California (the “Office”), pursuant to which the Office will insure the payment of the principal of and interest on the Series 2016 Bonds, and

* Preliminary; subject to change.

the District will enter into an Amended and Restated Regulatory Agreement, dated as of July 1, 2016 (the “Regulatory Agreement”), with the Office in connection with the Series 2009 Bonds (as defined herein), the Series 2010 Bonds (as defined herein), if such bonds remain outstanding, and the Series 2016 Bonds that will be Outstanding following the issuance and delivery of the Series 2016 Bonds. In the event that amounts received by the Trustee are not sufficient to pay in full, when due the principal of or interest on the Series 2016 Bonds, the Office will be obligated to continue to make payments on the Series 2016 Bonds or shall instruct the Trustee to declare the principal of all Series 2016 Bonds then Outstanding and interest accrued thereon to be due and payable immediately and make payment of such principal and interest, and, upon the occurrence of certain events, shall notify the Treasurer of the State of California (the “Treasurer”), and the Treasurer shall issue debentures to the holders of the Series 2016 Bonds fully and unconditionally guaranteed by the State in an amount equal to the principal of and accrued interest on the Series 2016 Bonds.

For a more detailed description of the obligation of the Office to insure the payment of the principal of and interest on the Series 2016 Bonds, the procedures with respect to insurance default, the obligations of the District pursuant to the Regulatory Agreement and the financial condition of the Office’s insurance program and the State of California, see “CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM,” “CERTAIN FINANCIAL INFORMATION REGARDING THE STATE,” “RISK FACTORS – State Bond Insurance,” “Rating” herein and “APPENDIX C – SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT” in this Official Statement.

The Office has previously insured the payment of principal of and interest on the Series 1996 Bonds, the Series 2009 Bonds and the Series 2010 Bonds under the Insurance Law. The payment of debt service on the Series 2001 General Obligation Bonds (as defined herein) is not insured by the Office.

Estimated Sources and Uses of Funds

Proceeds derived from the sale of the Series 2016 Bonds, together with certain available funds of the District, will be used to: (i) refund, on a current basis, all of the District’s outstanding Mendocino Coast Health Care District Insured Health Facility Refunding Revenue Bonds, Series 1996 (the “Series 1996 Bonds”), and all or a portion of the Mendocino Coast Health Care District Insured Health Facility Revenue Bonds, Series 2010 (the “Series 2010 Bonds”) and refund, on an advance basis, a portion of the District’s outstanding Mendocino Coast Health Care District Insured Health Facility Revenue Bonds, Series 2009 (the “Series 2009 Bonds”); (ii) fund a Bond Reserve Account established under the Indenture; and (iii) pay the expenses incurred in connection with the issuance of the Series 2016 Bonds, including the insurance premium payable to the Office. See “PLAN OF FINANCING” and “ESTIMATED SOURCES AND USES OF FUNDS” herein.

Security for the Series 2016 Bonds

The Series 2016 Bonds are limited obligations of the District payable solely from (i) Gross Revenues and (ii) certain funds held under the Indenture. Pursuant to the Indenture, the District is required to pay in full, when due, the principal of and premium, if any, and interest on the Series 2016 Bonds. See “SECURITY AND SOURCE OF PAYMENT FOR THE SERIES 2016 BONDS” in this Official Statement.

Parity Debt

“Parity Debt” as used herein means Long-Term Indebtedness incurred by the District in accordance with the terms of the Regulatory Agreement and secured equally and ratably with the Series 2016 Bonds by a lien on and security interest in the Gross Revenues. The pledge of the District’s Gross Revenues to the payment of the Series 2016 Bonds will be on a parity with the pledge of the District’s Gross Revenues to the payment of the Series 2009 Bonds and any of the Series 2010 Bonds that remain Outstanding following the issuance and delivery of the Series 2016 Bonds and any additional Parity Debt (as more fully described under the heading “SECURITY AND SOURCE OF PAYMENT FOR THE SERIES 2016 BONDS – Parity Debt” in this Official Statement) issued by the District in compliance with the provisions of the Regulatory Agreement. In addition, the District borrowed a total of \$1,005,806 from Cal-Mortgage to replace a line of credit with a bank in the amount of \$1,000,000 during fiscal year ended June 30, 2013. This obligation will be on a parity with the Series 2009 Bonds, the Series 2016 Bonds and other Parity Debt.

None of the Series 2016 Bonds, the Series 2010 Bonds, the Series 2009 Bonds, or the Series 1996 Bonds have a priority with respect to the District’s Gross Revenues. For a further description of the security of the Series 2016 Bonds and Parity Debt, see “SECURITY AND SOURCE OF PAYMENT FOR THE SERIES 2016 BONDS” in this Official Statement.

Risk Factors

There are risks associated with the purchase of the Series 2016 Bonds. See “RISK FACTORS” herein for a discussion of certain of these risks.

THE DISTRICT

The District is a public entity under the laws of the State formed by a vote of the District’s constituents on January 17, 1967, and is operated as a local health care district pursuant to California Health & Safety Code Section 3200, et seq. It is exempt from federal income tax under Section 115 of the Code. The District encompasses approximately 680 square miles and extends approximately 70 miles south from the Humboldt/Mendocino County line. The District is bordered on the west by the Pacific Ocean and includes the City of Fort Bragg (the “City”) and the communities of Westport, Mendocino, Albion and Elk. The estimated population of the District is approximately 25,000.

The District owns and operates the Hospital, a 25-bed acute care facility licensed by the State of California Department of Public Health. The Hospital is a critical access hospital (a “CAH”). The Hospital is located at 700 River Drive, in the City, which is approximately 165 miles north of San Francisco and approximately a fifty minute drive from the next closest hospital. See “APPENDIX A - INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT” in this Official Statement.

THE SERIES 2016 BONDS

General

The Series 2016 Bonds are being issued pursuant to a resolution of the governing body of the District and the Indenture in the original aggregate principal amount set forth on the cover of this Official Statement. The Series 2016 Bonds will be delivered in fully registered form without coupons. The Series 2016 Bonds will be dated their date of delivery and will be payable as to principal, subject to the redemption provisions set forth herein, on the dates and in the amounts set forth on the inside cover page hereof. The Series 2016 Bonds, when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”). DTC will act as securities depository for the Series 2016 Bonds. Ownership interests in the Series 2016 Bonds may be purchased in book-entry form only, in the denominations hereinafter set forth. See “THE SERIES 2016 BONDS -Book-Entry System” and “APPENDIX F - BOOK-ENTRY SYSTEM” in this Official Statement. The Series 2016 Bonds will be transferable and exchangeable as set forth in the Indenture.

The Series 2016 Bonds will bear interest at the rates set forth on the inside cover page hereof, payable semiannually on each February 1 and August 1, commencing on February 1, 2017 (each an “Interest Payment Date”), to the person whose name appears on the bond registration books of the Trustee as the Holder thereof as of the close of business on the record date (which will be the fifteenth day of the month immediately preceding an Interest Payment Date, whether or not such day is a Business Day) for each Interest Payment Date (except with respect to interest in default, for which a Special Record Date shall be established). So long as Cede & Co. is the registered owner of the Series 2016 Bonds, principal of and premium, if any, and interest on the Series 2016 Bonds are payable by wire transfer by the Trustee to Cede & Co., as nominee for DTC, which, in turn, will remit such amounts to DTC Participants (as defined herein) for subsequent disbursement to the Beneficial Owners. See “APPENDIX F – BOOK-ENTRY SYSTEM.”

Interest on the Series 2016 Bonds will be paid by check mailed by first-class mail on each Interest Payment Date to the registered owner (initially DTC) at its address as it appears on the bond registration books, or at such address as such owner may have filed with the Trustee for that purpose prior to the Record Date for each Interest Payment Date or, at the written request of any Holder of Series 2016 Bonds in the aggregate principal amount of \$1,000,000 or more received by the Trustee prior to the Record Date, by wire transfer to an account within the United States. Payment of the principal or redemption price of Series 2016 Bonds will be payable in lawful money of the United States of America upon surrender or presentation thereof at the Principal Corporate Trust Office of the Trustee.

Redemption*

Optional Redemption of the Series 2016 Bonds. The Series 2016 Bonds maturing on or after February 1, 20__, are subject to redemption prior to their respective stated maturities, at the option of the District, in whole or in part on or after February 1, 20__ (in such maturities as are designated by the District or, if the District fails to designate such maturities, in inverse order of maturity, and by lot within a maturity), upon at least forty-five (45) days’ prior written notice to the Trustee, from money deposited in the Optional Redemption Account or from any other source of available funds, at the principal amount of the Series 2016 Bonds called for redemption, together with interest accrued thereon to the date fixed for redemption, without premium.

* Preliminary; subject to change.

Mandatory Sinking Fund Redemption. The Series 2016 Bonds maturing February 1, 20__ are subject to redemption prior to their stated maturity in part (by lot) from Mandatory Sinking Account Payments on any February 1, on or after February __, 20__, in the amounts set forth below, at the principal amount thereof, together with interest accrued thereon to the date fixed for redemption, without premium.

Redemption Date (February 1)	Sinking Fund Principal Amount
---------------------------------	----------------------------------

(maturity)

Extraordinary Optional Redemption of the Series 2016 Bonds. The Series 2016 Bonds are subject to redemption prior to their respective stated maturities, at the option of the District, as a whole or in part (in such maturities as are designated by the District or, if the District fails to designate such maturities, in inverse order of maturity, and by lot within a maturity), on any date from certain insurance or condemnation proceeds required to be deposited in the Special Redemption Account with respect to the Facilities, in each case under the circumstances prescribed and as provided in the Regulatory Agreement, at the principal amount thereof, together with interest accrued thereon to the date fixed for redemption, without premium.

Notice of Redemption; Effect of Redemption. Notice of redemption will be mailed by first-class mail by the Trustee, not less than twenty (20) days nor more than sixty (60) days prior to the redemption date, to the Holders of any Series 2016 Bonds designated for redemption at their addresses appearing on the bond registration books of the Trustee, and to DTC and certain information services. Failure by the Trustee to give notice to a Bondholder or any defect in such notice shall not affect the validity of the redemption of any other Series 2016 Bonds. Failure of the Trustee to give notice to any one or more Information Services or Securities Depositories, or the insufficiency of such notice, shall not affect the sufficiency of the proceedings for redemption. Notice of redemption having been duly given and money for payment of the Redemption Price of, together with interest accrued to the redemption date on the Series 2016 Bonds so called for redemption being held by the Trustee on the redemption date designated in such notice, the Series 2016 Bonds so called for redemption shall become due and payable at the Redemption Price (together with interest accrued thereon, if any) specified in such notice; interest on such Series 2016 Bonds so called for redemption shall cease to accrue from and after the redemption date; said Series 2016 Bonds (or portions thereof) shall cease to be entitled to any benefit or security under the Indenture; and the Holders of said Series 2016 Bonds shall have no rights in respect thereof except to receive payment of said redemption price and accrued interest to the date fixed for redemption from funds held by the Trustee for such payment. Neither the District nor the Trustee shall have any responsibility for any defect in the CUSIP number that appears on any Bond or in any redemption notice with respect thereto.

The District may rescind an optional redemption of Series 2016 Bonds as to which notice has been given by giving notice of the rescission to the Trustee five (5) Business Days prior to the optional redemption date. The Trustee must give notice of such rescission to the same persons and in the same manner as the notice of redemption was given no later than the second (2nd) Business Day prior to the optional redemption date. Upon the mailing of notice of rescission to the Trustee, the optional redemption of such Series 2016 Bonds will be cancelled, and no Holder of such Bonds will be entitled to the redemption thereof on such date. Failure of any Holder of Series 2016 Bonds to receive such notice of rescission will not invalidate any of the proceedings taken in connection with such rescission.

Book-Entry System

The Series 2016 Bonds will be issued in book-entry form. DTC will act as securities depository for the Series 2016 Bonds. The Series 2016 Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee). One fully-registered Bond will be issued for each maturity in the total aggregate principal amount due on such maturity and will be deposited with DTC. See "APPENDIX F – BOOK-ENTRY SYSTEM" in this Official Statement.

SECURITY AND SOURCE OF PAYMENT FOR THE SERIES 2016 BONDS

General

The Series 2016 Bonds are limited obligations of the District and, except to the extent payable from Series 2010 Bond proceeds, investment earnings or proceeds of insurance or condemnation awards, are payable solely from Gross Revenues and from certain other funds held under the Indenture. In the Indenture, the District agrees to make payments to the Trustee, which payments, in the aggregate, are required to be in amounts sufficient for the payment in full of all amounts payable with respect to all Series 2016 Bonds, including the total interest payable on the Series 2016 Bonds to their respective stated maturities, the principal amount of the Series 2016 Bonds, and any redemption premiums, less any amounts available for such payment, as provided in the Indenture.

Moneys on deposit in the funds and accounts held under the Indenture do not secure any Parity Debt (all as described below).

Pledge of Gross Revenues

In connection with the issuance of the Series 1996 Bonds, the Series 2009 Bonds and the Series 2010 Bonds, the District pledged and granted a security interest (to the extent permitted by law) to the Trustee and to the Office in the Gross Revenue Fund and all Gross Revenues of the District to secure the payment of the principal of and interest on the Series 1996 Bonds, the Series 2009 Bonds, the Series 2010 Bonds and the performance by the District of the other obligations under the Regulatory Agreement and the respective indentures pursuant to which the Series 1996 Bonds, the Series 2009 Bonds and the Series 2010 Bonds were issued and with respect to Parity Debt. The Series 2016 Bonds are "Parity Debt" as that term is defined in the Regulatory Agreement and payment of the Series 2016 Bonds is secured by the same pledge by the District's Gross Revenues.

The District agrees that, so long as any of the Series 2016 Bonds or any Additional Bonds (as defined herein) remain Outstanding, all of the Gross Revenues shall be deposited as soon as practicable upon receipt in a fund designated as the "Gross Revenue Fund" established by the District in connection with the Series 2016 Bonds and which the District shall maintain at such banking or financial institution located in the State of California as the District shall from time to time designate for such purpose (herein called the "Depository Bank(s)"). Amounts in the Gross Revenue Fund may be used and withdrawn by the District at any time for any lawful purpose, except as provided in the Indenture. If an Event of Default shall occur, the Trustee shall notify the District, the Office and the Depository Bank(s) of such Event of Default, and the Trustee, but only with the prior written approval of the Office, shall cause the Depository Bank(s) to, and the Depository Bank(s) shall, transfer the Gross Revenue Fund to the name and credit of the Trustee. The Gross Revenue Fund shall remain in the name and to the credit of the Trustee until all Events of Default known to the Trustee shall have been made good or cured or provision shall have been made therefor, whereupon the Gross Revenue Fund shall be returned to the name and credit of the District. During any period that the Gross Revenue Fund is held in the name and to the credit of the Trustee, the Trustee shall, but only with the prior written approval of the Office, use and withdraw

amounts in said fund from time to time to make the transfers and deposits required by the Indenture, payments with respect to Parity Debt and to such other payments (including payment of the Trustee's extraordinary fees and expenses) in the order which the Trustee, in its discretion, shall determine to be in the best interests of the Holders of the Series 2016 Bonds, the holders of the Series 1996 Bonds, the holders of the Series 2009 Bonds, the holders of the Series 2010 Bonds and holders of other Parity Debt. During any period that the Gross Revenue Fund is held in the name and to the credit of the Trustee, the District shall not be entitled to use or withdraw any of the Gross Revenues unless and to the extent that the Trustee, with the prior written approval of the Office, so directs for the payment of current or past due operating expenses of the District. See "APPENDIX D – SUMMARY OF PRINCIPAL DOCUMENTS - INDENTURE."

The foregoing pledge of Gross Revenues of the District may, in several instances, be subordinated to the interest and claims of others. Some examples of cases of subordination or prior claims are (i) statutory liens, (ii) rights arising in favor of the United States of America or any agency thereof, (iii) present or future prohibitions against assignment in any federal statutes or regulations, (iv) constructive trusts, equitable liens or other rights impressed or conferred by any state or federal court in the exercise of its equitable jurisdiction, (v) federal or State of California bankruptcy or insolvency laws that may affect the enforceability of the Indenture or pledge of Gross Revenues, (vi) rights of third parties in Gross Revenues converted to cash and not in the possession of the Trustee or the Depository Bank(s), (vii) provisions prohibiting the direct payment of amounts due to health care providers from Medicare, Medi-Cal and Medicaid programs to persons other than such providers; (viii) certain judicial decisions that cast doubt upon the right of the Trustee, in the event of the bankruptcy of the District, to collect and retain accounts receivable from Medicare and Medicaid and other governmental programs; (ix) commingling of proceeds of Gross Revenues of the District with other moneys of the District not subject to the security interest in the Gross Revenues of the District; (x) claims that might arise if appropriate financing or continuation statements are not filed in accordance with the California Uniform Commercial Code, as from time to time in effect; and (xi) claims that might arise if a deposit account control agreement with respect to any bank accounts in which Gross Revenues are deposited is not in effect. In addition, it may not be possible to perfect a security interest in any manner whatsoever in certain types of Gross Revenues of the District (e.g., gifts, donations, certain insurance proceeds, Medicare and Medicaid payments) prior to actual receipt by the District for deposit in the Gross Revenue Fund. Further, it is still somewhat uncertain whether a security interest may be granted in Medicare and Medicaid receivables because of federal law prohibiting a provider from assigning such receivables. In addition, enforceable security interests in certain types of Gross Revenues (e.g., restricted donations) prior to actual receipt by the District for deposit in the Gross Revenue Fund may not be feasible in certain circumstances.

No Pledge of District Tax Revenues

Gross Revenues of the District pledged under the Indenture to the payment of debt service on the Series 2016 Bonds do not include tax revenues of the District. The taxing power of the District is not pledged to the payment of the principal of and interest on the Series 2016 Bonds. The Series 2016 Bonds are not an obligation of the District to which the full faith and *ad valorem* tax power of the District has been pledged. While not expressly pledged, tax revenues otherwise available to the District may be used to pay debt service on the Series 2016 Bonds. The Gross Revenues are not pledged to the payment of the District's Series 2001 General Obligation Bonds because the Series 2001 General Obligation Bonds are general obligations of the District and are payable from property tax receipts.

Bond Reserve Account

An amount equal to the Bond Reserve Account Requirement will be deposited in the Bond Reserve Account on the date of issuance of the Series 2016 Bonds. Under the Indenture the Bond Reserve Account Requirement, means as of each calculation date, an amount equal to the least of (i) 50% of Maximum Annual Debt Service with respect to each Series of Bonds Outstanding, (ii) 10% of the issue price with respect to each Series of Bonds as determined under the Code (or, if the issue price includes less than 2% original issue discount or premium, then 10% of the stated principal amount), or (iii) 125% of the average Annual Debt Service as of the date of issuance with respect to each Series of Bonds Outstanding. The Bond Reserve Account is required to be maintained in an amount equal to the Bond Reserve Account Requirement. The Bond Reserve Account will be valued annually on each July 1, beginning July 1, 2017 (or more frequently, but not more than quarterly, if requested by the District), by the Trustee. If amounts in the Bond Reserve Account are less than 90% of the Bond Reserve Account Requirement as a result of such valuation, the District is required to pay to the Trustee amounts sufficient to increase the balance in the Bond Reserve Account to the Bond Reserve Account Requirement in accordance with the Indenture. See “APPENDIX C — SUMMARY OF PRINCIPAL DOCUMENTS — INDENTURE - Revenue Fund” and “Application of Bond Reserve Account.”

The Bond Reserve Account is for the benefit of the Series 2016 Bonds and is not available to pay debt service on any other Parity Debt. Similarly, no bond reserve account established for other Parity Debt is available to pay debt service on the Series 2016 Bonds.

Insurance of the Series 2016 Bonds by the Office

The principal of and interest on the Series 2016 Bonds will be insured by the Office. If moneys are not available to pay the principal of or interest on the Series 2016 Bonds, the Office will be obligated to continue to make payments on the Series 2016 Bonds or shall instruct the Trustee to declare the principal of all Series 2016 Bonds then Outstanding and interest accrued thereon to be due and payable immediately and make payment of such principal and interest. Upon the occurrence of certain events, the Office shall notify the Treasurer, and the Treasurer shall issue debentures to the Holders of the Series 2016 Bonds fully and unconditionally guaranteed by the State in an amount equal to the principal of and accrued interest on the Series 2016 Bonds. See “CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM” herein.

For as long as the Contract of Insurance is in effect and the Office is not in default thereunder, the Office is deemed to be the Holder of the Series 2016 Bonds for purposes of (i) exercising all remedies and directing the Trustee to take actions or for any other purposes following an Event of Default, and (ii) granting any consent, direction or approval or taking any action permitted by or required under the Indenture, as the case may be, to be granted or taken by the Holders of such Series 2016 Bonds (including consenting to amendments to the Indenture that materially adversely affect the interest of the Holders of the Series 2016 Bonds. Anything in this Indenture to the contrary notwithstanding, upon the occurrence and continuance of an Event of Default, the Office shall be entitled to control and direct the enforcement of all rights and remedies granted to the Holders or the Trustee for the benefit of the Holders.

For as long as the Office is obligated under the Contract of Insurance, all rights and remedies under the Deed of Trust shall be exercised solely by the Office. With the consent of the Office, the Deed of Trust may be further amended, subordinated or terminated at any time without the consent of the Trustee, the Bondholders, holders of Parity Debt or the District.

No Financial or Operational Covenants in Indenture

The Indenture does not contain financial or operational covenants relating to the operations of the District, such as limitations on the ability of the District to incur indebtedness, to dispose of property or to create liens on property. Additionally, the Indenture does not require the District to maintain revenues at levels sufficient to provide coverage of debt service on the Series 2016 Bonds or any other indebtedness. Such covenants are contained in the Regulatory Agreement, but may be waived or amended by the Office without the necessity of obtaining the consent of the Holders of the Series 2016 Bonds, the District or any other party. See “APPENDIX C – SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT.”

Additional Bonds

The District may authorize the issuance of additional series of revenue bonds (“Additional Bonds”) upon the terms and conditions provided in the Indenture and the Regulatory Agreement. Additional Bonds must be insured by the Office pursuant to the Insurance Law or be issued with the consent of the Office.

Parity Debt and Other Existing Indebtedness

In addition to the District’s obligations with respect to the Series 1996 Bonds, the Series 2009 Bonds, the Series 2010 Bonds and the Series 2016 Bonds, the District has incurred and may incur other indebtedness that is or will be on a parity with the District’s obligations with respect to the Series 1996 Bonds, the Series 2009 Bonds, the Series 2010 Bonds and the Series 2016 Bonds, and therefore will constitute Parity Debt. Following the issuance and delivery of the Series 2016 Bonds, the District expects that the Series 1996 Bonds and all or a portion of the Series 2010 Bonds will no longer remain Outstanding. A portion of the Series 2009 Bonds are expected to remain Outstanding. See “APPENDIX A – INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT – OUTSTANDING INDEBTEDNESS” and “APPENDIX B – AUDITED FINANCIAL STATEMENTS OF THE DISTRICT FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND 2015” for a description of the existing indebtedness of the District. In addition, the District borrowed a total of \$1,005,806 from Cal-Mortgage to replace a line of credit with a bank in the amount of \$1,000,000 during fiscal year ended June 30, 2013. This obligation will be on a parity with the Series 2009 Bonds, the Series 2016 Bonds and other Parity Debt.

Parity Debt will only be issued for the purposes and subject to the conditions provided in the Regulatory Agreement. See “APPENDIX C – SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT.” However, Parity Debt may not be incurred unless it is insured by the Office or unless it is issued with the consent of the Office.

The debt service on the Series 2016 Bonds is set forth under “ANNUAL DEBT SERVICE REQUIREMENTS PAYABLE FROM GROSS REVENUES” in this Official Statement.

Limited Liability of the District

THE SERIES 2016 BONDS ARE LIMITED OBLIGATIONS OF THE DISTRICT PAYABLE SOLELY FROM GROSS REVENUES AND CERTAIN FUNDS HELD UNDER THE INDENTURE. NEITHER THE FAITH AND CREDIT NOR THE TAX REVENUES RECEIVED BY THE DISTRICT ARE PLEDGED TO THE PAYMENT OF THE PRINCIPAL OR, PREMIUM, IF ANY, OR INTEREST ON THE SERIES 2016 BONDS. THE SERIES 2016 BONDS ARE NOT A DEBT OF THE STATE OF CALIFORNIA OR MENDOCINO COUNTY, AND THE STATE AND MENDOCINO COUNTY ARE

NOT LIABLE FOR THE PAYMENT THEREOF EXCEPT THROUGH THE INSURANCE PROGRAM AS DISCUSSED HEREIN.

CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM

Description

The District has received a conditional commitment from the Office for insurance of the District's payment of the principal of and the interest on the Series 2016 Bonds. The California Health Facility Construction Loan Insurance Program (the "Program") is authorized by Article XVI, Section 4 of the California Constitution and is provided for in the Insurance Law. The Program is operated by the Office, which has adopted regulations implementing the Program. The insurance of the full amount of payment of the principal of and interest on the Series 2016 Bonds (but not any premium) is evidenced by the Contract of Insurance and the Regulatory Agreement, both of which will be entered into by the Office and the District, concurrently with the execution and delivery of the Series 2016 Bonds. The Regulatory Agreement sets out many of the financial covenants of the District relating to, among other things, the maintenance of specified debt service coverage levels and the limitations on incurrence of additional indebtedness or disposition of assets by the District. Prospective holders of the Series 2016 Bonds should note that the provisions of the Regulatory Agreement may be amended with the consent of the Office without the necessity of obtaining the consent of the Holders of the Series 2016 Bonds or the holders of Parity Debt. See "CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM – Rights of the Office Under the Regulatory Agreement" herein and "APPENDIX C – SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT."

The full amount of the principal of and interest, but no redemption premium, if any, on the Series 2016 Bonds is insured under the Program, and such payment under the Program is backed by the full faith and credit of the State.

Insurance Law section 129050, subsection (a) requires that a loan must be secured by a first mortgage, first deed of trust or first priority lien on an interest of the borrower in real property and any other security agreement as the Office may require. For this purpose, the District grants a security interest in the Gross Revenue Fund and all of the Gross Revenues under the Indenture and the District will enter into the Deed of Trust. *The Deed of Trust granted by the District to the Office is solely for the benefit of the Office. The Deed of Trust does not secure the Series 2016 Bonds. Prospective holders of the Series 2016 Bonds should note that the provisions of the Deed of Trust may be amended, subordinated or terminated at any time with the consent of the Office without the necessity of obtaining the consent of the holders of the Series 2016 Bonds or the holders of Parity Debt.*

Incontestability and Non-Cancelability

Under Insurance Law section 129110, the Contract of Insurance is incontestable from the date of execution thereof, except in case of fraud or misrepresentation on the part of the lender. The Insurance Law and the Contract of Insurance impose certain continuing obligations on the District as a condition of insuring the Series 2016 Bonds but specify that the remedies for breach of these obligations shall not include withdrawal or cancellation of the insurance. The insurance provided by the Contract of Insurance will terminate under certain circumstances, including payment in full by the Office of the insurance with respect to the Series 2016 Bonds or defeasance of the Series 2016 Bonds pursuant to the Indenture, as more fully described in APPENDIX G – "FORM OF CONTRACT OF INSURANCE." See also APPENDIX C – "SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT."

Procedures upon Default

If there is an event of default as specified under the Indenture (an “Event of Default”), the Trustee must notify the Office. The Trustee also must notify the Office if 30 days prior to an interest or principal payment date there are not sufficient available moneys held by the Trustee in the Revenue Fund (other than in the Bond Reserve Account) to make the next payment of principal or interest with respect to the Series 2016 Bonds.

Pursuant to the Regulatory Agreement, if there is an Event of Default and the Trustee has notified the Office that available moneys in the Principal and Interest Accounts will be insufficient to pay in full the next succeeding payment of interest and/or principal when due, the Office shall cause a sufficient amount to be deposited in the Principal Account and/or Interest Account at least three Business Days prior to the date on which such payment is due. The money will come from the Bond Reserve Account held under the Indenture or from the Health Facility Construction Loan Insurance Fund (the “HFCLIF”) that is established by the Insurance Law (sections 129010, subsection (g) and 129200). The obligation of the District to repay any money advanced from the HFCLIF is secured by the Deed of Trust.

Following an Event of Default, the Office may either (i) continue to approve such transfers or make such payments described in the preceding paragraph as are necessary to provide for the timely payment of the principal of and interest on the Series 2016 Bonds, (ii) accept title to the Facilities from the Trustee upon foreclosure pursuant to the Deed of Trust or otherwise, (iii) accept an assignment of the security interest created under the Deed of Trust and of all claims under the Indenture, or (iv) instruct the Trustee to declare the principal of all Series 2016 Bonds then Outstanding and the interest due thereon to be immediately due and payable and make such payment from the HFCLIF. If funds in the HFCLIF are not sufficient to make the required payments described above, the Office shall notify the Treasurer who is required to issue debentures in place of such Series 2016 Bonds. See “The Office, the Program and the Insurance Fund – State Debentures.”

While the Office has not requested the issuance of and the Treasurer has not issued any such debentures and while definitive procedures for their issuance have not been established, including procedures covering matters such as compliance with the provisions of the Code and the Treasury Regulations promulgated thereunder, the Office has all necessary power to establish such procedures, and it is expected that such procedures would be established and that interest on such debentures would not be includable in the gross income of the Holders of the Series 2016 Bonds for purposes of federal income taxation and would be exempt under the law as in effect on the date hereof from State personal income taxes. Upon the occurrence of certain Events of Default under the Indenture, there is the possibility that the interest on the Series 2016 Bonds could become subject to federal income taxation. The Indenture provides that there shall be no acceleration of the principal of and interest on the Series 2016 Bonds upon the occurrence of an Event of Default under the Indenture without the consent of the Office. If the Series 2016 Bonds were declared taxable by the IRS or another appropriate authority, thereby resulting in an Event of Default under the Indenture, and if the Office did not consent to an acceleration, the Bondholders would continue to receive interest payments, but those interest payments would not be excludable from gross income for federal income tax purposes. See “APPENDIX C - SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT - INDENTURE - Events of Default; Remedies on Default” and “- Acceleration of Maturities.”

Under the Insurance Law, payments of principal of and interest on the Series 2016 Bonds or payments on the debentures would be made by the Office from the HFCLIF.

The Office, the Program and the Insurance Fund

General. Under the Insurance Law, the Office is currently authorized to insure health facility construction, improvement and expansion loans, as specified in the Insurance Law. Entities which may obtain insurance for their facilities include both public agencies and nonprofit corporations, and authorized health facilities include a wide range from acute care facilities to local clinics, dependency centers and community mental health centers. The Insurance Law authorizes the Program to insure not more than \$3,000,000,000 principal amount of loans at any time. As of April 30, 2016, the principal amount of loans insured under the Program was approximately \$1,698,351,174, comprised of 94 loans.

Finances of the Program; Financial Reports. The Program is financed by an application fee of 0.5% of the loan applied for, but not to exceed \$500 (Insurance Law section 129090), an inspection fee not in excess of 0.4% of the loan that is insured (Insurance Law section 129035), and an insurance premium due in full at closing not in excess of 3.0% of the total amount of principal and interest payable over the term of the loan (Insurance Law section 129040). The fees and premiums charged are deposited in the HFCLIF and are used to defray administrative expenses of the Program, to cure defaults on loans and to pay principal of and interest on insured bonds and certificates of participation prior to issuance of debentures by the Treasurer.

Under the Insurance Law, payments of principal and interest with respect to the Series 2016 Bonds or payments on the debentures would be made by the Office from the HFCLIF. As of April 30, 2016, the cash balance of the HFCLIF was approximately \$165,711,501. The moneys in the HFCLIF are continuously appropriated to pay obligations insured by the Office under the Insurance Law. Insurance Law section 129215 states: "The Health Facility Construction Loan Insurance Fund, established pursuant to Section 129200, shall be a trust fund and neither the fund nor the interest or other earnings generated by the fund shall be used for any purpose other than those purposes authorized by this chapter." The moneys in the HFCLIF are invested in the State's Pooled Money Investment Account.

The Office is required by law to submit certain reports to the Legislature, consisting of an Annual Report, and a State Plan. The State Plan is prepared every two years, as of January 1 of each odd-numbered year. The State Plan has not yet been released but is expected to be available in 2016. The 2013 State Plan is available at the website of the Office. The Annual Report for the year ended June 30, 2014 (the "2014 Annual Report"), is available at the website of the Office. The Office also prepares monthly reports containing limited financial data. The monthly report available from the Office is for the period ended April 30, 2016.

The following table provides certain statistics for the Program as of the end of the last five fiscal years for which reports are available from the Office:

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Number of Loans Insured	132	122	117	109	105
Principal Amount of Loans Insured (\$000)	\$ 1,809,696	\$ 1,708,991	\$ 1,726,980	\$ 1,671,379	\$ 1,784,502
Cash Balance of HFCLIF	\$180,371,861	\$172,924,033	\$168,822,959	\$174,289,633	\$174,317,510

Program Loans; Status of Borrowers. The future financial status of the Program is directly affected by the financial performance of the borrowers in the Program and their current and projected ability to repay their loans. The Office has established a rating system to implement objective criteria and continues to monitor each borrower for compliance with loan covenants assigning a risk rating (A to F) to that borrower and all its loans.

The risk ratings have a corresponding relationship to the financial status of the borrower and risk to the HFCLIF:

A Rating - no material problems.

B Rating - minor problems such as one or more of the following: for more than one fiscal year, some of the borrower's covenant requirements have not been met; the borrower's financial trends indicate potential problems; the borrower is more than 6 months late in providing its financial and other reports as required by its Regulatory Agreement.

C Rating - serious problems, such as one or more of the following: the borrower's last insured loan payment was not paid within 30 days of the delinquency date defined in the borrower's Regulatory Agreement; the borrower's day's cash on hand is low; the last calculation of the insured debt service coverage ratio was below 1.0 and the project does not have a substantial cash cushion either in days cash on hand or in relation to amount of insured debt; payables and receivables indicate inappropriate lag time; economic indicators locally, regionally or statewide are impacting the borrower; management turnover and/or board oversight is in question; borrower has filed for bankruptcy protection but is making full payments on insured debt.

D Rating - very serious problems such as one or more of the following: the debt service reserve fund has been invaded and the borrower is not making substantial progress in fully replenishing its debt service reserve fund, pursuant to the loan documents; financial trends have been escalating downward with no action plan in place to correct the problem; the borrower's days cash on hand is exceedingly low, such that it does not appear that the borrower will be able to make its next payroll; payment(s) are not being made and HFCLIF may be used within the next 12 months.

E Rating - payments have been or are being made from the HFCLIF, but full recovery is expected. The Office has a work out plan with the borrower.

F Rating - payments have been or are being made from the HFCLIF and loss of some magnitude is expected.

As of May 30, 2016, there was one borrower with two loans in the portfolio with a D Rating, two borrowers with a total of five loans with E Ratings, and no borrowers with an F Rating; the total outstanding principal balance of these D and E rated borrower's loans was \$57,080,260.

Since the start of the Program in 1972, 20 borrowers (with 28 loans) have defaulted with all required payments coming from the HFCLIF (without cost to the State General Fund). Kern Valley Healthcare District ("Kern Valley") defaulted on its loan in the fiscal year ended June 30, 2011 and required payments from the HFCLIF during calendar year 2013 of approximately \$517,000. The Office anticipates that Kern Valley will require advances from the HFCLIF of approximately \$5,450,000 through August, 2021. Kern Valley is making partial payments through a workout agreement with the Office and the shortfall is expected to be repaid with interest starting in August, 2021 through August 2029.

On October 17, 2012, the District entered Chapter IX bankruptcy. See "DISTRICT BANKRUPTCY" herein. The Office insured three bond issues totaling \$9,205,000 and a bank line of credit of \$1,000,000 for the District. The District continues to make bond payments. When the District entered bankruptcy, its bank declared the line of credit in default and the Office paid on its insurance and asserted the claim in bankruptcy. The Office and the District have reached a settlement agreement which restructures the loan, but results in no loss to the Office.

The largest defaulted loan in the Program was a loan to Triad Healthcare Corporation in the original amount of \$182.3 million. The project is no longer in existence and the Triad loan is carried as a long-term liability of the Program. As of April 30, 2016, the remaining principal balance of the Triad loan is \$57,940,000. In December 2013, a portion of the outstanding bonds were refunded so the Program could realize interest expense savings. The HFCLIF will make payments for the Triad loan of approximately \$11.5 million each year until August 1, 2018, \$12.1 million in 2019 and 2020, and a final payment of \$8.2 million on August 1, 2021.

State Debentures. In the event the obligations of the HFCLIF to pay on an issue of defaulted bonds or certificates of participation exceeds the available balances in the HFCLIF, and upon receipt by the Office of title to subject facilities or assignment of the security interest in a deed of trust and upon surrender of the defaulted bonds or certificates of participation to the Office, the Office shall notify the Treasurer and request the Treasurer to issue debentures for the benefit of the holders of the defaulted bonds and certificates of participation so surrendered. Pursuant to Insurance Law section 129160, subsection (a), (1) the debentures shall bear interest at a rate equal to the insured loan or bonds, and shall be payable on a payment schedule identical to payments on the insured loan or bond, (2) the debentures are fully and unconditionally guaranteed as to principal and interest by the State, and (3) the amounts to be paid on the debentures will be continuously appropriated from the general fund of the State Treasury. Insurance Law section 129160, subsection (b) provides, “Any debenture issued under this article shall be paid on par with general obligation bonds issued by the state.” See “CERTAIN FINANCIAL INFORMATION REGARDING THE STATE” and “RATING” below.

While the Office has not requested the issuance of and the Treasurer has not issued any such debentures since the inception of the Program, and while definitive procedures for their issuance have not been established, including procedures covering matters such as compliance with the provisions of the Code and the Treasury Regulations promulgated thereunder, the Office and the Treasurer have all necessary power to establish such procedures, and it is expected that such procedures would be established in advance of any issuance of debentures. It is expected that, to the same extent as interest on the Series 2016 Bonds is not includable in the gross income of the holders thereof for purposes of federal income taxation, interest on the debentures would not be includable in the gross income of the holders, and that interest on debentures would be exempt under the law as in effect on the date hereof from State personal income taxes. Upon the occurrence of certain Events of Default under the Indenture, there is the possibility that the interest on the Series 2016 Bonds could become subject to federal income taxation. The Indenture provides that there shall be no acceleration of the principal and interest on the Series 2016 Bonds upon the occurrence of an Event of Default under the Indenture without the consent of the Office. If the Series 2016 Bonds were declared taxable by the IRS or another appropriate authority, thereby resulting in an Event of Default under the Indenture, and if the Office did not consent to an acceleration, the holders of the Series 2016 Bonds (and holders of any debentures exchanged for such Bonds) would continue to receive interest payments, but those interest payments would not be excludable from gross income for federal income tax purposes. See APPENDIX C- “SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT - INDENTURE - Events of Default; Remedies on Default” and “-Acceleration of Maturities.”

Actuarial Study. The Office obtains an independent actuarial review of the HFCLIF every two years. At the request of the Office, Oliver Wyman Actuarial Consulting, Inc. (“Oliver Wyman”) completed a study in July 2014 (the “2012 Actuarial Study”) to evaluate, among other matters, (1) the reserve sufficiency of the HFCLIF as of June 30, 2012; and (2) the risk to the State's General Fund from the Program. Oliver Wyman compared the HFCLIF cash balance as of June 30, 2012 of \$172.92 million against the reserve and capital requirements standards set by the California Department of Insurance for private financial guaranty insurers; the 2012 Actuarial Study indicated that the Program's assets were at least \$90.17 million below the level which would be required by the California Department of Insurance

standards for private insurers. As to the second subject, the 2012 Actuarial Study indicated that the HFCLIF as of June 30, 2012 under the “expected scenario” (which scenario assumed, among other things, a 6.25% default rate) should maintain a positive balance until at least the forecast period of 2041-42. Even under the “most pessimistic scenario” in which a 10% probability of catastrophic loss was used, the 2012 Actuarial Study indicated that there was a 70% likelihood that HFCLIF reserves as of June 30, 2012 would protect against any General Fund losses until at least 2020-21, and a 90% likelihood that HFCLIF reserves as of June 30, 2012 would protect against any General Fund losses until at least 2017-18.

The 2012 Actuarial Study is based on stated assumptions and estimates including, but not limited to, default rates, investment yields, termination rates, claim severities, catastrophic losses and payment patterns. Variation from such estimates or assumptions may cause actual results to vary from the analysis in the 2012 Actuarial Study and such variations could be material. A copy of the 2012 Actuarial Study is available upon request to: Office of Statewide Health Planning and Development, Cal-Mortgage Loan Insurance Division, 400 R Street, Suite 470, Sacramento, CA 95811, Telephone: (916) 319-8800; e-mail: cminsure@oshpd.ca.gov. See “RISK FACTORS-State Bond Insurance” for a discussion of the risks related to the Insurance. See “RATING” in this Official Statement for a discussion of the rating the Series 2016 Bonds are expected to receive due to the insurance by the Office of the Series 2016 Bonds.

FOR A FURTHER DESCRIPTION OF THE REGULATORY AGREEMENT AND THE CONTRACT OF INSURANCE, SEE “APPENDIX D – SUMMARY OF PRINCIPAL DOCUMENTS.”

Rights of the Office under the Regulatory Agreement

The Regulatory Agreement grants the Office extensive rights, including the right to attend and participate in all meetings of the District’s Board of Directors. Additionally, among other consent rights of the Office, the Regulatory Agreement prohibits the District, without first obtaining the consent of the Office, from:

1. affiliating with, merging into, or consolidating with any individual, company, organization, partnership or other legal entity;
2. transferring cash or cash equivalents to any entity, including but not limited to a subsidiary or an affiliate of the District, without first satisfying certain financial covenants;
3. selling, leasing, subleasing or otherwise disposing of all or portions of the real property subject to the Deed of Trust and, except in the ordinary course of business, buildings, improvements and tangible personal property located on such property;
4. acquiring by purchase, construction, merger or consolidation any property or equipment, except in the ordinary course of business;
5. acquiring by gift certain real property; and
6. entering into or terminating a contract to manage or operate all or substantially all of the Facilities with any individual, company, organization, partnership or other legal entity, including the District’s chief executive officer, chief financial officer and chief operating officer or all of those people who otherwise manage or operate all or substantially all of the Facilities (the “Management Agent”).

Additionally, upon the occurrence of an event of default under the Regulatory Agreement, the Deed of Trust or the Indenture, the Office may assume or direct managerial or financial control over the District. Under such circumstances, the Office may terminate and replace the existing Management Agent with a new Management Agent selected by the Office. Additionally, upon the occurrence of an event of default under the Regulatory Agreement, Deed of Trust or Indenture, the Office shall have the remedies provided in Insurance Law Section 129173. Additionally, for as long as the Office is obligated and in compliance under the Contract of Insurance, all remedies of the Trustee and Holders of the Series 2016 Bonds under the Indenture and the Regulatory Agreement will be exercised solely by the Office. See “APPENDIX C — SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT.”

Rate Covenant and Other Financial Covenants

Under the Regulatory Agreement, but not the Indenture, the District is required to fix, charge and collect rates, fees and charges which are reasonably projected to be sufficient in each Fiscal Year to produce a debt service coverage ratio of at least 1.25 times (commencing with the Fiscal Year beginning July 1, 2017). The Regulatory Agreement also requires the District to maintain a ratio of current assets to current liabilities of at least 1.5 to 1 as of June 30 of each year (commencing with June 30, 2017), and Days Cash on Hand of not less than 30 days beginning with the Fiscal Year ending June 30, 2017, and as of each June 30 thereafter. For more specific information relating to these covenants, see “APPENDIX C – SUMMARY OF PRINCIPAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT.” The Series 2016 Bonds will continue to be insured by the Office in the manner described above even if an Event of Default were to occur under financial or other covenants made by the District.

CERTAIN FINANCIAL INFORMATION REGARDING THE STATE

Information about the financial condition of the State, including the State budget and State spending, is available at various State-maintained websites. Information concerning the current year State budget, and the enacted budget for Fiscal Year 2016-17, may be found at the website of the Department of Finance, www.dof.ca.gov, under the heading “California Budget.” The Budget Act for Fiscal Year 2016-17 was signed by the Governor on June 27, 2016. Analyses of the current year budget and future budget proposals are posted from time to time by the independent Office of the Legislative Analyst at www.lao.ca.gov. Reference is made to the most recent preliminary official statement or official statement issued by the State in connection with general obligation bonds, lease revenue obligations, or revenue anticipation notes, which can be accessed from the website of the State Treasurer’s office, www.treasurer.ca.gov, under the headings “Public Finance Division – Current Offerings” (for preliminary official statements) or through the Electronic Municipal Market Access System (“EMMA”), a facility of the Municipal Securities Rulemaking Board, at <http://emma.msrb.org> (for official statements). All of such websites and other sources are provided for general informational purposes only and the material on such sites and from such resources is in no way incorporated into this Official Statement. Readers are cautioned that such information is not necessarily fully current and that the reported financial condition of the State may have changed since the date such information was published or posted.

**CERTAIN ANNUAL DEBT SERVICE REQUIREMENTS
PAYABLE FROM GROSS REVENUES**

The following table sets forth the gross annual debt service requirements for the Series 1996 Bonds, the Series 2009 Bonds, the Series 2010 Bonds and the Series 2016 Bonds, including amounts required to be made available for payment of principal of the Series 1996 Bonds, Series 2009 Bonds, the Series 2010 Bonds and Series 2016 Bonds from mandatory sinking fund redemption, assuming no optional redemptions are made. The table includes debt service on the Series 1996 Bonds, the Series 2009 Bonds and the Series 2010 Bonds prior to refunding of the Refunded Bonds and such table will be revised for the final Official Statement.

<u>Year Ending February 1</u>	<u>Parity Bonds Debt Service⁽¹⁾</u>	<u>Series 2016 Bonds Principal</u>	<u>Series 2016 Bonds Interest</u>	<u>Series 2016 Bonds Debt Service</u>	<u>Total Debt Service</u>
2017	\$773,359.38				
2018	952,821.26				
2019	951,637.50				
2020	953,410.00				
2021	637,680.00				
2022	638,180.00				
2023	637,566.26				
2024	640,828.76				
2025	637,715.00				
2026	637,005.00				
2027	635,000.00				
2028	636,700.00				
2029	636,635.00				

⁽¹⁾ Includes debt service on the Series 1996 Bonds, the Series 2009 Bonds and the Series 2010 Bonds prior to refunding of the Refunded Bonds.

As described in “PLAN OF REFUNDING” below, the proceeds of the Series 2016 Bonds will be used to refund the Refunded Bonds (as hereinafter defined).

The amounts listed in the table above do not include any capitalized leases of the District that are secured by the equipment financed pursuant to such leases. Capitalized leases of the District are not secured by the District’s Gross Revenues.

PLAN OF REFUNDING

The proceeds derived from the sale of the Series 2016 Bonds will be used, together with other available funds of the District, to: (i) to all or a portion of the refund the Refunded Bonds (as hereinafter defined); (ii) fund a Bond Reserve Account established under the Indenture in an amount equal to the Bond Reserve Account Requirement for the Series 2016 Bonds; and (iii) pay the expenses incurred in connection with the issuance of the Series 2016 Bonds, including the insurance premium.

Refunding of the Refunded Bonds

The District previously issued (i) the Series 1996 Bonds in the aggregate principal amount of \$4,030,000, of which \$1,095,000 currently remains outstanding, (ii) the Series 2009 Bonds in the aggregate principal amount of \$5,000,000, of which \$3,835,000 currently remains outstanding, and (iii) the Series 2010 Bonds in the aggregate principal amount of \$2,875,000, of which \$2,140,000 currently remains outstanding. Concurrently with the delivery of the Series 2016 Bonds, a portion of the proceeds thereof will be irrevocably deposited into escrow fund(s) (the “Escrow Fund”) created pursuant to the Escrow Agreement or Agreements, each dated as of July 1, 2016 (the “Escrow Agreement”), by and between the District and The Bank of New York Mellon Trust Company, N.A., trustee with respect to the Refunded Bonds, acting as escrow agent (the “Escrow Agent”) under the Escrow Agreement.

A portion of Series 2016 Bond proceeds, together with other funds held under the indentures relating to the Refunded Bonds, will be applied to the purchase of direct obligations issued by the United States Treasury (“Defeasance Securities”) or otherwise held in the Escrow Fund as unvested cash. Upon such irrevocable deposit, the Refunded Bonds will be defeased, and the holders of the Refunded Bonds will be entitled to payment solely out of the moneys and Defeasance Securities deposited in the Escrow Fund.

The Verification Agent will verify the computations concluding that moneys and Defeasance Securities deposited in the Escrow Fund will together produce sufficient funds to provide for (i) the payment of interest on the Refunded 2009 Bonds (as hereinafter defined) through and including February 1, 2019, (ii) the redemption of the Refunded 1996 Bonds (as hereinafter defined) and the Refunded 2010 Bonds (as hereinafter defined) on August 1, 2016 at a redemption price of 100% of the principal amount thereof, plus accrued but unpaid interest thereon, and (iii) the redemption of the Refunded 2009 Bonds on February 1, 2019 at a redemption price of 100% of the principal amount thereof, plus accrued but unpaid interest thereon. See “VERIFICATION OF MATHEMATICAL COMPUTATIONS” herein.

On August 1, 2016, the Escrow Agent will apply moneys on deposit in the Escrow Fund to redeem the Refunded 1996 Bonds and the Refunded 2010 Bonds and on February 1, 2019, the Escrow Agent will apply moneys on deposit in the Escrow Fund to redeem the Refunded 2009 Bonds.

The following table sets forth the Series 1996 Bonds (the “Refunded 1996 Bonds”), the Series 2009 Bonds (the “Refunded 2009 Bonds”) and the Series 2010 Bonds (the “Refunded 2010 Bonds” and, together with the Refunded 1996 Bonds and the Refunded 2009 Bonds, the “Refunded Bonds”) respectively, that may be refunded in whole or in part by the District, subject to market conditions. All refunded bonds, dates and amounts are subject to change by the District in its sole discretion.

Series 1996 Bonds

<u>Maturity Date</u> <u>(February 1)*</u>	<u>Redemption Date</u>	<u>Principal</u> <u>Amount</u> <u>Outstanding</u>	<u>CUSIP</u> <u>(Base No. 586581)</u>
2020	August 1, 2016	\$1,095,000	AS9

Series 2009 Bonds

<u>Maturity Date</u> <u>(February 1)*</u>	<u>Redemption Date</u>	<u>Principal</u> <u>Amount</u> <u>Outstanding</u>	<u>CUSIP</u> <u>(Base No. 586581)</u>
2020	February 1, 2019	\$ 250,000	BC3
2024	February 1, 2019	1,130,000	BD1
2029	February 1, 2019	1,765,000	BE9

Series 2010 Bonds

<u>Maturity Date</u> <u>(February 1)</u>	<u>Redemption Date</u>	<u>Principal</u> <u>Amount</u> <u>Outstanding</u>	<u>CUSIP</u> <u>(Base No. 586581)</u>
2017	August 1, 2016	\$125,000	BM1
2018	August 1, 2016	130,000	BN9
2019	August 1, 2016	135,000	BP4
2020	August 1, 2016	140,000	BQ2
2021	August 1, 2016	150,000	BR0
2022	August 1, 2016	155,000	BS8
2023	August 1, 2016	160,000	BT6
2024	August 1, 2016	170,000	BU3
2027	August 1, 2016	555,000	BX7
2029	August 1, 2016	420,000	BZ2

* Preliminary, subject to change.

ESTIMATED SOURCES AND USES OF FUNDS

The following table sets forth the estimated sources and uses of funds related to the Series 2016 Bonds and amounts relating to the Refunded Bonds.

SOURCES:

Principal Amount of Series 2016 Bonds	\$
Net Original Issue [Premium][Discount]	
Release of Amounts relating to the Refunded Bonds	
Total	\$

USES

Escrow Fund	\$
Bond Reserve Account	
Costs of Issuance ⁽¹⁾	
Bond Insurance Premium and Related Fees	
Total	\$

⁽¹⁾ Costs of issuance include rating agency fees, trustee fees, fees and expenses of bond counsel, disclosure counsel and trustee's counsel, underwriter's discount, verification agent fees, printing fees and other costs relating to the issuance of the Series 2016 Bonds.

RISK FACTORS

The purchase of the Series 2016 Bonds involves certain investment risks that are discussed throughout this Official Statement. Accordingly, each prospective purchaser of the Series 2016 Bonds should make an independent evaluation of all of the information presented in this Official Statement in order to make an informed investment decision. This section on BONDHOLDERS' RISKS focuses primarily on the general risks associated with healthcare providers, whereas APPENDIX A describes the District specifically. These should be read together.

General

As described herein, the Series 2016 Bonds are limited obligations of the District, secured under the provisions of the Indenture, as described herein, and payable solely from Gross Revenues and from certain funds held under the Indenture. There can be no assurance that income and receipts will be realized by the District in amounts sufficient to pay the principal of, premium, if any, or interest on the Series 2016 Bonds when due. The Series 2016 Bonds are not a general obligation of the District and the taxing power of the District is not pledged to the payment of debt service on the Series 2016 Bonds. See

"SECURITY AND SOURCE OF PAYMENT FOR THE SERIES 2016 BONDS" in this Official Statement.

The District is subject to a wide variety of federal and state regulatory actions and legislative and policy changes by those governmental and private agencies that administer Medicare, Medicaid and other payors and is subject to actions by, among others, the National Labor Relations Board, The Joint Commission, the Centers for Medicare & Medicaid Services ("CMS") of the U.S. Department of Health and Human Services ("DHHS"), and other federal, state and local government agencies. The future financial condition of the District could be adversely affected by, among other things, changes in the method and amount of payments to the District by governmental and nongovernmental payors, the financial viability of these payors, increased competition from other health care entities, decreased demand for health care, changes in the methods by which employers purchase health care for employees, capability of management, changes in the structure of how health care is delivered and paid for, future

changes in the economy, demographic changes, availability of physicians, nurses and other health care professionals, and malpractice claims and other litigation.

The District derives a significant portion of its revenues from Medicare, Medicaid and other third party payor programs. See “APPENDIX A – INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT – OPERATION AND UTILIZATION DATA – Sources of Revenue.” The District is subject to governmental regulations applicable to health care providers and the receipt of future revenues from the operation of the District’s facilities is subject to, among other factors, federal and State policies affecting the health care industry and other conditions that are impossible to predict. Such conditions may include difficulties in increasing room charges and other fees while maintaining an appropriate amount and quality of health services, changes in reimbursement or prospective payment policies and unanticipated competition from other health care providers. The effect on the District of recently enacted laws and regulations and of future changes in federal and State laws and policies cannot be fully or accurately determined at this time.

For more than a decade, healthcare providers, including the District, have been under increasing economic pressure from various third party payors, both governmental (particularly Medicare and MediCal) and private (e.g., health maintenance organizations). Certain payors have pressured health care providers to accept “capitated” reimbursement, which has the effect of shifting the economic risk of providing healthcare from the payors to the health care providers. Shifts in third party payor policies and the need for providers to adapt to changing and complex payment arrangements have had and will continue to have a significant impact upon the economic performance of the District.

Future economic and other conditions, including demand for healthcare services, the ability of the District to provide the services required by residents, public confidence in the District, economic developments in the service area, competition, rates, costs, third-party reimbursement and governmental regulations may adversely affect revenues and, consequently, payment of principal of and interest on the Series 2016 Bonds. Any of these factors may affect the District’s ability to generate revenues and to pay the principal of and premium, if any, and interest on the Series 2016 Bonds. There can be no assurance that the financial condition of the District and/or the utilization of the District’s facilities will not be adversely affected by any of these circumstances.

For information concerning the District, its operations and management, see “APPENDIX A – INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT.” See also “APPENDIX B – AUDITED FINANCIAL STATEMENTS OF THE DISTRICT FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND 2015” in this Official Statement.

Maintenance of Credit Rating

The Series 2016 Bonds will be rated as to their creditworthiness by Standard & Poor’s Ratings Services (“S&P” or the “Rating Agency”) based upon the credit rating of the obligations insured by the Office under the Program. No assurance can be given that the Series 2016 Bonds will maintain their original rating from the Rating Agency. If the rating on the Series 2016 Bonds decreases, the Series 2016 Bonds may lack liquidity in the secondary market in comparison to other municipal bonds. Adverse developments with respect to the financial condition of the Program or the State may have an unfavorable effect upon a holder’s ability to sell the holder’s Series 2016 Bonds or the bid and ask prices for the Series 2016 Bonds. See “RATING” in this Official Statement.

No Pledge of District Tax Revenues

Gross Revenues of the District pledged under the Indenture to the payment of debt service on the Series 2016 Bonds do not include tax revenues of the District. The taxing power of the District is not pledged to the payment of the principal of and interest on the Series 2016 Bonds. The Series 2016 Bonds are not an obligation of the District to which the full faith and ad valorem tax power of the District has been pledged. While not expressly pledged, tax revenues otherwise available to the District may be used to pay debt service on the Series 2016 Bonds.

Tax-Exempt Status

To maintain the exclusion from gross income for federal income tax purposes of the interest on the Series 2016 Bonds, the District has covenanted in the Indenture to comply with each applicable requirement of Section 103 and Sections 141 and 150 of the Code. The interest on the Series 2016 Bonds could become includable gross income for purposes of federal income taxation retroactive to the date of issuance of the Series 2016 Bonds as a result of acts or omissions of the District in violation of this or other covenants in the Indenture. The Series 2016 Bonds are not subject to redemption or any increase in interest rates should an event of taxability occur and will remain outstanding until maturity or prior redemption in accordance with the provisions contained in the Indenture.

State Bond Insurance

Because the principal and interest payments on the Series 2016 Bonds will be insured by the Office, if the principal and interest payments on the Series 2016 Bonds are not made by the District, such payments would be made by the Office from the HFCLIF. The last actuarial study of HFCLIF obtained by the Office was as of June 30, 2012, and indicated that the HFCLIF could be depleted prior to the maturity date of the Series 2016 Bonds in the event a 10% probability of catastrophic loss was assumed. The 2014 Annual Reports are available at the website of the Office. See “CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM – The Office, the Program and the Insurance Fund.”

To the extent the HFCLIF reserves are depleted and subject to the requirements of the Insurance Law, the Office shall request the Treasurer to issue debentures which are fully and unconditionally guaranteed as to principal and interest by the State in an amount equal to the then outstanding principal amount of the Series 2016 Bonds. Accordingly, any decline in the State’s fiscal condition could adversely affect the State’s ability to make payment on debentures in the event of a claim on such insurance. See “CERTAIN FINANCIAL INFORMATION REGARDING THE STATE.”

In addition, over certain time periods, deterioration in the State’s budget and cash situation may cause the nationally recognized rating services to reduce the State’s credit ratings. Standard & Poor’s Ratings Services, the rating agency for the Series 2016 Bonds, has indicated that it rates the Office’s insured bonds on par with the rating of the State’s general obligations bonds and that any rating action affecting the State will directly affect the rating on the Cal-Mortgage insurance program. Therefore, any decline in the State’s fiscal condition could adversely affect the rating on the Series 2016 Bonds. See “CALIFORNIA HEALTH FACILITY CONSTRUCTION LOAN INSURANCE PROGRAM – The Office, the Program and the Insurance Fund.” See also “CERTAIN FINANCIAL INFORMATION REGARDING THE STATE” and “RATING.”

General Health Care Risk Factors

Certain of the primary risks associated with the operations of the health facilities are briefly summarized in general terms below, and are explained in greater detail in subsequent sections. The occurrence of one or more of these risks could have a material adverse effect on the financial condition and results of operations of the District and, in turn, the ability of the District to make payments of principal of and interest on the Series 2016 Bonds.

Federal Health Care Reform and Deficit Reduction. The federal health care reform legislation has changed and will change how health care services are covered, delivered and reimbursed. These changes will result in lower hospital reimbursement from Medicare, utilization changes, increased government enforcement and the necessity for health care providers to assess, and potentially alter, their business strategies and practices, among other consequences. While most providers will receive reduced payments for care, millions of previously uninsured Americans will gain coverage. Further, it is unclear how on-going efforts to repeal the legislation will be resolved. Efforts to reduce the federal deficit and balance the State budget will likely curb Medicare and Medi-Cal spending further to the detriment of providers.

General Economic Conditions; Bad Debt, Indigent Care and Investment Losses. Health care providers are economically influenced by the environment in which they operate. To the extent that (1) unemployment rates are high, (2) employers reduce their budgets for employee health care coverage or (3) private and public insurers seek to reduce payments to health care providers or curb utilization of health care services, health care providers may experience decreases in insured patient volume and reductions in payments for services. In addition, to the extent that State, county or city governments are unable to provide a safety net of medical services, pressure is applied to local health care providers to increase free care. Furthermore, economic downturns and lower funding of Medicare and Medi-Cal programs may increase the number of patients who are unable to pay for their medical and hospital services. These conditions may give rise to increases in health care providers' uncollectible accounts, or "bad debt," uninsured, discounted and charity care and, consequently, to reductions in operating income. Declines in investment portfolio values may reduce or eliminate non-operating revenues. Investment losses (even if unrealized) may cause debt covenants to be violated and may jeopardize hospitals' economic security. Losses in pension and benefit funds may result in increased funding requirements. Potential failure of lenders, insurers or vendors may negatively impact the results of operations and the overall financial condition of health care providers. Philanthropic support may also decrease or be delayed.

Capital Needs vs. Capital Capacity. Hospital and other health care operations are capital intensive. Regulation, technology and physician/patient expectations require constant and often significant capital investment. In California, seismic requirements mandated by the State may require that many hospital facilities be substantially modified, replaced or closed. Estimated construction costs are substantial and actual costs of compliance may exceed estimates. Total capital needs may exceed capital capacity. Furthermore, capital capacity of hospitals and health systems may be reduced as a result of recent credit market dislocations, and it is uncertain how long those conditions may persist.

Technical and Clinical Developments. New clinical techniques and technology, as well as new pharmaceutical and genetic developments and products, may alter the course of medical diagnosis and treatment in ways that are currently unanticipated, and that may dramatically change medical and hospital care. These could result in higher hospital costs, reductions in patient populations and/or new sources of competition for hospitals.

Proliferation of Competition. Hospitals increasingly face competition from specialty providers of care and ambulatory care facilities. This may cause hospitals to lose essential inpatient or outpatient market share. Competition may be focused on services or payor classifications for which hospitals realize their highest margins, thus negatively affecting programs that are economically important to hospitals.

Specialty hospitals may attract specialists as investors and may seek to treat only profitable classifications of patients, leaving full-service hospitals with higher acuity and/or lower paying patient populations. These sources of competition may have a material adverse impact on hospitals, particularly where a group of a hospital's principal physician admitters may curtail their use of a hospital service in favor of competing facilities.

Hospitals and other health care providers face increased pressure to operate transparently and make available information about cost and quality of services. Consumers and payors accessing cost and quality information accumulated on various data-bases may shift business among providers or make different health care choices based on such information.

Rate Pressure from Insurers and Major Purchasers. Certain health care markets, including many communities in California, are strongly impacted by large health insurers and, in some cases, by major purchasers of health services. In those areas, health insurers may have significant influence over the rates, utilization and competition of hospitals and other health care providers. Rate pressure imposed by health insurers or other major purchasers, including managed care payors, may have a material adverse impact on hospitals and other health care providers, particularly if major purchasers put increasing pressure on payors to restrain rate increases. Business failures by health insurers also could have a material adverse impact on contracted hospitals and other health care providers in the form of payment shortfalls or delays, and/or continuing obligations to care for managed care patients without receiving payment. In addition, disputes with non-contracted payors may result in an inability to collect billed charges from these payors.

Reliance on Medicare. Inpatient hospitals rely to a high degree on payment from the federal Medicare program. Recent changes in the underlying laws and regulations, as well as in payment policy and timing, create uncertainty and could have a material adverse impact on hospitals' payment streams from Medicare. With health care and hospital spending reported to be increasing faster than the rate of general inflation, Congress and CMS are expected to take action in the future to decrease or restrain Medicare outlays for hospitals.

Costs and Restrictions from Governmental Regulation. Nearly every aspect of hospital operations is regulated, in some cases by multiple agencies of government. The level and complexity of regulation and compliance audits appear to be increasing, imposing greater operational limitations, enforcement and liability risks, and significant and sometimes unanticipated costs.

Government "Fraud" Enforcement. "Fraud and abuse" in government funded health care programs is a significant concern of federal and state regulatory agencies overseeing health care programs, and is one of the federal government's prime law enforcement priorities. The federal government and, to a lesser degree, state governments impose a wide variety of extraordinarily complex and technical requirements intended to prevent over-utilization based on economic inducements, misallocation of expenses, overcharging, improper billing or coding, and other forms of "fraud" in the Medicare and Medicaid programs, as well as other state and federally-funded health care programs. This body of regulation impacts a broad spectrum of hospital and other health care provider commercial activity, including billing, accounting, recordkeeping, medical staff oversight, physician contracting and recruiting, cost allocation, clinical trials, discounts and other functions and transactions.

Violations and alleged violations may be deliberate, but also frequently occur in circumstances where management is unaware of the conduct in question, as a result of mistake, or where the individual participants do not know that their conduct is in violation of law. Violations may occur and be prosecuted in circumstances that do not have the traditional elements of fraud, and enforcement actions may extend to conduct that occurred in the past. Violations carry significant sanctions. The government periodically conducts widespread investigations covering categories of services, or certain accounting or billing practices.

Violations Carry Significant Sanctions. The government and/or private “whistleblowers” often pursue aggressive investigative and enforcement actions. The government has a wide array of civil, criminal, monetary and other penalties, including suspending essential hospital and other health care provider payments from the Medicare or Medicaid programs, or exclusion from those programs. Aggressive investigation tactics, negative publicity and threatened penalties can be, and often are, used to force health care providers to enter into monetary settlements in exchange for releases of liability for past conduct, as well as agreements imposing prospective restrictions and/or mandated compliance requirements and monitoring on health care providers. Such negotiated settlement terms may have a material adverse impact on hospital and other health care provider operations, financial condition, results of operations and reputation. Multi-million dollar fines and settlements for alleged intentional misconduct, fraud or false claims are not uncommon in the health care industry. These risks are generally uninsured. Government enforcement and private whistleblower suits may increase in the hospital and health care sector. Many large hospital and other health care provider systems have been and are liable to be adversely impacted.

State Medicaid Programs. The California Medicaid program, known as Medi-Cal, is an important payor source to many hospitals and may become a proportionately larger source of revenue as federal health care reform is implemented, expanding Medicaid coverage to significant numbers of previously uninsured Americans. This program often pays hospitals and physicians at levels that may be below the actual cost of the care provided. As Medi-Cal is partially funded by the State, any financial instability of the State may result in lower funding levels and/or payment delays. These could have a material adverse impact on California hospitals. See “Patient Service Revenues” below.

Professional Staff Shortages. From time to time, a shortage of certain physician specialties, nurses and medical technicians exists which may have a significant impact on hospitals. The shortages are particularly acute in the fields of primary care and certain medical and surgical specialties. Such shortages may adversely affect hospitals, which rely on skilled health care practitioners to deliver care. Some studies predict that such shortages may be exacerbated in the future by decreased reimbursement and inadequate support for medical education. In California regulation of nurse staffing ratios can intensify the potential shortage of nursing personnel. A new influx of patients with insurance coverage as a result of health care reform may also exacerbate personnel shortages. Hospital operations, patient and physician satisfaction, financial condition, results of operations and future growth could be negatively affected by these shortages, resulting in a material adverse impact on hospitals.

Labor Costs and Disruption. The delivery of health care services is labor intensive. Labor costs, including salary, benefits and other liabilities associated with the workforce, have significant impacts on hospital and health care provider operations and financial condition. Hospital and health care employees are increasingly organized in collective bargaining units, and may be involved in work actions of various kinds, including work stoppages and strikes. Overall costs of the hospital workforce are high, and turnover is high. Pressure to recruit, train and retain qualified employees is expected to accelerate. These factors may materially increase hospital costs of operation. Workforce disruption may negatively impact hospital revenues, employment recruitment efforts and reputation.

Pension and Benefit Funds. As large employers, hospitals may incur significant expenses to fund pension and benefit plans for employees and former employees, and to fund required workers' compensation benefits. Plans are often underfunded or may become underfunded and funding obligations in some cases may be erratic or unanticipated and may require significant commitments of available cash needed for other purposes.

Medical Liability Litigation and Insurance. Medical liability litigation is subject to public policy determinations and legal and procedural rules that may be altered from time to time, with the result that the frequency and cost of such litigation, and resultant liabilities, may increase in the future. Hospitals may be affected by negative financial and liability impacts on physicians. Costs of insurance, including self-insurance, may increase dramatically.

Other Actions. Hospitals and health systems have long been subject to a wide variety of litigation risks, including liability for care outcomes, employer liability, property and premises liability, and peer review litigation with physicians, among others. In recent years, consumer class action litigation has emerged as a potentially significant source of litigation liability for hospitals and health systems. These class action suits have most recently focused on hospital billing and collection practices, and they may be used for a variety of currently unanticipated causes of action. Since the subject matter of class action suits may involve uninsured risks, and since such actions often involve alleged large classes of plaintiffs, they may have material adverse consequences on hospitals and health systems in the future.

Facility Damage. Hospitals are highly dependent on the condition and functionality of their physical facilities. Damage from earthquakes, floods, fire, other natural causes, deliberate acts of destruction, or various facilities system failures may have a material adverse impact on operations, financial conditions and results of operations.

Federal Budget Cuts

The Budget Control Act of 2011 (the "BCA") mandates significant reductions and spending caps on the federal budget for fiscal years 2012-2021. The BCA also created a Joint Select Committee on Deficit Reduction (the "Super Committee") to develop a plan to further reduce the federal deficit by \$1.2 trillion on or before November 23, 2011. Because the Super Committee failed to act in a timely manner, the BCA mandated that a 2% reduction in Medicare spending, among other reductions, would be triggered to take effect in January 2013. The American Taxpayer Relief Act of 2012 ("ATRA") postponed this scheduled reduction until March 2013, and the 2% Medicare spending reduction ultimately took effect beginning in April 2013. In December 2013, the Bipartisan Budget Act of 2013 was enacted, which extended through 2023 the 2% reduction in Medicare spending.

It is possible that Congress will take action to eliminate some or all of the reductions in the future and any Congressional action could be made retroactive in order to eliminate some or all of the cuts even to the extent they were imposed. However, there is no certainty that Congress will take any action. Ultimately, these reductions or alternatives could have a disproportionate impact on hospital providers and could have a material adverse effect on the financial condition of the District.

Debt Limit Increase

The federal government has through legislation created a debt "ceiling" or limit on the amount of debt that may be issued by the United States Treasury. In the past several years, political disputes have arisen within the federal government in connection with discussions concerning the authorization for an increase in the federal debt ceiling. Any failure by Congress to increase the federal debt limit may impact

the federal government's ability to incur additional debt, pay its existing debt instruments and to satisfy its obligations relating to the Medicare and Medicaid programs.

Management of the District is unable to determine at this time what impact any future failure to increase the federal debt limit may have on the operations and financial condition of the District, although such impact may be material. Additionally, the market price or marketability of the Series 2016 Bonds in the secondary market may be materially adversely impacted by any failure to increase the federal debt limit.

Health Care Reform

Federal Health Care Reform. As a result of the Patient Protection and Affordable Care Act, as amended, enacted in 2010 (the "ACA"), substantial changes have occurred and are anticipated to occur in the United States health care system. The ACA affects the delivery of health care services, the financing of health care costs, reimbursement of health care providers and the legal obligations of health insurers, providers, employers and consumers. These provisions have taken effect or are slated to take effect at specified times over approximately the next decade, and, therefore, the full consequences of the ACA on the health care industry cannot be immediately realized. The full ramifications of the ACA may become apparent only following implementation or through later regulatory and judicial interpretations. The uncertainties regarding the implementation of the ACA create unpredictability for the strategic and business planning efforts of health care providers, which in itself constitutes a risk.

The changes in the health care industry brought about by the ACA may have both positive and negative effects, directly and indirectly, on the nation's hospitals and other health care providers, including the District. For example, the projected increase in the numbers of individuals with health care insurance occurring as a consequence of Medicaid expansion, creation of health insurance exchanges, subsidies for insurance purchase and the penalty on certain individuals who do not purchase insurance could result in lower levels of bad debt and increased utilization or profitable shifts in utilization patterns for hospitals. A negative impact to the hospital industry overall will likely result from scheduled cumulative reductions in Medicare payments, as such reductions are substantial. The ACA's cost-cutting provisions to the Medicare program include reduction in Medicare market basket updates to hospital reimbursement rates under the inpatient prospective payment system, as well as additional reductions to or elimination of Medicare reimbursement for certain patient readmissions and hospital-acquired conditions. Industry experts also expect that private insurers and payors may follow with similar actions.

Health care providers could be further subjected to decreased reimbursement as a result of implementation of recommendations of the ACA-created Independent Payment Advisory Board ("IPAB"). If the projected Medicare per capita growth rate exceeds a target growth rate in any year, IPAB is directed to make recommendations for cost reductions, and those recommendations will be automatically implemented unless alternative legislation is enacted that meets equivalent Medicare savings targets. While hospitals may be largely exempted from recommendations from the IPAB, industry experts also expect that private insurers and payors may follow with similar actions.

Beginning in 2014, the ACA created state "health insurance exchanges" in which health insurance can be purchased by certain groups and segments of the population, expanded the availability of subsidies and tax credits for premium payments by some consumers and employers, and required that certain terms and conditions be included by commercial insurers in contracts with providers. In addition, the ACA imposed many new obligations on states related to health insurance. It is unclear how the increased federal oversight of state health care may affect future state oversight or affect the District. The health insurance exchanges may have a positive impact for hospitals by increasing the availability of health insurance to individuals who were previously uninsured. Conversely, employers or individuals

may shift their purchase of health insurance to new plans offered through the exchanges, which may or may not reimburse providers at rates equivalent to rates the providers currently receive. The exchanges could alter the health insurance markets in ways that cannot be predicted, and exchanges might, directly or indirectly, take on a rate-setting function that could negatively impact providers. Because the exchanges are still so new, the effects of these changes upon the financial condition of any third party payor that offers health insurance, rates paid by third-party payors to providers and, thus, the revenues of the District, and upon the operations, results of operations and financial condition of the District cannot be predicted.

High-deductible insurance plans have become more common in recent years, and the ACA is expected to encourage the increase in high-deductible insurance plans as the health care exchanges include a variety of plans, several of which offer lower monthly premiums in return for higher deductibles. Many plans offered on the exchanges have high deductibles. High-deductible plans may contribute to lower inpatient volumes as patients may forgo or choose less expensive medical treatment to avoid having to pay the costs of the high deductibles. There is also a potential concern that some patients with high-deductible plans will not be able to pay their medical bills as they may not be able to cover their high deductible.

The ACA will likely affect some health care organizations differently from others, depending, in part, on how each organization adapts to the legislation's emphasis on directing more federal health care dollars to integrated provider organizations and providers with demonstrable achievements in quality care. The ACA proposes a value-based purchasing system for hospitals under which a percentage of payments will be contingent on satisfaction of specified performance measures related to common and high-cost medical conditions, such as cardiac, surgical and pneumonia care. The ACA also creates various demonstration programs and pilot projects and other voluntary programs to evaluate and encourage new provider delivery models and payment structures, including "accountable care organizations" and bundled provider payments. The outcomes of these projects and programs, including the likelihood of their being made permanent or expanded or their effect on health care organizations' revenues or financial performance cannot be predicted.

The ACA contains amendments to existing criminal, civil and administrative anti-fraud statutes and increases in funding for enforcement and efforts to recoup prior federal health care payments to providers. Under the ACA, a broad range of providers, suppliers and physicians are required to adopt a compliance and ethics program. While the government has already increased its enforcement efforts, failures to implement certain core compliance program features provide new opportunities for regulatory and enforcement scrutiny, as well as potential liability if an organization fails to prevent or identify improper federal health care program claims and payments. See also "Regulatory Environment" below.

Efforts to repeal or amend provisions of the ACA are from time to time pending in Congress. In June 2012, the Supreme Court upheld most provisions of the ACA, while limiting the power of the federal government to penalize states for refusing to expand Medicaid, and on June 25, 2015, the Supreme Court issued a decision in *King v. Burwell*, ruling that health insurance subsidies under the ACA would be available in all states, including those with a federally-facilitated health insurance exchange. At this time it is not possible to predict the outcomes of any legislative attempts to repeal or amend the ACA or any judicial interpretations of the ACA.

California Health Care Reform. The State has enacted several laws intended to implement the ACA within the required federal timeframes. Among the steps taken to date to implement or advance the ACA:

- The State established a state health insurance exchange. As of October, 2012, the California Health Benefit Exchange operates under the brand name, “Covered California.”
- The Legislature approved expansion of Medi-Cal coverage, effective January 1, 2014, to include adults with incomes up to 138% of the federal poverty level who are under age 65, not pregnant and not otherwise currently eligible for Medi-Cal. In addition, legislation was provided prohibiting insurers from denying health coverage based on preexisting conditions.
- The State won approval from the federal government to implement a Medicaid demonstration project known as “California’s Bridge to Reform” in an effort to implement the ACA’s Medicaid expansion earlier than required by federal law.
- The State is also running a dual-eligibles pilot program known as the “Cal MediConnect Program” with federal funding, in an effort to coordinate health care delivery to seniors and people with disabilities who are eligible for both Medicare and Medicaid.

Patient Service Revenues

The Medicare Program. Medicare is the federal health insurance system under which hospitals are paid for services provided to eligible elderly and disabled persons, or those who qualify under the End Stage Renal Disease Program. Medicare is administered by CMS, which delegates to the states the process for certifying hospitals to which CMS will make payment. In order to achieve and maintain Medicare certification, hospitals must meet CMS’s “Conditions of Participation” on an ongoing basis, as determined by the State and/or The Joint Commission. The requirements for Medicare certification are subject to change, and, therefore, it may be necessary for hospitals to effect changes from time to time in their facilities, equipment, personnel, billing, policies and services. The District is certified to participate in the Medicare program.

As the population ages, more people will become eligible for the Medicare program. Current projections indicate that demographic changes and continuation of current cost trends will exert significant and negative forces on the overall federal budget. The Medicare program reimburses hospitals based on a fixed schedule of rates based on categories of treatments or conditions. These rates change over time and there is no assurance that these rates will cover the actual costs of providing services to Medicare patients. The ACA institutes multiple mechanisms for reducing the rate of increase in the costs of the Medicare program, including the following:

Value-Based Purchasing Program. Beginning in federal fiscal year 2013, Medicare inpatient payments to hospitals have been determined, in part, based on a program under which value-based incentive payments are made in a fiscal year to hospitals that meet certain performance standards during that fiscal year. The program is funded through the reduction of hospital inpatient care payments by a specified percentage (1% in the federal fiscal year 2013, progressing to 2% by federal fiscal year 2017) and then using the estimated total amount of those payment reductions to fund value-based incentive payments for hospitals that meet or exceed quality standards.

Market Basket Reductions. Generally, Medicare payment rates to hospitals are adjusted annually based on a “market basket” of estimated cost increases. In recent years, market basket adjustments for inpatient hospital care have averaged approximately 2-4% annually. The ACA required automatic 0.25% reductions in the “market basket” for federal fiscal years 2010 and 2011, and calls for reductions in the annual “market basket” update amount ranging from 0.10% to 0.75 % each year through federal fiscal year 2019.

Market Productivity Adjustments. Beginning in federal fiscal year 2012 and thereafter, the ACA provides for “market basket” adjustments based on overall national economic productivity statistics calculated by the Bureau of Labor Statistics. This adjustment is currently anticipated to result in an approximately 1% additional reduction to the “annual market basket” update.

Hospital Acquired Conditions Penalty. Beginning in federal fiscal year 2015, CMS began reducing payments by 1% for those Medicare inpatient payments to hospitals in the top quartile nationally for frequency of certain “hospital-acquired conditions”.

Readmission Rate Penalty. Beginning in federal fiscal year 2013, Medicare inpatient payments to those hospitals with excess readmissions compared to the national average for three patient conditions (acute myocardial infarction, pneumonia and heart failure) are reduced based on the dollar value of that hospital’s percentage of excess preventable Medicare readmissions within 30 days of discharge, for certain medical conditions. The maximum penalty was 1% in fiscal year 2013, increasing to 3% in fiscal year 2015 and for future years. In fiscal year 2015, CMS is expanding the patient conditions assessed for this penalty to include acute exacerbation of chronic obstructive pulmonary disease, elective total hip arthroplasty, and total knee arthroplasty.

Medicare/Medicaid DSH Payments. Beginning in federal fiscal year 2014, hospitals receiving supplemental disproportionate share or “DSH” payments from Medicare (i.e., those hospitals that care for a disproportionate share of low-income Medicare beneficiaries) began having their DSH payments reduced by 75%, although a portion of this reduction potentially can be offset by new, additional payments based on the volume of uninsured and uncompensated care provided by each such hospital. Separately, beginning in federal fiscal year 2017, Medicaid DSH allotments to each state will be reduced, based on a methodology to be determined by DHHS, accounting for statewide reductions in uninsured and uncompensated care.

Hospitals also receive payments from private health plans under the Medicare Advantage program. The ACA includes significant changes to federal payments to Medicare Advantage plans. Payments to plans were frozen for fiscal year 2011 and thereafter have transitioned to benchmark payments tied to the level of fee-for-service spending in the applicable county. These reduced federal payments could in turn affect the scope of coverage of these plans or cause plan sponsors to negotiate lower payments to providers.

Components of the 2009 federal stimulus package, the American Recovery and Reinvestment Act (“ARRA”), provide for Medicare and Medicaid incentive payments that began in 2011 to hospital providers meeting designated deadlines for the installation and use of electronic health information systems. For those hospital providers failing to meet a 2016 deadline, Medicare payments will be significantly reduced.

In addition to components of the ACA described above, the legislation enacted in 2013 to avert the “fiscal cliff,” ATRA, also negatively affected hospital Medicare reimbursement. Specifically, ATRA reduced Medicare reimbursement for hospitals by \$10.5 billion to help offset the \$30 billion cost of deferring a 27% reduction in Medicare physician payments that would otherwise have gone into effect as

well as the cost of extending for one year several CMS payment policies that would otherwise have expired.

For information concerning the Medicare payments received by the District for the fiscal years ended June 30, 2014 and 2015, see APPENDIX A – “APPENDIX A - INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT – FINANCIAL INFORMATION – Sources of Patient Services Revenue.”

Hospital Inpatient Reimbursement. Hospitals are generally paid for inpatient services provided to Medicare beneficiaries based on established categories of treatments or conditions known as diagnosis related groups (“DRGs”). The actual cost of care, including capital costs, may be more or less than the DRG rate. DRG rates are subject to adjustment by CMS, including reductions mandated by the ACA and the BCA, and are subject to federal budget considerations. There is no guarantee that DRG rates, as they change from time to time, will cover actual costs of providing services to Medicare patients. For information regarding the impact of the ACA on payments to hospitals for inpatient services, see “– Medicare Program” and “– Market Basket Reductions” above.

Effective October 1, 2013, CMS adopted a policy known as the Inpatient Hospital Prepayment Review “Probe & Educate” review process or the “Two-Midnight” rule. The “Two-Midnight” policy specifies that hospital stays spanning two or more midnights after the beneficiary is properly and formally admitted as an inpatient will be presumed to be “reasonable and necessary” for purposes of inpatient reimbursement. With some exceptions, patients whose stays are not expected to extend past two midnights should not be admitted as inpatients and instead their stays should be billed as outpatient visits. On April 30, 2015, CMS announced it would delay enforcement of the “Two-Midnight” rule until September 30, 2015, and therefore will continue to prohibit Recovery Audit Contractor inpatient hospital patient status reviews for dates of admission occurring between October 1, 2013 and September 30, 2015. The implementation of the “Two-Midnight” rule may have an adverse financial impact for hospitals.

Medicare Bad Debt Reimbursement. Under Medicare, the costs attributable to the deductible and coinsurance amounts which remain unpaid by the Medicare beneficiary can be added to the Medicare share of allowable costs as cost reports are filed. Hospitals generally receive interim pass-through payments during the cost report year which were determined by the Medicare Administrative Contractor (“MAC”) from the prior cost report filing. Bad debts must meet the following criteria to be allowable:

- the debt must be related to covered services and derived from deductible and coinsurance amounts;
- the provider must be able to establish that reasonable collection efforts were made;
- the debt was actually uncollectible when claimed as worthless; and
- sound business judgment established that there was no likelihood of recovery at any time in the future.

The amounts uncollectible from specific beneficiaries are to be charged off as bad debts in the accounting period in which the accounts are deemed to be uncollectible. In some cases, an amount previously written off as a bad debt and allocated to the program may be recovered in a subsequent accounting period. In these cases, the recoveries must be used to reduce the cost of beneficiary services for the period in which the collection is made. In determining reasonable costs for hospitals, the amount of bad debts otherwise treated as allowable costs is reduced by 35%. Amounts incurred by a hospital as

reimbursement for bad debts are subject to audit and recoupment by the MAC. Bad debt reimbursement has been a focus of MAC audit/recoupment efforts in the past.

Hospital Outpatient Reimbursement. Hospitals are generally paid for outpatient services provided to Medicare beneficiaries based on established categories of treatments or conditions known as ambulatory payment classifications (“APC”). The actual cost of care, including capital costs, may be more or less than the reimbursements. There is no guarantee that APC rates, as they change from time to time, will cover actual costs of providing services to Medicare patients.

Other Medicare Service Payments. Medicare payment for skilled nursing services, psychiatric services, inpatient rehabilitation services, general outpatient services and home health services are based on regulatory formulas or pre-determined rates. There is no guarantee that these rates, as they may change from time to time, will be adequate to cover the actual cost of providing these services to Medicare patients.

Reimbursement of Hospital Capital Costs. Hospital capital costs apportioned to Medicare patient use (including depreciation and interest) are paid by Medicare on the basis of a standard federal rate (based upon average national costs of capital), subject to limited adjustments specific to the hospital. There can be no assurance that future capital-related payments will be sufficient to cover the actual capital-related costs of the District applicable to Medicare patient stays or will provide flexibility to meet changing capital needs.

Recovery Audit Contractor Program. CMS has implemented a Recovery Audit Contractor (“RAC”) program on a nationwide basis pursuant to which CMS contracts with private contractors to conduct pre- and post-payment reviews to detect and correct improper payments in the fee-for-service Medicare program. The ACA expanded the RAC program’s scope to include managed Medicare plans and Medicaid claims. CMS also employs Medicaid Integrity Contractors to perform post-payment audits of Medicaid claims and identify overpayments. These programs tend to result in retroactively reduced payment and higher administration costs to hospitals. See “Medicare and Medicaid Audits” herein. Although the District has undergone RAC audits, and some of those audits have resulted in substantial adjustments, the District’s management is not aware of a situation in which any future RAC audit, if conducted, and any resulting payments made by the District would materially adversely affect the financial condition of the District. However, in light of the complexity of the regulations relating to the Medicare program and the ongoing threat of audits, there can be no assurance that any audit would not affect the financial condition of the District.

Medicaid Program. Medicaid is a program of medical assistance, funded jointly by the federal government and the states, for certain needy individuals and their dependents. Under Medicaid, the federal government provides limited funding to states that have medical assistance programs that meet federal standards. Attempts to balance or reduce the federal budget, along with balanced-budget requirements in the State, will likely negatively impact Medicaid funding. Payments made to health care providers under the Medicaid program are subject to change as a result of federal or state legislative and administrative actions, including changes in the methods for calculating payments, the amount of payments that will be made for covered services, the eligibility requirements for Medicaid coverage, and the types of services that will be covered under the program. Such changes have occurred in the past and may be expected to occur in the future, particularly in response to federal and state budgetary constraints and increased fiscal pressure on the Medicaid program in periods of high unemployment. Reduction in coverage of persons under Medicaid, by changes in the poverty level threshold required for eligibility or otherwise, to eliminate groups of currently eligible California residents, could increase the number of uninsured persons treated by health care providers and increase the risk of unreimbursed expenses.

Medi-Cal Program. Medi-Cal is the Medicaid program in California. The State selectively contracts with general acute care hospitals to provide inpatient services to Medi-Cal patients. The financial impact of selective contracting on a particular hospital depends upon a variety of factors such as the base contract rates, whether a hospital qualifies as a disproportionate share hospital, the availability of supplemental payments for private disproportionate share hospitals and an individual hospital's ability to control costs. Generally, such selective contracting is made on a negotiated per diem payment basis. Historically, such payment rates have not increased in direct relation to inflation, costs or other factors.

Legislation enacted in 2010 directed the State of California Department of Health Care Services ("DHCS") to replace the prevailing reimbursement method for hospital inpatient services, which provided for per-diem payments, with reimbursement according to DRGs. Effective July 1, 2013, the DRG payment method replaced the prior reimbursement method. The DRG payment method is based on All-Patient Refined Diagnosis Related Groups ("APR-DRGs"), which is a proprietary classification system for clinical conditions that is currently licensed and in use by many other state Medicaid programs. Under the new payment method, DHCS will reimburse hospitals a fixed amount for each inpatient admission based on the APR-DRG for that admission, which DHCS will assign based on the diagnoses, procedures, patient age and discharge status submitted by the hospital on its claim form. As DHCS and hospitals gain experience with the new method, DHCS intends to make adjustment in certain circumstances. It is anticipated that some California hospitals will see decreases in Medi-Cal payments while other hospitals will receive increases.

The State is obligated to make contractual payments only to the extent the State legislature appropriates adequate funding. Except in areas of the State that have been excluded from contracting, a general acute care hospital generally will not qualify for payment for non-emergency acute inpatient services rendered to a Medi-Cal beneficiary unless it is a contracting hospital. Typically, either party may terminate such contracts on 120 days' notice and the State may terminate without notice under certain circumstances. No assurances can be made that hospitals will be awarded Medi-Cal contracts or that any such contracts will reimburse hospitals for the cost of delivering services.

For information concerning the Medi-Cal payments received by the District, for the fiscal years ended June 30, 2014 and 2015, see APPENDIX A – "APPENDIX A - INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT – FINANCIAL INFORMATION – Sources of Patient Services Revenue."

Medicaid Payment Reductions. The ACA makes changes to Medicaid funding and substantially increases the potential number of Medicaid beneficiaries. To fund this expansion, the ACA provides that the federal government will fund 100% of the costs from 2014-2016, decreasing to 90% of the costs in 2020 and thereafter. In June 2012, the Supreme Court ruled that the federal government cannot withhold existing federal funds for states that refuse to expand Medicaid as required by the ACA. It is uncertain to what extent this risk may be mitigated if the increased Medicaid utilization replaces previously uncompensated patients.

California Hospital Provider Fee. In 2009, the State legislature enacted the Medi-Cal Hospital Provider Rate Stabilization Act and the Quality Assurance Fee Act, which imposed a "quality assurance fee" (the "Provider Fee") on California's general acute care hospitals, except for public hospitals and certain exempt hospitals. The Medi-Cal hospital provider fee is essentially a tax on hospitals to raise funds for provider payments. The proceeds are used to earn federal matching funds for Medi-Cal, and to increase Medi-Cal payments to hospitals. Under this program, some California hospitals receive more funding in increased Medi-Cal reimbursement than the quality assurance fees paid, while other California hospitals receive less money in Medi-Cal payments than the fees paid. The State has enacted legislation to extend this program to December 31, 2016.

The District, as a non-designated public hospital in the State, is not subject to the Provider Fee according to the legislation, but does receive various supplemental funds through federal programs of matching funds administered by the State. In fiscal years 2015 and 2014, the District recognized net patient services revenues of approximately \$250,000 and \$175,000, respectively, in supplemental funding, including intergovernmental transfers and grants. The District cannot predict whether such payments will continue in the future. Any material reductions in these supplemental payments could have a material adverse effect on the District.

California State Budget. The State of California has in the past faced severe financial challenges, including erosion of general tax revenues, falling real estate values, slow economic growth and high unemployment. More recently, California's financial health has improved, with California's unemployment rate dropping in recent quarters, corporate profits trending upward, housing prices increasing, and the percentage of foreclosures dropping. Additional reasons for California's improved fiscal outlook are the temporary tax revenues generated by Proposition 30, passed by California voters in November 2012 and additional revenues from Proposition 2 passed by California voters in November 2014.

It is impossible to predict the impact of future financial challenges to the California economy, including threat of future recessions, historic drought problems, changes in federal spending policy and other events that could result in budget deficits. It is also impossible to predict what the State's budget will be in future years or the actions that the Governor, the State legislature or voters, via ballot initiative, will take in the future. It is reasonable to expect, however, that the Governor and the State legislature will continue to pursue cost containment measures to keep the State's budget in balance, in part by aggressively managing the State's health care spending, which may have an adverse effect on the financial condition of the District. Past actions such as those set forth below may be indicative:

- Aggressive health care cost-containment efforts by the Governor and the State legislature to help eliminate prior years' budget deficits, including the State's substantial cuts to health care provider reimbursement, including Medi-Cal payments to hospitals. For example, California enacted legislation to reduce its Medicaid expenditures through eligibility restrictions, (causing a greater number of indigent, uninsured or underinsured patients) and reductions in Medicaid payment rates. In October 2011, CMS approved the State's request for 10% reductions in Medi-Cal payments for certain outpatient services and for long-term care. A Ninth Circuit Court of Appeals panel in December 2012, and later the full court in May 2013, upheld the reductions. In January 2014, the Supreme Court declined to review.
- The significant expansions to Medicaid programs, Medi-Cal in California, under the ACA. This expansion will require additional program funding. Federal funding is available for some of this expansion, but it is conditioned on states maintaining specified beneficiary eligibility criteria and California has sought to limit program eligibility in recent years to reduce program costs.
- While federal funding is available to facilitate Medicaid program expansion, this funding is expected to be temporary. The Medicaid program expansion and the expected longer-term loss of federal financial support to offset longer-term expansion-related costs may require the State to reduce provider reimbursement rates further.

Health Plans and Managed Care. Most private health insurance coverage is provided by various types of “managed care” plans, including health maintenance organizations (“HMOs”) and preferred provider organizations (“PPOs”) that generally use discounts and other economic incentives to reduce or limit the utilization of or payment for health care services. Medicare and Medicaid also purchase health care using managed care options. Payments to health care organizations from managed care plans typically are lower than those received from traditional indemnity or commercial insurers.

In California, managed care plans have replaced indemnity insurance as the primary source of nongovernmental payment for hospital services. Hospitals must be capable of attracting and maintaining managed care business, often on a regional basis. Regional coverage and aggressive pricing may be required. However, it is also essential that contracting hospitals be able to provide the contracted services without significant operating losses, which may require multiple forms of cost containment.

Many HMOs and PPOs currently pay providers on a negotiated fee-for-service basis or on a fixed rate per day of care, or a fixed-rate per hospital stay, which, in each case, usually is discounted from the usual and customary charges for the care provided. As a result, the discounts offered to HMOs and PPOs could, in some cases, result in payment to a provider that is less than its actual cost. Additionally, the volume of patients directed to a provider may vary significantly from projections, and changes in the utilization may be dramatic and unexpected, thus jeopardizing the provider’s ability to manage this component of revenue and cost.

Some HMOs employ a “capitation” payment method under which hospitals are paid a predetermined periodic rate for each enrollee in the HMO who is “assigned” or otherwise directed to receive care from a particular hospital. The hospital may assume financial risk for the cost and scope of institutional care given. If payment is insufficient to meet the hospital’s actual costs of care, or if utilization by such enrollees materially exceeds projections, the financial condition of the hospital could erode rapidly and significantly. In addition to this standard managed care risk sharing approach, private health insurance companies are increasingly adopting various additional risk sharing/cost containing measures, sometimes similar to those introduced by government payors. Providers may expect health care cost containment and its associated risk sharing to continue to increase in the coming years among all payors.

Often, HMO contracts are enforceable for a stated term, regardless of hospital losses and may require hospitals to care for enrollees for a certain time period, regardless of whether the HMO is able to pay the hospital. Hospitals from time to time have disputes with HMOs, PPOs and other managed care payors concerning payment and contract interpretation issues. Such disputes may result in mediation, arbitration or litigation.

Failure to maintain contracts could have the effect of reducing the District’s market share and net patient services revenues. Conversely, participation may result in lower net income if participating hospitals are unable to adequately contain their costs. In part to reduce costs, health plans are increasingly implementing, and offering to purchasing employers, tiered provider networks, which involve classification of a plan’s network providers into different tiers based on care quality and cost. With tiered benefit designs, plan enrollees are generally encouraged, through incentives or reductions in copayments or deductibles, to seek care from providers in the top tier. Classification of a hospital in a non-preferred or lower tier by a significant payor may result in a material loss of volume. The new demands of dominant health plans and other shifts in the managed care industry may also reduce patient volume and revenue. Thus, managed care poses one of the most significant business risks (and opportunities) that health care organizations face.

With implementation of the ACA, substantial numbers of employers may elect to discontinue employer-funded medical care for employees eligible for federal assistance in securing private insurance, and the employees could then choose health insurance under the health insurance exchanges. Individuals choosing their own coverage may become highly price sensitive, which could increase the number of enrollees in HMO plans and increase the use of capitation, making price negotiations with HMO and other insurance plans more difficult.

For information concerning the managed care payments received by the District for the fiscal years ended June 30, 2014 and 2015, see APPENDIX A – “APPENDIX A – INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT – FINANCIAL INFORMATION – Sources of Patient Services Revenue.”

International Classification of Diseases, 10th Revision Coding System. In 2009, CMS published the final rule adopting the International Classification of Diseases, 10th Revision coding system (“ICD-10”). The ICD-10 implementation deadline was October 1, 2015. ICD-10 provides a common approach to the classification of diseases and other health problems, allowing the United States to align with other nations to better share medical information, diagnosis, and treatment codes. While the District has transitioned to ICD-10, the transition is not without risk as staff will need to be retrained, processes redesigned, and computer applications modified as the current available codes and digit size will dramatically increase. Additionally, there is a potential for temporary coding and payment backlog, as well as potential increases in claims errors. There is a potential for revenue stream disruption for health care organizations and the magnitude of the transition within the industry may add pressure to health care organizations’ cash flows. Health care organizations will be dependent on outside software vendors, clearinghouses and third-party billing services to develop products and services to allow timely, full and successful implementation of ICD-10.

Negative Rankings Based on Clinical Outcomes, Cost, Duality, Patient Satisfaction and Other Performance Measures. Health plans, Medicare, Medicaid, employers, trade groups and other purchasers of health services, private standard-setting organizations and accrediting agencies increasingly are using statistical and other measures in efforts to characterize, publicize, compare, rank and change the quality, safety and cost of health care services provided by hospitals and providers. The ACA shifts payments from paying for volume to paying for value, based on various health outcome measures. Published rankings such as “score cards,” “pay for performance” and other financial and non-financial incentive programs are being introduced to affect the reputation and revenue of hospitals, the members of their medical staffs and other providers and to influence the behavior of consumers and providers such as the District. Currently prevalent are measures of quality based on clinical outcomes of patient care, reduction in costs, patient satisfaction and investment in health information technology. Measures of performance set by others that characterize a hospital or a provider negatively may adversely affect its reputation and financial condition.

Increased Enforcement Affecting Clinical Research. In addition to increasing enforcement of laws governing payment and reimbursement, the federal government has also stepped up enforcement of laws and regulations governing the conduct of clinical trials at hospitals. DHHS elevated and strengthened its Office of Human Research Protection, one of the agencies responsible for monitoring federally funded research. In addition, the National Institutes of Health significantly increased the number of facility inspections that these agencies perform. The Food and Drug Administration (“FDA”) also has authority over the conduct of clinical trials performed in hospitals when these trials are conducted on behalf of sponsors seeking FDA approval to market the drug or device that is the subject of the research. Moreover, the Office of Inspector General (the “OIG”), in its recent “Work Plans” has included several enforcement initiatives related to reimbursement for experimental drugs and devices (including kickback concerns) and has issued compliance program guidance directed at recipients of extramural research

awards from the National Institutes of Health and other agencies of the U.S. Public Health Service. The District is occasionally the direct recipient of such awards, and the District receives payments for health care items and services under many of these grants as a subcontractor. The District is subject to complex and ambiguous coverage principles and rules governing billing for items or services it provides to patients participating in clinical trials funded by governmental agencies and private sponsors. The enforcement powers of agencies with oversight of clinical research range from substantial fines and penalties to exclusion of researchers and suspension or termination of entire research programs. Billing of the Medicare Program for experimental care provided to patients enrolled in clinical trials that is not eligible for Medicare reimbursement can subject the District to sanctions as well as repayment obligations.

Regulatory Environment

“Fraud” and “False Claims.” Health care “fraud and abuse” laws at the federal and state levels broadly regulate providers of services to government program beneficiaries and the methods and requirements for submitting claims for services rendered. Hospitals and others can be penalized for a wide variety of conduct, including submitting claims for services that are not provided, billing in a manner that does not comply with government requirements or including inaccurate billing information, billing for services deemed to be medically unnecessary, or billings accompanied by certain proscribed inducements to utilize or refrain from utilizing a service or product.

Federal and state governments have a broad range of criminal, civil and administrative sanctions available to penalize and remediate health care fraud, including the exclusion of a hospital from participation in the Medicare/Medicaid programs, civil monetary penalties, and suspension of Medicare/Medicaid payments. Fraud and abuse cases may be prosecuted by one or more government entities or brought by private individuals, and more than one of the available sanctions may be, and often are, imposed for each violation. The ACA authorizes the Secretary of DHHS to exclude a provider’s participation in Medicare and Medicaid, as well as suspend payments to a provider pending an investigation or prosecution of a credible allegation of fraud against the provider.

Laws governing fraud and abuse may apply to a hospital and to nearly all individuals and entities with which a hospital does business. Fraud investigations, settlements, prosecutions and related publicity can have a material adverse effect on hospitals. See “Enforcement Activity,” below. Major elements of these often highly technical laws and regulations are generally summarized below.

False Claims Act. The federal False Claims Act (“FCA”) makes it illegal to knowingly submit or present a false, fictitious or fraudulent claim to the federal government. A person may be charged with knowledge of the falsity of a claim based not only on actual knowledge but also based on deliberate ignorance or reckless disregard of the relevant facts. The FCA has become one of the federal government’s primary weapons against health care fraud. Due to the broad range of conduct covered by the statute, FCA investigations and cases are common and may cover a range of activity from intentionally inflated billings, to highly technical billing infractions and to allegations of inadequate care. Damages under the FCA may include “treble damages” (i.e., damages up to three times the amount of the false claims) plus civil monetary penalties of up to \$11,000 per false claim. As a result, violation or alleged violations of the FCA frequently result in settlements involving multi-million dollar payments and compliance agreements. The FCA also permits individuals to initiate civil actions on behalf of the government in lawsuits called “qui tam” actions. Qui tam plaintiffs, or “whistleblowers,” can share in the damages recovered by the government. FCA violations or alleged violations could lead to settlements, fines, exclusion or reputation damage that could have a material adverse impact on hospitals and other health care providers.

Under the ACA, the FCA has been expanded to include overpayments that are identified by a health care provider and not timely reported or refunded to the applicable federal health care program, even if the claims relating to the overpayment were initially submitted without any knowledge that they were false. This expansion of the FCA exposes hospitals and other health care providers to liability under the FCA for a considerably broader range of claims than in the past.

Anti-Kickback Law. The federal “Anti-Kickback Law” prohibits anyone from soliciting, receiving, offering or paying any remuneration, directly or indirectly, overtly or covertly, in cash or in kind, in return for a referral (or to induce a referral) for any item or service that is paid by any federal or state health care program. The Anti-Kickback Law potentially applies to many common health care transactions between persons and entities with which a hospital does business, including hospital-physician joint ventures, medical director arrangements, physician recruitments, physician office leases and other transactions with persons or entities in a position to provide federal health care program business to hospitals. The ACA provides explicitly that a claim that includes items or services resulting from a violation of the Anti-Kickback Law constitutes a false or fraudulent claim for purposes of the FCA.

Violations or alleged violations of the Anti-Kickback Law may result in settlements that require multi-million dollar payments and onerous corporate integrity agreements. The Anti-Kickback Law can be prosecuted either criminally or civilly. A criminal violation may be prosecuted as a felony, subject to a fine of up to \$25,000 for each act (which may be each item or each bill sent to a federal program), imprisonment and/or exclusion from the Medicare and Medicaid programs. In addition, civil monetary penalties of \$10,000 per violation and an “assessment” of three times the amount claimed may be imposed. Violations of the Anti-Kickback Law are increasingly being prosecuted under the FCA, triggering the FCA penalties discussed above.

Stark Referral Law. The federal “Stark Law” prohibits the referral by a physician of Medicare and Medicaid patients for certain designated health services (including inpatient and outpatient hospital services, clinical laboratory services, and radiation therapy services, radiology and certain other imaging services) to entities with which the referring physician has a financial relationship unless that relationship fits within a Stark exception. It also prohibits a hospital furnishing the designated services from billing Medicare, or any other payor or individual for services performed pursuant to a prohibited referral. The government does not need to prove that the entity knew that the referral was prohibited to establish a Stark violation. If all technical requirements of an applicable exception are not satisfied, many ordinary business practices and economically desirable arrangements between hospitals and physicians, which constitute “financial relationships” within the meaning of the Stark Law, result in the prohibition on referrals and billing. Most providers of the designated health services with physician relationships have exposure to liability under the Stark Law.

Medicare may deny payment for all services performed based on a prohibited referral and a hospital that has billed for prohibited services may be obligated to refund the amounts collected from the Medicare program. For example, if an office lease between a hospital and a large group of heart surgeons is found to violate Stark, the hospital could be obligated to repay CMS for the payments received from Medicare for all of the heart surgeries performed by all of the physicians of the group for the duration of the lease; a potentially significant amount. As a result, even relatively minor, technical violations of the law may trigger substantial refund obligations. Moreover, if the violations of the Stark Law were knowing, the government may also seek civil monetary penalties of up to \$15,000 per claim, and in some cases, a hospital may be excluded from the Medicare and Medicaid programs. In addition, violations of the Stark Law increasingly are being prosecuted under the FCA, triggering the FCA penalties discussed above. Potential repayments to CMS, settlements, fines or exclusion for a Stark violation or alleged violation could have a material adverse impact on a hospital.

CMS has established a voluntary self-disclosure program under which hospitals and other health care providers or suppliers may report potential Stark violations and seek a reduction in potential refund obligations. However, the program is relatively new and therefore it is difficult to determine at this point in time whether it will provide significant monetary relief to hospitals that discover inadvertent Stark Law violations. The District may make self-disclosures pursuant to this program as appropriate, and may make other disclosures from time to time.

State “Fraud” and “False Claims” Laws. Hospital providers in California also are subject to a variety of State laws related to false claims (similar to the FCA or that are generally applicable false claims laws), anti-kickback (similar to the federal Anti-Kickback Law or that are generally applicable anti-kickback or fraud laws), and physician referral (similar to the Stark Law). These prohibitions while similar in public policy and scope to the federal laws have not in all instances been avidly enforced to date. However, in the future they could pose the possibility of material adverse impact for the same reasons as the federal statutes. See discussion under the subheadings “– False Claims Act,” “– Anti-Kickback Law” and “Stark Referral Law” above.

Medicare and Medicaid Audits. Hospitals that participate in the Medicare and Medicaid programs are subject from time to time to audits and other investigations relating to various aspects of their operations and billing practices, as well as to retroactive audit adjustments with respect to reimbursements claimed under these programs. Medicare and Medicaid regulations also provide for withholding reimbursement payments in certain circumstances. New billing rules and reporting requirements for which there is no clear guidance from CMS or state Medicaid agencies could result in claims submissions being considered inaccurate. The penalties for violations may include an obligation to refund money to the Medicare or Medicaid program, payment of criminal or civil fines and, for serious or repeated violations, exclusion from participation in federal health programs. The ACA requires states to institute a Recovery Audit Contractor (“RAC”) program for Medicaid, similar to the RAC program conducted for Medicare, in order to search for and recoup improper payments made by Medicare and Medicaid in prior years. The RACs will be private contractors, paid a contingency fee from any recovery of overpayments. Although required to identify both overpayments and underpayments, RACs have in practice collected significantly more in overpayments from providers in proportion to the underpayments to providers.

HIPAA, HITECH and Other Privacy Requirements. The Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) addresses the confidentiality of individuals’ health information. HIPAA requires the establishment of distinct privacy and security protections for individually identifiable health information maintained by health care providers, hospitals, health plans, health insurers and health care clearinghouses. Disclosure of certain broadly defined protected health information is prohibited unless expressly permitted under the provisions of HIPAA and related regulations or authorized by the patient. HIPAA’s privacy and security provisions extend not only to patient medical records, but also to a wide variety of health care clinical and financial settings where patient privacy restrictions often impose new communication, operational, accounting and billing restrictions.

On January 25, 2013, HHS issued comprehensive modifications to the existing HIPAA regulations to implement the requirements of the Health Information Technology for Economic and Clinical Health Act (the “HITECH Act”), commonly known as the “HIPAA Omnibus Rule.” The HIPAA Omnibus Rule became effective on March 26, 2013, and covered entities were required to be in compliance by September 23, 2013 (though certain requirements have a longer timeframe). Key aspects of the HIPAA Omnibus Rule include, but are not limited to: (i) a new standard for what constitutes a breach of private health information; (ii) establishing four levels of culpability with respect to civil monetary penalties assessed for HIPAA violations; (iii) direct liability of business associates for certain violations of HIPAA; (iv) modifications to the rules governing research; (v) stricter requirements

regarding non-exempt marketing practices; (vi) modification and re-distribution of notices of privacy practices; (vii) rights of individuals to restrict disclosure of their health information; and (viii) stricter requirements regarding the protection of genetic information. As a result of the HIPAA Omnibus Rule HHS' Office for Civil Rights (the "OCR") has increased its enforcement efforts, and several large settlements have resulted.

The HITECH Act revises the civil monetary penalties associated with violations of HIPAA as well as provides state attorneys general with authority to enforce the HIPAA privacy and security regulations. The revised civil monetary penalty provisions establish a tiered system, ranging from a minimum of \$100 per violation for an unknowing violation to \$1,000 per violation due to reasonable cause, but not willful neglect. For a violation due to willful neglect, the penalty is a minimum of \$10,000 per violation if the violation was corrected within 30 days of the date the violator knew or should have known of the violation and a minimum of \$50,000 if corrected after 30 days. Maximum penalties may reach \$1,500,000 for identical violations. The new levels of civil monetary penalties apply immediately for unknowing violations or violations due to reasonable cause. Criminal penalties may be enforced against persons who obtain or disclose personal health information without authorization. While there is currently no private cause of action for violations of HIPAA or the HITECH Act, an individual may have a right to sue based on state law.

The OCR is the administrative office that is tasked with enforcing HIPAA. OCR has stated that it has now moved from education to enforcement in its implementation of the law. Recent settlements of HIPAA violations for breaches involving lost data have reached the millions of dollars. Any breach of HIPAA, regardless of intent or scope, may result in penalties or settlement amounts that are material to a covered health care provider.

States may adopt privacy laws that are more restrictive than HIPAA but not less restrictive. California has broadened its data security breach notification law to cover compromised medical and health insurance information. Together, all of these laws and regulations create communication, operational, and accounting obligations that add costs and create potentially unanticipated sources of liability.

Security Breaches and Unauthorized Releases of Personal Information. State and local authorities are increasingly focused on the importance of protecting the confidentiality of individuals' personal information, including patient health information. Many states, including California, have enacted laws requiring businesses to notify individuals of security breaches that result in the unauthorized release of personal information. In some states, notification requirements may be triggered even where information has not been used or disclosed, but rather has been inappropriately accessed.

California medical privacy laws penalize unlawful access, use or disclosure of patient's medical information, as well as unauthorized access, which the laws define as the inappropriate viewing of patient medical information without the direct need for diagnosis, treatment or other lawful use. Administrative penalties under these medical privacy laws may reach \$250,000 per violation.

State consumer protection laws may also provide the basis for legal action for privacy and security breaches and frequently, unlike HIPAA, authorize a private right of action. In particular, the public nature of security incidents exposes health organizations to increased risk of individual or class action lawsuits from patients or other affected persons, in addition to government enforcement. Failure to comply with restrictions on patient privacy or to maintain robust information security safeguards, including taking steps to ensure that contractors who have access to sensitive patient information maintain the confidentiality of such information, could consequently damage a hospital's reputation and materially adversely affect business operations.

Business Associates. Under existing HIPAA regulations, covered entities must include certain required provisions in their contractual relationships with organizations that perform functions on their behalf which involve use or disclosure of protected health information. These organizations are called business associates, and have been indirectly regulated by HIPAA through those contractual obligations. The HITECH Act and the final rules promulgated thereunder provide that all of the HIPAA security administrative, physical, and technical safeguards, as well as security policies, procedures and documentation requirements now apply directly to all business associates. In addition, the HITECH Act makes certain privacy provisions directly applicable to business associates. These changes are significant because business associates will now be directly regulated by DHHS for those requirements, and as a result, will be subject to penalties imposed by DHHS and/or state attorneys general. Likewise, to the extent a business associate is deemed to be an agent of the covered entity under the Federal common law, the covered entity will be liable for the breaches of the business associate. Covered entities have had to review and amend their business associate agreements in recent years in order to comply with these changing rules, which can be costly and administratively burdensome.

Civil Monetary Penalty Act. The federal Civil Monetary Penalty Act (“CMPA”) provides for administrative sanctions against health care providers for a broad range of billing and other abuses. A health care provider is liable under the CMPA if it knowingly presents, or causes to be presented, improper claims for reimbursement under Medicare, Medicaid and other federal health care programs. A hospital that participates in arrangements known as “gainsharing” by paying a physician to limit or reduce services to Medicare fee-for-service beneficiaries also could be subject to CMPA penalties. A health care provider that provides benefits to Medicare or Medicaid beneficiaries that such provider knows or should know are likely to induce the beneficiaries to choose the provider for their care also could be subject to CMPA penalties. The CMPA authorizes imposition of a civil money penalty and treble damages. The ACA also amended the CMPA laws to establish various new grounds for exclusion and civil monetary penalties, as well as increased penalty thresholds for existing civil monetary penalties.

Health care providers may be found liable under the CMPA even when they did not have actual knowledge of the impropriety of their action. Knowingly undertaking the action is sufficient. Ignorance of the Medicare regulations is no defense. The imposition of civil money penalties on a health care provider could have a material adverse impact on the provider’s financial condition.

Exclusions from Medicare or Medicaid Participation. The government may exclude a hospital from Medicare/Medicaid program participation if it is convicted of a criminal offense relating to the delivery of any item or service reimbursed under Medicare or a state health care program, any criminal offense relating to patient neglect or abuse in connection with the delivery of health care, fraud against any federal, state or locally financed health care program or an offense relating to the illegal manufacture, distribution, prescription, or dispensing of a controlled substance. The government also may exclude individuals or entities under certain other circumstances, such as an unrelated conviction of fraud, or other financial misconduct relating either to the delivery of health care in general or to participation in a federal, state or local government program. Exclusion from the Medicare/Medicaid program means that a hospital would be decertified from program participation and no program payments can be made. Any hospital exclusion could be a materially adverse event. In addition, exclusion of hospital employees under Medicare or Medicaid may be another source of potential liability for hospitals or health systems based on services provided by those excluded employees.

Administrative Enforcement. Administrative regulations may require less proof of a violation than do criminal laws, and, thus, health care providers may have a higher risk of imposition of monetary penalties as a result of administrative enforcement actions.

Compliance with Conditions of Participation. CMS, in its role of monitoring participating providers' compliance with conditions of participation in the Medicare program, may determine that a provider is not in compliance with its conditions of participation. In that event, a notice of termination of participation may be issued or other sanctions potentially could be imposed.

EMTALA. The Emergency Medical Treatment and Active Labor Act ("EMTALA") is a federal civil statute that requires hospitals to treat or conduct a medical screening for emergency conditions and to stabilize a patient's emergency medical condition before releasing, discharging or transferring the patient. A hospital that violates EMTALA is subject to civil penalties of up to \$50,000 per offense and exclusion from the Medicare and Medicaid programs. In addition, the hospital may be liable for any claim by an individual who has suffered harm as a result of a violation.

Licensing, Surveys, Investigations and Audits. Health facilities are subject to numerous legal, regulatory, professional and private licensing, certification and accreditation requirements. These include, but are not limited to, requirements of state licensing agencies and The Joint Commission. Renewal and continuation of certain of these licenses, certifications and accreditations are based on inspections or other reviews generally conducted in the normal course of business of health facilities. Loss of, or limitations imposed on, hospital licenses or accreditations could reduce hospital utilization or revenues, or a hospital's ability to operate all or a portion of its facilities.

Environmental Laws and Regulations. Health facilities are subject to a wide variety of federal, state and local environmental and occupational health and safety laws and regulations. These include but are not limited to: air and water quality control requirements; waste management requirements; specific regulatory requirements applicable to asbestos and radioactive substances; requirements for providing notice to employees and members of the public about hazardous materials handled by or located at the hospital; and requirements for training employees in the proper handling and management of hazardous materials and wastes.

Health facilities may be subject to requirements related to investigating and remedying hazardous substances located on their property, including such substances that may have migrated off the property. Typical hospital operations include the handling, use, storage, transportation, disposal and discharge of hazardous, infectious, toxic, radioactive, flammable and other hazardous materials, wastes, pollutants and contaminants. As such, hospital operations are particularly susceptible to the practical, financial and legal risks associated with the environmental laws and regulations. Such risks may result in damage to individuals, property or the environment; may interrupt operations and increase their cost; may result in legal liability, damages, injunctions or fines; and may result in investigations, administrative proceedings, civil litigation, criminal prosecution, penalties or other governmental agency actions; and may not be covered by insurance.

Enforcement Activity. Enforcement activity against health care providers has increased, and enforcement authorities have adopted aggressive approaches. In the current regulatory climate, it is anticipated that many hospitals and physician groups will be subject to an audit, investigation, or other enforcement action regarding the health care fraud laws mentioned above.

Enforcement authorities are often in a position to compel settlements by providers charged with or being investigated for false claims violations by withholding or threatening to withhold Medicare, Medicaid and similar payments or to recover higher damages, assessments or penalties by instituting criminal action. In addition, the cost of defending such an action, the time and management attention consumed, and the facts of a case may dictate settlement. Therefore, regardless of the merits of a particular case, a hospital could experience materially adverse settlement costs, as well as materially

adverse costs associated with implementation of any settlement agreement. Prolonged and publicized investigations could be damaging to the reputation and business of a hospital, regardless of outcome.

Certain acts or transactions may result in violation or alleged violation of a number of the federal health care fraud laws described above, and therefore penalties or settlement amounts often are compounded. Generally these risks are not covered by insurance. Enforcement actions may involve multiple hospitals or other facilities in a health system, as the government often extends enforcement actions regarding health care fraud to other entities in the same organization. Therefore, Medicare fraud related risks identified as being materially adverse as to a hospital could have materially adverse consequences for a health system taken as a whole.

Antitrust. Antitrust liability may arise in a wide variety of circumstances, including medical staff privilege disputes, payor contracting, physician relations, joint ventures, merger, affiliation and acquisition activities, certain pricing or salary setting activities, as well as other areas of activity. The application of the federal and state antitrust laws to health care is evolving, and therefore not always clear. Currently, the most common areas of potential liability are joint action among providers with respect to payor contracting and medical staff credentialing disputes.

Violation of the antitrust laws could result in criminal and/or civil enforcement proceedings by federal and state agencies, as well as actions by private litigants. In certain actions, private litigants may be entitled to treble damages, and in others, governmental entities may be able to assess substantial monetary fines.

Business Relationships and Other Business Matters

Integrated Delivery Systems. Hospitals and health care systems often own, control or have affiliations with physician groups and independent practice associations. Generally, the sponsoring health facility or health system is the primary capital and funding source for such alliances and may have an ongoing financial commitment to provide growth capital and support operating deficits. As separate operating units, integrated physician practices and medical foundations sometimes operate at a loss and require subsidies or other support from the related hospital or health system. Inability to attract or retain participating physicians may negatively affect managed care contracting and utilization. The technological and administrative infrastructure necessary both to develop and operate integrated delivery systems and to implement new payment arrangements in response to changes in Medicare and other payor reimbursement is costly. Hospitals may not achieve savings sufficient to offset the substantial costs of creating and maintaining this infrastructure.

These types of alliances are generally designed to respond to trends in the delivery of medicine to better integrate hospital and physician care, to increase physician availability to the community and/or to enhance the managed care capability of the affiliated hospitals and physicians. However, these goals may not be achieved, and an unsuccessful alliance may be costly and counterproductive to all of the above-stated goals.

These types of alliances are likely to become increasingly important to the success of hospitals in the future as a result of changes to the health care delivery and reimbursement systems that are intended to restrain the rate of increases of health care costs, encourage coordinated care, promote collective provider accountability and improve clinical outcomes. The ACA authorizes several alternative payment programs for Medicare that promote, reward or necessitate integration among hospitals, physicians and other providers.

Whether these programs will achieve their objectives and be expanded or mandated as conditions of Medicare participation cannot be predicted. However, Congress and CMS have clearly emphasized continuing the trend away from the fee-for-service reimbursement model, which began in the 1980s with the introduction of the prospective payment system for inpatient care, and toward an episode-based payment model that rewards use of evidence-based protocols, quality and satisfaction in patient outcomes, efficiency in using resources, and the ability to measure and report clinical performance. This shift is likely to favor integrated delivery systems, which may be better able than stand-alone providers to realize efficiencies, coordinate services across the continuum of patient care, track performance and monitor and control patient outcomes. Changes to the reimbursement methods and payment requirements of Medicare, which is the dominant purchaser of medical services, are likely to prompt equivalent changes in the commercial sector, because commercial payors frequently follow Medicare's lead in adopting payment policies.

While payment trends may stimulate the growth of integrated delivery systems, these systems carry with them the potential for legal or regulatory risks. Many of the risks discussed in “ -- Regulatory Environment” above, may be heightened in an integrated delivery system. The foregoing laws were not designed to accommodate coordinated action among hospitals, physicians and other health care providers to set standards, reduce costs and share savings, among other things. The ability of hospitals or health systems to conduct integrated physician operations may be altered or eliminated in the future by legal or regulatory interpretation or changes, or by health care fraud enforcement. In addition, participating physicians may seek to maintain their independence for a variety of reasons, thus putting the hospital or health system's investment at risk, and potentially reducing its managed care leverage and/or overall utilization. Although CMS and the agencies that enforce these laws are expected to institute new regulatory exceptions, safe harbors or waivers that will enable providers to participate in payment reform programs, there can be no assurance that such waivers or other regulations or guidance will be forthcoming and/or will sufficiently clarify the scope of permissible activity in all cases. State law prohibitions, such as the bar on the corporate practice of medicine, or state law requirements, such as insurance laws regarding licensure and minimum financial reserve holdings of risk-bearing organizations, may also introduce complexity, risk and additional costs in organizing and operating integrated delivery systems.

Health care providers, responding to health care reform and other industry pressures, are increasingly moving toward integrated delivery systems, managing the health of populations of individuals, patient-centered medical homes, bundled payments, and capitated insurance plans. These trends will require new competencies, including the appropriate mix of physician specialties, new administrative skills, close and aligned relationships between physicians and hospitals, insurance risk management, and new relationships between patients and providers. Providers may be unsuccessful in assembling successful integrated networks, fail to achieve savings sufficient to offset the substantial costs of creating and maintaining the necessary capabilities to support such developments, or otherwise could incur losses or damage reputations from assuming increased risk.

Hospital Medical Staff. The primary relationship between a hospital and physicians who practice in it is through the hospital's organized medical staff. Medical staff bylaws, rules and policies establish the criteria and procedures by which a physician may have his or her privileges or membership curtailed, denied or revoked. Physicians who are denied medical staff membership or certain clinical privileges or who have such membership or privileges curtailed or revoked often file legal actions against hospitals and medical staffs. Such actions may include a wide variety of claims, some of which could result in substantial uninsured damages to a hospital. In addition, failure of the hospital governing body to adequately oversee the conduct of its medical staff may result in hospital liability to third parties.

Physician Supply. Sufficient community-based physician supply is important to hospitals and other health care facilities. CMS annually reviews overall physician reimbursement formulas for Medicare and Medicaid. Changes to physician compensation under these programs could lead to physicians ceasing to accept Medicare and/or Medicaid patients. Regional differences in reimbursement by commercial and governmental payors, along with variations in the costs of living, may cause physicians to avoid locating their practices in communities with low reimbursement or high living costs. Hospitals and health systems may be required to invest additional resources in recruiting and retaining physicians, or may be compelled to affiliate with, and provide support to, physicians in order to continue serving the growing population base and maintain market share. The physician-to-population ratio in certain parts of the State is below the national average, and the shortage of physicians could become a significant issue for hospitals and health care systems in the State.

Competition Among Health Care Providers. Increased competition from a wide variety of sources, including specialty hospitals, other hospitals and health care systems, HMOs, inpatient and outpatient health care facilities, long-term care and skilled nursing services facilities, clinics, physicians and others, may adversely affect the utilization and/or revenues of hospitals. Existing and potential competitors may not be subject to various restrictions applicable to hospitals, and competition, in the future, may arise from new sources not currently anticipated or prevalent.

Freestanding ambulatory surgery centers may attract away significant commercial outpatient services traditionally performed at hospitals. Commercial outpatient services, currently among the most profitable services for hospitals, may be lost to competitors who can provide these services in an alternative, less costly setting. Full-service hospitals rely upon the revenues generated from commercial outpatient services to fund other less profitable services, and the decline of such business may result in the significant reduction of profitable income. Competing ambulatory surgery centers, more likely for-profit businesses, may not accept indigent patients or low paying programs and would leave these populations to receive services in the full-service hospital setting. Consequently, hospitals are vulnerable to competition from ambulatory surgery centers.

Additionally, scientific and technological advances, new procedures, drugs and appliances, preventive medicine and outpatient health care delivery may reduce utilization and revenues of the hospitals in the future or otherwise lead the way to new avenues of competition. In some cases, hospital investment in facilities and equipment for capital-intensive services may be lost as a result of rapid changes in diagnosis, treatment or clinical practice brought about by new technology or new pharmacology.

Action by Purchasers of Hospital Services and Consumers. Major purchasers of hospital services could take action to restrain hospital charges or charge increases. As a result of increased public scrutiny, it is also possible that the pricing strategies of hospitals may be perceived negatively by consumers, and hospitals may be forced to reduce fees for their services. Decreased utilization could result, and hospitals' revenues may be negatively impacted. In addition, consumers and groups on behalf of consumers are increasing pressure for hospitals and other health care providers to be transparent and provide information about cost and quality of services that may affect future consumer choices about where to receive health care services.

Employer Status. Hospitals are major employers with mixed technical and nontechnical workforces. Labor costs, including salary, benefits and other liabilities associated with a workforce, have significant impacts on hospital operations and financial condition. Developments affecting hospitals as major employers include: (i) imposing higher minimum or living wages; (ii) enhancing occupational health and safety standards; and (iii) penalizing employers of undocumented immigrants. Legislation or regulation on any of the above or related topics could have a material adverse impact on the District.

Labor Relations and Collective Bargaining. Hospitals are large employers with a wide diversity of employees. Increasingly, employees of hospitals are becoming unionized, and many hospitals have collective bargaining agreements with one or more labor organizations. Employees subject to collective bargaining agreements may include essential nursing and technical personnel, as well as food service, maintenance and other trade personnel. Renegotiation of such agreements upon expiration may result in significant cost increases to hospitals. Employee strikes or other adverse labor actions may have an adverse impact on operations, revenue and hospital reputation. Currently, all of the District's employees are covered by collective bargaining agreements. See APPENDIX A – "APPENDIX A – INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT – EMPLOYEES."

Class Actions and Litigation. Federal law and many states, including notably California, impose standards related to worker classification, eligibility and payment for overtime, liability for providing rest periods and similar requirements. Large employers with complex workforces, such as hospitals, are susceptible to actual and alleged violations of these standards. In recent years there has been a proliferation of lawsuits over these "wage and hour" issues, often in the form of large class actions. For large employers such as hospitals, such class actions can involve multi-million dollar claims, judgments and settlements. Additionally, hospitals and health systems have long been subject to a wide variety of litigation risks, including liability for care outcomes, employer liability, property and premises liability, and peer review litigation with physicians, among others. In recent years, consumer class action litigation has emerged as a potentially significant source of litigation liability for hospitals and health systems. These class action suits may be used for a variety of currently unanticipated causes of action. Since the subject matter of class action suits may involve uninsured risks, and since such actions often involve alleged large classes of plaintiffs, they may have material adverse consequences on hospitals and health systems.

Health Care Worker Classification. Health care providers, like all businesses, are required to withhold income taxes from amounts paid to employees. If the employer fails to withhold the tax, the employer becomes liable for payment of the tax imposed on the employee. On the other hand, businesses are not required to withhold federal taxes from amounts paid to a worker classified as an independent contractor. The IRS has established criteria for determining whether a worker is an employee or an independent contractor for tax purposes. If the IRS were to reclassify a significant number of hospital independent contractors (e.g., physician medical directors) as employees, back taxes and penalties could be material.

Staffing. In recent years, the health care industry has suffered from a scarcity of nursing personnel, respiratory therapists, pharmacists and other trained health care and information system technicians. In addition, aging medical staffs and difficulties in recruiting physicians are leading to physician shortages. A significant factor underlying this trend includes a decrease in the number of persons entering such professions. This is expected to intensify in the future, aggravating the general shortage and increasing the likelihood of hospital-specific shortages. Competition for physicians and other health care professionals, coupled with increased recruiting and retention costs will increase hospital-operating costs, possibly significantly. This trend could have a material adverse impact on the financial condition and results of operations of hospitals and other health care facilities. This scarcity may further be intensified if utilization of health care services increases as a consequence of the ACA's expansion of the number of insured consumers. As reimbursement amounts are reduced to health care facilities and organizations that employ or contract with physicians, nurses and other health care professionals, pressure to control and possibly reduce wage and benefit costs may further strain the supply of those professionals.

California imposes mandatory nurse staffing ratios for all hospital patient care areas. The nurse to patient ratio standards increased as of January 1, 2008. It is possible that the State may take further action to regulate nurse to patient staffing and the impact on California hospitals will vary by department and facility, but the increased required staffing, in aggregate, could incur higher costs for hospitals.

Professional Liability Claims and General Liability Insurance. Professional and general liability suits and the dollar amounts of damage recoveries may have contributed to substantial increases in malpractice insurance premiums, higher deductibles and generally less coverage. Professional liability and other actions alleging wrongful conduct and seeking punitive damages are often filed against health care providers. Insurance does not provide coverage for judgments of punitive damages; however, California District hospitals are not subject to punitive damages.

Litigation also arises from the corporate and business activities of hospitals, from a hospital's status as an employer or as a result of medical staff or provider network peer review or the denial of medical staff or provider network privileges. As with professional liability, many of these risks are covered by insurance, but some are not. For example, some antitrust claims or business disputes are not covered by insurance or other sources and may, in whole or in part, be a liability of the District if determined or settled adversely.

There is no assurance that hospitals will be able to maintain coverage amounts currently in place in the future, that the coverage will be sufficient to cover malpractice judgments rendered against a hospital or that such coverage will be available at a reasonable cost in the future.

Information Systems. The ability to adequately price and bill health care services and to accurately report financial results depends on the integrity of the data stored within information systems, as well as the operability of such systems. Information systems require an ongoing commitment of significant resources to maintain, protect and enhance existing systems and develop new systems to keep pace with continuing changes in information processing technology, evolving systems and regulatory standards. There can be no assurance that efforts to upgrade and expand information systems' capabilities, protect and enhance these systems, and develop new systems to keep pace with continuing changes in information processing technology will be successful or that additional systems issues will not arise in the future.

Electronic media are also increasingly being used in clinical operations, including the conversion from paper to electronic medical records, computerization of order entry functions and the implementation of clinical decision-support software. The reliance on information technology for these purposes imposes new expectations on physicians and other workforce members to be adept in using and managing electronic systems. It also introduces risks related to patient safety, and to the privacy, accessibility and preservation of health information. See "Regulatory Environment—HIPAA, HITECH and Other Privacy Requirements" above. Technology malfunctions or failure to understand and use information systems properly could result in the dissemination of or reliance on inaccurate information, as well as in disputes with patients, physicians and other health care professionals. Health information systems may also be subject to different or higher standards or greater regulation than other information technology or the paper-based systems previously used by health care providers, which may increase the cost, complexity and risks of operations. All of these risks may have adverse consequences on hospitals and health care providers.

Outsourcing of Information Management. The District relies on a number of outside vendors to manage information on its behalf. Pursuant to certain of these arrangements, vendors have access to personal information of the Hospital's patients. Even though the District takes many precautions against the unauthorized use and disclosure of individually identifiable information by its vendors, including

through the terms of its contracts and security requirements and through security audits and vulnerability assessments, it does not control the actions and practices of outside entities. In addition, despite the security measures the District has in place to ensure compliance with applicable laws and rules, its facilities and systems and those of its third-party service providers may be vulnerable to security breaches, acts of vandalism or theft, computer viruses, misplaced or lost data, programming and/or human errors or other similar events. Noncompliance with any privacy laws or any security breach involving the misappropriation, loss or other unauthorized use or disclosure of sensitive or confidential health or other personal information, whether by the District or by one of its vendors, could have a material adverse effect on the District's business, reputation and results of operations, and could result in any or all of the following: material fines and penalties; compensatory, special, punitive, and statutory damages; consent orders regarding privacy and security practices; and adverse actions against the District's licenses to do business.

Physician Financial Relationships. In addition to the physician integration relationships referred to above, hospitals and health systems frequently have various additional business and financial relationships with physicians and physician groups. These are in addition to hospital physician contracts for individual services performed by physicians in hospitals. They potentially include: joint ventures to provide a variety of outpatient services; recruiting arrangements with individual physicians and/or physician groups; loans to physicians; medical office leases; equipment leases from or to physicians; and various forms of physician practice support or assistance. These and other financial relationships with physicians (including hospital physician contracts for individual services) may involve financial and legal compliance risks for the hospitals and health systems involved. From a compliance standpoint, these types of financial relationships may raise federal and state "anti-kickback" and federal "Stark" issues (see "Regulatory Environment," above), as well as other legal and regulatory risks, and these could have a material adverse impact on hospitals.

Section 340B Drug Pricing Program. Hospitals that participate in the prescription drug discount program established under Section 340B of the federal Public Health Service Act (the "340B Program") are able to purchase certain outpatient drugs for their patients at reduced cost. The District currently participates in and receives discounts through the 340B Drug Discount Program.

The Health Resources and Services Administration issued proposed 340B Drug Pricing Program Omnibus Guidance on August 28, 2015 in the Federal Register (the "Proposed 340B Guidance"). The public comment period for the Proposed 340B Guidance ended on October 27, 2015. The Proposed 340B Guidance addresses key 340B policy issues, including eligibility and registration of hospitals and outpatient facilities, individuals eligible to receive 340B drugs, drugs eligible for purchase under the 340B Program, and prohibition of duplicate discounts. If the Proposed 340B Guidance is implemented without change, it will likely materially decrease the discounts that the District will be able to receive under the 340B Drug Pricing Program going forward, and may result in a material adverse effect.

Cybersecurity Risks. Despite the implementation of network security measures by the District, its information technology systems may be vulnerable to breaches, hacker attacks, computer viruses, physical or electronic break-ins and other similar events or issues. Such events or issues could lead to the inadvertent disclosure of protected health information or other confidential information or could have an adverse effect on the ability of the District to provide health care services.

Licensing, Surveys, Investigations and Audits

Healthcare facilities, including those of the District, are subject to numerous legal, regulatory, professional and private licensing, certification and accreditation requirements. These include, but are not limited to, requirements relating to Medicare and Medi-Cal participation and payment, state licensing

agencies and private payors. Renewal and continuation of certain of these licenses, certifications and accreditations are based on inspections, surveys, audits, investigations or other reviews, some of which may require or include affirmative activity or response by the District. These activities generally are conducted in the normal course of business of healthcare facilities. Nevertheless, an adverse result could cause a loss or reduction in the District's scope of licensure, certification or accreditation, could reduce the payment received, or could require repayment of amounts previously remitted to the provider.

Management of the District currently anticipates no difficulty renewing or continuing currently held licenses, certifications or accreditations, nor does it anticipate a reduction in third-party payments from such events that would materially adversely affect the operations or financial condition of the District. Nevertheless, actions in any of these areas could result in the loss of utilization or revenues, or the District's ability to operate all or a portion of its health facilities, and, consequently, could have a material and adverse effect on the District's ability to make the debt service payments relating to the Series 2016 Bonds.

Impact of Market Turmoil

The current domestic and international financial crisis has had and will continue to have negative repercussions upon the national and global economies, including a scarcity of credit, lack of confidence in the financial sector, extreme volatility in the financial markets, potential increase in interest rates, reduced business activity, increased consumer bankruptcies and increased business failures and bankruptcies.

The financial crisis has had a particularly acute impact upon the financial sector and credit markets, and has caused many banks and other financial institutions to seek additional capital, to merge, and in some cases, to fail. One of the results of the recent financial crisis has been increased volatility in the municipal bond marketplace. Additionally, substantial amounts have been withdrawn from tax-exempt mutual funds and from hedge funds, traditionally some of the largest purchasers of municipal bonds. There has been a general weakening of the economy which also could have a material adverse effect upon the District. There can be no assurance that continued turmoil in the financial and bond markets will not negatively impact the marketability of the Series 2016 Bonds in the secondary market.

Competition

The closest competitor to the Hospital is approximately a fifty minute drive from the Hospital. Existing and potential competitors may not be subject to various regulations and restrictions applicable to the District; consequently, these competitors may be more flexible in their ability to adapt to competitive opportunities and risks. If these competitors and any future competitors not currently anticipated or prevalent are successful, some of the most profitable aspects of healthcare operations may be stripped away and/or overall utilization may decline.

The District competes with other providers for the limited sources of funding for its services. See "APPENDIX A – INFORMATION CONCERNING MENDOCINO COAST HEALTH CARE DISTRICT – SERVICE AREA AND COMPETITION."

Bankruptcy

In the event of bankruptcy of the District, the rights and remedies of the Holders of the Series 2016 Bonds are subject to various provisions of the federal Bankruptcy Code. If the District were to file a petition in bankruptcy, payments made by the District during the 90-day (or perhaps one-year) period immediately preceding the filing of such petition may be voidable as preferential transfers to the extent such payments allow the recipients thereof to receive more than they would have received in the event of the District's liquidation. Security interests and other liens granted to a Trustee and perfected during such preference period also may be voided as preferential transfers to the extent such security interest or other lien secures obligations that arose prior to the date of such perfection. Such a bankruptcy filing would operate as an automatic stay of the commencement or continuation of any judicial or other proceeding against the District and its property and as an automatic stay of any act or proceeding to enforce a lien upon or to otherwise exercise control over its property as well as various other actions to enforce, maintain or enhance the rights of a Trustee. If the bankruptcy court so ordered, the property of the District, including accounts receivable and proceeds thereof, could be used for the financial rehabilitation of the District despite any security interest of a Trustee therein. The rights of the Trustee to enforce its security interests and other liens it may have could be delayed during the pendency of the rehabilitation proceeding.

The District could file a plan for the adjustment of its debts in any such proceeding, which plan could include provisions modifying or altering the rights of creditors generally or any class of them, secured or unsecured. The plan, when confirmed by a court, binds all creditors who had notice or knowledge of the plan and, with certain exceptions, discharges all claims against the debtor to the extent provided for in the plan. No plan may be confirmed unless certain conditions are met, among which are conditions that the plan be feasible and that it shall have been accepted by each class of claims impaired thereunder. Each class of claims has accepted the plan if at least two-thirds in dollar amount and more than one-half in number of the class cast votes in its favor. Even if the plan is not so accepted, it may be confirmed if the court finds that the plan is fair and equitable with respect to each class of non-accepting creditors impaired thereunder and does not discriminate unfairly.

Pursuant to the Indenture, the Office shall have the right to vote in the place and stead of all Holders of Series 2016 Bonds with respect to any plan of reorganization on any agreement for composition of creditors and on any assignment for the benefit of creditors.

In the event of bankruptcy of the District, there is no assurance that certain covenants, including tax covenants, contained in the Indenture or other documents would survive. Accordingly, a bankruptcy trustee could take action that would adversely affect the exclusion of interest on the Series 2016 Bonds from gross income for federal income tax purposes.

In the Fiscal Year ended 2013, the District filed for bankruptcy under Chapter 9 of Title 11 of the United States Bankruptcy Code. As of March 2015, the District emerged from bankruptcy. For a further discussion, see "DISTRICT BANKRUPTCY" herein.

Enforceability of the Indenture and the Lien on the District's Gross Revenues

The remedies available to the Trustee, or the holders of the Series 2016 Bonds to enforce the obligations of the District under the Indenture may be limited by laws relating to bankruptcy (see "Bankruptcy" above), insolvency, reorganization or moratorium and by other similar laws affecting creditors rights, including equitable principles. In addition, the Trustee's ability to enforce such agreements will depend upon the exercise of various remedies specified by such documents which may in

many instances require judicial actions that are often subject to discretion, delay and substantial costs or that otherwise may not be readily available or be limited.

The various legal opinions to be delivered concurrently with the issuance of the Series 2016 Bonds will be qualified as to the enforceability of the various legal instruments by limitations imposed by

State and federal laws, rulings and decisions affecting remedies, and by bankruptcy, reorganization or other laws of general application affecting the enforcement of creditors' rights, including equitable principles.

Environmental Risks

There are potential risks relating to liabilities for environmental conditions with respect to the District's ownership of and maintenance of its healthcare facilities. If hazardous substances are found to be located on property, owners of such property may be held liable for costs and other liabilities related to the presence, migration or removal of such substances, which costs and liabilities could exceed the value of the property. The District is not aware of any pending or threatened claim, investigation or enforcement action regarding environmental issues relating to its facilities. Any future claim, investigation or enforcement action, if determined adversely to the District, would have material adverse consequences to the operations or financial condition of the District and would likely impact the ability of the District to pay debt service on the Series 2016 Bonds when due.

A phase one environmental site assessment has not been completed in connection with the issuance of the Series 2016 Bonds because the Office did not require such an environmental assessment in connection with the issuance of the Office's Contract of Insurance relating to the Series 2016 Bonds. Owners of real estate (such as the District) may, in the future, be adversely affected by legislative, regulatory, administrative and enforcement actions involving environmental controls.

Seismic Risks

Many hospitals in California are in close proximity to active earthquake faults. A significant earthquake in California could destroy or disable the Hospital.

Earthquakes affecting California hospitals have prompted the State to impose new hospital seismic safety standards pursuant to California Senate Bill 1953. Under these new standards, generally by 2013 (or in some cases as extended to 2030), California hospitals have been required to meet stringent seismic safety criteria which may necessitate major renovation in certain facilities or even their partial or full replacement. The potential capital costs and negative operating effects of such a replacement could be material and adverse. In 2009, the District received confirmation from the State of California that it was deemed to be compliant with seismic safety standards for structural integrity through the year 2030.

CONTINUING DISCLOSURE

The District has covenanted for the benefit of owners of the Series 2016 Bonds to provide certain financial information and operating data relating to the District on an annual basis and to provide notices of the occurrence of certain enumerated events. These covenants have been made in order to assist the Underwriter in complying with United States Securities Exchange Commission Rule 15c2-12 (the "Rule"). The specific nature of the information to be provided by the District and notices of enumerated events is set forth in the form of Disclosure Certificate attached hereto in "APPENDIX D – FORM OF CONTINUING DISCLOSURE CERTIFICATE."

The District has previously entered into previous undertakings under the Rule in connection with the issuance of other long-term obligations. In the previous five years, the District has failed to timely file its audited financial statements in connection with the Series 1996 Bonds, Series 2009 Bonds and Series 2010 Bonds. No audited financial statements were linked to the Series 2001 General Obligation Bonds. The District also failed to file the required operational or financial information in the past five years as required by its undertakings. In addition, the District did not file any quarterly reports, as required by the undertakings with respect to the Series 2009 Bonds and the Series 2010 Bonds. Further, while some event notices were filed in connection with the District's 2013 bankruptcy, the District has not filed notices of other enumerated events or rating changes with respect to any bond issue of the District. The District has retained Willdan Financial Services to cure all outstanding filing lapses prior to the sale of the Series 2016 Bonds and assist the District in complying with each of its undertakings, including as set forth in the Disclosure Certificate, in the future.

DISTRICT BANKRUPTCY

During the fiscal year ended June 30, 2013, the District filed for bankruptcy under Chapter 9 of Title 11 of the United States Bankruptcy Code in United States Bankruptcy Court - Northern District of California. The District's plan for adjustment was confirmed by the bankruptcy court on October 31, 2014 and on March 31, 2015, the District emerged from bankruptcy under Chapter 9 of the Bankruptcy Code. The purpose of the District's plan of reorganization was to restructure certain classifications of the District's debt and provide for their payment in whole or in part. The ultimate success of the plan will depended primarily on the ability of the District's management to operate at a level of increased cash flow and thereby coupled with District property taxes, meet its obligations in the normal course of operations.

Prior to filing for bankruptcy, the District was not in compliance with the rate covenant under the Regulatory Agreement or other financial covenants contained therein.

ABSENCE OF MATERIAL LITIGATION

There is no controversy or litigation of any nature now pending against the District or, to the knowledge of the District, threatened, restraining or enjoining the issuance of the Series 2016 Bonds or in any way contesting or affecting (i) the validity of the Series 2016 Bonds, or (ii) any proceedings of the District taken concerning the issuance or sale thereof, or the collection of Gross Revenues pledged under the Indenture or in any way contesting the validity or enforceability of the Indenture, the Deed of Trust, the Continuing Disclosure Certificates, the Contract of Insurance or the Regulatory Agreement or contesting in any way the completeness or accuracy of the Official Statement, or the existence or powers of the District relating to the issuance of the Series 2016 Bonds. As with virtually all health care providers, the District experiences medical malpractice claims related to the provision of services. These claims are covered by insurance. See "APPENDIX A – Information Concerning Mendocino Coast Health Care District – ADDITIONAL INFORMATION –Insurance and Litigation."

In addition, given the District's insurance coverage, there is no litigation of any nature now pending against the District or, to the best knowledge of the District's officers, threatened, which, if successful, would materially adversely affect the operations or financial condition of the District.

TAX MATTERS

Tax Exemption

The delivery of the Series 2016 Bonds is subject to the opinion of Bond Counsel to the effect that interest on the Series 2016 Bonds for federal income tax purposes (1) will be excludable from gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date of such opinion (the “Code”), pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions, and (2) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations. The delivery of the Series 2016 Bonds is also subject to the delivery of the opinion of Bond Counsel, based upon existing provisions of the laws of the State of California, that interest on the Series 2016 Bonds is exempt from personal income taxes of the State of California. A form of Bond Counsel's opinion is reproduced as Appendix E. The statutes, regulations, rulings, and court decisions on which such opinion is based are subject to change.

Interest on the Series 2016 Bonds owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate investment trust, a real estate mortgage investment conduit, or a financial asset securitization investment trust (“FASIT”). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by Section 55 of the Code will be computed.

In rendering the foregoing opinions, Bond Counsel will rely upon representations and certifications of the District made in a certificate dated the date of delivery of the Series 2016 Bonds pertaining to the use, expenditure, and investment of the proceeds of the Series 2016 Bonds and will assume continuing compliance by the District with the provisions of the Indenture subsequent to the issuance of the Series 2016 Bonds. The Indenture contains covenants by the District with respect to, among other matters, the use of the proceeds of the Series 2016 Bonds and the facilities financed therewith by persons other than state or local governmental units, the manner in which the proceeds of the Series 2016 Bonds are to be invested, the periodic calculation and payment to the United States Treasury of arbitrage “profits” from the investment of proceeds, and the reporting of certain information to the United States Treasury. Failure to comply with any of these covenants may cause interest on the Series 2016 Bonds to be includable in the gross income of the owners thereof from the date of the issuance of the Series 2016 Bonds.

Bond Counsel's opinion is not a guarantee of a result, but represents its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the District described above. No ruling has been sought from the Internal Revenue Service (the “IRS”) with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel's opinion is not binding on the IRS. The IRS has an ongoing program of auditing the tax-exempt status of the interest on tax-exempt obligations. If an audit of the Series 2016 Bonds is commenced, under current procedures the IRS is likely to treat the District as the “taxpayer,” and the owners of the Series 2016 Bonds would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Series 2016 Bonds, the District may have different or conflicting interests from the owners of the Series 2016 Bonds. Public awareness of any future audit of the Series 2016 Bonds could adversely affect the value and liquidity of the Series 2016 Bonds during the pendency of the audit, regardless of its ultimate outcome.

Except as described above, Bond Counsel expresses no other opinion with respect to any other federal, state or local tax consequences under present law, or proposed legislation, resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Series 2016 Bonds. Prospective purchasers of the Series 2016 Bonds should be aware that the ownership of tax-exempt obligations such as the Series 2016 Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a FASIT, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

Existing law may change to reduce or eliminate the benefit to bondholders of the exclusion of interest on the Series 2016 Bonds from gross income for federal income tax purposes. Any proposed legislation or administrative action, whether or not taken, could also affect the value and marketability of the Series 2016 Bonds. Prospective purchasers of the Series 2016 Bonds should consult with their own tax advisors with respect to any proposed or future changes in tax law.

Tax Accounting Treatment of Discount and Premium on Certain Bonds

The initial public offering price of certain Series 2016 Bonds (the “Discount Bonds”) may be less than the amount payable on such Bonds at maturity. An amount equal to the difference between the initial public offering price of a Discount Bond (assuming that a substantial amount of the Discount Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Bond. A portion of such original issue discount allocable to the holding period of such Discount Bond by the initial purchaser will, upon the disposition of such Discount Bond (including by reason of its payment at maturity), be treated as interest excludable from gross income, rather than as taxable gain, for federal income tax purposes, on the same terms and conditions as those for other interest on the Series 2016 Bonds described above under “Tax Exemption.” Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Bond, taking into account the semiannual compounding of accrued interest, at the yield to maturity on such Discount Bond and generally will be allocated to an initial purchaser in a different amount from the amount of the payment denominated as interest actually received by the initial purchaser during the tax year.

However, such interest may be required to be taken into account in determining the alternative minimum taxable income of a corporation, for purposes of calculating a corporation's alternative minimum tax imposed by Section 55 of the Code, and the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, S corporations with subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, owners of an interest in a FASIT, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Moreover, in the event of the redemption, sale or other taxable disposition of a Discount Bond by the initial owner prior to maturity, the amount realized by such owner in excess of the basis of such Discount Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Bond was held) is includable in gross income.

Owners of Discount Bonds should consult with their own tax advisors with respect to the determination of accrued original issue discount on Discount Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Discount Bonds. It is possible that, under applicable provisions governing determination of state and local income taxes, accrued interest on Discount Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment.

The initial public offering price of certain Series 2016 Bonds (the “Premium Bonds”) may be greater than the amount payable on such Bonds at maturity. An amount equal to the difference between the initial public offering price of a Premium Bond (assuming that a substantial amount of the Premium Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes premium to the initial purchaser of such Premium Bonds. The basis for federal income tax purposes of a Premium Bond in the hands of such initial purchaser must be reduced each year by the amortizable bond premium, although no federal income tax deduction is allowed as a result of such reduction in basis for amortizable bond premium. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon a sale or other taxable disposition of a Premium Bond. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser's yield to maturity.

Purchasers of the Premium Bonds should consult with their own tax advisors with respect to the determination of amortizable bond premium on Premium Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Premium Bonds.

LEGAL MATTERS

The validity of the Series 2016 Bonds and certain other legal matters are subject to the approving opinion of Norton Rose Fulbright US LLP, Bond Counsel to the District. A complete copy of the proposed form of opinion of Bond Counsel is attached as Appendix E hereto. Bond Counsel undertakes no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters will be passed upon for the District by Norton Rose Fulbright US LLP, as Disclosure Counsel, and by John J. Ruprecht, as counsel to the District. Certain legal matters will be passed upon for the Underwriter by Nossaman LLP, Irvine, California. Compensation paid to Bond Counsel, Disclosure Counsel and Underwriter's Counsel is contingent on the successful issuance of the Series 2016 Bonds.

ENFORCEABILITY OF OBLIGATIONS

While the Series 2016 Bonds are secured by the Indenture, the practical realization of such security upon any default may depend upon the exercise of various remedies, which may be dependent upon judicial actions that are subject to discretion and delay. Under existing constitutional, statutory and judicial law, such remedies may not be readily available or may be limited. A court may decide not to order the specific performance of covenants contained in the documents. The various legal opinions to be delivered concurrently with the delivery of the Series 2016 Bonds will be qualified as to the enforceability of the various legal instruments by limitations imposed by state and federal laws affecting remedies and by bankruptcy, reorganization or other laws affecting the enforcement of creditor's rights.

UNDERWRITING

The Series 2016 Bonds are being purchased by the Underwriter at a purchase price of \$_____, which is the par amount of the Series 2016 Bonds of \$_____, less an Underwriter's discount of \$_____ [plus][less] a [net] original issue [premium][discount] of \$_____. The Bond Purchase Agreement for the Series 2016 Bonds provides that the Underwriter will purchase all of the Series 2016 Bonds, if any

are purchased, and contains the agreement of the District to indemnify the Underwriter against certain liabilities to the extent permitted by law. The obligation of the Underwriter to make such purchase is subject to certain terms and conditions set forth in the Bond Purchase Agreement.

The Underwriter may offer and sell the Series 2016 Bonds to certain dealers and others at prices or yields different from the prices or yields stated on the cover page of this Official Statement. The offering prices or yields may be changed from time to time without notice by the Underwriter.

FINANCIAL STATEMENTS

The financial statements of the District for the years ended June 30, 2014 and 2015 are included in APPENDIX B to this Official Statement have been audited by JWT & Associates, LLP, LLP, Fresno, California. Except for the financial statements of the District contained in APPENDIX B, TCA Partners, LLP has not reviewed or audited any financial information of the District contained in this Official Statement or contained in APPENDIX A to this Official Statement.

VERIFICATION OF MATHEMATICAL ACCURACY

Upon delivery of the Series 2016 Bonds, the Verification Agent will verify the accuracy of (i) mathematical computations concerning the adequacy of the maturing principal amounts of and interest earned on the Defeasance Securities deposited in the Escrow Fund, together with amounts held as cash therein, to provide for payment of interest on the Refunded 2009 Bonds to and including February 1, 2019, payment of the redemption price of the Refunded 1996 Bonds and the Refunded 2010 Bonds on August 1, 2016, and payment of the redemption price of the Refunded 2009 Bonds on February 1, 2019, and (ii) certain mathematical computations supporting the conclusion that the Series 2016 Bonds are not “arbitrage bonds” under the Code, which verification will be relied upon by Bond Counsel in preparing its opinion to be delivered at the closing of the Series 2016 Bonds in concluding that interest on the 2016 Bonds is excluded from gross income of the holders thereof for federal income tax purposes under present laws, including applicable provisions of the Code, existing court rulings, regulations and Internal Revenue Service rulings.

The report of the Verification Agent will include the statement to the effect that the scope of its engagement is limited to verifying the mathematical accuracy of the computations contained in such schedules provided to it, and that it has no obligation to update its report because of events occurring, or date or information coming to its attention, subsequent to the date of its report.

RATING

Standard & Poor’s Ratings Services, a Standard & Poor’s Financial Services LLC business (“S&P”), has assigned its municipal bond rating of “AA-” to the Series 2016 Bonds with the understanding that, upon delivery of the Series 2016 Bonds, payment of the principal of and interest on the Series 2016 Bonds will be insured by the Office. The rating reflects S&P’s current assessment of the creditworthiness of the Office and its ability and the ability of the State to pay claims under the Program. Any explanation of the significance of such rating may only be obtained from S&P. The District furnished to S&P certain information and material concerning the Series 2016 Bonds, the Office, the Program and itself. Generally, rating agencies such as S&P base their ratings on such information and materials and on investigations, studies and assumptions made by the rating agencies themselves. There is no assurance that the credit rating mentioned above will remain in effect for any given period of time or that it might not be lowered or withdrawn entirely by the rating agency, if, in its judgment, circumstances so warrant. The Underwriter has undertaken no responsibility either to bring to the attention of the Holders of the Series 2016 Bonds any proposed change in or withdrawal of any rating or to oppose any

such proposed revision or withdrawal. Any such downward change in or withdrawal of any rating might have an adverse effect on the market price or marketability of the Series 2016 Bonds.

MISCELLANEOUS

The summaries and references contained herein with respect to the Series 2016 Bonds, the Contract of Insurance, the Indenture, the Continuing Disclosure Certificate, and the Regulatory Agreement and all references to other materials not purporting to be quoted in full are only brief outlines of some of the provisions thereof and do not purport to summarize or describe all of the provisions thereof. Reference is made to said documents for full and complete statements of the provisions of such documents. The appendices attached hereto are a part of this Official Statement. Copies, in reasonable quantity, of the Indenture, the Contract of Insurance, the Continuing Disclosure Certificate, and the Regulatory Agreement may be obtained during the offering period upon request to the Underwriter and thereafter upon request to the principal corporate trust office of the Trustee.

This Official Statement has been issued and approved by the District. This Official Statement is not to be construed as a contract or agreement between the District and the purchasers or Holders of any of the Series 2016 Bonds.

MENDOCINO COAST HEALTH CARE
DISTRICT

By: _____
Chief Executive Officer

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APPENDIX A

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MENDOCINO COAST HEALTH CARE DISTRICT

THE DISTRICT

Mendocino Coast Health Care District (the “District”), a local healthcare district formed in 1967, is a public entity under the laws of the State of California (the “State”) organized pursuant to the State’s Local Health Care District Law (formerly the Local Hospital District Law) as set forth in the State’s Health and Safety Code. The District encompasses approximately 680 square miles and extends approximately 70 miles south from the Humboldt/Mendocino County line. The District is bordered on the west by the Pacific Ocean and includes the City of Fort Bragg and the communities of Westport, Mendocino, Albion and Elk. The District also provides healthcare services to people living outside the District, the majority of which live within an area extending from Elk south along the coast to the Mendocino/Sonoma county line and visitors to the area.

The 2016 estimated population for the City of Fort Bragg and Mendocino County was 7,672 and 88,378, respectively. Management of the District estimates that there are approximately 25,000 residents living within its boundaries. Projections made by the State Department of Finance estimates Mendocino County’s population will reach approximately 92,203 by the year 2025. The District owns and operates the Hospital and operates a rural health clinic, both of which are located within the City of Fort Bragg, Mendocino County, California.

District’s Mission and Vision

The District’s stated mission is to make a positive difference in the health of the District’s rural community.

The District’s stated vision is to play a vital role in the overall health and well-being of the community and to be the key element in the healthcare system serving the needs of the community; to provide leadership to enhance the efficiency, coordination, quality and range of services provided within its rural healthcare system; to be the healthcare provider and employer of choice within the community and to continually address and keep up with technology and superior clinical skills.

The District is committed to providing excellent quality, patient centered, cost effective healthcare in a caring, safe and professional environment, and serving the community’s healthcare needs with current technology and superior clinical skills. The District believes in the right to local access to a wide range of excellent quality healthcare services for its rural community. District management promotes patient safety and satisfaction, and consistently works toward a high level of care that results in its patients recommending the Hospital to others and in patients returning to the Hospital for needed healthcare.

GOVERNING BODY, DISTRICT MANAGEMENT AND STAFF

Board of Directors

The District is governed by a Board of Directors (the “Board”), which consists of five members, each elected to four-year alternating terms at elections held every two years. The Board has responsibility for the quality of patient care, District policies, strategic planning, as well as fiduciary responsibility for protecting and enhancing District assets. Members of the Board serve in a voluntary capacity and receive no compensation for their services. Current Board members and their Board positions, occupations and current terms are as follows:

<u>Name</u>	<u>Position</u>	<u>Occupation</u>	<u>Term Expiration</u>
Tom Birdsell	Chair	Office Manager	12/5/2016
Kitty Bruning	Vice Chair	Retired	12/5/2018
Peter Glusker, M.D.	Secretary	Retired	12/5/2018
Sean Hogan	Treasurer	Retired	12/5/2016
Vacant	Member		

Source: The District.

Board Committees and Relationships

There are five standing committees of the Board, each consisting of up to two Board members and as many as eight additional non-Board members. The Board's current standing committees include: finance, planning, legislative, audit and compensation. Standing committees to the Board serve solely in an advisory capacity and recommend action items to the Board for their approval. Special committees may be formed by appointment of the Board's President with full Board concurrence to investigate, study or review specific matters.

Members of the Board have various relationships with service or product providers who may, from time to time, provide services or products to the District, but these relationships are not considered to be material. The Board has established a conflict of interest policy to identify, approve and manage such relationships.

Management

The Board delegates day-to-day operations of the District and its health facilities to the executive managers of the District who are profiled below:

Chief Executive Officer. Bob S. Edwards, Jr. MBA FACHE, Chief Executive Officer. Mr. Edwards has been with Mendocino Coast Health Care District since April 15, 2015. He has 25 years of hospital CEO experience in small to medium size hospitals. Mr. Edwards has lead teams to achieve top 100 Critical Access Hospital status in two hospitals, there are over 1,300 Critical Access Hospitals in the United States. MBA, with specialty in Health Care Administration, City University, Bellevue, WA 1989; BS, Respiratory Therapy, University of Central Arkansas, Conway, AR 1977.

Chief Financial Officer. Wade Sturgeon, Chief Financial Officer. Mr. Sturgeon has been with Mendocino Coast Health Care District since September of 2015. He started his career in hospital finance in 1997 and worked at three other hospitals, all small/rural Critical Access Hospitals as CFO prior to moving to California. Mr. Sturgeon has worked in California since 2011 in the capacity of CEO, COO and CFO. Mr. Sturgeon has an Associate's Degree in Accountancy from the College of Southern Idaho along with his Bachelors of Business Administration in Accountancy from Boise State University. In 2014, he graduated from the California Health Leadership College. Mr. Sturgeon is a member of the Healthcare Financial Management Association as well as the American College of Healthcare Executives.

District Employees

As of June 21, 2016, the District employed 228 full-time, 29 part-time and 54 per-diem personnel (253 full-time equivalent employees). The District has a collective bargaining agreement with Local 588 of the United Food and Commercial Workers Union representing all hourly employees. This contract expires on June 30, 2016. The District is currently in negotiations to renew this contract.

FACILITIES AND SERVICES

District Facilities

The District owns and operates Mendocino Coast Hospital (the “Hospital”), a 49-bed acute care facility licensed by the State of California Department of Public Health. The Hospital is located at 700 River Drive, in the City of Fort Bragg, which lies approximately 165 miles north of the City of San Francisco and approximately a fifty minute drive from the next closest hospital located in Willits, California. The Hospital opened in June of 1971, and was financed by the issuance of \$2,250,000 in general obligation bonds authorized at an election held in the District on December 5, 1967, and the receipt of a \$637,934 federal Hill-Burton grant in 1969. Pursuant to a 1991 Health and Human Services audit, the District’s Hill-Burton obligation has been deemed fulfilled. A 9,000 square foot addition to the Hospital was completed in 1994 and funded in part by revenue bonds issued in 1990 by the District. This addition contained a new emergency room and laboratory department. In 1996, the District issued revenue bonds to refund the 1990 revenue bonds and to finance radiology and surgery department improvements. In 2001, the District issued current interest general obligation bonds in the aggregate principal amount of \$4,615,000 and capital appreciation general obligation bonds in the aggregate principal amount of \$884,627.75 (collectively, the “Series 2001 General Obligation Bonds”). Proceeds of the Series 2001 General Obligation Bonds were used to finance the construction and equipping of the patient services building, which includes the rehabilitation department, patient registration, the hematology/oncology clinic, administrative offices for finance, and a conference room. In 2009, the District issued \$5,000,000 in revenue bonds to construct and equip an 8,000 square foot diagnostic imaging facility. In 2010, the District issued \$2,875,000 in revenue bonds to construct and equip a central plant for the Hospital and retrofit facilities for earthquake protection, among other capital improvement projects.

The Hospital was licensed for 52 acute beds until March 31, 2004, at which time the State Department of Public Health granted the Hospital a change in its licensed beds to 49 beds. Although the Hospital continues to be licensed for 49 beds (24 beds were placed in suspense), in October of 2006, the Hospital became a 25-bed Critical Access Hospital (“CAH”). A CAH is a hospital that is certified to receive cost-based reimbursement from Medicare. See “RISK FACTORS – Patient Services Revenues – Medicare Payments” in this Official Statement for a discussion of reimbursement from Medicare for Critical Access Hospitals.

The Hospital offers inpatient and outpatient services including respiratory care, ophthalmology, laboratory services, chemotherapy, oncology, radiology, cardiology, neurophysiology, obstetrics, physical therapy, outpatient surgery, nuclear medicine, CT scanning, home health, hospice care, ambulance service, and outpatient mobile magnetic resonance imaging. Fifteen of the Hospital’s acute care Medical/Surgical beds are licensed by the State Department of Public Health for utilization as swing beds for use as either acute care beds or as skilled nursing beds, as the need demands.

In 2007, the District purchased a local physician group and converted the practice into a provider-based rural health clinic. The purchase of the North Coast Family Health Center permits the District to maintain a continuity of care for primary care services in the community and provides an additional revenue source for the District. The North Coast Family Health Center is operated by the District as a department of the Hospital and offers primary care and specialty care services to the community.

The North Coast Family Health Center, a 95-210 rural health clinic, utilizes approximately 10,000 square feet of space available in the approximate 12,300 square foot Mendocino Coast Medical Plaza located on District property. The Mendocino Coast Medical Plaza is owned by a California Limited Liability Company formed for the purpose of constructing and managing the Mendocino Coast Medical Plaza building. Construction of the Mendocino Coast Medical Plaza building began in 2004 and was

completed in 2005. The Hospital and the North Coast Family Health Center are herein referred to as the Health Facilities.

The Hospital also has an active auxiliary consisting of approximately 48 volunteers who provide supplemental services to patients and District staff. The auxiliary also assists in fundraising efforts and has contributed funds to the District for equipment acquisitions. The auxiliary is not responsible for repayment of the Series 2016 Bonds.

Bed Complement

The Hospital has a combined licensed capacity of 49 beds. The current bed count for the Hospital, however, classified by service type, is as follows:

<u>Bed Service Type</u>	<u>Licensed Beds</u>
General Acute Care ⁽¹⁾⁽²⁾	14
Intensive Care	4
Perinatal (Obstetrics) ⁽²⁾	<u>7</u>
Total Licensed Beds	25

Source: State Department of Public Health license.

⁽¹⁾ Fifteen of the Hospital's general acute care beds are approved as swing beds for skilled nursing services. The swing bed designation allows the Hospital to utilize these fifteen beds for either acute care patients or skilled nursing patients, as demand requires.

⁽²⁾ Twenty general acute care beds and four perinatal beds have been suspended by the District.

Licensure, Accreditations and Memberships

The Hospital is licensed by the State Department of Public Health and accredited by The Joint Commission. The Hospital is inspected by the State and surveyed by The Joint Commission. The most recent accreditation review by The Joint Commission was completed on February 16, 2016, and is valid for up to 36 months.

The District is an eligible provider under Medicare, Medi-Cal, Blue Cross and other commercial insurance programs. The District holds memberships in the California Hospital Association, the Association of California Healthcare Districts, the American Hospital Association, the Hospital Council of Northern and Central California, and other professional healthcare organizations. The Hospital is designated as a CAH, is located in a health professional shortage area and has sole community provider status. The Hospital is also designated as a rural hospital.

The District has also established affiliation programs for clinical site training with the following schools and programs: the nursing program at California State University, Chico; the nursing and paramedic programs at Mendocino College in Ukiah; the radiology program at Santa Rosa Junior College; and the phlebotomy and emergency medical technician program at Mendocino County Office of Education.

Services

Core medical services along with other inpatient and outpatient specialty services are provided by the District at the site of the Health Facilities. Core services delivered by the District include medical, pediatrics, emergency medicine, imaging (radiology), laboratory and physical therapy. Specialty services

include inpatient and outpatient surgery, outpatient occupational and speech therapy, cardiac rehabilitation, obstetrics and an orthotics lab. Some of these services are described more fully below.

The Hospital provides primary care and certain secondary services, within the capability of its medical staff (family practice, general surgery and orthopedic surgery). Cases which require a medical specialty not represented by the Hospital's Medical Staff and cases that require technology not available at the Hospital are transferred to other health facilities located in Santa Rosa and San Francisco.

Emergency Department - The Emergency Department is staffed 24-hours a day by an experienced team of medical professionals. All Emergency Department physicians are certified in Advanced Cardiac Life Support ("ACLS"). Emergency Department registered nurses are assisted by Paramedics and Emergency Medical Technicians ("EMT"). Medical consultants are available on-call in various specialties such as gynecology, internal medicine, obstetrics, pathology, pediatrics, radiology, surgery, anesthesiology and ophthalmology.

ICU/CCU - The four-bed combination Intensive and Coronary Care Unit is designed to provide specialized care for critically ill or injured patients. The ICU/CCU Unit is staffed by registered nurses who have completed the specialized education and technical training required for the care of these patients. The unit is equipped with sophisticated life-support equipment, as well as current medical technology which allows physicians and nurses to monitor continuously all vital signs (blood pressure, temperature, heart rate, etc.). The unit also has telemetry services which enable Hospital staff to monitor cardiac functions for an additional four patients in the Medical/Surgical unit.

Obstetrics (perinatal) - The Hospital's Obstetrical Unit was one of the first in-house, family-centered maternity care programs in California. The Obstetrical Unit includes labor, delivery and recovery services, plus a four-bed nursery with facilities for immediate care, stabilization and transport for critically ill newborns.

Medical/Surgical - The Medical/Surgical Unit provides care for both medical patients and patients hospitalized under any of the specialty surgical services offered at the Hospital, such as general surgery and orthopedic surgery. In addition, a designated pediatric area is available to provide medical and surgical care to infants and children. The medical/surgical area is staffed by registered nurses, and certified nursing assistants.

Swing Bed Program - Fifteen of the Hospital's acute care beds are licensed by the State for utilization as skilled nursing beds. The Swing Bed Program allows patients whose medical condition has stabilized to remain in the Hospital if they still require skilled nursing services. Such services may include physical therapy, occupational therapy, speech therapy, respiratory therapy, IV therapy, and/or other skilled nursing services.

Inpatient and Outpatient Surgical Services - Surgery facilities at the Hospital consist of two operating rooms and a three-bed post anesthesia recovery unit. The Hospital offers a wide variety of surgical services and has the equipment and expertise to perform gynecological and general surgery via the laparoscope, and advanced orthopedic procedures via the arthroscope. The Hospital's Ambulatory Surgical Service allows patients to have surgery and return home on the same day. This service is located within the surgical suites of the Hospital, providing immediate access to support services such as radiology and laboratory.

Laboratory - The Laboratory Department provides clinical laboratory, medicine, pathology and transfusion services. Under the supervision of a physician pathologist, the Clinical and Pathology

Laboratories allow for a wide variety of tests to assist doctors in diagnosis and treatment. Over 95% of requested tests are performed in-house, reducing delays in reporting results.

Outpatient Services - In addition to outpatient surgical services, the Hospital provides treatment for patients receiving chemotherapy, blood transfusions, diagnostic clinical studies including endoscopic exam and biopsy, and other specialized treatments or procedures.

Radiology X-Ray - The Radiology Department has the only fast high resolution CT scanning equipment on the Mendocino Coast between San Francisco and Eureka. The Hospital's State licensed mammography program provides a follow-up reminder and monitoring service. Other services provided by the department include ultrasonography, diagnostic X-ray, MRI, and nuclear medicine modalities. The tele-radiology system allows images to be transferred via telephone lines to other hospitals for consultation. Together these services eliminate the need to refer patients out of the area for anything other than specialized services provided by large medical centers.

Respiratory Care - The Respiratory Care Department has a pulmonary diagnostic lab and participates in all phases of respiratory therapy from the simplest aerosol treatment to continuous artificial ventilation.

Cardiology - In addition to standard cardiographic services, the Hospital's Cardiology Department has a cardiac stress lab and specializes in echocardiography for non-invasive cardiac evaluation, Holter monitoring and 24-hour blood pressure monitoring.

Physical Therapy - The Physical Therapy Department provides inpatient as well as outpatient treatment. In addition to all standard physical therapy treatments, such as neurological, orthopedic and sports rehabilitations, the Physical Therapy Department is equipped with all physical and electrical modalities.

Occupational Therapy - The Occupational Therapy Department provides services to both inpatients and outpatients who have a wide variety of neurological and orthopedic disorders. Treatment focuses on increasing independence in activities of daily living. In addition to all standard treatment modalities, home evaluations are provided to ease the transition between hospital and home by identifying equipment needs and addressing safety issues. In addition to rehabilitation services, a hand treatment program provides comprehensive treatment modalities including static and dynamic splinting of the injured hand.

Speech Pathology - The Speech Pathology Department, state licensed for inpatients and outpatients, provides assessment and treatment of speech, language, cognition and swallowing disorders. Therapists are certified by the American Speech, Language and Hearing Association. Specialized exercises and compensatory strategies assist patients in reaching their maximum potential for both rehabilitation or habilitation of a communication or swallowing disorder. Videofluoroscopic swallowing exams are used to assess specific swallowing disorders and define treatment strategies. Therapy is coordinated with rehabilitation team members enhancing a trans-disciplinary approach.

Hematology/Oncology - The Hospital based Hematology-Oncology-Infusion Clinic opened in the spring of 2006. The clinic specializes in hematology and oncology, treating patients with blood diseases and a wide variety of cancers. The professional team consists of registered nurses specially trained in cancer and infusion therapy as well as a physician who is board certified as a diplomat of the American Board of Internal Medicine, a fellow of the American Board of Hospital Physicians and certified by the American Board of Ethical Physicians.

Pharmacy - The Pharmacy Department serves both inpatients and outpatients. It provides medications to inpatients through a unit dose distribution system, automated dispensing cabinets and a centralized IV admixture program. The Hospital has instituted interim measures to achieve compliance with the requirements of USP 797 with respect to pharmaceutical compounding -- sterile preparations.

Outpatient services include the provision of chemotherapy, IV admixtures and clinical support in the Outpatient Surgery Department and the on-site Hematology-Oncology-Infusion Clinic. Pharmacists provide on-site and on-call support to nurses and physicians by providing drug information, drug selection and dosing calculation assistance, and patient monitoring through established protocols designed to provide patients with optimal drug therapy.

Nutrition Department - The District's Nutrition Department is dedicated to providing nutritious, tasteful and attractive meals to aid in the healing process of patients. A registered dietician provides inpatient nutrition counseling. Individual outpatient instruction is available with a physician's referral.

Home Health Care Program - Under the direction of a referring physician, the home care program provides skilled healthcare and social services to the patient and family in familiar and comfortable surroundings. The home care team promotes family integrity and independence by teaching families the skills they need to care for the home patient. The Home Health service area extends from Westport to Sea Ranch. All referrals and communications are received through the Fort Bragg Home Health office.

Hospice Program - Hospice care responds to the special needs of the terminally ill patient. Hospice is a coordinated program of palliative and supportive care (physical, psychological, social, and spiritual) for dying persons and their families. Services are provided by an interdisciplinary team of professionals and volunteers.

Ambulance Service - The Hospital is designated as a "base hospital." It monitors local and county-wide emergency radio channels and can dispatch two advanced life support ambulances to any location in the District.

Outpatient Clinic (North Coast Family Health Center) - The North Coast Family Health Center offers primary care and specialty care services to the community, including family practice, internal medicine, women's health, general medicine, endocrinology, orthopedics, osteopathy, podiatry, pediatrics, diabetes education, bone densitometry, pacemaker checks and spinal adjustments.

MEDICAL STAFF

The medical staff of the Hospital is comprised of physicians and allied health professionals. A Chief of Staff oversees the physicians at the Hospital and his biography is provided below.

John Kermen, D.O., Chief of Staff. Dr. Kermen is the Hospital's Medical Director of Anesthesiology Service. Dr. Kermen has practiced at the Hospital since October 1995 and has served as Chief of the Medical Staff for a cumulative ten years. Prior to practicing at the Hospital, Dr. Kermen practiced at a number of other hospitals, including the University of Arizona Medical Center, Cuyahoga Falls General Hospital, Michigan Capital Medical Center, Akron Children's Hospital and the Cleveland Clinic Foundation. Dr. Kermen received his Doctor of Osteopathy from Ohio University College of Osteopathic Medicine, where he also completed his residency in anesthesiology.

Hospital Medical Staff

As of June 21, 2016, the medical staff of the Hospital consisted of 77 physicians, including 41 active staff, 7 affiliate staff and 26 provisional staff. The average age and tenure of the active medical staff at the Hospital is 61 years and 16 years, respectively. Approximately 100% of the Hospital's active medical staff is board certified. The active staff, affiliate staff and provisional staff designations are described below.

Active Staff. Appointees to this category must have served on the medical staff for one year, be involved in 25 patient contacts, which is defined as an inpatient admission, consultation, outpatient surgical procedure, or have faithfully served on a medical staff committee at the Hospital for a two-year period. If an appointee to the active staff category does not meet the qualifications for reappointment to the active staff category, and if the appointee is otherwise abiding by all bylaws, rules, regulations and policies of the staff, the appointee may be appointed to the affiliate staff category. Appointees to this category may exercise such clinical privileges as are granted by the Board, vote on all matters presented by the medical staff and by the appropriate department and committee of which he or she is a member, and hold office and sit on or be the chairperson of any committee, unless otherwise specified in the District's bylaws. Appointees to this category must contribute to the organizational and administrative affairs of the medical staff; actively participate in recognized functions of the staff appointment including quality/performance improvement, risk management and monitoring activities, including monitoring of new appointees during the provisional period and in discharging other staff functions as may be required from time to time; and fulfill any meeting attendance requirements as established by the medical staff.

Affiliate Staff. The affiliate category is reserved for practitioners who do not meet the eligibility requirements for the active staff category or choose not to pursue active staff status. Practitioners assigned to this category must be involved in 25 patient contacts, which is defined as an inpatient admission, consultation, outpatient surgical procedure and/or an outpatient ancillary referral at the Hospital for a two-year period, except as expressly waived for practitioners with at least ten years of services in the affiliate category or for those practitioners who document their efforts to support the Hospital's patient care mission to the satisfaction of the Medical Executive Committee and the Board. Appointees to this category may exercise such clinical privileges as are granted by the Board and attend meetings of the staff and department of which he or she is an appointee and any staff or Hospital education programs. Appointees to this category must assist the Hospital in the fulfillment of its mission.

Provisional Staff. The provisional staff category consists of physicians newly appointed to the medical staff. Except as otherwise provided, the members of the provisional staff are entitled to admit patients and exercise certain clinical privileges and attend meetings of the medical staff and the department of which that person is a member, including open committee meetings and educational programs, but have no right to vote at such meetings, except within committees when the right to vote is specified at the time of appointment. Members of the provisional staff are not eligible to hold office in the medical staff organization but may serve upon committees. All members of the provisional staff must undergo a period of observation.

The table below summarizes the age distribution of active medical staff physicians who provided patient care for the Hospital during the fiscal year ended June 30, 2015:

<u>Age Distribution</u>	<u>Number</u>	<u>Percent</u>
35-40	11	14.2%
41-50	14	18.2
51-60	28	36.4
61-70	19	24.7
71-80	4	5.2
80+	<u>1</u>	<u>1.3</u>
Total	77	100.0

Source: The District.

Hospitalist Program

In November 2001, a contract between the District and a local medical group was approved to implement a hospitalist program at the Hospital. The hospitalist program is part of a well-established practice of using physician specialists for the care and treatment of patients in the Hospital. Hospitalists are hospital-based physicians with no outpatient office practice who specialize in treating inpatients. Each hospitalist works as a member of the patient care team to ensure patients receive a continuity of care and maintains communication with the primary care physician of each patient. The program was initially managed and staffed by a local medical group. In 2005, the District took over management of the program and the District implemented a full-time hospitalist program in 2006. The program provides 24-hour coverage to patients admitted to the Hospital. These include unassigned patients, patients admitted through the Emergency Department and also admitted patients who have primary care and sub-specialty physicians in the area.

SERVICE AREA AND COMPETITION

Service Area

The Hospital serves an area that encompasses the coastal corridor from Elk to Westport in Mendocino County, California (the “County”). The Hospital is located on the north coast of the State, approximately 165 miles north of San Francisco. The District is the sole provider of hospital services for the region, providing emergency and primary care, and assisting with preventive and rehabilitative services.

Employment

The service area’s economic base is changing. Tourism provides the highest percentage of employment of all other employment categories followed by retail, health services and construction. As of April 2016, the unemployment rate was 4% in Fort Bragg and 5.2% in Mendocino. (Source: State of California Employment Development Department.)

Competition

The closest competitor to the Hospital is approximately a fifty minute drive from the Hospital. Existing and potential competitors may not be subject to various regulations and restrictions applicable to the District; consequently, these competitors may be more flexible in their ability to adapt to competitive opportunities and risks. If these competitors and any future competitors not currently anticipated or

prevalent are successful, some of the most profitable aspects of healthcare operations may be stripped away and/or overall utilization may decline.

OPERATION AND UTILIZATION DATA

Sources of Revenue

Payments on behalf of certain patients are made to the District by commercial insurance carriers, private payors, the federal government under the Medicare program, and by the State and federal government under the Medicaid program known as Medi-Cal in California. The following table shows the District's percentage of gross revenues for the District by source of payment for the fiscal years ended June 30, 2013, 2014 and 2015.

<u>Payor</u>	<u>Fiscal Years Ended June 30,</u>		
	<u>2013</u>	<u>2014</u>	<u>2015</u>
Medicare	\$51,674,439.93	\$49,338,314.34	\$52,803,068.62
Medi-Cal	20,995,069.65	20,094,338.77	21,836,846.65
Commercial Insurance	16,828,399.40	16,335,953.01	16,983,124.55
Other	<u>2,672,640.95</u>	<u>2,853,512.78</u>	<u>2,042,512.13</u>
Total	\$92,170,549.93	\$88,622,118.90	\$93,665,551.95
Medicare	56.06%	55.67%	56.37%
Medi-Cal	22.78	22.67	23.31
Commercial Insurance	18.26	18.43	18.13
Other	2.90	3.22	2.18

Source: Internal District Data.

Description of Medicare, Medicaid and Private Payor Reimbursement

Medicare

Prior to converting the Hospital to a CAH, inpatient services rendered by the District to Medicare program beneficiaries were paid at prospectively determined rates per discharge. These rates varied according to a patient classification system that was based on clinical, diagnostic and other factors. Outpatient services were paid based on prospectively determined fee-scale rates as defined and limited by the Medicare program.

In 2006, the Hospital was designated as a CAH. Currently, the District is reimbursed by Medicare for inpatient and most outpatient services provided to Medicare patients on a cost basis as defined and limited by the Medicare program. The Medicare program's administrative procedures allow final determination of amounts due to the District for such services three years after the District's cost reports are audited or otherwise reviewed and settled by the Medicare intermediary. The District's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the District.

In July 2007, the District became the owner of the North Coast Family Health Center. North Coast Family Health Center is recognized by Medicare as a provider-based rural health clinic and is reimbursed on a cost-per-visit basis.

California Medicaid (Medi-Cal)

Payments for inpatient services rendered to Medi-Cal (non-managed care) patients were made based on reasonable costs through December 31, 2014. Effective January 1, 2015, the State of California's Medi-Cal program changed inpatient reimbursement to Diagnosis-Related Groups ("DRG"), similar to the Medicare inpatient payment methodology. Outpatient payments continue to be paid on pre-determined charge screens. The District is paid for cost-based inpatient services at an interim rate with final settlement determined after submission of annual cost reports and audits thereof by Medi-Cal. Medi-Cal rural health care clinic services are paid on a per patient services rate established by the State from a base-year cost report submitted by the District and audited by the State and are no longer subject to cost reimbursement. Medi-Cal Home Health and managed care services are paid on pre-determined rates and are not subject to cost reimbursement.

Other Payors

The District has entered into payment agreements with certain commercial insurance carriers and preferred provider organizations, including Blue Cross, Blue Shield and United Health Care. The basis for payments to the District on these agreements is an average 30% discount off charges. The District has no HMO or risk-based contracts.

See "RISK FACTORS – Patient Services Revenues" in this Official Statement for a more detailed discussion of patient service revenues received from Medicare, Medicaid and other payors.

Health Facilities Utilization Statistics

The table below presents selected statistical indicators of inpatient and outpatient activity at the Hospital during the past three fiscal years ended June 30, 2013, 2014 and 2015.

	<u>Fiscal Years Ended June 30,</u>		
	<u>2013</u>	<u>2014</u>	<u>2015</u>
Licensed Beds*	49	49	49
Critical Access Licensed Beds	25	25	25
Admissions	1,226	1,188	1,278
Total Deliveries	163	141	126
Inpatient Days	5,276	4,494	4,790
Total Newborn Days	299	254	266
Average Length of Stay in Days	4.3	3.7	4.0
Occupancy Rate (%) (based on 25 beds)*	57.8	49.2	52.5
Emergency Visits	9,525	9,469	10,199
OP Encounters	52,139	51,255	55,061
Clinic Visits	26,649	25,873	31,107
Home Health Visits	5,275	4,635	4,635

Source: The District.

* The Hospital is currently licensed for 49 beds but as a CM-1, uses only 25 licensed beds with 24 beds in suspense.

OUTSTANDING INDEBTEDNESS

The District has one general obligation bond issues outstanding and three revenue bond issues outstanding.

On May 9, 2001, the District issued its (i) Mendocino Coast Health Care District, Mendocino County, California, Election of 2000 General Obligation Bonds (Current Interest Bonds) (Bank Qualified) in the original aggregate principal amount of \$4,615,000, with a final maturity of August 1, 2030, and (ii) Mendocino Coast Health Care District, Mendocino County, California Election of 2000 General Obligation Bonds (Capital Appreciation Bonds) (Bank Qualified) in the original aggregate principal amount of \$884,627.75, with a final maturity of August 1, 2017. The Series 2001 General Obligation Bonds are general obligations of the District to which the District has pledged its full faith and credit and unlimited taxing power.

The District issued \$2,875,000 in revenue bonds in 2010 that are insured by the Cal-Mortgage program and are currently outstanding in the aggregate principal amount of \$2,140,000. The final maturity of the Series 2010 Bonds is February 1, 2029. A portion of the Series 2010 Bonds will be refunded with a portion of the proceeds of the Series 2016 Bonds.

The District issued \$5,000,000 in revenue bonds in 2009 that are insured by the Cal-Mortgage program and are currently outstanding in the aggregate principal amount of \$3,835,000. The final maturity of the Series 2009 Bonds is February 1, 2029. A portion of the Series 2009 Bonds will be refunded with a portion of the proceeds of the Series 2016 Bonds.

The District issued \$4,030,000 in revenue bonds in 1996 that are insured by the Cal-Mortgage program and are currently outstanding in the aggregate principal amount of \$1,095,000. The final maturity of the Series 1996 Bonds is February 1, 2020. A portion of the Series 1996 Bonds will be refunded with a portion of the proceeds of the Series 2016 Bonds.

The District borrowed funds in the amount of \$2,100,000 from UHC (the "UHC Note") secured by a deed of trust under a program established to finance certain EMR conversion and installation required by CMS. This obligation is subordinate to the Series 2016 Bonds and other Parity Debt. The note carries an interest rate of 4.0% and the principal payments are scheduled to coincide with both federal and State reimbursement payments to the District over the meaningful use program life.

In addition, the District borrowed a total of \$1,005,806 from Cal-Mortgage to replace a line of credit with a bank in the amount of \$1,000,000 during fiscal year ended June 30, 2013. This obligation is on a parity with the Series 2016 Bonds and other Parity Debt. This was done to help facilitate the District's bankruptcy filing. The District also has two notes payable to equipment financing companies totaling \$501,371 at June 30, 2015. These notes were used to purchase certain pieces of medical equipment. The notes carry interest at rates from 6.35% to 7.09%. Principal and interest payments are due monthly through 2017. The District has a note payable to CMS related to a settlement for a self-reported Stark Law violation. The settlement was for \$400,000, carries interest at 5.0%, with principal and interest payments due monthly through 2018. The balance of the note payable to CMS was \$132,046 at June 30, 2015.

Following the issuance of the Series 2016 Bonds, the pledge of the District's Gross Revenues to the payment of the Series 2016 Bonds will be on a parity with the District's pledge of its Gross Revenues to the payment of the remaining outstanding Series 2009 Bonds, Series 2010 Bonds, if any, and any

additional parity debt issued by the District in the future in compliance with the provisions of the Regulatory Agreement and the Indenture. The Series 2001 General Obligation Bonds are not secured by the District's Gross Revenues.

FINANCIAL INFORMATION

The following is a summary of certain financial information of the District for each of the three fiscal years ended June 30, 2013, 2014 and 2015. This information has been derived from the audited financial statements of the District. These summaries should be read in conjunction with the audited financial statements for the fiscal years ended June 30, 2014 and 2015, and notes thereto included in Appendix B of this Official Statement.

The summaries of statements of revenue, expenses and changes in net assets have been obtained from unaudited financial statements of the District. These financial statements have been prepared in accordance with generally accepted accounting principles on a basis consistent with the accounting policies reflected in the audited financial statements of the District presented below.

They do not, however, include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of District management, the unaudited financial statements reflect all significant adjustments (which are of a normal, recurring nature) necessary for a fair presentation of the results for the interim periods presented. Operating results for the interim periods presented are not necessarily indicative of the results that may be expected for any other interim period or for the year as a whole.

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Summary Statement of Revenue and Expenses:

	Fiscal Years Ended June 30,		
	2013	2014	2015
	(audited)	(audited)	(audited)
Operating Revenues:			
Net Patient Service Revenue	\$42,937,651	\$44,228,194	\$45,353,121
Other Operating Revenue	<u>801,241</u>	<u>382,780</u>	<u>1,927,929</u>
Total Operating Revenues	\$43,738,892	\$44,610,974	\$47,281,050
Operating Expenses:			
Salaries & Wages	\$15,886,108	\$14,346,253	\$15,781,501
Employee Benefits	9,629,811	8,833,023	9,316,891
Registry	949,115	1,593,059	2,632,005
Professional Fees	6,111,179	6,150,027	7,289,015
Purchased Services	6,771,742	6,452,678	7,393,028
Supplies	1,378,305	1,424,145	1,498,363
Repairs & Maintenance	878,348	883,220	971,773
Utilities	650,951	758,496	740,714
Lease/Rental	977,799	490,845	632,403
Depreciation & Amortization	705,463	682,568	594,097
Insurance	1,836,350	2,458,665	2,535,214
Other Expense	<u>1,177,467</u>	<u>897,719</u>	<u>1,932,544</u>
Total Operating Expenses	<u>\$46,952,638</u>	<u>\$44,970,698</u>	<u>\$51,317,548</u>
Operating Income (Loss)	(3,213,746)	(359,724)	(4,036,498)
Non-Operating Revenues:			
District Tax Revenues	1,136,279	1,121,434	1,116,211
Investment Income	15,830	11,111	11,599
Interest Expense	(844,742)	(897,002)	(789,383)
Grants and Contributions	<u>361,277</u>	<u>668,287</u>	<u>298,207</u>
Other Non-Operating Income (expenses)		-	<u>2,683</u>
Total Non-Operating Revenue (expenses)	<u>\$ 668,644</u>	<u>\$ 903,830</u>	<u>\$ 639,317</u>
Excess of Revenues (expenses)	<u>-</u>	<u>544,106</u>	<u>(3,397,181)</u>
Other increases in net position	<u>(2,044,828)</u>	<u>476,801</u>	<u>1,588,546</u>
Increase (decrease) in net position	<u>(2,545,102)</u>	<u>1,020,907</u>	<u>(1,808,635)</u>
Net position, beginning of the year	<u>7,770,101</u>	<u>6,958,093</u>	<u>7,979,000</u>
Net position, end of the year	<u>\$7,269,827</u>	<u>\$7,979,000</u>	<u>\$6,170,365</u>

Source: Audited financial statements of the District for the fiscal years ended June 30, 2013, 2014 and 2015.

Unaudited Fiscal Year-to-date actual Net Patient Service Revenue through May 2016 was \$46,882,194 and unaudited Other Operating Revenue was \$1,959,121 for the same period. Total unaudited Operating Expenses were \$47,860,098 for the same period. The District reported that as of

May 2016 it was operating within its financial covenants with 48.38 day's cash on hand and a debt service coverage ratio of 4.20.

Concentration of Credit Risk

The District grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patient and third-party payors at June 30, 2013, 2014 and 2015, was as follows:

	<u>Fiscal Years Ended June 30,</u>		
	<u>2013</u>	<u>2014</u>	<u>2015</u>
	<u>audited</u>	<u>(audited)</u>	<u>(audited)</u>
Medicare	\$ 2,889,534	\$ 3,174,192	\$ 4,019,400
Medi-Cal	2,309,831	2,344,976	2,334,213
Commercial and Other Third-party Payors	3,104,932	3,444,343	2,916,943
Private Pay and Other	2,470,667	1,167,358	2,135,161
Total Gross Patient Accounts Receivable	\$10,774,964	\$10,130,869	\$11,405,717
Less Allowances for contractual adjustments and bad debts	<u>(7,420,000)</u>	<u>(6,875,000)</u>	<u>(7,568,248)</u>
Net Patient Accounts Receivable	<u>\$3,354,964</u>	<u>\$3,255,869</u>	<u>\$3,837,469</u>

Source: District's audited financial statements for the fiscal years ended June 30, 2013, 2014 and 2015.

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Compliance Issues

Through its compliance program, the District identified certain situations that raised potential issues with respect to compliance with the strict requirements of the Stark Law and the corresponding regulations. The issues included missing signatures on agreements, operating under agreements after their stated expirations and other technical issues. The District's investigation showed little or no benefit to physicians and no inappropriate costs to any governmental entity as a result of these technical violations. The District self-disclosed these issues to CMS in 2013, utilizing the Self-Referral Protocol issued by CMS in September 2010. As required by the Self-Referral Disclosure Protocol, the District informed CMS that the estimated value of the physician referrals potentially affected by the matters identified in the self-disclosure is approximately \$11,555,000. Because there is little precedent with CMS's settlement of matters disclosed by hospitals under the Self-Referral Disclosure Protocol, the ultimate outcome was difficult to estimate. The District management negotiated aggressively with CMS and was able to reach a settlement in early 2015. CMS imposed a \$210,000 fine for the self-disclosed non-compliance issues, payable in monthly installments through 2017 with interest at 5.0%. The balance owed to CMS as of June 30, 2015 was \$132,046.

Insurance and Litigation

The District currently has property insurance through Alliant Insurance Services in the amount of \$1,000,000,000 per occurrence, which includes certain specified coverage for structures (real property), contents (personal property) and business interruption. The District currently has general and professional liability insurance in the amount of \$10,000,000 per claim and automobile liability insurance in the amount of \$2,000,000 per accident through Beta Healthcare Group Risk Management Authority. The

District also currently has a Flood Loss Limit policy in the amount of \$15,000,000 per occurrence. The District also purchases policies covering directors' and officers' liability in amounts that the District believes to be customary for institutions of its size and character. The District has limited earthquake insurance. The insurance coverage the District currently has may change in the future.

It is not unusual for healthcare organizations to have multiple medical legal inquiries and claims in today's litigious environment. The District believes that it has ample insurance coverage that is appropriate for its size and scope of services. The District maintains a proactive risk management philosophy and vigorously defends itself against any medical legal claim.

At this time, the District has no pending or threatened litigation claims that are expected to be outside insurance coverage limits.

Investment Policies

The District's investments are made pursuant to a recently revised Board Investment Policy. The objective of the investment policy is to preserve investment principal, assure financial liquidity, and maximize investment income consistent with the need for safety of principal. The District invests only in fixed income securities of a quality that makes them readily liquid. Any securities transactions not specifically authorized by the Board Investment Policy are excluded, unless approved, in writing, by the Board. As of July 1, 2016, the District's cash on hand is invested in the Local Agency Investment Fund (LAIF), a money market fund established by the State of California, which allows local agencies to pool their investment resources. Pursuant to the Board Investment Policy, the District may also invest in U.S. Treasury Bills, U.S. Treasury Notes, U.S. Treasury Bonds, U.S. Government Agencies, certificates of deposit, mutual funds and money market mutual funds as expressly approved by the Board. Eligible investment alternatives for the District are also limited by California Government Code sections that allow only high-grade fixed income securities or fixed income securities collateralized up to 110% with government securities.

Charity Care

The District accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the District. Essentially, these policies define charity services as those services for which no payment is anticipated. Because the District does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenues. Services provided are recorded as gross patient service revenues and then written off entirely as an adjustment to net patient service revenues.

Employees' Retirement Plan

The District provides retirement benefits for substantially all of its employees under a District administered noncontributory, defined contribution pension plan. Assets of the plan consist of a group annuity contract. The District's annual contribution to the plan is approximately 6.00% of qualified employee earnings. The total pension expense for the fiscal years ended June 30, 2015, 2014 and 2013, were \$938,651, \$682,691 and \$1,011,695, respectively.

Certain employees have elected to participate in a District sponsored deferred compensation plan. The plan provides for payment of the value of each participant's account at retirement or separation from service. Investments of participant contributions consist of mutual funds and guaranteed fixed income contracts, and are the property of the District. The District has recorded a liability to participants for deferred compensation equal to the amount of assets invested, including income accrued thereon.

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APPENDIX B

**AUDITED FINANCIAL STATEMENTS FOR THE DISTRICT FOR THE
FISCAL YEARS ENDED 2014 AND 2015**

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Report of Independent Auditors
And Financial Statements

MENDOCINO COAST DISTRICT HOSPITAL

June 30, 2015 & 2014

JWT & Associates, LLP
Certified Public Accountants

MENDOCINO COAST DISTRICT HOSPITAL

Audited Financial Statements

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JWT & Associates, LLP

Certified Public Accountants

1111 East Herndon, Suite 211, Fresno, California 93720
Voice: (559) 431-7708 Fax: (559) 431-7685

Report of Independent Auditors

The Board of Directors
Mendocino Coast District Hospital
Fort Bragg, California

Report on the Financial Statements

We have audited the accompanying financial statements of Mendocino Coast District Hospital (the District) as of June 30, 2015 which comprise the statement of net position as of June 30, 2015 and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States and in accordance with the State Controller's Minimum Audit Requirements for Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the 2015 financial statements referred to above present fairly, in all material respects, the financial position of the District at June 30, 2015, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Other Matters

The financial statements of the District as of June 30, 2015, were audited by TCA Partners, LLP, who merged into JWT & Associates, LLP as of February 1, 2015. TCA Partners, LLP's report dated November 19, 2015, expressed an unmodified opinion on those statements.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 be presented to supplement the financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management regarding the methods of preparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

JWT & Associates, LLP

Fresno, California
February 25, 2016

MENDOCINO COAST DISTRICT HOSPITAL

Management's Discussion and Analysis

June 30, 2015

The management of Mendocino Coast Health Care District (the District), dba as Mendocino Coast District Hospital, (the Hospital) has prepared this annual discussion and analysis in order to provide an overview of the Hospital's performance for the fiscal year ended June 30, 2015 in accordance with the Governmental Accounting Standards Board Statement No. 34, *Basic Financials Statements; Management's Discussion and Analysis for State and Local Governments*. The intent of this document is to provide additional information on the Hospital's historical financial performance as a whole in addition to providing a prospective look at revenue growth, operating expenses, and capital development plans. This discussion should be reviewed in conjunction with the audited financial statements for the fiscal year ended June 30, 2015 and accompanying notes to the financial statements to enhance one's understanding of the Hospital's financial performance.

Financial Summary

- Total assets decreased by \$2,332,647 from the fiscal year ended June 30, 2014.
- Total cash and cash equivalents for operations increased by \$45,638 over the prior year. Capital assets decreased by a net \$1,288,895 over the prior year.
- Net patient accounts receivable increased by \$526,964 as collections stayed at relatively the same level as compared to the prior year. Net days in patient accounts receivable were 29.05 at June 30, 2015 as compared to 26.99 at June 30, 2014
- Current liabilities increased by \$677,540 from the prior fiscal year.
- Long-term debt decreased in 2015 by a \$1,235,547.
- Net position decreased \$1,808,635 for 2015 as compared to an increase of \$1,020,907 for the prior fiscal year.
- The Debt Service Coverage Ratio was 1.61 for 2015 as compared to 2.33 for 2014.

Cash and Investments

For the fiscal year ended June 30, 2015, the Hospital's operating cash and cash equivalents and board designated cash and cash equivalents totaled \$5,338,232 as compared to \$6,577,093 in fiscal year 2014. At June 30, 2015, days cash on hand was 40.60 as compared to the prior year of 57.25. The majority of the Hospital's cash is deposited with local banks and in short-term money market accounts to maintain liquidity.

MENDOCINO COAST DISTRICT HOSPITAL

Management's Discussion and Analysis

June 30, 2015

Current Liabilities

As previously noted, current liabilities of the Hospital increased by \$667,540. The significant changes were related to increases in accounts payable of \$276,374, and increases in accrued payroll and related liabilities of \$430,657.

Capital Assets

During the year, the Hospital reinvested into the facility a net \$1,503,572 in building remodels and equipment, while disposing of \$297,109 in equipment. Major additions were: (1) a central plant building; (2) a chiller and (3) a boiler. Various equipment purchases also occurred. Depreciation for the year was \$2,511,464.

Volumes

- Total acute patient days were 3,302 for fiscal year 2015 as compared to 3,247 for the prior year. Swing bed care days were 1,488 for 2015 as compared to 1,247 for 2014. This increase was due to more patients medically qualifying for sub-acute level of care.
- The Emergency Department visits increased to 10,199 for June 30, 2015 from 9,469 for June 30, 2014.
- Average acute care length of stay decreased to 3.12 in 2015 from 3.23 in 2014 due to better efficiencies in patient care utilization and case management and continued lower case mix index.
- Outpatient referral visits increased to 55,061 in 2015 from 51,255 in the prior year due to moderate increases in patient activity in a few of the outpatient departments along with a 17% increase in our Rural Health Clinic visits.
- Total inpatient and outpatient surgeries decreased to 1,538 in 2015 from 1,618 in the prior year. Surgeries decreased due to fewer outpatient and inpatient cases.
- Home health visits remained at 4,635 in 2015 unchanged from 4,635 in the prior year.
- Rural health clinic visits increased to 31,107 in 2015 from 25,873 in the prior year. Visits increased by 5,234 due to an increase in available staff for family nurse practitioners and physicians at the North Coast Family Health Center.

MENDOCINO COAST DISTRICT HOSPITAL

Management's Discussion and Analysis

June 30, 2015

Gross Patient Charges

The Hospital charges all its patients equally based on its established pricing structure for the services rendered. The charge master is evaluated on an ongoing basis to ensure that all only allowable charges are billed to comply with Medicare and Medi-Cal regulations. Gross patient revenues increased by \$6,417,714 due mainly to volume changes already discussed.

Deductions from Revenue

Deductions from revenue are deductions based on the difference between (1) gross charges and the contractually agreed upon rates of reimbursement with third party government-based programs such as Medicare and Medi-Cal and other third party payors such as Blue Cross, and (2) provisions for bad debts on self-pay financial classes.

Deductions from revenue (as a percentage of gross patient service charges) were 53.76% for fiscal year 2015 as compared to 52.95% for fiscal year 2014. The deductions from revenue remained fairly consistent from the prior year with some reimbursement and supplemental program changes coupled with changes in third party settlements.

Net Patient Service Revenues

Net patient service revenues are the resulting difference between gross patient charges and the deductions from revenue. Net patient service revenues increased by \$1,124,927 in fiscal year 2015 over the prior year. This was primarily due to increases in patient volumes.

Operating Expenses

Total operating expenses were \$51,137,548 for fiscal year 2015 as compared to \$44,970,698 for fiscal year 2014. The following changes were noteworthy:

- A \$1,919,116 increase in salaries, wages and benefits due mainly to an increase in FTE's from 243.52 FTE's in 2014 to 267.77 in 2015. Staffing growth mainly comprised of need due to increased patient volumes.
- An increase of \$1,038,946 in registry due mainly to the increase in patient volumes.
- An increase of \$940,350 in supplies due mainly to the increase in patient volumes.
- An increase of \$76,549 in depreciation and amortization due aging of assets.
- A \$141,558 increase in building rents and leases.

MENDOCINO COAST DISTRICT HOSPITAL

Management's Discussion and Analysis

June 30, 2015

- An increase of \$1,034,825 in other operating expenses due to deferred expenses and volume increases.
- Other increases and decreases in expenses were considered fairly minor from one year to the other.

Other Issues

As a result of a number of financial pressures, in October, 2012, the Hospital filed for Bankruptcy for protection under Chapter 9 (the "Bankruptcy Filing") of Title 11 of the United States Code (the "Bankruptcy Code"). The approximate amount of pre-bankruptcy debt was \$1,991,000. The Hospital exited Bankruptcy in April 2015 with a net gain due to removal of debt of \$1,186,068.

Economic Factors and Next Fiscal Year's Budget

The Hospital's Board approved the fiscal year June 30, 2016 budget at a recent Board meeting. For fiscal year 2016, the Hospital has budgeted a net loss of \$13,804. The significant contributing factors to this budgeted net loss are:

- Gross patient service revenues were budgeted to be \$102,117,514 and are projected to increase slightly from the fiscal 2015 year due to projected increases in patient volumes.
- Net patient service revenues were budgeted to be \$48,012,896 and are projected to be, again, slightly higher than the fiscal 2015 year due to projected increases in patient volumes.
- Total operating expenses are expected to be \$51,848,280 and are projected to increase from the fiscal 2015 year, due to projected increases salaries and benefits.
- Other increases in net position were budgeted and are considered minor.

MENDOCINO COAST DISTRICT HOSPITAL

Statements of Net Position

June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Assets		
Current Assets		
Cash and cash equivalents	\$ 1,392,104	\$ 1,346,466
Patient accounts receivable, net of allowances	3,797,978	3,271,014
Other receivables	191,561	225,994
Assets whose use is limited	1,244,442	1,977,037
Third-party payor settlements	125,223	156,592
Supplies	783,107	651,983
Prepaid expenses and deposits	706,453	992,286
Total current assets	<u>8,240,868</u>	<u>8,621,372</u>
Assets whose use is limited, less current portion	4,553,327	5,192,825
Capital assets, net of accumulated depreciation	<u>17,568,737</u>	<u>18,857,632</u>
Total assets	<u>30,362,932</u>	<u>32,671,829</u>
Deferred outflows of resources	188,601	212,351
	<u><u>\$ 30,551,533</u></u>	<u><u>\$ 32,884,180</u></u>
Liabilities and Net Position		
Current liabilities		
Current maturities of long-term debt	\$ 1,447,868	\$ 1,477,359
Accounts payable and accrued expenses	4,605,087	4,328,713
Accrued payroll and related liabilities	2,909,992	2,479,335
Total current liabilities	<u>8,962,947</u>	<u>8,285,407</u>
Other long-term liabilities	1,100,392	1,095,888
Long-term debt, net of current maturities	<u>14,317,829</u>	<u>15,523,885</u>
Total liabilities	<u>24,381,168</u>	<u>24,905,180</u>
Net position		
Invested in capital assets, net of related debt	2,940,892	2,873,958
Expendable for restricted purposes	88,790	86,572
Unrestricted	3,140,683	5,018,470
Total net position	<u>6,170,365</u>	<u>7,979,000</u>
Total liabilities and net position	<u><u>\$ 30,551,533</u></u>	<u><u>\$ 32,884,180</u></u>

See accompanying notes to the financial statements

MENDOCINO COAST DISTRICT HOSPITAL

Statements of Revenues, Expenses and Changes in Net position

For The Years Ended June 30, 2015 and 2014

	2015	2014
Operating revenues		
Net patient service revenue	\$ 45,353,121	\$ 44,228,194
Other operating revenue	1,927,929	382,780
Total operating revenues	47,281,050	44,610,974
Operating expenses		
Salaries & wages	15,781,501	14,346,253
Employee benefits	9,316,891	8,833,023
Registry	2,632,005	1,593,059
Professional Fees	7,289,015	6,150,027
Supplies	7,393,028	6,452,678
Purchased services	1,498,363	1,424,145
Repairs & maintenance	971,773	883,220
Utilities	740,714	758,496
Rentals and leases	632,403	490,845
Insurance	594,097	682,568
Depreciation & amortization	2,535,214	2,458,665
Other operating expenses	1,932,544	897,719
Total operating expenses	51,317,548	44,970,698
Operating loss	(4,036,498)	(359,724)
Nonoperating revenues (expenses)		
District tax revenues	1,116,211	1,121,434
Investment income	11,599	11,111
Interest expense	(789,383)	(897,002)
Grants and contributions	298,207	668,287
Other non-operating income (expense)	2,683	-
Total nonoperating revenues (expenses)	639,317	903,830
Excess of revenues (expenses)	(3,397,181)	544,106
Other increases in net position	1,588,546	476,801
Increase (decrease) in net position	(1,808,635)	1,020,907
Net position, beginning of the year	7,979,000	6,958,093
Net position, end of year	\$ 6,170,365	\$ 7,979,000

See accompanying notes to the financial statements

MENDOCINO COAST DISTRICT HOSPITAL

Statements of Cash Flows

For The Years Ended June 30, 2015 and 2014

	2015	2014
Cash flows from operating activities		
Cash received from patients and third-party payers	\$ 44,857,526	\$ 44,305,111
Other receipts	1,962,362	691,547
Cash payments to suppliers and contractors	(23,252,859)	(19,207,324)
Cash payments to employees and benefit programs	(24,667,735)	(23,478,702)
Net cash provided by operating activities	(1,100,706)	2,310,632
Cash flows from non-capital and related financing activities		
District tax revenue	720,122	724,359
Non-capital grants and donations	298,207	668,287
Proceeds from debt borrowings	210,000	-
Payments of long-term debt	(77,954)	-
Interest paid on non-capital debt	(10,160)	-
Other non-operating revenue	2,683	-
Net other changes to net position	1,588,546	476,801
Net cash provided by non-capital and related financing activities	2,731,444	1,869,447
Cash flows from capital and related financing activities		
District tax revenue	396,089	397,075
Purchase of property, plant & equipment	(1,222,569)	(1,472,615)
Proceeds from debt borrowings	4,504	63,909
Payments of long-term debt	(1,367,593)	(1,528,134)
Interest paid on capital debt	(779,223)	(897,002)
Net cash used in capital and related financing activities	(2,968,792)	(3,436,767)
Cash flows from investing activities		
Net change in assets limited as to use	1,372,093	(265,159)
Investment income	11,599	11,111
Net cash provided by (used in) investing activities	1,383,692	(254,048)
Increase in cash and cash equivalents	45,638	489,264
Cash and cash equivalents at beginning of year	1,346,466	857,202
Cash and cash equivalents at end of year	\$ 1,392,104	\$ 1,346,466

See accompanying notes to the financial statements

MENDOCINO COAST DISTRICT HOSPITAL

Statements of Cash Flows (continued)

For The Years Ended June 30, 2015 and 2014

	<u>2015</u>	<u>2014</u>
Reconciliation of income from operations to net cash provided by operating activities		
Operating loss	\$ (4,036,498)	\$ (359,724)
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	2,535,214	2,458,665
Changes in operating assets and liabilities		
Patient accounts receivable	(526,964)	83,950
Other receivables	34,433	332,087
Supplies	(131,124)	20,986
Prepaid expenses	285,833	292,244
Accounts payable and accrued expenses	276,374	(211,117)
Accrued payroll and related expenses	430,657	(299,426)
Third-party payor settlements	31,369	(7,033)
Net cash provided by operating activities	<u>\$ (1,100,706)</u>	<u>\$ 2,310,632</u>

See accompanying notes to the financial statements

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity: Mendocino Coast Health Care District (the District), dba as Mendocino Coast District Hospital, (the Hospital) is comprised two separate divisions, a hospital division and a home health/hospice division, both of which are wholly owned by the District, a public entity organized under Local Hospital District Law as set forth in the Health and Safety Code of the State of California. The Hospital is a political subdivision of the State of California and is generally not subject to federal or state income taxes. The Hospital is governed by a five-member Board of Directors, elected from within the district to specified terms of office. The Hospital is located in Fort Bragg, California and operates a 25-bed general acute care hospital. The Hospital provides health care services primarily to individuals who reside in the local geographic area.

Basis of Preparation: The accounting policies and financial statements of the Hospital generally conform with the recommendations of the audit and accounting guide, *Health Care Organizations*, published by the American Institute of Certified Public Accountants. The financial statements are presented in accordance with the pronouncements of the Governmental Accounting Standards Board (GASB). For purposes of presentation, transactions deemed by management to be ongoing, major or central to the provision of health care services are reported as operational revenues and expenses.

The Hospital uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on GASB Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, the Hospital has elected to apply the provisions of all relevant pronouncements as the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

Recent Pronouncements: The GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* ("GASB No. 65"), which was effective for financial statements for periods beginning after December 15, 2012. GASB No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. It also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The adoption of this pronouncement did not materially affect the District's financial statements.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

GASB issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions- an amendment of GASB Statement No. 27* ("GASB No. 68"), which was effective for financial statements for periods beginning after June 15, 2015. GASB No. 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The requirements of Statements 27 and 50 remain applicable for pensions that are not covered by the scope of this Statement. It establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about pensions also are addressed. The District has evaluated the impact of the adoption of GASB No. 68 for the fiscal year ending June 30, 2015 and there is no effect to the District's financial statements.

GASB also issued GASB Statement No. 69, *Government Combinations and Disposals of Government Operations* ("GASB No. 69"), which was effective for financial statements for periods beginning after December 15, 2014. GASB No. 69 requires the use of carrying values to measure the assets and liabilities in a government merger. Conversely, government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. This Statement requires measurements of assets acquired and liabilities assumed generally to be based upon their acquisition values. It also provides guidance for transfers of operations that do not constitute entire legally separate entities and in which no significant consideration is exchanged. It defines the term operations for purposes of determining the applicability of this Statement and requires the use of carrying values to measure the assets and liabilities in a transfer of operations, and provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold. The District has evaluated the impact of the adoption of GASB No. 69 for the fiscal year ending June 30, 2015 and there is no effect to the District's financial statements.

Management's Discussion and Analysis: Statement 34 requires that financial statements be accompanied by a narrative introduction and analytical overview of the Hospital's financial activities in the form of "management's discussion and analysis" (MD&A). This analysis is similar to the analysis provided in the annual reports of organizations in the private sector.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

Risk Management: The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and medical malpractice. Commercial insurance coverage is purchased for claims arising from such matters.

Cash and Cash Equivalents and Investments: The Hospital considers cash and cash equivalents to include certain investments in highly liquid debt instruments, when present, with an original maturity of a short-term nature or subject to withdrawal upon request. Exceptions are for those investments which are intended to be continuously invested. Investments in debt securities are reported at market value. Interest, dividends and both unrealized and realized gains and losses on investments are included as investment income in non-operating revenues when earned.

Patient Accounts Receivable: Patient accounts receivable consist of amounts owed by various governmental agencies, insurance companies and private patients. The Hospital manages its receivables by regularly reviewing the accounts, inquiring with respective payors as to collectibility and providing for allowances on their accounting records for estimated contractual adjustments and uncollectible accounts. Significant concentrations of patient accounts receivable are discussed further in the footnotes.

Inventories: Inventories are consistently reported from year-to-year at cost, determined by average costs and replacement values, which are not in excess of market. The Hospital does not maintain levels of inventory values such as those under a first-in, first out or last-in, first out method.

Assets Limited as to Use: Assets limited as to use include contributor restricted funds, amounts designated by the Board of Directors for replacement or purchases of capital assets, and other specific purposes, and amounts held by trustees under specified agreements. Assets limited as to use consist primarily of deposits on hand with local banking and investment institutions, and bond trustees.

Capital Assets: Capital assets consist of property and equipment and are reported on the basis of cost, or in the case of donated items, on the basis of fair market value at the date of donation. Routine maintenance and repairs are charged to expense as incurred. Expenditures which increase values, change capacities, or extend useful lives are capitalized. Depreciation of property and equipment and amortization of property under capital leases are computed by the straight-line method for both financial reporting and cost reimbursement purposes over the estimated useful lives of the assets, which range from 10 to 30 years for buildings and improvements, and 3 to 10 years for equipment. The Hospital periodically reviews its capital assets for value impairment. As of June 30, 2015 and 2014, the Hospital has determined that no capital assets are significantly impaired.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

Deferred Outflows of Resources: Deferred outflows of resources are comprised of deferred financing cost of the issuance of revenue and general obligation bonds. Amortization of these costs is computed by the straight-line method over the life of the repayment agreements. For current and advance refundings which result in defeasance of debt, the difference between the reacquisition price and the net carrying amount of the old debt, together with any unamortized deferred financing costs, is deferred and amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter, in accordance with GASB requirements. Amortization expense was \$25,005 and \$26,546 for the years ended June 30, 2015 and 2014, respectively.

Compensated Absences: The Hospital's employees earn paid-time-off (PTO) benefits at varying rates depending on years of service. Benefits can accumulate up to specified maximum levels. Employees are paid for accumulated PTO if they leave either upon termination or retirement. Accrued PTO liabilities as of June 30, 2015 and 2014 were \$1,377,926 and \$1,319,755 respectively.

Net position: Net position are presented in three categories. The first category is net position "invested in capital assets, net of related debt". This category of net position consists of capital assets (both restricted and unrestricted), net of accumulated depreciation and reduced by the outstanding principal balances of any debt borrowings that were attributable to the acquisition, construction, or improvement of those capital assets.

The second category is "restricted" net position. This category consists of externally designated constraints placed on those net position by creditors (such as through debt covenants), grantors, contributors, law or regulations of other governments or government agencies, or law or constitutional provisions or enabling legislation.

The third category is "unrestricted" net position. This category consists of net position that do not meet the definition or criteria of the previous two categories

Net Patient Service Revenues: Net patient service revenues are reported in the period at the estimated net realized amounts from patients, third-party payors and others including estimated retroactive adjustments under reimbursement agreements with third-party programs. Normal estimation differences between final reimbursement and amounts accrued in previous years are reported as adjustments of current year's net patient service revenues.

Charity Care: The Hospital accepts all patients regardless of their ability to pay. A patient is classified as a charity patient by reference to certain established policies of the Hospital. Essentially, these policies define charity services as those services for which no payment is anticipated. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as net patient service revenues. Services provided are recorded as gross patient service revenues and then written off entirely as an adjustment to net patient service revenues.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)

District Tax Revenues: The Hospital receives approximately 2% of its financial support from property taxes. These funds are used to support operations and meet required debt service agreements. They are classified as non-operating revenue as the revenue is not directly linked to patient care. Property taxes are levied by the County on the Hospital's behalf during the year, and are intended to help finance the Hospital's activities during the same year. Amounts are levied on the basis of the most current property values on record with the County. The County has established certain dates to levy, lien, mail bills, and receive payments from property owners during the year. Property taxes are considered delinquent on the day following each payment due date.

Operating Revenues and Expenses: The Hospital's statement of revenues, expenses and changes in net position distinguishes between operating and non-operating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, which is the Hospital's principal activity. Operating expenses are all expenses incurred to provide health care services, other than financing costs. Non-operating revenues and expenses are those transactions not considered directly linked to providing health care services.

Subsequent Events: The District's management evaluated the effect of subsequent events on the financial statements through January 12, 2016, the date the financial statements are issued, and determined that there are no material subsequent events that have not been disclosed.

NOTE 2 - CASH, CASH EQUIVALENTS AND INVESTMENTS

As of June 30, 2015 and 2014, the Hospital had deposits invested in various financial institutions in the form of operating cash and cash equivalents amounted to \$1,501,663, and \$1,468,903. All of these funds were held in deposits, which are collateralized in accordance with the California Government Code (CGC), except for \$250,000 per account that is federally insured.

Under the provisions of the CGC, California banks and savings and loan associations are required to secure the Hospital's deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of the Hospital's deposits. California law also allows financial institutions to secure Hospital deposits by pledging first trust deed mortgage notes having a value of 150% of the Hospital's total deposits. The pledged securities are held by the pledging financial institution's trust department in the name of the Hospital.

Investments generally consist of U.S. Government securities and state and local agency funds invested in U. S. Government securities are stated at quoted market values. Changes in market value between years are reflected as a component of investment income in the accompanying statement of revenues, expenses and changes in net position.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 3 - NET PATIENT SERVICE REVENUES

Gross and net patient service revenues summarized by payor are as follows:

	2015	2014
Acute care inpatient hospital services	\$ 26,659,875	\$ 26,352,692
Long-term care daily hospital services (swing bed)	3,120,745	2,535,529
Acute care outpatient hospital services	64,023,257	59,691,799
Home health services	1,241,474	1,280,005
Rural health services	5,305,281	4,142,024
Gross patient service revenues	100,350,632	94,002,049
Less deductions from revenue	(55,027,152)	(49,773,855)
Net patient service revenues	<u>\$ 45,323,480</u>	<u>\$ 44,228,194</u>

The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare: As a designated critical access hospital, Medicare reimbursement is generally settled with the Hospital on cost-based formulas. Interim payments for inpatient and outpatient care services rendered to Medicare program beneficiaries are based on estimated determined rates throughout the year. After year end and the submission of an annual cost report, program expenses are audited by the Medicare fiscal intermediary and settlements are reached to finalized the reimbursement of Medicare program expenses for the year. At June 30, 2015, cost reports through June 30, 2012 have been audited or otherwise final settled.

Medi-Cal: Payments for inpatient services rendered to Medi-Cal (non-managed care) patients were made based on reasonable costs through December 31, 2014. Effective January 1, 2015, the State of California's Medi-Cal program changed inpatient reimbursement to Diagnosis-Related Groups (DRG), similar to the Medicare inpatient payment methodology. Outpatient payments continue to be paid on pre-determined charge screens. The Hospital is paid for cost-based inpatient services at an interim rate with final settlement determined after submission of annual cost reports and audits thereof by Medi-Cal. At June 30, 2015, cost reports through June 30, 2014, have been audited or otherwise final settled. Medi-Cal rural health care clinic services are paid on a PPS rate established by the State from a base-year cost report submitted by the Hospital and audited by the State and are no longer subject to cost reimbursement. Medi-Cal Home Health and managed care services are paid on pre-determined rates and are not subject to cost reimbursement.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 3 - NET PATIENT SERVICE REVENUES (continued)

Other: Payments for services rendered to other than Medicare and traditional Medi-Cal patients are based on established rates or on agreements with certain commercial insurance companies, health maintenance organizations and preferred provider organizations which provide for various discounts from established rates.

NOTE 4 - INVESTMENTS

The District's investment balances and average maturities were as follows at June 30, 2015 and 2014:

2015				
	Fair Value	Investment Maturities in Years		
		Less than 1	1 to 5	Over 5
Government investment funds	\$ 3,946,128	\$ 3,946,128	\$ -	\$ -
Money market accounts	1,446,144	1,446,144	-	-
Interest bearing checking	405,497	405,497	-	-
Total investments	<u>\$ 5,797,769</u>	<u>\$ 5,797,769</u>	<u>\$ -</u>	<u>\$ -</u>
2014				
	Fair Value	Investment Maturities in Years		
		Less than 1	1 to 5	Over 5
Government investment funds	\$ 5,230,627	\$ 5,230,627	\$ -	\$ -
Money market accounts	1,536,527	1,536,527	-	-
Interest bearing checking	402,708	402,708	-	-
Total investments	<u>\$ 7,169,862</u>	<u>\$ 7,169,862</u>	<u>\$ -</u>	<u>\$ -</u>

The District's investments are reported at fair value as previously discussed. The District's investment policy allows for various forms of investments generally set to mature within a few months to others over 15 years. The policy identifies certain provisions which address interest rate risk, credit risk and concentration of credit risk.

Interest Rate Risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. The District's exposure to interest rate risk is minimal as 100% of their investments have a maturity of less than one year. Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the preceding schedules that shows the distribution of the District's investments by maturity.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 4 – INVESTMENTS (continued)

Credit Risk: Credit risk is the risk that the issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization, such as Moody's Investor Service, Inc. The District's investments in such obligations are in government investment funds. The District believes that there is minimal credit risk with these obligations at this time.

Custodial Credit Risk: Custodial credit risk is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer), the District will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The District's investments are generally held by banks or government agencies. The District believes that there is minimal custodial credit risk with their investments at this time. District management monitors the entities which hold the various investments to ensure they remain in good standing.

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributed to the magnitude of the District's investment in a single issuer. The District's investments are held as follows: governmental agencies 68% and banks 32%. The District believes that there is minimal custodial credit risk with their investments at this time. District management monitors the entities which hold the various investments to ensure they remain in good standing.

NOTE 5 - ASSETS LIMITED AS TO USE

Assets limited as to use as of June 30, 2015 and 2014 were comprised of cash and cash equivalents held by the County of Mendocino under a General Obligation bond agreement, held by a trustee under bond indenture agreements, designated by the board for specific purposes and restricted by outside donors. Interest income, dividends, and both realized and unrealized gains and losses on investments are recorded as investment income. These amounts were \$11,599 and \$11,111 for the years ended June 30, 2015 and 2014, respectively. Total investment income includes both income from operating cash and cash equivalents and cash and cash equivalents related to assets limited as to use. Debt securities, when present, are recorded at market price or the fair market value as of the date of each balance sheet.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 5 - ASSETS LIMITED AS TO USE (continued)

Assets limited as to use as of June 30, 2015 and 2014 were comprised of the following:

	2015	2014
Amounts held by the County of Mendocino per GO bond agreement	\$ 293,797	\$ 293,325
Amounts held by trustees under bond indenture agreements	1,446,144	1,536,382
Board and outside donor restricted or limited	4,057,828	5,340,155
	5,797,769	7,169,862
Less amount available for current obligations	(1,244,442)	(1,977,037)
	<u>\$ 4,553,327</u>	<u>\$ 5,192,825</u>

NOTE 6 - CONCENTRATION OF CREDIT RISK

The Hospital grants credit without collateral to its patients and third-party payors. Patient accounts receivable from government agencies represent the only concentrated group of credit risk for the Hospital and management does not believe that there are any credit risks associated with these governmental agencies. Contracted and other patient accounts receivable consist of various payors including individuals involved in diverse activities, subject to differing economic conditions and do not represent any concentrated credit risks to the Hospital. Concentration of patient accounts receivable at June 30, 2015 and 2014 were as follows:

	2015	2014
Medicare	\$ 4,019,400	\$ 3,174,192
Medi-Cal and Medi-Cal pending	2,334,213	2,344,976
Other third party payors	2,916,943	3,444,343
Self pay and other	2,135,161	1,167,358
Gross patient accounts receivable	11,405,717	10,130,869
Less allowances for contractual adjustments and bad debts	(7,568,248)	(6,875,000)
Net patient accounts receivable	<u>\$ 3,837,469</u>	<u>\$ 3,255,869</u>

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 7 - OTHER RECEIVABLES

Other receivables as of June 30, 2015 and 2014 were comprised of the following:

	2015	2014
Property taxes receivable from the County	\$ 58,117	\$ 52,482
Electronic Health Records (EHR) receivables	10,874	112,874
Receivable from the Foundation	40,494	40,047
Other miscellaneous receivables	82,076	20,590
	<u>\$ 191,561</u>	<u>\$ 225,993</u>

The Hospital has entered into physician guarantee agreements due to the need to recruit physicians in certain specialties to the area. The agreements provide for a certain level of income for a specified period of time. The physician is then expected to practice in the area for another specified period of time, during which the amounts paid to the physicians are ratably forgiven. FASB guidelines require the Hospital to establish both an asset and a liability for the estimated fair value of its physician income guarantees at the inception of contracts entered into after January 1, 2006. The asset is amortized to expense using the straight-line amortization method over the life of the guarantee, while the liability is reduced by actual amounts paid on the guarantee. As the Hospital's contracts of this nature are not considered material, both the asset and the liability are netted and recorded as a net other receivable. Recourse provisions in the contracts provide for the recovery from the physicians if all the terms of the contract are not fulfilled.

NOTE 8 - EMPLOYEES' RETIREMENT PLANS

The Hospital has a noncontributory, defined contribution pension plan which covers substantially all employees. Assets of the plan consist of a group of annuity contracts. The annual contribution made by the Hospital is equal to approximately 6% of eligible employee salaries. Total pension costs for the years ended June 30, 2015 and 2014 were \$938,651 and \$682,691 respectively. For the year ended June 30, 2014, actual annual contribution by the Hospital credited to the pension plan totaled \$927,378. The amount the Hospital was required to actually pay was reduced by accumulated plan account forfeitures in the amount of \$244,686, for a net pension cost of \$682,691.

The Hospital has a 403(b) salary savings plan which is available to substantially all employees. The 403(b) plan is wholly employee funded through regular deductions from wages and salaries. There is no provision for any matching or other such contributions by the Hospital.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 9 - CAPITAL ASSETS

Capital assets as of June 30, 2015 and 2014 were comprised of the following:

	Balance at June 30, 2014	Transfers & Additions	Transfers & Retirements	Balance at June 30, 2015
Land and land improvements	\$ 922,888	\$ -	\$ -	\$ 922,888
Buildings and improvements	22,626,847	1,783,598	-	24,410,445
Equipment	21,672,216	689,712	(16,106)	22,345,822
Construction-in-progress	1,489,120	-	(1,250,741)	238,379
Totals at historical cost	46,711,071	<u>\$ 2,473,310</u>	<u>\$ (1,266,847)</u>	47,917,534
Less accumulated depreciation	(27,853,439)	<u>\$ (2,511,464)</u>	<u>\$ 16,106</u>	(30,348,797)
Capital assets, net	<u>\$ 18,857,632</u>			<u>\$ 17,568,737</u>

	Balance at June 30, 2013	Transfers & Additions	Transfers & Retirements	Balance at June 30, 2014
Land and land improvements	\$ 922,888	\$ -	\$ -	\$ 922,888
Buildings and improvements	22,329,454	297,393	-	22,626,847
Equipment	19,495,895	2,473,430	(297,109)	21,672,216
Construction-in-progress	2,806,938	-	(1,317,818)	1,489,120
Totals at historical cost	45,555,175	<u>\$ 2,770,823</u>	<u>\$ (1,614,927)</u>	46,711,071
Less accumulated depreciation	(25,716,887)	<u>\$ (2,433,661)</u>	<u>\$ 297,109</u>	(27,853,439)
Capital assets, net	<u>\$ 19,838,288</u>			<u>\$ 18,857,632</u>

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 10 - DEBT BORROWINGS

As of June 30, 2015 and 2014, debt borrowings were as follows:

	<u>2015</u>	<u>2014</u>
Refunding revenue bonds, series 1996; due in annual principal payments through 2020 at various amounts; interest due semi-annually at rates between 5.75% to 5.875%; collateralized by Hospital assets	\$ 1,330,000	\$ 1,555,000
General obligation bonds, series 2000 (interest); due in annual principal payments through 2030 at various amounts; interest due semi-annually at various rates; collateralized by District taxes.	3,940,000	3,940,000
General obligation bonds, series 2000 (capital appreciation); due in annual principal payments starting in 2015 through 2024 at various amounts; interest due semi-annually at various rates; collateralized by District taxes.	661,474	736,975
Refunding revenue bonds, series 2009; due in annual principal payments through 2029 at various amounts; interest due semi-annually at various rates; collateralized by Hospital assets.	4,045,000	4,250,000
Refunding revenue bonds, series 2010; due in annual principal payments through 2029 at various amounts; interest due semi-annually at various rates; collateralized by Hospital assets.	2,260,000	2,380,000
Note payable to UHC of California; principal payable per schedule starting in November, 2015; bearing interest at 4.0%; secured by certain assets of the District.	1,890,000	2,100,000
Other notes payable	1,639,223	2,039,269
Total debt borrowings	<u>15,765,697</u>	<u>17,001,244</u>
Less current maturities	<u>(1,447,868)</u>	<u>(1,477,359)</u>
Debt borrowings, net of current maturities	<u>\$ 14,317,829</u>	<u>\$ 15,523,885</u>

Property and equipment that have been capitalized under capital lease obligations are considered minor. Future principal payments on debt borrowings for the next five succeeding years are: \$1,447,868 in 2016; \$1,044,282 in 2017; \$1,013,968 in 2018; \$1,069,659 in 2019; \$1,178,463 in 2020; and \$10,011,457 thereafter.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 10 - DEBT BORROWINGS (continued)

Refunding Revenue Bonds, Series 1996: Interest is payable semiannually at rates ranging from 5.75% to 5.875%. Principal maturities on the serial bonds range from \$235,000 in 2016 to \$300,000 in 2020, and are due annually on February 1st of each year. The term bonds aggregating \$1,330,000 mature in 2020. Mandatory sinking fund deposits to retire the term bonds ranging from \$200,000 to \$300,000 are due annually on February 1, 2015 through 2020.

The bonds are secured by a pledge of gross revenues, a first deed of trust on the Hospital's facilities and a deposit control agreement covering substantially all the Hospital's operating bank accounts. Repayment of the bonds is insured pursuant to a Contract of Insurance and a Regulatory Agreement (Agreement) through the California Health Facility Construction Loan Insurance Program administered by the Office of Statewide Health Planning and Development of the State of California (OSHPD). The Hospital is required to maintain certain financial ratios and to make monthly deposits to a trustee for bond sinking fund payments and insurance payments becoming due and payable within the next 12 months, and for interest payments becoming due and payable within the next six months.

The Agreement with OSHPD sets out certain business covenants of the Hospital, including maintenance, operation and management of facilities and limitations on encumbrances, assignment and transfer of any part of the facilities and other matters. The Agreement also provides for the rights and obligations of the parties in the event of a default. Under the Agreement, the Hospital has agreed to fix, charge and collect such rates, fees and charges which, together with all other receipts and revenues of the Hospital, will produce a debt coverage ratio of at least 1.25 times the Hospital's aggregate debt service for a fiscal year. The debt service coverage ratio was calculated to be at (0.06) as of June 30, 2015 placing the Hospital out of compliance with this loan covenant.

General Obligation Bonds, Series 2000: Upon voter approval in November 2000, the Hospital issued \$5,500,000 principal amount of general obligation bonds, \$4,615,000 of current interest bonds and \$884,638 of capital appreciation bonds. Interest on the current interest bonds is payable semiannually at rates ranging from 5.25% to 7.125% and principal maturities ranging from \$200,000 in 2023 to \$700,000 in 2030 are due annually on August 1st of each year. Interest rates ranging from 5.7% to 7.1% and principal of the capital appreciation bonds are payable only at maturity.

Bonds maturing on or after August 1, 2012, may be redeemed prior to maturity at the Hospital's option. The redemption price is 101% during the period August 1, 2011 to July 31, 2012, and 100% thereafter. The Bonds are general obligations of the Hospital payable from ad valorem taxes. Payment of principal, interest and maturity value of the Bonds, when due, are insured by a municipal bond insurance policy.

Refunding Revenue Bonds, Series 2009: Interest is payable semiannually at rates ranging from 2.625% to 5.3%. Principal maturities on the serial bonds range from \$205,000 in 2015 to \$250,000 in 2020, and are due annually on February 1. The term bonds aggregating \$4,925,000 mature in 2029. Bonds maturing on February 1, 2019 and thereafter may be called by the District at a redemption price of 100%.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 10 - DEBT BORROWINGS (continued)

The bonds are secured by a pledge of gross revenues, a first deed of trust on the Hospital's facilities and a deposit control agreement covering substantially all the Hospital's operating bank accounts. Repayment of the bonds is insured pursuant to a Contract of Insurance and a Regulatory Agreement (Agreement) through the California Health Facility Construction Loan Insurance Program administered by the Office of Statewide Health Planning and Development of the State of California (OSHPD). The Hospital is required to maintain certain financial ratios and to make monthly deposits to a trustee for bond sinking fund payments and insurance payments becoming due and payable within the next 12 months, and for interest payments becoming due and payable within the next six months.

The Agreement with OSHPD sets out certain business covenants of the Hospital, including maintenance, operation and management of facilities and limitations on encumbrances, assignment and transfer of any part of the facilities and other matters. The Agreement also provides for the rights and obligations of the parties in the event of a default. Under the Agreement, the Hospital has agreed to fix, charge and collect such rates, fees and charges which, together with all other receipts and revenues of the Hospital, will produce a debt coverage ratio of at least 1.25 times the Hospital's aggregate debt service for a fiscal year. The debt service coverage ratio was calculated to be at (0.06) as of June 30, 2015 placing the Hospital out of compliance with this loan covenant.

Revenue Bonds, Series 2010: In July 2010, the Hospital issued the Mendocino Coast Health Care District (Mendocino County, California) Insured Health Facility Revenue Bonds, Series 2010 in the amount of \$2,875,000. The bond principal is payable yearly at various amounts from \$115,000 to \$170,000. Bond interest is payable semi-annually at various rates from 2.0% to 4.85%. The bonds mature in 2024 and are secured by a pledge of gross revenues, a deed of trust on the Hospital's facilities and a deposit control agreement covering substantially all the Hospital's operating bank accounts. Repayment of the bonds is insured pursuant to a Contract of Insurance and a Regulatory Agreement through the California Health Facility Construction Loan Insurance Program administered by the Office of Statewide Health Planning and Development of the State of California (OSHPD). The Hospital is required to maintain certain financial ratios and to make monthly deposits to a trustee for bond sinking fund payments and insurance payments becoming due and payable within the next 12 months, and for interest payments becoming due and payable within the next six months.

The Agreement with OSHPD sets out certain business covenants of the Hospital, including maintenance, operation and management of facilities and limitations on encumbrances, assignment and transfer of any part of the facilities and other matters. The Agreement also provides for the rights and obligations of the parties in the event of a default. Under the Agreement, the Hospital has agreed to fix, charge and collect such rates, fees and charges which, together with all other receipts and revenues of the Hospital, will produce a debt coverage ratio of at least 1.25 times the Hospital's aggregate debt service for a fiscal year. The debt service coverage ratio was calculated to be at (0.06) as of June 30, 2015 placing the Hospital out of compliance with this loan covenant.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 10 - DEBT BORROWINGS (continued)

UHC Note: The Hospital borrowed funds in the amount of \$2,100,000 from UHC under a program established to finance certain EMR conversion and installation required by CMS. The note carries an interest rate of 4.0% and principal payments are scheduled to coincide with both Federal and State reimbursement to the Hospital over the meaningful use program life.

Other: The Hospital borrowed a total of \$1,005,806 from Cal Mortgage to replace a line of credit with a bank in the amount of \$1,000,000 during fiscal year ended June 30, 2013. This was done to help facilitate the Hospital's bankruptcy filing. The Hospital also has two notes payable to equipment financing companies totaling \$501,371 at June 30, 2015. These notes were used to purchase certain pieces of medical equipment. The notes carry interest at rates from 6.35% to 7.09%. Principal and interest payments are due monthly through 2017. The hospital has a note payable to CMS related to a settlement for a self-reported Stark Law violation. The settlement was for \$400,000, carries interest at 5.0%, with principal and interest payments due monthly through 2018. The balance of the note payable to CMS was \$132,046 at June 30, 2015. See Note 14.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Construction-in-Progress: As of June 30, 2015, the Hospital had \$238,379 recorded as construction-in-progress representing cost capitalized for various remodeling, major repair, or expansion projects on the Hospital's premises. During times of construction, interest expense associated with construction debt can be capitalized under accounting rules. Future commitments related to these projects are approximated to be \$1,120,000.

Operating Leases: The Hospital leases various equipment and facilities under operating leases expiring at various dates. Total building and equipment rent expense for the years ended June 30, 2015 and 2014, were \$632,403 and \$490,845, respectively. Future minimum lease payments for the succeeding years under operating leases as of June 30, 2015, that have initial or remaining lease terms in excess of one year are not considered material.

Litigation and Regulatory Contingencies: The Hospital may from time-to-time be involved in litigation and regulatory investigations which arise in the normal course of doing business. After consultation with reimbursement consultants, possible regulatory contingencies surrounding supplemental reimbursement exist as of year-end which may have a negative impact on future operations but is undeterminable at this time. After consultation with legal counsel, management estimates that any legal matters existing as of June 30, 2015 will be resolved without material adverse effect on the Hospital's future financial position, results from operations, or cash flows.

Medical Malpractice Claims: The Hospital maintains commercial malpractice liability insurance coverage under various claims-made policies covering losses up to \$10 million per claim with a per claim deductible of \$1,000. The Hospital plans to maintain the coverage by renewing its current policy or by replacing it with equivalent insurance.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 11 - COMMITMENTS AND CONTINGENCIES (continued)

Workers Compensation Program: The Hospital is a participant in the Association of California Hospital District's Alpha Fund (the Fund) which administers a self-insured worker's compensation plan for participating hospital employees of its member hospitals. The Hospital pays premiums to the Fund which are adjusted annually. If participation in the Fund is terminated by the Hospital, the Hospital would be liable for its share of any additional premiums necessary for final disposition of all claims and losses covered by the Fund.

Health Care Reform: The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, and Medicare and Medi-Cal fraud and abuse. Government activity has increased with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that the Hospital is in compliance with fraud and abuse as well as other applicable government laws and regulations. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time.

NOTE 12 – RELATED PARTY TRANSACTIONS

The Mendocino Coast Hospital Foundation (the Foundation), has been established as a nonprofit public benefit corporation to solicit contributions on behalf of the community in the Mendocino County coastal area. Funds raised, except for funds required for operation of the Foundation, are distributed to the Hospital or held for the benefit of the Hospital and other healthcare functions within the community. The Foundation's funds, which represent the Foundation's unrestricted resources, are donated to the Hospital in amounts and in periods determined by the Foundation's Board of Trustees, who may also restrict the use of such funds for Hospital property or equipment replacement, expansion, or other specific purposes.

The Hospital received contributions from the Foundation in the amount of \$278,578 and \$241,760 during the years ended June 30, 2015 and 2014, respectively. The Hospital provides office space to the Foundation at no charge and the Foundation's directors and computer equipment are covered under the Hospital's general liability, directors and officers and property insurance.

MENDOCINO COAST DISTRICT HOSPITAL

Notes to Financial Statements

June 30, 2015 and 2014

NOTE 13 - CHAPTER 9 BANKRUPTCY

During the year ended June 30, 2013, the Hospital filed for Bankruptcy under Chapter 9 of Title 11 of the United States Bankruptcy Code in the United States Bankruptcy Court - Northern District of California. The Hospital is represented by legal counsel in this reorganization under Chapter 9. The purpose of the Hospital's plan of reorganization was to restructure certain classifications of the Hospital's debt and provide for their payment in whole or part. The Hospital's bankruptcy filing and related reorganization plan was approved by the courts in early 2015. Certain debt was restructured, reduced, discharged or rendered unenforceable. The ultimate success of this plan will depend primarily on the ability of the Hospital's management to operate at a level of increased cash flows, coupled with Hospital property taxes, to meet their obligations in the normal course of operations going forward. Hospital management is continuing a program of cost reductions and revenue enhancement which it believes will result in improved cash flows.

During the years ended June 30, 2015 and 2014, the Hospital received forgiveness of debt related to settlement and approval of its bankruptcy filing. A total net gain of \$1,662,869 has been reflected in the financial statements as of June 30, 2015. The Hospital reported a net gain of \$1,186,068 for the year ended June 30, 2015 and \$476,801 for the year ended June 30, 2014.

NOTE 14 – COMPLIANCE ISSUE

Through its compliance program, the Hospital identified certain situations that raised potential issues with respect to compliance with the strict requirements of the Stark Law (42 U.S.C. §1395nn) and the corresponding regulations (42 CFR §411.351 et seq). The issues included missing signatures on agreements, operating under agreements after their stated expiration, and other technical issues. The Hospital's investigation showed little or no benefit to physicians and no inappropriate costs to any governmental entity as a result of these technical violations. The Hospital self-disclosed these issues to CMS in 2013, utilizing the Self-Referral Disclosure Protocol issued by CMS in September 2010. As required by the Self-Referral Disclosure Protocol, the Hospital informed CMS that the estimated value of the physician referrals potentially affected by the matters identified in the self-disclosure is approximately \$11,555,000. Because there is little precedence with CMS's settlement of matters disclosed by hospitals under the Self-Referral Disclosure Protocol, the ultimate outcome was difficult to estimate. However, Hospital management negotiated aggressively with CMS and was able to reach a settlement in early 2015. CMS imposed a \$210,000 fine for the self-disclosed non-compliance issues, payable in monthly instalments through 2017 with interest at 5.0%. The balance owed to CMS at June 30, 2015 totals \$132,046.

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APPENDIX C

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS AND FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT

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DEFINITIONS OF CERTAIN TERMS

Authorized Representative

“Authorized Representative” means, (1) with respect to the District, its president, vice president, chief executive officer, chief financial officer, secretary or deputies or assistants thereto, or any other person designated as an Authorized Representative of the District by a Certificate of the District signed by its president, vice president, chief executive officer, chief financial officer, secretary, or assistants thereto and filed with the Trustee, and (2) with respect to the Office, the Director of the Office or Deputy Director of the Cal-Mortgage Loan Insurance Division, or any other person designated as an Authorized Representative of the Office by a Certificate of the Office signed by its Director or Deputy Director of the Cal-Mortgage Loan Insurance Division, and filed with the Trustee.

Board

“Board” means the Board of Directors of the District.

Bond Proceeds Account

“Bond Proceeds Account” means the account by that name in the Bond Reserve Account established pursuant to the Indenture.

Bond Reserve Account

“Bond Reserve Account” means the account by that name in the Revenue Fund established pursuant to the Indenture.

Bond Reserve Account Requirement

“Bond Reserve Account Requirement” means, as of each calculation date, an amount equal to the least of (i) 50% of Maximum Annual Debt Service with respect to each Series of Bonds Outstanding, (ii) 10% of the issue price with respect to each Series of Bonds as determined under the Code (or, if the issue price includes less than 2% original issue discount or premium, then 10% of the stated principal amount), or (iii) 125% of the average Annual Debt Service as of the date of issuance with respect to each Series of Bonds Outstanding.

Bond Year

“Bond Year” means the period of twelve consecutive months ending on February 1 in any year in which Bonds are Outstanding.

Bonds, Serial Bonds, Term Bonds, Series 2016 Bonds, Additional Bonds

“Additional Bonds” means all Bonds authorized by and at any time Outstanding pursuant to the Indenture and any Supplemental Indenture, other than the Series 2016 Bonds.

“Bonds” means the District’s Insured Health Facility Revenue Bonds, authorized by, and at any time Outstanding pursuant to, the Indenture, and including Additional Bonds.

“Serial Bonds” means the Bonds, falling due by their terms in specified years, for which no Mandatory Sinking Account Payments are provided.

“Term Bonds” means the Bonds payable at or before their specified maturity date or dates from Mandatory Sinking Account Payments established for that purpose and calculated to retire such Bonds on or before their specified maturity date or dates.

“Series 2016 Bonds” means the District’s Insured Health Facility Refunding Revenue Bonds, Series 2016, issued and Outstanding hereunder.

Certificate, Statement, Request, Requisition or Order of the District or the Office

“Certificate,” “Statement,” “Request,” “Requisition” and “Order” of the District or the Office mean, respectively, a written certificate, statement, request, requisition or order signed in the name of the District or the Office by an Authorized Representative of the District or the Office, as the case may be. Any such instrument and supporting opinions or representations, if any, may, but need not, be combined in a single instrument with any other instrument, opinion or representation, and the two or more so combined shall be read and construed as a single instrument. If and to the extent required by the Indenture, each such instrument shall include the statements provided for in the Indenture.

Code

“Code” means the Internal Revenue Code of 1986.

Contract of Insurance

“Contract of Insurance” means that certain contract of insurance by and between the Office and the District, dated as of July 1, 2016, and effective as of the date of issuance of the Series 2016 Bonds, and any amendment or supplement thereto, and includes any additional contracts of insurance between such parties relating to any Bonds at the time Outstanding.

Costs of Issuance Accounts

“Costs of Issuance Accounts” means the accounts so designated and established pursuant to the Indenture.

Costs of Issuance

“Costs of Issuance” means all items of expense directly or indirectly payable by the District and related to the authorization, issuance, sale and delivery of the Bonds, including but not limited to advertising and printing costs, costs of preparation and reproduction of documents, filing and recording fees, initial fees and charges of the Trustee, legal fees and charges, fees and disbursements of consultants and professionals, rating agency fees, initial fees and charges of the Office, fees and charges

for preparation, execution, transportation and safekeeping of Bonds, and any other cost, charge or fee in connection with the original issuance of Bonds.

Deposit Account

“Deposit Account” means the account by that name in the Bond Reserve Account established pursuant to the Indenture.

Depository Bank

“Depository Bank” means any of the banks or financial institutions so designated pursuant to the Indenture.

Escrow Agent

“Escrow Agent” means The Bank of New York Mellon Trust Company, N.A., and its successors and assigns.

Escrow Agreement

“Escrow Agreement” means the Escrow Agreement, dated as of July 1, 2016, by and between the District and the Escrow Agent.

Event of Default

“Event of Default” means any of the events specified in the Indenture.

Facilities

“Facilities” has the meaning ascribed to such term in the Regulatory Agreement.

Fair Market Value

“Fair Market Value” means the price at which a willing buyer would purchase the investment from a willing seller in a bona fide, arm’s length transaction (determined as of the date the contract to purchase or sell the investment becomes binding) if the investment is traded on an established securities market (within the meaning of section 1273 of the Code) and, otherwise, the term “Fair Market Value” means the acquisition price in a bona fide arm’s length transaction (as referenced above) if (i) the investment is a certificate of deposit that is acquired in accordance with applicable regulations under the Code, (ii) the investment is an agreement with specifically negotiated withdrawal or reinvestment provisions and a specifically negotiated interest rate (for example, a guaranteed investment contract, a forward supply contract or other investment agreement) that is acquired in accordance with applicable regulations under the Code, (iii) the investment is a United States Treasury Security – State and Local Government Series that is acquired in accordance with applicable regulations of the United States Bureau of Public Debt, or (iv) the investment is the Local Corporation Investment Fund of the State but only if at all times during which the investment is held its yield is reasonably expected to be equal to or greater than the yield on a reasonably comparable direct obligation of the United States of America.

Fiscal Year

“Fiscal Year” means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other twelve-month period hereafter selected and designated as the official fiscal year period of the District.

Government Obligations

“Government Obligations” means any of the following which are noncallable by the issuer thereof except to the extent not permitted by the laws of the State as an investment for the moneys to be invested therein at the time of investment:

(i) (a) direct general obligations of the United States of America, (b) obligations the payment of the principal of and interest on which are unconditionally guaranteed as to the full and timely payment by the United States of America, or (c) any fund or other pooling arrangement whose assets consist exclusively of the obligations listed in clause (a) or (b) of this clause (i) and which is rated at least “P-1” by Moody’s; provided that, such obligations shall not include unit investment trusts or mutual fund obligations;

(ii) advance refunded tax-exempt obligations that (a) are rated by Moody’s and S&P, (b) are secured by obligations specified in clause (i), (c) are tax-exempt because they are secured by obligations specified in clause (i), and (d) have the same ratings as the obligations specified in clause (i);

(iii) bonds, debentures or notes issued by any of the following federal agencies: Federal Farm Credit Bank, Federal Home Loan Mortgage Corporation or Fannie Mae; provided, that such bonds, debentures or notes shall be the senior obligations of such agencies (including participation certificates) and have the same ratings by Moody’s and S&P as the obligations specified in clause (i); and

(iv) bonds, debentures or notes issued by any Federal agency hereafter created by an act of Congress, the payment of the principal of and interest on which are unconditionally guaranteed by the United States of America as to the full and timely payment; provided, that, such obligations shall not include unit investment trusts or mutual fund obligations.

Gross Revenue Fund

“Gross Revenue Fund” means the fund by that name described in the Indenture.

Gross Revenues

“Gross Revenues” has the meaning ascribed to such term in the Regulatory Agreement.

Health Facility Construction Loan Insurance Fund

“Health Facility Construction Loan Insurance Fund” means the fund by that name established under the Insurance Law.

Holder or Bondholder

“Holder” or “Bondholder,” whenever used in the Indenture with respect to a Bond, means the person in whose name such Bond is registered.

Insurance and Condemnation Proceeds Fund

“Insurance and Condemnation Proceeds Fund” means the fund by that name established pursuant to the Indenture.

Insurance Law

“Insurance Law” means the California Health Facility Construction Loan Insurance Law, constituting Chapter 1, Part 6, Division 107 of the Health and Safety Code of the State, as now in effect and as it may from time to time hereafter be amended or supplemented.

Interest Account

“Interest Account” means the account by that name in the Revenue Fund established pursuant to the Indenture.

Investment Securities

“Investment Securities” means any of the following, except to the extent not permitted by the laws of the State as an investment for the moneys to be invested therein at the time of investment (provided that the Trustee shall be entitled to rely upon any Certificate of the District as conclusive certification to the Trustee that the investments described therein are permissible under the laws of the State):

(a) Direct obligations of the United States of America (including obligations issued or held in book-entry form on the books of the Department of the Treasury of the United States of America) or obligations the timely payment of the principal of and interest on which are fully guaranteed by the United States of America, including instruments evidencing an ownership interest in securities described in this clause (a) such as CATS, TIGRs, Treasury Receipts and Stripped Treasury Coupons;

(b) Obligations of any of the following federal agencies which obligations represent the full faith and credit of the United States of America (including stripped securities if the agency has stripped them itself)

- (i) U.S. Export-Import Bank;
- (ii) Farmers Home Administration;
- (iii) Federal Financing Bank;
- (iv) Federal Housing Administration;
- (v) General Services Administration;
- (vi) Government National Mortgage Association (“GNMA”) (including guaranteed mortgage-backed bonds and guaranteed pass-through obligations);
- (vii) Rural Economic Community Development Administration;
- (viii) Small Business Administration;
- (ix) U.S. Maritime Administration (guaranteed Title XI financing); and

(x) U.S. Department of Housing and Urban Development (including project notes, local authority bonds, new communities debentures, U.S. government guaranteed debentures, U.S. Public Housing Notes and Bonds and U.S. government guaranteed public housing notes and bonds;

(c) Debentures, bonds, notes or other evidence of indebtedness issued or guaranteed by any of the following U.S. government agencies which obligations are not fully guaranteed by the full faith and credit of the United States of America (including stripped securities if the agency has stripped them itself):

(i) Federal Home Loan Bank System (senior debt obligations);

(ii) Resolution Funding Corporation (REFCORP) obligations;

(iii) Federal Home Loan Mortgage Corporation (FHLMC or “Freddie Mac”) senior debt obligations or participation certificates;

(iv) Federal National Mortgage Association (FNMA or “Fannie Mae”) mortgage-backed securities and senior debt obligations;

(v) Senior debt obligations of other government sponsored agencies approved by the Office.

(d) Investments in money market funds registered under the Federal Investment Company Act of 1940, whose shares are registered under the Federal Securities Act of 1933, and having a rating by S&P of AAAm-G, AAAM or better (including funds for which the Trustee, its parent holding company, if any, or any affiliates or subsidiaries of the Trustee provide investment advisory or other management services);

(e) Pre-refunded municipal obligations defined as follows: any bonds or other obligations of any state of the United States of America or of any agency, instrumentality or local governmental unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice; and

(i) which are rated, based on an irrevocable escrow account or fund (the “Escrow”), in the highest rating category of Moody’s or S&P or any successors thereto; or

(ii) (A) which are fully secured as to principal, interest and redemption premium, if any, by an Escrow consisting only of cash or obligations described in paragraph (a) above, which Escrow may be applied only to the payment of such principal of and interest and redemption premium, if any, on such bonds or other obligations on the maturity date or dates thereof or the specified redemption date or dates pursuant to such irrevocable instructions, as appropriate, and (B) which Escrow is sufficient, as verified by a nationally recognized independent certified public accountant, to pay principal of and interest and redemption premium, if any on the bonds or other obligations described in this paragraph on the maturity date or dates specified in the irrevocable instructions referred to above, as appropriate;

(f) Repurchase agreements fully secured by collateral security described in clauses (a) (b), (c), or (h) of this definition, which collateral (i) is held by the Trustee or a third party agent during the term of such repurchase agreement, (ii) is not, pursuant to the terms of such agreement, subject to liens or claims of third parties and (iii) has a market value (determined at least once every five days) at least equal to the amount so invested;

(g) demand deposits, including trust accounts, trust funds, interest bearing money market accounts, overnight bank deposits, interest bearing deposits, banker’s acceptances or

certificates of deposit of, or time deposits in, any bank (including the Trustee or any of its affiliates) or savings and loan association (i) which certificates of deposit or time deposits are fully insured by the Federal Deposit Insurance Corporation or (ii) which certificates of deposit (including those placed by a third party pursuant to an agreement between the Trustee and the Corporations) or time deposits are secured at all times, in the manner and to the extent provided by law, by collateral security (described in clauses (a), (b), (c), or (h) of this definition) with a market value (valued at least quarterly) of no less than the original amount of moneys so invested;

(h) Municipal obligations rated “Aaa/AAA” on the basis of insurance or credit enhancement, provided the underlying rating of the municipal obligation must be at least “Baa/BBB,” uninsured or unenhanced municipal obligations rated at least Aa2/AA or general obligations of states with a rating of “A2/A” by Moody’s or S&P;

(i) U.S. dollar denominated deposit accounts, federal funds or bankers acceptances with domestic commercial banks which may include the Trustee and its affiliates which have a rating on their short term certificates of deposit on the date of purchase of “P-1” by Moody’s and “A-1” or “A-1+” by S&P (for purposes of rating, ratings on holding companies are not considered as the rating of the bank) and maturing not more than 360 calendar days after the date of purchase;

(j) the Local Agency Investment Fund of the State, created pursuant to Section 16429.1 of the California Government Code, to the extent the Trustee is authorized to register such investment in its name; and

(k) direct obligations of the State of California (including obligations issued or held in book-entry form on the books of the Office of the Treasurer of the State of California) or obligations the timely payment of the principal of and interest on which are fully guaranteed by the State of California; and

(l) Other forms of investments approved in writing by the Office.

“Law” means The Local Health Care District Law, constituting Division 23 of the Health and Safety Code of the State, as now in effect and as it may from time to time hereafter be amended or supplemented.

Mandatory Sinking Account Payment

“Mandatory Sinking Account Payment” means, with respect to Bonds of any Series and maturity, the amount required by the Indenture or any Supplemental Indenture to be paid by the District on any single date for the retirement of Term Bonds of such Series and maturity.

Maximum Annual Bond Service

“Maximum Annual Bond Service” means, as of any date of calculation, the sum of (1) the interest falling due on Bonds then Outstanding (assuming that all Serial Bonds then Outstanding are retired on their respective maturity dates and that all Term Bonds then Outstanding are retired at the times of and in the amounts provided for by Mandatory Sinking Account Payments), (2) the principal installments for Serial Bonds then Outstanding falling due by their terms, and (3) the amount of all Mandatory Sinking Account Payments required; all as computed for the Bond Year in which such sum shall be largest.

Moody's

“Moody’s” means Moody’s Investors Service, its successors and assigns, except that if such corporation shall no longer perform the function of a securities rating agency for any reason, the term “Moody’s” shall be deemed to refer to any other nationally recognized securities rating agency selected by the District.

Office

“Office” means the Office of Statewide Health Planning and Development of the State, and its successors.

Opinion of Counsel

“Opinion of Counsel” means a written opinion of counsel (who may be counsel for the District) selected by the District and not objected to by the Trustee.

Optional Redemption Account

“Optional Redemption Account” means the account by that name in the Redemption Fund established pursuant to the Indenture.

Outstanding

“Outstanding,” when used as of any particular time with reference to Bonds, means (subject to the provisions of the Indenture) all Bonds theretofore, or thereupon being, authenticated and delivered by the Trustee under the Indenture except: (1) Bonds theretofore cancelled by the Trustee or surrendered to the Trustee for cancellation; (2) Bonds with respect to which all liability of the District shall have been discharged in accordance with the Indenture, including Bonds (or portions of Bonds) referred to in the Indenture; and (3) Bonds for the transfer or exchange of or in lieu of or in substitution for which other Bonds shall have been authenticated and delivered by the Trustee pursuant to the Indenture.

Parity Debt

“Parity Debt” means Long-Term Indebtedness which is incurred by the District in accordance with the provisions of the Regulatory Agreement and is secured equally and ratably with the Bonds by a lien on and security interest in the Gross Revenues.

Person

“Person” means an individual, corporation, firm, association, partnership, trust, or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

Principal Account

“Principal Account” means the account by that name in the Revenue Fund established pursuant to the Indenture.

Principal Corporate Trust Office

“Principal Corporate Trust Office” means the corporate trust office of the Trustee, except that with respect to presentation of Bonds for payment or for registration of transfer and exchange, such term means the office or agency of the Trustee at which, at any particular time, its corporate trust agency business shall be conducted.

Rating Agency

“Rating Agency” means Moody’s or S&P.

Rebate Fund

“Rebate Fund” means the fund by that name established pursuant to the Indenture.

Record Date

“Record Date” means, with respect to any interest payment date for the Bonds, the fifteenth (15th) day of the calendar month preceding such interest payment date.

Redemption Fund

“Redemption Fund” means the fund by that name established pursuant to the Indenture.

Redemption Price

“Redemption Price” means, with respect to any Bond (or portion thereof) the principal amount of such Bond (or portion) plus the applicable premium, if any, payable upon redemption thereof pursuant to the provisions of such Bond and the Indenture.

Regulatory Agreement

“Regulatory Agreement” means that certain amended and restated regulatory agreement, dated as of July 1, 2016, and effective as of the date of issuance of the Series 2016 Bonds, by and between the Office and the District, and any amendment or supplement thereto, and includes any additional regulatory agreement between such parties relating to any Bonds at the time Outstanding.

Repository

“Repository” means the Municipal Securities Rulemaking Board or any other entity designated or authorized by the Securities and Exchange Commission or any successor agency thereto to receive reports and notices pursuant to the Securities and Exchange Commission Rule 15c2-12, as supplemented and amended from time to time.

Revenue Fund

“Revenue Fund” means the fund by that name established pursuant to the Indenture.

S&P

“S&P” means Standard & Poor’s Ratings Services, a Standard & Poor’s Financial Services LLC business, its successors and assigns, except that if such entity shall no longer perform the

functions of a securities rating agency for any reason, the term “S&P” shall be deemed to refer to any other nationally recognized securities rating agency selected by the District.

Securities Depository

“Securities Depository” means The Depository Trust Company and its successors and assigns, or any other securities depository selected as set forth in the Indenture, which agrees to follow the procedures required to be followed by such securities depository in connection with the Bonds.

Series

“Series,” whenever used in the Indenture with respect to Bonds, means all of the Bonds designated as being of the same series, authenticated and delivered in a simultaneous transaction, regardless of variations in maturity, interest rate, redemption and other provisions, and any Bonds thereafter authenticated and delivered upon transfer or exchange of or in lieu of or in substitution for (but not to refund) such Bonds as provided in the Indenture.

Sinking Accounts

“Sinking Accounts” means the subaccounts in the Principal Account so designated and established pursuant to the Indenture.

Special Record Date

“Special Record Date” means the date established by the Trustee pursuant to the Indenture as a record date for the payment of defaulted interest on Bonds.

Special Redemption Account

“Special Redemption Account” means the account by that name in the Redemption Fund established pursuant to the Indenture.

State

“State” means the State of California.

Supplemental Indenture

“Supplemental Indenture” means any indenture hereafter duly authorized and entered into between the District and the Trustee, amendatory of or supplemental to the Indenture; but only if and to the extent that such Supplemental Indenture is specifically authorized hereunder.

Tax Certificate

“Tax Certificate” means that certain tax certificate of the District, dated as of the date of issuance of the Series 2016 Bonds, as the same may be amended or supplemented in accordance with its terms, and includes any additional tax certificate of the District relating to any Bonds at the time Outstanding.

Tax-Exempt Bonds

“Tax-Exempt Bonds” means Bonds, the interest on which is excluded from the gross income of the holders thereof for federal income tax purposes upon the initial issuance thereof, regardless of whether such interest is includable as an item of tax preference or otherwise includable directly or indirectly for purposes of calculating other tax liabilities, including any alternative minimum tax or environmental tax under the Code.

Trustee

“Trustee” means The Bank of New York Mellon Trust Company, N.A., a national banking association organized and existing under the laws of the United States of America, and acting as an independent trustee with the rights and obligations provided in the Indenture, and its successors and assigns, or any other corporation or association which at any time may be substituted in its place as provided in the Indenture.

Issuance of Additional Series of Bonds. In addition to the Series 2016 Bonds, the District may by Supplemental Indenture establish one or more other Series of Bonds, payable from Gross Revenues and secured by the pledge made under the Indenture equally and ratably with Bonds previously issued, and the District may issue, and the Trustee may authenticate and deliver to the purchasers thereof, Bonds of any Series so established, in such principal amount as shall be determined by the District, but only upon compliance by the District with the provisions of the Indenture and any additional requirements set forth in such Supplemental Indenture and subject to the following specific conditions, which are made conditions precedent to the issuance of any such additional Series of Bonds:

- (a) No Event of Default shall have occurred and then be continuing.
- (b) The Supplemental Indenture providing for the issuance of such Series shall specify the purposes for which such Series is being issued, which shall be one or more of the following: (1) to provide moneys needed to acquire, install, construct or complete an Additional Project, including reimbursements of any sums advanced by the District for such purposes, by depositing into the Construction Account established for such Additional Project, as the case may be, the proceeds of such Series to be so applied, (2) to refund all or part of the Bonds of any one or more Series then Outstanding, by depositing with the Trustee, in trust, moneys or Investment Securities as more particularly provided in the Indenture in the necessary amount to discharge all liability of the District with respect to the Bonds to be refunded as provided in the Indenture and the related fees and expenses of the Trustee, or (3) to provide moneys needed to refund all or part of any other Long-Term Indebtedness. Such Supplemental Indenture may, but is not required to, provide for the payment of expenses incidental to such purposes, including the costs of issuance of such Series, interest on Bonds of such Series and, in the case of Bonds issued to refund other Bonds or Long-Term Indebtedness, expenses incident to calling, redeeming, paying or otherwise discharging the Bonds or Long-Term Indebtedness to be refunded.
- (c) The Supplemental Indenture providing for the issuance of such Series also shall require that the balance in the Bond Reserve Account, forthwith upon the receipt of the proceeds of the sale of such Series, be increased, if necessary, to an amount at least equal to the Bond Reserve Account Requirement with respect to all Bonds to be Outstanding upon the issuance of such Series.
- (d) The aggregate principal amount of Bonds issued hereunder shall not exceed any limitation imposed by law or by any Supplemental Indenture.

(e) The Office shall have agreed to insure such Series under the California Health Facility Construction Loan Insurance Law, provided, however, that the Office is then legally authorized to provide such insurance and such insurance is being offered.

(f) The conditions described in the Regulatory Agreement shall have been satisfied.

(g) The Supplemental Indenture providing for the issuance of such Series shall require that interest on such Series shall be payable on February 1 and August 1, and that principal of such Series shall be payable on February 1.

Nothing in the Indenture contained shall prevent or be construed to prevent the Supplemental Indenture providing for the issuance of Additional Bonds from pledging or otherwise providing, in addition to the security given or intended to be given by the Indenture, additional security for the benefit of such Additional Bonds or any portion thereof.

Nothing in the Indenture shall be construed to prohibit the District from issuing bonds under an indenture separate from the Indenture.

Pledge and Assignment; Gross Revenue Fund; Revenue Fund. Subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture, there are pledged to secure the payment of the principal of and interest on the Bonds in accordance with their terms and the provisions of the Indenture, all of the Gross Revenues and any other amounts (including proceeds of the sale of Bonds) held by the Trustee in any fund or account established pursuant to the Indenture (other than the Rebate Fund). Such pledge shall constitute a lien on and security interest in such assets and shall attach, be perfected and be valid and binding from and after delivery by the Trustee of the Bonds, without any physical delivery thereof or further act. The District assigns under the Indenture to the Trustee, for the benefit of the Holders from time to time of the Bonds, all of the right, title and interest of the District in the Contract of Insurance and the Regulatory Agreement. The Trustee shall be entitled to and shall take all steps, actions and proceedings reasonably necessary in its judgment to enforce, either jointly with the Office or separately, all of the rights of the District under the Contract of Insurance and the Regulatory Agreement.

The District agrees that, so long as any of the Bonds remain Outstanding, all of the Gross Revenues shall be deposited as soon as practicable upon receipt in a fund designated as the "Gross Revenue Fund" which the District has heretofore established and shall maintain at such banking or financial institution or institutions located in the State of California as the District shall from time to time designate for such purpose (in the Indenture called the "Depository Bank(s)"). Subject only to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in the Indenture, the District pledges and, to the extent permitted by law, grants a security interest to the Trustee in the Gross Revenue Fund to secure the payment of the principal of and interest on the Bonds and Parity Debt. Nothing in the Indenture shall be construed to impair or alter the pledge of Gross Revenues made to other outstanding Parity Debt holders.

Amounts in the Gross Revenue Fund may be used and withdrawn by the District at any time for any lawful purpose, except as hereinafter provided. If an Event of Default shall occur, the Trustee shall notify the District, the Office and the Depository Bank(s) of such Event of Default, and the Trustee, but only with the prior written approval of the Office, for so long as the Contract of Insurance is in effect and the Office is not in default thereunder, shall cause the Depository Bank(s) to, and the Depository Bank(s) shall, transfer the Gross Revenue Fund to the name and credit of the Trustee. The Gross Revenue Fund shall remain in the name and to the credit of the Trustee until all Events of Default known to the Trustee shall have been made good or cured or provision shall have been made therefor,

whereupon the Gross Revenue Fund shall be returned to the name and credit of the District. During any period that the Gross Revenue Fund is held in the name and to the credit of the Trustee, the Trustee shall, but only with the prior written approval of the Office, for so long as the Contract of Insurance is in effect and the Office is not in default thereunder, use and withdraw amounts in such fund from time to time to make the transfers and deposits required by the Indenture, payments with respect to Parity Debt and to such other payments (including payment of the Trustee's extraordinary fees and expenses) in the order which the Trustee, in its discretion, shall determine to be in the best interests of the Holders of the Bonds and holders of Parity Debt. During any period that the Gross Revenue Fund is held in the name and to the credit of the Trustee, the District shall not be entitled to use or withdraw any of the Gross Revenues unless and to the extent that the Trustee, with the prior written approval of the Office, so directs for the payment of current or past due operating expenses of the District. The District agrees to execute and deliver all instruments as may be required to implement this provision (including financing statements, continuation statements and deposit account control agreements). The District further agrees that a failure to comply with the terms of the Indenture shall cause irreparable harm to the Holders from time to time of the Bonds and shall entitle the Trustee, with or without notice, to take immediate action to compel the specific performance of the obligations of the District as provided in the Indenture.

The Trustee shall establish, maintain and hold in trust a special fund designated as the "Revenue Fund." On or before the first (1st) day of each month beginning with the month following the execution and delivery of the Indenture and as long as any of the Bonds remain Outstanding, the District shall pay to the Trustee for deposit in the Revenue Fund such amount as is required by the Trustee to make the transfers and deposits required in such month by the Indenture. The District's monthly payments shall be in such amounts so that (i) the full amount required for the payment of interest on the Bonds on each February 1 Interest Payment Date is on deposit with the Trustee by the January 1 preceding such February 1 Interest Payment Date, (ii) the full amount required for the payment of interest on Bonds on each August 1 Interest Payment Date is on deposit with the Trustee by the July 1 preceding such August 1 Interest Payment Date, and (iii) the full amount required for the payment of principal (or Mandatory Sinking Account Payment) on the Bonds on an August 1 principal payment date or Mandatory Sinking Account Payment date is on deposit with the Trustee by the July 1 preceding such August 1 principal payment date or Mandatory Sinking Account Payment date.

Notwithstanding the foregoing, if on the first (1st) day of the month prior to any interest or principal payment date with respect to the Bonds, the aggregate amount in the Revenue Fund (other than the Bond Reserve Account) is for any reason insufficient or unavailable to make the required payments of principal (or Redemption Price) of or interest on the Bonds then becoming due (whether by maturity, redemption or acceleration), the District shall forthwith transfer the amount of any such deficiency to the Trustee. Each transfer by the District to the Trustee hereunder shall be in lawful money of the United States of America and paid to the Trustee at its Principal Corporate Trust Office. All such moneys shall be promptly deposited by the Trustee upon receipt thereof in the Revenue Fund. All moneys deposited with the Trustee shall be held, disbursed, allocated and applied by the Trustee only as provided in the Indenture.

If by the fifth (5th) day of any month, the Trustee has not received moneys sufficient to make the transfers and deposits required in such month by the Indenture, the Trustee shall immediately notify the District and the Office of such insufficiency by facsimile and confirm such notification by written notice.

If thirty (30) days prior to an interest payment date or principal payment date, there are insufficient amounts in the Revenue Fund (other than the Bond Reserve Account) to pay the interest or principal becoming due on such date, the Trustee shall immediately notify the Office by telephone, telegram or telecopy and in writing. Such notice shall state:

(1) that available moneys held by the Trustee (other than in the Bond Reserve Account) will be insufficient to pay in full the next succeeding payment of principal and/or interest on the Bonds; and

(2) the amount by which the obligation to make such payment exceeds the amount available therefor (the "Shortfall").

Such notice shall request the Office to deposit an amount equal to the Shortfall into the Principal Account and/or Interest Account at least three (3) days prior to the date on which such payment is due. Such deposit may be made from the Bond Reserve Account upon notice to the Trustee by the Office by telegram, telex or other telecommunication device producing a written notice, or from the Health Facility Construction Loan Insurance Fund, as provided in the Regulatory Agreement.

Allocation of Gross Revenues. On or before the twenty-fifth (25th) day of each month, the Trustee shall transfer from the Revenue Fund and deposit into the following respective accounts, the following amounts, in the following order of priority, the requirements of each such account (including the making up of any deficiencies in any such account resulting from lack of Gross Revenues sufficient to make any earlier required deposit) at the time of deposit to be satisfied before any transfer is made to any account subsequent in priority:

First: to the Interest Account (which the Trustee shall establish and maintain within the Revenue Fund), one-sixth of the aggregate amount of interest becoming due and payable during the next ensuing six months on all Bonds then Outstanding, less any amounts to be transferred to the Interest Account from the Capitalized Interest Accounts for the payment of such interest, until the balance in such account is equal to such aggregate amount of interest (taking into account such transfers from the Capitalized Interest Accounts); provided that from the date of delivery of a Series of Bonds until the first interest payment date with respect to such Series (except to the extent interest to be paid with respect to such Series is to be transferred from a Capitalized Interest Account established for such Series), transfers from the Revenue Fund to the Interest Account on account of such Series shall be sufficient on a monthly pro rata basis to pay the aggregate amount of interest becoming due and payable on such interest payment date with respect to such Series;

Second: to the Principal Account (which the Trustee shall establish and maintain within the Revenue Fund), one-twelfth of the aggregate amount of principal becoming due and payable on the Outstanding Serial Bonds plus the aggregate amount of Mandatory Sinking Account Payments required to be paid into the respective Sinking Accounts for Outstanding Term Bonds, in each case during the next ensuing twelve months, until the balance in such account is equal to such aggregate amount of such principal and Mandatory Sinking Account Payments; provided that from the date of delivery of a Series of Bonds until the first principal payment date with respect to such Series (if less than twelve months), transfers to the Principal Account on account of such Series shall be sufficient on a monthly pro rata basis to pay the principal becoming due and payable on such principal payment date with respect to such Series; and

Third: to the Bond Reserve Account (which the Trustee shall establish and maintain within the Revenue Fund), one-twelfth of (i) the aggregate amount of each prior withdrawal from the Bond Reserve Account for the purpose of making up a deficiency in the Interest Account or Principal Account, or (ii) the aggregate amount necessary to raise the amount in the Bond Reserve Account to the Bond Reserve Account Requirement

because of a deficiency caused by a valuation pursuant to the Indenture) (until deposits on account of such withdrawal or deficiency are sufficient to fully restore the amount withdrawn or deficient); provided that no deposit need be made into the Bond Reserve Account so long as the balance in such account shall be at least equal to the Bond Reserve Account Requirement.

Fourth: upon direction of the District, to the Rebate Fund, such amounts as are required to be deposited therein by the Indenture.

Any moneys remaining in the Revenue Fund after the foregoing transfers shall be transferred first to the Office to the extent necessary to repay insurance advances made by the Office to the District (as directed by the Office to the Trustee in writing), including interest thereon as specified in the Regulatory Agreement, and thereafter to the District.

Application of Interest Account. All amounts in the Interest Account shall be used and withdrawn by the Trustee solely for the purpose of paying interest on the Bonds as it shall become due and payable (including accrued interest on any Bonds purchased or redeemed prior to maturity pursuant to the Indenture).

Application of Principal Account. All amounts in the Principal Account shall be used and withdrawn by the Trustee solely for the purposes of paying the principal of the Bonds when due and payable, except that all amounts in the Sinking Accounts shall be used and withdrawn by the Trustee solely to purchase or redeem or pay at maturity Term Bonds, as provided in the Indenture. The Trustee shall establish and maintain within the Principal Account a separate subaccount for the Term Bonds of each Series and maturity, designated as the “_____ Sinking Account,” inserting therein the Series and maturity (if more than one such account is established for such Series) designation of such Bonds. On or before the twenty-fifth (25th) day of each month, the Trustee shall transfer the amount deposited in the Principal Account pursuant to the Indenture for the purpose of making a Mandatory Sinking Account Payment (if such deposit is required in such month) from the Principal Account to the applicable Sinking Account. With respect to each Sinking Account, on each Mandatory Sinking Account Payment date established for such Sinking Account, the Trustee shall apply the Mandatory Sinking Account Payment required on that date to the redemption (or payment at maturity, as the case may be) of Term Bonds of the Series and maturity for which such Sinking Account was established, upon the notice and in the manner provided in the Indenture; provided that, at any time prior to selection of Bonds for redemption, the Trustee upon the Order of the District shall apply moneys in such Sinking Account to the purchase by the District of Term Bonds of such Series and maturity at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued interest, which is payable from the Interest Account) as shall be directed by the District, except that the purchase price (excluding accrued interest) shall not exceed the Redemption Price that would be payable for such Bonds upon redemption by application of such Mandatory Sinking Account Payment. If, during the twelve-month period immediately preceding such Mandatory Sinking Account Payment date, the Trustee upon Order of the District has purchased Term Bonds of such Series and maturity with moneys in such Sinking Account, or, during such period and prior to giving such notice of redemption, such Bonds were at any time purchased or redeemed by the Trustee from the Redemption Fund and allocable to such Mandatory Sinking Account Payment, such Bonds so purchased or deposited or redeemed shall be applied, to the extent of the full principal amount thereof, to reduce such Mandatory Sinking Account Payment. All Bonds purchased or deposited pursuant to this subsection shall be cancelled and delivered by the Trustee to or upon the Order of the District. Any amounts remaining in a Sinking Account when all of the Term Bonds for which such account was established are no longer Outstanding shall be withdrawn by the Trustee and transferred to the Revenue Fund, and such Sinking Account shall be closed. Subject to a different allocation provided in a Supplemental Indenture for a Series of Bonds issued pursuant to such Supplemental Indenture, all

Term Bonds purchased from a Sinking Account or deposited by the District with the Trustee shall be allocated as set forth in a schedule prepared by the District and provided to the Trustee, subject to the terms of the Tax Certificate for the applicable Bonds.

Application of Bond Reserve Account. The Trustee shall establish and maintain within the Bond Reserve Account a separate Bond Proceeds Account and a separate Deposit Account. All amounts deposited in the Bond Reserve Account from the proceeds of any Series of Bonds shall be credited to the Bond Proceeds Account. Any amounts deposited in the Bond Reserve Account from any other sources (including moneys transferred from the Revenue Fund and any other moneys deposited in the Bond Reserve Account by the District, which deposits the Trustee shall accept) shall be credited to the Deposit Account. All amounts in the Bond Reserve Account shall be used and withdrawn by the Trustee (first from the Bond Proceeds Account and then from the Deposit Account) solely for the purpose of making up any deficiency in the Interest Account or Principal Account (but only upon Order of the Office directing such use with respect to such account or accounts), or (together with any other moneys available therefor) for the payment or redemption of all Bonds then Outstanding. On the fifth day of the month in which a valuation is made pursuant to the following paragraph, any amount in the Bond Reserve Account in excess of the Bond Reserve Account Requirement shall be transferred (first from the Bond Proceeds Account and then from the Deposit Account) to the Principal Account.

All Investment Securities in the Bond Reserve Account shall be valued by the Trustee at their Fair Market Value annually on February 1 (or more frequently if requested in writing by the District, but not more frequently than quarterly), and such valuation shall be reported immediately to the District. Any amount in the Bond Reserve Account in excess of 100% of the Bond Reserve Account Requirement shall then be transferred, upon Request of the District, to the District. To the extent that amounts in the Bond Reserve Account are less than 90% of the Bond Reserve Account Requirement, the District shall within sixty (60) days after receiving notice of such valuation pay to the Trustee an amount sufficient to increase the balance in the Bond Reserve Account to the Bond Reserve Account Requirement. The Trustee may engage an independent consultant, at the District's expense, to make this valuation. The Trustee shall have no duty in connection with the determination of Fair Market Value other than to follow its normal practice in determining the value of Investment Securities, which may include utilizing computerized securities pricing services that may be available to it, including those available through its regular accounting system.

Application of Redemption Fund. The Trustee shall establish and maintain within the Redemption Fund (which the Trustee shall establish, maintain and hold in trust) a separate Optional Redemption Account and a separate Special Redemption Account. The District may at any time deposit moneys into the Optional Redemption Account for the purposes of redeeming Bonds in accordance with the terms of the Indenture. All amounts deposited in the Optional Redemption Account and in the Special Redemption Account shall be used and withdrawn by the Trustee solely for the purpose of redeeming Bonds, in the manner and upon the terms and conditions specified in the Indenture, at the next succeeding date of redemption for which notice has not been given and at the redemption prices then applicable to redemptions from the Optional Redemption Account and the Special Redemption Account, respectively; provided that, at any time prior to selection of Bonds for redemption, the Trustee upon Order of the District shall apply such amounts to the purchase of Bonds by the District at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued interest, which is payable from the Interest Account) as shall be directed by the District, except that the purchase price (exclusive of accrued interest) may not exceed the par value of such Bonds. One or more Supplemental Indentures may provide for the establishment of subaccounts within the Optional Redemption Account or the Special Redemption Account for the redemption or purchase of Bonds of particular Series from moneys allocable to such Series and required by a Supplemental Indenture to be deposited into such subaccount. Subject to a different allocation provided for such subaccounts by Supplemental Indentures,

all Term Bonds purchased or redeemed from the Redemption Fund shall be allocated as set forth in a schedule prepared by the District and provided to the Trustee, subject to the terms of the Tax Certificate for the applicable Bonds. The Trustee at the direction from the District will set up defeasance account pursuant to the Indenture.

Investment of Moneys in Funds and Accounts. Subject to the provisions of the Indenture, all moneys in any of the funds and accounts established pursuant to the Indenture shall be invested by the Trustee solely in Investment Securities, as directed pursuant to the Request of the District filed with the Trustee at least two (2) Business Days in advance of the making of such investments. In the absence of any such directions from the District, the Trustee shall invest any such moneys in Investment Securities described in clause (d) of the definition thereof; provided, however, that so long as the Trustee is The Bank of New York Mellon Trust Company, N.A., the Trustee shall invest such money in the money market fund set forth in the letter of authorization and direction executed by the District and delivered to the Trustee. If no specific money market fund has been specified by the District, the Trustee shall hold such money in cash, uninvested, until specific investment directions are provided by the District to the Trustee. Obligations purchased as an investment of moneys in any fund shall be deemed to be part of such fund or account. All interest or gain derived from the investment of amounts in any of the funds or accounts established hereunder shall be deposited in the fund or account from which such investment was made. The Trustee may act as principal or agent in the acquisition of any investment. The Trustee shall incur no liability for losses arising from any investments made pursuant to the Indenture. The District acknowledges that to the extent regulations of the Comptroller of the Currency or other applicable regulatory entity grant the District the right to receive brokerage confirmations of security transactions as they occur, the District specifically waives receipt of such confirmations to the extent permitted by law. The Trustee will furnish the District with monthly account statements as provided in the Indenture which include detail for all investment transactions made by the Trustee hereunder. All Investment Securities shall be acquired subject to the limitations set forth in the Indenture, the limitations as to maturities set forth in the Indenture and such additional limitations or requirements consistent with the foregoing as may be established by Request of the District. The Trustee shall value all investments held under the Indenture at least annually. For investment purposes, the Trustee may commingle the funds and accounts established hereunder, but shall account for each separately.

Moneys in the Bond Reserve Account shall be invested in Investment Securities maturing prior to the final maturity of the Bonds. Moneys in the remaining funds and accounts shall be invested in Investment Securities maturing not later than the date on which it is estimated that such moneys will be required by the Trustee. Investment Securities purchased under a repurchase agreement or an investment agreement shall be deemed to mature on the date or dates on which the Trustee may either deliver such Investment Securities for repurchase or withdraw funds under such agreement, without penalty.

Punctual Payment. The District shall punctually pay or cause to be paid the principal or Redemption Price and interest to become due in respect of all the Bonds, in strict conformity with the terms of the Bonds and of the Indenture, according to the true intent and meaning thereof, and shall punctually pay or cause to be paid all Mandatory Sinking Account Payments, but only out of Gross Revenues and other assets pledged for such payment as provided in the Indenture.

Events of Default. The following events shall be Events of Default under the Indenture:

(a) default in the due and punctual payment of the principal or Redemption Price of any Bond when and as the same shall become due and payable, whether at maturity as therein expressed, by proceedings for redemption, by declaration or otherwise, or default in the redemption from any Sinking Account of any Term Bonds in the amounts and at the times provided therefor;

(b) default in the due and punctual payment of any installment of interest on any Bond when and as such interest installment shall become due and payable;

(c) default in the due and punctual payment of any monthly payment to the Trustee required by the Indenture, if such default shall have continued for a period of fifteen (15) days after written notice thereof, specifying such default and requiring the same to be remedied, shall have been given to the District by the Trustee or the Office.

(d) default by the District in the observance of any of the covenants, agreements or conditions on its part in the Indenture, the Regulatory Agreement, the Contract of Insurance or in the Bonds contained (other than as referred to in subsections (a), (b) or (c) of this Section), if such default shall have continued for a period of sixty (60) days after written notice thereof, specifying such default and requiring the same to be remedied, shall have been given to the District by the Trustee, or to the District and the Trustee by the Holders of not less than twenty-five per cent (25%) in aggregate principal amount of the Bonds at the time Outstanding;

(e) abandonment of the Facilities, or any substantial part thereof by the District, and such abandonment shall continue for a period of sixty (60) days after written notice thereof shall have been given to the District by the Trustee, or to the District and the Trustee by the Holders of not less than twenty-five percent (25%) in aggregate principal amount of the Bonds at the time Outstanding;

(f) existence of any default under any agreement respecting Long-Term Indebtedness with an outstanding principal amount in excess of five percent of Adjusted Annual Operating Revenues of the District for the most recent Fiscal Year for which audited financial statements are available and if, as a result thereof, such Long-Term Indebtedness shall be declared immediately due and payable or a proceeding is brought for enforcement thereof; or

(g) filing by the District of a petition in voluntary bankruptcy, for the composition of its affairs or for its corporate reorganization under any state or federal bankruptcy or insolvency law, or making of an assignment for the benefit of creditors, or admission in writing to its insolvency or inability to pay debts as they mature, or consent in writing to the appointment of a trustee or receiver for itself or for the whole or any substantial part of the Facilities.

Acceleration of Maturities. If an Event of Default shall occur, then, and in each and every such case during the continuance of such Event of Default, the Trustee or the Holders of not less than a majority in aggregate principal amount of the Bonds at the time Outstanding or the Office shall be entitled, upon notice in writing to the District and the Office, to declare the principal of all of the Bonds then Outstanding, and the interest accrued thereon, to be due and payable immediately, and upon any such declaration the same shall become and shall be immediately due and payable, anything in the Indenture or in the Bonds contained to the contrary notwithstanding; provided, however, that no such declaration may be made if the Contract of Insurance is in effect and the Office is not in default thereunder unless (i) the Trustee is required to make such declaration pursuant to the Indenture, or (ii) the Office consents to such acceleration and agrees to pay an amount equal to the full principal amount of Bonds then Outstanding and interest thereon at the stated interest rates on the Bonds to the date of acceleration.

Any such declaration is further subject to the condition that if, at any time after such declaration and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the District or the Office shall deposit with the Trustee a sum sufficient to pay all the principal or Redemption Price of and installments of interest on the Bonds payment of which is overdue, with interest on such overdue principal at the rate borne by the respective Bonds, and the reasonable charges and expenses of the Trustee, and any and all other defaults known to the Trustee (other than in the

payment of principal of and interest on the Bonds due and payable solely by reason of such declaration) shall have been made good or cured to the satisfaction of the Trustee or provision deemed by the Trustee to be adequate shall have been made therefor, then, and in every such case, the Holders of not less than a majority in aggregate principal amount of the Bonds then Outstanding, by written notice to the District, the Office and the Trustee, or the Trustee if such declaration was made by the Trustee, may, on behalf of the Holders of all of the Bonds, rescind and annul such declaration and its consequences and waive such default; but no such rescission and annulment shall extend to or shall affect any subsequent default, or shall impair or exhaust any right or power consequent thereon. Notwithstanding the foregoing, the Trustee shall waive any Event of Default which is caused solely by a default under the Regulatory Agreement if the Office waives such default in writing.

Collection Upon Insurance. Upon the occurrence and continuance of an Event of Default, the Trustee shall proceed to take such steps as are necessary to collect upon the insurance provided by the Insurance Law. If the Office and the Treasurer of the State elect to pay such insurance by means of debentures of the Office's Health Facility Construction Loan Insurance Fund, the Trustee shall immediately provide notice of the exchange of such debentures for the Bonds then Outstanding in the same manner as for notice of redemption pursuant to the Indenture, and shall deliver to each Bondholder, as soon as practicable after surrender of such Bondholder's Bonds, debentures in the same aggregate principal amount (plus accrued interest thereon) and maturities as such Bonds, bearing interest at such rate or rates equal to the rates on the respective Bonds.

Application of Gross Revenues and Other Funds After Default. If an Event of Default shall occur and be continuing, all Gross Revenues and any other funds then held or thereafter received by the Trustee under any of the provisions of the Indenture shall be applied by the Trustee as follows and in the following order:

(1) To the Trustee for the payment and reimbursement for reasonable fees for its services rendered hereunder and all advances, if any, including interest on all such advances at its prime rate then in effect, reasonable external counsel fees (including expenses), the reasonable allocated cost of internal legal services (to the extent such services are not redundant of services performed by external counsel) and all reasonable disbursements of internal counsel, and other expenses reasonably and necessarily made or incurred by the Trustee in connection with such services and, in the Event of Default, the Trustee shall have a first and prior lien on the funds held hereunder to secure the same; provided, however, that in no event shall the Trustee have a lien on premiums paid in connection with an optional redemption of Bonds or of any moneys held for the benefit of Holders; provided further, however, that no fees, charges, expenses or disbursements shall be made from moneys derived from the Contract of Insurance);

(2) To the payment of the principal or Redemption Price of and interest then due on the Bonds (upon presentation of the Bonds to be paid, and stamping thereon of the payment if only partially paid, or surrender thereof if fully paid) subject to the provisions of the Indenture, as follows:

(a) Unless the principal of all of the Bonds shall have become or have been declared due and payable,

First: To the payment to the Persons entitled thereto of all installments of interest then due in the order of the maturity of such installments, and, if the amount available shall not be sufficient to pay in full any installment or installments maturing on the same date, then to the payment thereof ratably, according to the amounts due thereon, to the Persons entitled thereto, without any discrimination or preference; and

Second: To the payment to the Persons entitled thereto of the unpaid principal or Redemption Price of any Bonds which shall have become due, whether at maturity or by call for redemption, in the order of their due dates, with interest on the overdue principal at the rate borne by the respective Bonds, and, if the amount available shall not be sufficient to pay in full all the Bonds due on any date, together with such interest, then to the payment thereof ratably, according to the amounts of principal or Redemption Price due on such date to the Persons entitled thereto, without any discrimination or preference.

(b) If the principal of all of the Bonds shall have become or have been declared due and payable, to the payment of the principal and interest then due and unpaid upon the Bonds, with interest on the overdue principal at the rate borne by the respective Bonds, and, if the amount available shall not be sufficient to pay in full the whole amount so due and unpaid, then to the payment thereof ratably, without preference or priority of principal over interest, or of interest over principal, or of any installment of interest over any other installment of interest, or of any Bond over any other Bond, according to the amounts due respectively for principal and interest, to the Persons entitled thereto without any discrimination or preference;

(3) To the Office to the extent necessary to repay insurance advances (including interest thereon) made by the Office to the District.

Trustee to Represent Bondholders. The Trustee is irrevocably appointed under the Indenture (and the successive respective Holders of the Bonds, by taking and holding the same, shall be conclusively deemed to have so appointed the Trustee) as trustee and true and lawful attorney-in-fact of the Holders of the Bonds for the purpose of exercising and prosecuting on their behalf such rights and remedies as may be available to such Holders under the provisions of the Bonds, the Indenture, the Regulatory Agreement, the Contract of Insurance, the Law (including Section 32127.2 of the California Health and Safety Code) and applicable provisions of any other law. Upon the occurrence and continuance of an Event of Default or other occasion giving rise to a right in the Trustee to represent the Bondholders, the Trustee in its discretion may, and upon the written request of the Holders of not less than twenty-five per cent (25%) in aggregate principal amount of the Bonds then Outstanding (or, if more than one such request is received, the written request executed by the Holders of the greatest percentage of Bonds then Outstanding in excess of twenty-five percent (25%)), and upon being indemnified to its satisfaction therefor, shall, in each case (except in the case of an Event of Default arising under the tax covenants of the Indenture) with the written consent of the Office (so long as the Contract of Insurance is in effect and the Office is not in default thereunder), proceed to protect or enforce its rights or the rights of such Holders by such appropriate action, suit, mandamus or other proceedings as it shall deem most effectual to protect and enforce any such right, at law or in equity, either for the specific performance of any covenant or agreement contained in the Indenture, or in aid of the execution of any power in the Indenture granted, or for the enforcement of any other appropriate legal or equitable right or remedy vested in the Trustee or in such Holders under the Indenture, the Regulatory Agreement, the Contract of Insurance, the Law (including Section 32127.2 of the California Health and Safety Code) or any other law; and upon instituting such proceeding, the Trustee shall be entitled, as a matter of right, to the appointment of a receiver of the Gross Revenues and other assets pledged under the Indenture, pending such proceedings. All rights of action under the Indenture or the Bonds or otherwise may be prosecuted and enforced by the Trustee without the possession of any of the Bonds or the production thereof in any proceeding relating thereto, and any such suit, action or proceeding instituted by the Trustee shall be brought in the name of the Trustee for the benefit and protection of all the Holders of such Bonds, subject to the provisions of the Indenture.

Office and Bondholders' Direction of Proceedings. Anything in the Indenture to the contrary notwithstanding, the Office (so long as the Contract of Insurance is in effect and the Office is not

in default thereunder) and/or Holders of a majority in aggregate principal amount of the Bonds then Outstanding, in each case (except in the case of an Event of Default arising as otherwise provided in the Indenture) where the Holders seek to direct proceedings with the written consent of the Office (so long as the Contract of Insurance is in effect and the Office is not in default thereunder), shall have the right, by an instrument or concurrent instruments in writing executed and delivered to the Trustee, to direct the method of conducting all remedial proceedings taken by the Trustee hereunder, provided that such direction shall not be otherwise than in accordance with law and the provisions of the Indenture, and that, unless the Office is the Holder of all Bonds or has caused all Bonds to be paid in full, the Trustee shall have the right to decline to follow any such direction which in the opinion of the Trustee would be unjustly prejudicial to Bondholders not parties to such direction or which may involve the Trustee in personal liability.

Anything in the Indenture to the contrary notwithstanding, if any of the following has occurred and is continuing:

(1) the District files a petition in voluntary bankruptcy, for the composition of its affairs or for its corporate reorganization under any state or federal bankruptcy or insolvency law, or makes an assignment for the benefit of creditors, or admits in writing to its insolvency or inability to pay debts as they mature, or consents in writing to the appointment of a trustee or receiver for itself or for the whole or any substantial part of the Facilities;

(2) a court of competent jurisdiction enters an order, judgment or decree declaring the District insolvent, or adjudging it bankrupt, or appointing a trustee or receiver of the District or of the whole or any substantial part of the Facilities, or approving a petition filed against the District seeking reorganization of the District under any applicable law or statute of the United States of America or any state thereof, and such order, judgment or decree has not been vacated or set aside or stayed within sixty (60) days from the date of the entry thereof; or

(3) under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction assumes custody or control of the District or of the whole or any substantial part of the Facilities, and such custody or control is not terminated within sixty (60) days from the date of assumption of such custody or control;

then, so long as the Contract of Insurance is in effect and the Office is not in default thereunder, the Office shall have the right to vote in the place and stead of all Holders with respect to any plan of reorganization, on any agreement for composition of creditors, and on any assignment for the benefit of creditors.

Limitation on Bondholders' Right to Sue. No Holder of any Bond shall have the right to institute any suit, action or proceeding at law or in equity, for the protection or enforcement of any right or remedy under the Indenture, the Law or any other applicable law with respect to such Bond, unless (1) such Holder shall have given to the Trustee written notice of the occurrence of an Event of Default; (2) the Holders of not less than twenty-five per cent (25%) in aggregate principal amount of the Bonds then Outstanding shall have made written request upon the Trustee to exercise the powers hereinbefore granted or to institute such suit, action or proceeding in its own name; provided that, if more than one such request is received, the written request referred to in the Indenture shall mean the request executed by the Holders of the greatest percentage of Bonds then Outstanding in excess of twenty-five percent (25%); (3) such Holder or such Holders shall have tendered to the Trustee indemnity reasonable to the Trustee against the costs, expenses and liabilities to be incurred in compliance with such request; (4) the Trustee shall have refused or omitted to comply with such request for a period of sixty (60) days after such written request shall have been received by, and such tender of indemnity shall have been made

to, the Trustee; (5) except in the case of an Event of Default arising under the tax covenants section of the Indenture, the Office consents in writing to the action specified in such request (provided that such consent shall be required only so long as the Contract of Insurance is in effect and the Office is not in default thereunder); and (6) any suit, action or proceeding instituted by a Bondholder shall conform to that contemplated by the request.

Such notification, request, tender of indemnity and refusal or omission are hereby declared, in every case, to be conditions precedent to the exercise by any Holder of Bonds of any remedy hereunder or under law; it being understood and intended that no one or more Holders of Bonds shall have any right in any manner whatever by his or their action to affect, disturb or prejudice the security of the Indenture or the rights of any other Holders of Bonds, or to enforce any right under the Indenture, the Regulatory Agreement, the Contract of Insurance, the Law (including Section 32127.2 of the California Health and Safety Code) or other applicable law with respect to the Bonds, except in the manner provided in the Indenture, and that all proceedings at law or in equity to enforce any such right shall be instituted, had and maintained in the manner provided in the Indenture and for the benefit and protection of all Holders of the Outstanding Bonds, subject to the provisions of the Indenture.

Absolute Obligation of District. Nothing in the Indenture, or in the Bonds, contained shall affect or impair the obligation of the District, which is absolute and unconditional, to pay the principal or Redemption Price of and interest on the Bonds to the respective Holders of the Bonds at their respective dates of maturity, or upon call for redemption, as provided in the Indenture, but only out of the Gross Revenues and other assets pledged in the Indenture therefor, or affect or impair the right of such Holders, which is also absolute and unconditional, to enforce such payment by virtue of the contract embodied in the Bonds.

Amendments Permitted.

(A) The Indenture and the rights and obligations of the District and of the Holders of the Bonds and of the Trustee may be modified or amended from time to time and at any time by a Supplemental Indenture, which the District and the Trustee may execute when the written consent of (i) the Office or (ii) the Office and the Holders of a majority in aggregate principal amount of the Bonds then Outstanding shall have been filed with the Trustee; provided that if such modification or amendment will, by its terms, not take effect so long as any Bonds of any particular maturity remain Outstanding, the consent of the Holders of such Bonds shall not be required and such Bonds shall not be deemed to be Outstanding for the purpose of any calculation of Bonds Outstanding under the Indenture. No such modification or amendment shall (1) extend the fixed maturity of any Bond, or reduce the amount of principal thereof, or extend the time of payment or reduce the amount of any Mandatory Sinking Account Payment provided in the Indenture for the payment of any Bond, or reduce the rate of interest thereon, or extend the time of payment of interest thereon, or reduce any premium payable upon the redemption thereof, without the consent of the Holder of each Bond so affected, or (2) reduce the aforesaid percentage of Bonds the consent of the Holders of which is required to effect any such modification or amendment, or permit the creation of any lien on the Gross Revenues and other assets pledged under the Indenture prior to or on a parity with the lien created by the Indenture, or deprive the Holders of the Bonds of the lien created by the Indenture on such Gross Revenues and other assets (except as expressly provided in the Indenture), or terminate the insurance of the Bonds, without the consent of the Holders of all of the Bonds then Outstanding. It shall not be necessary for the consent of the Bondholders to approve the particular form of any Supplemental Indenture, but it shall be sufficient if such consent shall approve the substance thereof. Promptly after the execution by the District and the Trustee of any Supplemental Indenture pursuant to this subsection (A), the Trustee shall mail a notice on behalf of the District, setting forth in general terms the substance of such Supplemental Indenture to the Bondholders at the addresses

shown on the registration books maintained by the Trustee. Any failure to give such notice, or any defect therein, shall not, however, in any way impair or affect the validity of any such Supplemental Indenture.

(B) The Indenture and the rights and obligations of the District, of the Trustee and of the Holders of the Bonds may also be modified or amended from time to time and at any time by a Supplemental Indenture, which the District and the Trustee may execute without the consent of any Bondholders but with the written consent of the Office, but only to the extent permitted by law and only for any one or more of the following purposes:

(1) to add to the covenants and agreements of the District in the Indenture contained other covenants and agreements thereafter to be observed, to pledge or assign additional security for the Bonds (or any portion thereof), or to surrender any right or power reserved to or conferred upon the District, provided, that no such covenant, agreement, pledge, assignment or surrender shall materially adversely affect the interests of the Holders of the Bonds;

(2) to make such provisions for the purpose of curing any ambiguity, inconsistency or omission, or of curing or correcting any defective provision, contained in the Indenture, or in regard to matters or questions arising under the Indenture, as the District may deem necessary or desirable, and which shall not materially adversely affect the interests of the Holders of the Bonds;

(3) to provide for the issuance of a Series of Bonds, and to provide the terms and conditions under which such Bonds may be issued, subject to and in accordance with the provisions of the Indenture.

Discharge of Indenture. Bonds of any Series may be paid by the District in any of the following ways; provided that the District also pays or causes to be paid any other sums payable hereunder by the District and related to the respective Series:

(a) by paying or causing to be paid the principal or Redemption Price of and interest on Bonds Outstanding of the Series, as and when the same become due and payable;

(b) by depositing with the Trustee, in trust, at or before maturity, money or securities in the necessary amount to pay or redeem Bonds Outstanding of the Series; or

(c) by delivering to the Trustee, for cancellation by it, Bonds Outstanding of the Series.

If the District shall pay all Series for which any Bonds are Outstanding and shall also pay or cause to be paid all other sums payable hereunder by the District, then and in that case, at the election of the District (evidenced by a Certificate of the District, filed with the Trustee, signifying the intention of the District to discharge all such indebtedness and the Indenture), and notwithstanding that any Bonds shall not have been surrendered for payment, the Indenture and the pledge of Gross Revenues and other assets made under the Indenture and all covenants, agreements and other obligations of the District under the Indenture shall cease, terminate, become void and be completely discharged and satisfied, except only as otherwise provided in the Indenture. In such event, upon Request of the District, the Trustee shall cause an accounting for such period or periods as may be requested by the District to be prepared and filed with the District and shall execute and deliver to the District all such instruments as may be necessary or desirable to evidence such discharge and satisfaction, and the Trustee shall pay over, transfer, assign or deliver to the District all moneys or securities or other property held by it pursuant to the Indenture (other

than amounts held in the Rebate Fund) which are not required for the payment or redemption of Bonds not theretofore surrendered for such payment or redemption.

Discharge of Liability on Bonds. Upon the deposit with the Trustee, in trust, at or before maturity, of money or securities in the necessary amount to pay or redeem any Outstanding Bond (whether upon or prior to its maturity or the redemption date of such Bond), provided that, if such Bond is to be redeemed prior to maturity, notice of such redemption shall have been given as in the Indenture provided or provision satisfactory to the Trustee shall have been made for the giving of such notice, then all liability of the District in respect of such Bond shall cease, terminate and be completely discharged, except only that thereafter the Holder thereof shall be entitled to payment of the principal of and interest on such Bond by the District, and the District shall remain liable for such payment, but only out of such money or securities deposited with the Trustee as aforesaid for such payment, provided further, however, that the provisions of the Indenture shall apply in all events.

The District may at any time surrender to the Trustee for cancellation by it any Bonds previously issued and delivered which the District may have acquired in any manner whatsoever, and such Bonds, upon such surrender and cancellation, shall be deemed to be paid and retired.

Liability of District Limited to Gross Revenues. Notwithstanding anything in the Indenture or in the Bonds contained, the District shall not be required to advance any moneys derived from any source other than the Gross Revenues and other assets pledged under the Indenture for any of the purposes in the Indenture mentioned, whether for the payment of the principal or Redemption Price of or interest on the Bonds or for any other purpose of the Indenture.

FORM OF AMENDED AND RESTATED REGULATORY AGREEMENT

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RECORDING REQUESTED BY
AND WHEN RECORDED MAIL TO:
Norton Rose Fulbright US LLP
555 South Flower Street, Suite 4100
Los Angeles, California 90071
Attention: Russell C. Trice, Esq.

**AMENDED AND RESTATED REGULATORY AGREEMENT
STATE OF CALIFORNIA
OFFICE OF STATEWIDE HEALTH PLANNING AND DEVELOPMENT
HEALTH FACILITY CONSTRUCTION LOAN INSURANCE**

Dated as of:	July 1, 2016
Amended and Restated as of:	July __, 2016
Office Insured Loan No. (10/2009):	0929
Office Insured Loan No. (3/2010):	0944
Office Insured Loan No. (7/2010):	0945
Office Insured Loan No. (2016):	
Amount of 2009 Bonds:	\$
Amount of 2010 Insured Line of Credit:	\$
Amount of 2010 Bonds:	\$
Amount of 2016 Bonds:	\$
Borrowing District:	Mendocino Coast Health Care District
Trustee:	The Bank of New York Mellon Trust Company, N.A.
Date of 2009 Bonds:	October 14, 2009
Amount of 2010 Insured Line of Credit	March 1, 2010
Date of 2010 Bonds:	July 8, 2010
Date of 2016 Bonds:	July __, 2016
Deed of Trust Recorded in:	County of Mendocino, State of California
Date Deed of Trust Recorded:	October 13, 2009, April 20, 2010, July 7, 2010 and July __, 2016
Regulatory Agreement Recorded in:	County of Mendocino, State of California
Date Amended and Restated Regulatory Agreement Recorded:	_____, 2016
Title Insurance Policy Issuer (2009 Bonds):	Chicago Title Insurance Company
Title Insurance Policy Number (2009 Bonds):	CACTI 7734-7734-2311-0235101623-009-14
Title Insurance Policy Issuer (2010 Bonds):	Chicago Title Insurance Company
Title Insurance Policy Number (2010 Bonds):	CACTI 7734-7734-2311-0235101957-CTIC-2010-14
Title Insurance Policy Issuer (2016 Bonds):	Chicago Title Insurance Company
Title Insurance Policy Number (2016 Bonds):	
Borrower's Fiscal Year:	From July 1 to June 30
Type of Facilities:	District Hospital
Project (2009):	To finance the acquisition, construction, improvement and equipping of certain health care facilities of the District
Project (3/2010):	To secure a Line of Credit
Project (7/2010):	To (a) finance certain central plant improvements at its acute care hospital facility located in Fort Bragg, California, and to reimburse the District for costs thereof previously made, including but not limited to any or all expenses incidental thereto or connected therewith, (b) finance certain SB 1953-mandated earthquake retrofit improvements to the District's health care facilities, and (c) to finance additional improvements to the District's health care facilities.
Project (__/2016):	

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AMENDED AND RESTATED REGULATORY AGREEMENT

This AMENDED AND RESTATED REGULATORY AGREEMENT (this “Regulatory Agreement”), dated as of the date set forth on the cover hereof, and effective as of _____, 2016, is by and between the Borrowing District set forth on the cover hereof, a local healthcare district of the State of California (“District”), and the Office of Statewide Health Planning and Development of the State of California (“Office”), amending, supplementing and restating that certain regulatory agreement, dated as of July 1, 2010, between the District and the Office, recorded in the official records of the County of Mendocino, State of California, on July 7, 2010, in book _____, page _____, as amended by that certain First Amendment to Amended and Restated Regulatory Agreement, dated as of March 1, 2010, between the District and the Office (together, the “2010 Regulatory Agreement”).

WHEREAS, the Office is authorized to enter into this Regulatory Agreement pursuant to California Health and Safety Code sections 127045 and 129105;

WHEREAS, the Director of the Office is authorized to enter into this Regulatory Agreement on behalf of the Office pursuant to California Health and Safety Code section 127010 and California Government Code section 11150, *et seq.*;

WHEREAS, the undersigned Deputy Director of the Office was appointed by the Director of the Office to act on the Director’s behalf pursuant to Delegation Order 16.03, effective April 25, 2016, and is so authorized by California Health and Safety Code Section 7 and California Government Code Sections 1194, 7 and 18572;

WHEREAS, the District is authorized to enter into this Regulatory Agreement pursuant to the District’s resolution dated June 30, 2016;

WHEREAS, the District and the Office entered into the 2010 Regulatory Agreement in connection with the issuance by the Office of the 2010 Bonds (hereinafter defined);

WHEREAS, the District has requested that the Office insure the 2016 Bonds (hereinafter defined) and the Office has agreed to so insure the 2016 Bonds with one of the conditions being the amendment, supplementation, and restatement of the 2010 Regulatory Agreement;

NOW, THEREFORE, in consideration of the insurance by the Office of the Bonds (hereinafter defined), the proceeds of which will be used by the District for the Project (hereinafter defined) of the District; and in order to comply with the requirements of the Insurance Law (hereinafter defined), the District and the Office agree for themselves, their successors and assigns, that in connection with the Facilities (hereinafter defined) so long as the Contract of Insurance (hereinafter defined) continues in effect and thereafter if and so long as the Office shall be the owner of the security interest created pursuant to the Indenture (hereinafter defined) and the Deed of Trust (hereinafter defined):

SECTION I
Definitions

A. Unless the context clearly otherwise requires, all capitalized terms not defined below and used herein shall have the meanings assigned to such terms in the Indenture hereinafter defined.

B. As used in this Regulatory Agreement the term:

1. “*Accountant*” means any Independent certified public accountant or firm of such accountants with a national or regional reputation selected by the District and not objected to by the Office, and so long as such Accountant is acceptable to the Office. The initial Accountant of TCA Partners, LLP, is acceptable to the Office.

2. “*Adjusted Annual Operating Revenues*” means operating revenue and investment income of the District, less contractual allowances, allowance for bad debts and free services for any Fiscal Year, all as determined in accordance with generally accepted accounting principles.

3. “*Affiliate*” means a Person which, directly or indirectly through one or more intermediaries, controls, is controlled by or is under common control with the District.

4. “*Aggregate Debt Service*” means, as of any date of calculation and with respect to any period, the sum of amounts of Debt Service for all Long-Term Indebtedness for such period.

5. “*ALTA*” means American Land Title Association.

6. “*Board*” means the Board of Directors of the District.

7. “*Bond Counsel*” means Independent counsel of recognized national standing in the field of obligations the interest on which is excluded from gross income for federal income tax purposes, selected by the District and acceptable to the Office.

8. “*Bonds*” means the 2009 Bonds, the 2010 Bonds or the 2016 Bonds, collectively or individually, as applicable.

9. “*Business Day*” means any day other than a Saturday, Sunday, or a day on which banking institutions in the city in which the Principal Corporate Trust Office of the Trustee is located are authorized or obligated by law or executive order to be closed or a day on which the Federal Reserve System is closed.

10. “*CERCLA*” means the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (42 U.S.C. § 9601 *et seq.*), as heretofore or hereafter amended from time to time.

11. “*Code*” means the Internal Revenue Code of 1986, as amended.

12. “*Contract of Insurance*” means, collectively or as applicable, (a) the 2009 Contract of Insurance, the 2010 Contract of Insurance or the 2016 Contract of Insurance, as applicable.

13. “*Debt Service*,” when used with respect to any Long-Term Indebtedness, means, as of any date of calculation and with respect to any period, the sum of

(a) the interest falling due on such Long-Term Indebtedness during such period (except to the extent that such interest is payable from the proceeds of such Long-Term Indebtedness set aside for such purpose), and

(b) the scheduled principal (or mandatory sinking fund or installment purchase price or lease rental or similar) payments or deposits required with respect to such Long-Term Indebtedness during such period (except to the extent such principal is payable from the proceeds of such Long-Term Indebtedness set aside for such purpose), computed on the assumption that no portion of such Long-Term Indebtedness shall cease to be outstanding during such period except by reason of the application of such scheduled payments, provided, however, that for purposes of such computation:

(1) if Long-Term Indebtedness is

(i) secured by an irrevocable letter of credit or irrevocable line of credit issued by a financial institution having a combined capital and surplus of at least fifty million dollars (\$50,000,000) and whose unsecured securities are rated in one of the two highest short-term or long-term rating categories (without regard to numerical modifier) by each rating agency then rating the Bonds, or

(ii) insured by an insurance policy or surety bond issued by an insurance company rated at least A+ by Alfred M. Best Company in Best’s Insurance Reports,

principal payments or deposits with respect to such Long-Term Indebtedness nominally due in the last Fiscal Year in which such Long-Term Indebtedness matures may, at the option of the District, be treated as if they were due as specified in any loan agreement or installment sale/purchase agreement issued in connection with such letter of credit, line of credit, insurance policy or surety bond or pursuant to the repayment provisions of such letter of credit, line of credit, insurance policy or surety bond (or, if such loan agreement or installment sale/purchase agreement or repayment provisions provide for repayment over less than 20 years and the Trustee receives a Statement of the District to the effect that the District intends to refinance such Long-Term Indebtedness prior to maturity, as if they were amortized over a 20-year period with substantially level debt service) and interest on such Long-Term Indebtedness after such Fiscal Year shall be assumed to be payable at an interest rate equal to a rate per annum equal to the 25-year revenue bond index most recently published preceding the date of calculation in The Bond Buyer (subject to any adjustment for errors therein which may be acknowledged by the publishers thereof);

(2) if interest on Long-Term Indebtedness is payable pursuant to a variable interest rate formula, the interest rate on such Long-Term Indebtedness for periods when the actual interest rate cannot yet be determined shall be assumed to be equal to the greater of

(i) the average rate of interest borne (or which would have been borne) by such Long-Term Indebtedness during the Fiscal Year immediately preceding the date of calculation plus one percent (1%), or

(ii) the average rate of interest borne by such Long-Term Indebtedness during the three full calendar months immediately preceding the date of calculation plus one percent (1%);

(3) if interest is capitalized with respect to Long-Term Indebtedness, Debt Service on such Long-Term Indebtedness shall be included in computations of Maximum Aggregate Annual Debt Service under this Regulatory Agreement only in proportion to the amount of interest payable in the then-current Fiscal Year from sources other than amounts funded to pay such capitalized interest;

(4) with respect to a Guarantee, there shall be included in the Debt Service of the District

(i) twenty-five percent (25%) of the District's maximum possible monetary liability under the Guarantee in any Fiscal Year unless the Guarantee is drawn upon, and

(ii) one hundred percent (100%) of the District's monetary liability under the Guarantee which has been drawn upon, until such time as all amounts drawn upon the Guarantee have been repaid to the District, and for two Fiscal Years thereafter;

(5) if moneys or Investment Securities described in the definition thereof contained in Section 1.01 of the Indenture (not callable by the issuer thereof prior to maturity) have been deposited with a trustee or escrow agent in an amount, together with earnings thereon, sufficient to pay the principal of or interest on Long-Term Indebtedness as it comes due, such principal or interest, as the case may be, shall not be included in computations of Debt Service; and

(6) principal and interest with respect to general obligation bonded indebtedness shall not be included in computations of Debt Service.

14. "*Deed of Trust*" means the 2009 Deed of Trust, the 2010 Deed of Trust, and the 2016 Deed of Trust.

15. "*Deed Trustee*" means the Person at the time serving as such under the Deed of Trust.

16. “*District*” means the Borrowing District named on the cover hereof, a political subdivision of the State and any entity which may be obligated under the Indenture pursuant to Section VI of this Regulatory Agreement, or any entity which is the surviving, resulting or transferee entity in any merger, consolidation or transfer of assets permitted under this Regulatory Agreement.

17. “*Environmental Claim*” means any accusation, allegation, notice of violation, claim, demand, abatement order or other order or direction (conditional or otherwise) by any governmental authority or any person for any damage, including, without limitation, personal injury (including sickness, disease or death), tangible or intangible property damage, contribution, indemnity, indirect or consequential damages, damage to the environment, nuisance, pollution, contamination or other adverse effects on the environment, or for fines, penalties or restrictions, resulting from or based upon

(a) the existence of a Release (whether sudden or nonsudden or accidental or non-accidental) of, or exposure to, any Hazardous Material, in, into or onto the environment at, in, by, from or related to the Facilities,

(b) the use, handling, transportation, storage, treatment or disposal of Hazardous Materials in connection with the operation of the Facilities, or

(c) the violation, or alleged violation, of any statutes, ordinances, orders, rules, regulations, permits, licenses or authorizations of or from any governmental authority, agency or court relating to environmental matters connected with the Facilities.

18. “*Environmental Indemnities*” means the indemnities executed by the District, as indemnitor, in favor of the Office, the Trustee and the other parties named therein, as indemnitees, each setting forth certain indemnification obligations relating to Hazardous Materials.

19. “*Environmental Laws*” means all present and future federal, state or local laws, rules or regulations relating to environmental matters, permits, pollution, waste disposal, industrial hygiene, land use and other requirements of governmental authorities relating to the environment or to any Hazardous Material or Hazardous Material Activity (including, without limitation, CERCLA and the applicable provisions of the California Health and Safety Code and the California Water Code) or the protection of human or animal health or welfare, including, without limitation, those related to any Release or threatened Release of Hazardous Materials and to the generation, use, storage, transportation, or disposal of Hazardous Materials, in any manner applicable to the District or the Facilities.

20. “*Facilities*” means

(a) the real property described in Exhibit A attached hereto and all real property required to be added, from time to time, to this definition of Facilities pursuant to Section XX(H) entitled “Lien on Future Acquired Real Property” of this Regulatory Agreement;

(b) all buildings and structures thereon and fixtures and improvements thereto, whether now existing or hereafter constructed, installed or acquired; and

(c) all tangible personal property owned by the District, whether now existing or hereafter constructed, installed or acquired, and used in, around or about the aforesaid real property, including but not limited to the personal property described in Exhibit B attached hereto.

21. “*Fiscal Year*” means the period set forth on the cover hereof, or any other twelve-month period hereafter selected and designated as the official fiscal year period of the District.

22. “*Gross Revenues*” means all revenues, income, receipts and money received in any period by the District (other than donor-restricted gifts, grants, bequests, donations, contributions and tax revenues), including, but without limiting the generality of the foregoing, the following:

(a) gross revenues derived from its operation and possession of and pertaining to its properties,

(b) proceeds with respect to, arising from, or relating to its properties and derived from (1) insurance (including business interruption insurance) or condemnation proceeds (except to the extent such proceeds are required by the terms of this Regulatory Agreement or other agreements with respect to the Indebtedness which the District is permitted to incur pursuant to the terms of this Regulatory Agreement to be used for purposes inconsistent with their use for the payment of debt service on the Bonds or similar payments with respect to Parity Debt), (2) accounts, including but not limited to, accounts receivable, (3) securities and other investments, (4) inventory and intangible property, (5) payment/reimbursement programs and agreements, and (6) contract rights, accounts, instruments, claims for the payment of moneys and other rights and assets now or hereafter owned, held or possessed by or on behalf of the District, and

(c) rentals received from the lease of the District’s properties or space in its facilities.

23. “*Guarantee*” means any obligation of the District guaranteeing in any manner, whether directly or indirectly, any obligation of any Person which would, if such Person were the District, constitute Long-Term Indebtedness.

24. “*Hazardous Material Activity*” means any actual, proposed or threatened storage, holding, existence, release, emission, discharge, generation, processing, abatement, removal, disposition, handling or transportation of any Hazardous Materials from, under, into or on the Facilities or the Project or surrounding property.

25. “*Hazardous Materials*” means

(a) any chemical, material or substance now or in the future defined as or included in the definition of “hazardous substances,” “hazardous wastes,” “hazardous materials,” “extremely hazardous waste,” “restricted hazardous waste,” “infectious waste,” “toxic pollutant” or “toxic substances” or any other term intended to define, list, or classify substances by reason of deleterious properties such as ignitability, corrosivity, reactivity,

carcinogenicity, toxicity, reproductive toxicity, “TCLP toxicity,” “EP toxicity” or words of similar import under any applicable local, state or federal law or under the regulations adopted or publications promulgated pursuant thereto, including, without limitation, Environmental Laws,

- (b) any oil, petroleum or petroleum-derived substance,
- (c) any drilling fluids, produced waters and other wastes associated with the exploration, development or production of crude oil, natural gas or geothermal resources,
- (d) any flammable substances or explosives,
- (e) any radioactive materials,
- (f) asbestos in any form which is or could become friable,
- (g) urea formaldehyde foam insulation,
- (h) electrical equipment which contains any oil or dielectric fluid containing levels of polychlorinated biphenyls in excess of fifty parts per million,
- (i) pesticides, and
- (j) any other chemical, material or substance, exposure to which is prohibited, limited or regulated by any governmental authority as one that may or could pose a hazard to the health and safety of the owners, occupants or any persons in the vicinity of the Facilities.

26. “*Indebtedness*” means

- (a) any Guarantee, and
- (b) any indebtedness or obligation of the District (other than accounts payable and accruals), as determined in accordance with generally accepted accounting principles, including obligations under conditional sales contracts or other title retention contracts, and rental obligations under leases which are considered capital leases under generally accepted accounting principles.

Indebtedness shall not include Nonrecourse Indebtedness.

27. “*Indenture*” means the 2009 Indenture, the 2010 Indenture, or the 2016 Indenture, collectively or individually, as applicable.

28. “*Independent*,” when referring to an Accountant, counsel, Management Consultant or Person, means an Accountant, counsel, Management Consultant or Person who

- (a) is independent of and not under the control of the District,

(b) does not have any substantial interest, direct or indirect, in the District, and

(c) in the case of an individual, is not connected, including through a spouse, with the District as a director, officer or employee of the District, and in the case of a firm, is not connected with the District as a partner, director, officer or employee of the District, but who may be regularly retained by the District.

29. “*Insurance Law*” means Chapter 1, Part 6, Division 107 of the Health and Safety Code of the State, cited as the “California Health Facility Construction Loan Insurance Law” as now in effect and as it may from time to time hereafter be amended or supplemented.

30. “*Long-Term Indebtedness*” means Indebtedness having an original maturity greater than one (1) year or renewable at the option of the District for a period greater than one (1) year from the date of original incurrence or issuance thereof unless, by the terms of such Indebtedness, no Indebtedness is permitted to be outstanding thereunder for a period of at least thirty (30) consecutive days during each calendar year; but excluding any such Indebtedness that is a general obligation of the District payable from tax revenues.

31. “*Management Agent*” means that Person or those Persons with whom the District has entered into a contract, whether as an independent contractor or employee, for managerial services, relating to the management or operation of all or substantially all of the Facilities. In the event the District does not have a separate management contract, then “Management Agent” shall mean all of those Persons serving as the District’s chief executive officer, chief financial officer, chief operating officer, or other similar officers. In the event the District does not have such officers, then “Management Agent” shall mean all of those Persons that manage or operate all or substantially all of the Facilities.

32. “*Management Consultant*” means an Independent Person of regional or national reputation qualified to report on questions relating to the financial condition, operations and forecasts of health facilities, selected by the District so long as such Management Consultant is acceptable to the Office.

33. “*Maximum Aggregate Annual Debt Service*” means, as of any date of calculation, the Aggregate Debt Service as computed for the then current or any future Fiscal Year in which such sum shall be largest.

34. “*Maximum Annual Debt Service*,” when used with respect to any item of Long-Term Indebtedness, means, as of any date of calculation, the maximum amount of Debt Service to become due on such Long-Term Indebtedness in the current or any future Fiscal Year after the date of calculation.

35. “*Net Income Available for Debt Service*” means, with respect to any period, the excess of revenues over expenses from operations of the District for such period, determined in accordance with generally accepted accounting principles, to which shall be added unrestricted non-operating net income, interest, amortization, depreciation expense and other non-cash charges, each item determined in accordance with generally accepted accounting principles, and excluding:

(a) any profits or losses on the sale or other disposition, not in the Ordinary Course of Business, of investments or fixed or capital assets or resulting from the early extinguishment of debt or losses that are marked to market losses;

(b) gifts, grants, bequests, donations and contributions, to the extent specifically restricted by the donor to a particular purpose inconsistent with their use for the payment of Debt Service or operating expenses;

(c) the net proceeds of insurance (other than business interruption insurance) and condemnation awards; and

(d) tax revenues received for the sole purpose of repaying outstanding general obligation indebtedness.

36. “*Nonrecourse Indebtedness*” means any indebtedness of the District, which is not a general obligation of the District and is secured by a lien on property of the District, liability for which is effectively limited to the property subject to such lien (which property is not integral to the operation of the Facilities) with no recourse, directly or indirectly, to any other property of the District.

37. “*Note*” means the \$1,005,806 note from the Office.

38. “*Office*” means the Office of Statewide Health Planning and Development of the Health and Human Services Agency of the State, or its successors.

39. “*Ordinary Course of Business*” means any action that transpires as a matter of normal and incidental daily customs and practices in business.

40. “*Parity Debt*” means (i) the obligations of the District with respect to the 2009 Bonds, the 2010 Bonds and the 2016 Bonds, and (ii) Long-Term Indebtedness which is incurred by the District in accordance with the provisions of Section XII of this Regulatory Agreement and secured equally and ratably with the obligations of the District under the 2009 Indenture, the 2010 Indenture and the 2016 Indenture by a lien on and security interest in the Gross Revenues.

41. “*Permitted Encumbrances*” means and includes:

(a) undetermined liens and charges incident to construction or maintenance, and liens and charges incident to construction or maintenance now or hereafter filed of record which are being contested in good faith and have not proceeded to final judgment (and for which all applicable periods for appeal or review have not expired), provided that the District shall have set aside reserves with respect thereto which, in the opinion of the Office, are adequate;

(b) notices of *lis pendens* or other notices of or liens with respect to pending actions which are being contested in good faith and have not proceeded to final judgment (and for which all applicable periods for appeal or review have not expired), provided

that the District shall have set aside reserves with respect thereto which, in the opinion of the Office, are adequate;

(c) the lien of taxes and assessments which are not delinquent, or, if delinquent, are being contested in good faith, provided that the District shall have set aside reserves with respect thereto which are adequate;

(d) minor defects and irregularities in title to the Facilities which in the aggregate do not materially adversely affect the value or operation of the Facilities for the purposes for which they are or may reasonably be expected to be used;

(e) easements, exceptions or reservations for the purpose of ingress and egress, parking, pipelines, telephone lines, telegraph lines, power lines and substations, roads, streets, alleys, highways, railroad purposes, drainage and sewerage purposes, dikes, canals, laterals, ditches, the removal of oil, gas, coal or other minerals, and other like purposes, or for the joint or common use of real property, facilities and equipment, which in the aggregate do not materially interfere with or impair the operation of the Facilities for the purposes for which they are or may reasonably be expected to be used;

(f) rights reserved to or vested in any municipality or governmental or other public authority to control or regulate or use in any manner any portion of the Facilities which do not materially impair the operation of the Facilities for the purposes for which they are or may reasonably be expected to be used;

(g) present or future valid zoning laws and ordinances;

(h) the rights of the District, the Office, the Trustee and holders of Parity Debt under the Indenture, this Regulatory Agreement and the Deed of Trust and the lien and charge of the Indenture, this Regulatory Agreement and the Deed of Trust;

(i) liens securing indebtedness for the payment, redemption or satisfaction of which money (or evidences of indebtedness) in the necessary amount shall have been deposited in trust with a trustee or other holder of such indebtedness;

(j) purchase money security interests and security interests existing on any personal property prior to the time of its acquisition by the District through purchase, merger, consolidation or otherwise, whether or not assumed by the District, or placed upon property being acquired by the District to secure a portion of the purchase price thereof, or lessor's interests in leases required to be capitalized in accordance with generally accepted accounting principles;

(k) statutory liens arising in the Ordinary Course of Business which are not delinquent or are being contested in good faith by the District;

(l) the lease or license of the use of a part of the Facilities for use in performing professional or other services necessary for the proper and economical operation of the Facilities in accordance with customary business practices in the health care industry;

(m) liens or encumbrances existing as of the date of initial execution and delivery of the Bonds as listed on Exhibit D attached hereto;

(n) liens securing Parity Debt on a parity with the obligations of the District hereunder;

(o) statutory rights of the United States of America to recover against the District by reason of federal funds made available under 42 U.S.C. § 291 *et seq.*, and similar rights under other federal and state statutes;

(p) a prior security interest in the District's accounts receivable to provide short-term borrowing as permitted under Section IX(A)(3) hereof, subject to the prior consent of the Office; and

(q) other liens and encumbrances specifically approved in writing by the Office.

42. “*Person*” means a natural person, individual, company, firm, association, organization, partnership, trust, corporation or other legal entity or group of entities, including a governmental entity or any agency or political subdivision thereof.

43. “*Project*” means, collectively, the Project (2009 Bonds), the Project (2010 Bonds) and the Project (2016 Bonds) set forth on the cover of this Regulatory Agreement.

44. “*Release*” means any release, spill, emission, leaking, pumping, pouring, injection, escaping, deposit, disposal, discharge, dispersal, leaching, or migration into the indoor or outdoor environment (including, without limitation, the abandonment or disposal of any barrels, containers or other closed receptacles containing any Hazardous Materials), or into or out of the Facilities, including the movement of any Hazardous Material through the air, soil, surface water, groundwater or property.

45. “*Regulatory Agreement*” means this Amended and Restated Regulatory Agreement, dated as of July 1, 2016, amending, supplementing, and restating the 2010 Regulatory Agreement.

46. “*Risk Management Consultant*” means an Independent Person having experience and a favorable reputation in consulting on the insurance requirements of health facilities in the State of the general size and character of the Facilities, selected by the District and not objected to by the Office, and so long as such Risk Management Consultant is acceptable to the Office. The initial Risk Management Consultant of Alliant Insurance Services, Inc., is acceptable to the Office.

47. “*Short-Term Indebtedness*” means Indebtedness having an original maturity less than or equal to one year and not renewable at the option of the District for a term greater than one year from the date of original incurrence or issuance unless, by the terms of such Indebtedness, no Indebtedness is permitted to be outstanding thereunder for a period of at least thirty (30) consecutive days during each calendar year.

48. “*State*” means the State of California.

49. “*Statement*” means a written certification, certificate or statement or other appropriate written instrument normally provided in the applicable circumstance where required by this Regulatory Agreement to be provided or delivered by the Accountant, counsel, insurance agent, Risk Management Consultant, Management Consultant, District, Office or other appropriate Person. The Statement shall be dated and signed by a person authorized to execute the Statement.

50. “*Trustee*” means the Trustee named on the cover hereof, as trustee, together with the Trustee’s permitted successors as trustee, under the Indenture.

51. “*2009 Bonds*” means the Mendocino Coast Health Care District Insured Health Facility Revenue Bonds, Series 2009.

52. “*2009 Contract of Insurance*” means that certain contract of insurance entered into by and between the District and the Office dated as of October 1, 2009, as amended, modified and supplemented from time to time.

53. “*2009 Indenture*” means that certain indenture by and between the District and the Trustee, dated as of October 1, 2009, as amended, modified and supplemented from time to time.

54. “*2010 Bonds*” means the Mendocino Coast Health Care District Insured Health Facility Revenue Bonds, Series 2010.

55. “*2010 Contract of Insurance*” means that certain contract of insurance entered into by and between the District and the Office dated as of July 1, 2010, as amended, modified and supplemented from time to time.

56. “*2010 Indenture*” means that certain indenture by and between the District and the Trustee, dated as of July 1, 2010, as amended, modified and supplemented from time to time.

57. “*2016 Bonds*” means the Mendocino Coast Health Care District Insured Health Facility Refunding Revenue Bonds, Series 2016.

58. “*2016 Contract of Insurance*” means that certain contract of insurance entered into by and between the District and the Office dated as of July 1, 2016, as amended, modified and supplemented from time to time.

59. “*2016 Indenture*” means that certain indenture by and between the District and the Trustee, dated as of July 1, 2016, as amended, modified and supplemented from time to time.

SECTION II
General Covenants

A. Security of Gross Revenues Pledged and Deed of Trust.

1. In order to secure full and faithful performance of the obligations of the District to the Office hereunder and under the Contract of Insurance, the District hereby pledges to the Office and grants to the Office a security interest in and to the Gross Revenues, including, but not limited to, future interest in any and all revenues or incomes of any nature or kind which accrue to the District or Facilities, as well as other collateral, all as set forth in Exhibit E hereto. The District shall execute and deliver to the Office upon the effective date of this Regulatory Agreement UCC-1 Financing Statements and such additional UCC-1 Financing Statements, continuation statements, deposit account control agreements, security account control agreement and other documentation as demanded by the Office in order to further evidence, perfect and maintain the security interest granted hereby.

2. In addition, full and faithful performance of the obligations hereunder and under the Contract of Insurance by the District to the Office is hereby deemed further secured by the lien on the Facilities created by the District pursuant to the Deed of Trust. The District covenants and agrees that the lien of the Deed of Trust shall be subject only to:

(a) liens, conditions, covenants and restrictions, easements, taxes, and assessments of record approved by the Office as exceptions to the ALTA title insurance policy identified on the first page of this Regulatory Agreement, and

(b) Permitted Encumbrances.

3. The District hereby pledges to the Office and grants to the Office a security interest in and to, revenues (including Gross Revenues), moneys, accounts, accounts receivable, contract rights, general intangibles, documents, instruments, chattel paper, and other rights to payment of whatever kind, to secure the obligations of the Office under this Regulatory Agreement and the Contract of Insurance. Notice is hereby given that the lien of the above stated pledges created by this Regulatory Agreement is perfected pursuant to California Health and Safety Code Sec. 129052, which reads in pertinent part:

“The revenues, moneys, accounts, accounts receivable, contract rights, general intangibles, documents, instruments, chattel paper, and other rights to payment of whatever kind pledged by or to the office or its assignees shall immediately be subject to the lien of the pledge without physical delivery or further act. The lien of such pledge shall be valid and binding against all parties, irrespective of whether the parties have notice of the lien. The indenture, trust agreement, resolution, or another instrument by which such pledge is created need not be recorded or the security interest otherwise perfected.”

B. Use of Proceeds of Bonds. The proceeds of the Bonds together with other available funds shall be used exclusively by the District for the following purposes: to refinance the acquisition, construction, improvement and equipping of certain health care facilities of the

District, and, to the extent permitted by the Tax Certificate, for reimbursing the Borrowing District for costs thereof previously made, including but not limited to any or all expenses incidental thereto or connected therewith, to fund a Bond Reserve Account established under the Indenture, and to pay expenses related to the execution and issuance of the Bonds.

NONE OF THE PROCEEDS OF THE BONDS SHALL GO DIRECTLY OR INDIRECTLY TO ANY PRESENT OR FORMER OFFICER, DIRECTOR, MEMBER, EMPLOYEE OR RELATIVE OF ANY OFFICER, DIRECTOR, MEMBER OR EMPLOYEE OF THE DISTRICT.

C. Bond Maturity Date; Economic Life. Pursuant to Insurance Law Section 129050(d) the Bonds shall have a maturity date or dates not exceeding thirty (30) years from the beginning of the amortization of the Bonds, as provided in the Bonds and the Indenture, which term does not exceed 75% of the Office's estimate of the economic life of the Facilities.

D. Periodic Payments. The Indenture contains complete amortization provisions requiring periodic payments by the District, as provided in the Bonds, which provisions are acceptable to the Office.

E. Interest on Bonds. The Bonds bear interest on the amount of the principal obligation outstanding at any time, at the rates provided in the Bonds, which rates are acceptable to the Office.

F. Payment on Principal. The Indenture provides for the application of a portion of the District's periodic payments to amortization of the principal of the Bonds as provided in the Indenture and the Bonds.

G. Documents Acceptable to Office. The Indenture is acceptable to the Office.

H. Section 129050(i) Limitation. To the extent Insurance Law Section 129050(i) applies, the Bonds shall be in a principal amount not in excess of the amount set forth on the cover of this Regulatory Agreement, which amount does not exceed 95 percent of the "total construction cost" of the Project.

I. Payments. The District, through the Trustee pursuant to the Indenture, shall promptly make all payments for which it is obligated under the Bonds and the Indenture, as the case may be.

J. Debt Service Reserve Account. The District shall cause the Trustee to establish and continue to maintain a debt service reserve account (i.e., the Bond Reserve Account established pursuant to the Indenture) which shall be subject to the terms and conditions specified in the Indenture and which may be disbursed only on order of the Office as provided in the Indenture.

K. Compliance with Insurance Law. The District shall comply with all applicable laws including, specifically, the Insurance Law.

L. Compliance with Agreements; No Amendment without Office Consent. The District shall abide by all of the terms of the Bonds, the Deed of Trust, the Note, the Contract of Insurance and the Indenture by which it is bound, none of which may be modified, amended or supplemented without the prior or concurrent consent of the Office in writing.

M. Office Attendance at Meetings. The Office has the right to attend and participate in all meetings of the members of the governing board of the District including, but not limited to, executive committee, subcommittee meetings and all other committee meetings, but excluding meetings at which attendance by the Office would abrogate the attorney-client privilege between the District and its legal counsel, the quality assurance privilege, or any other recognized privilege, or would result in a violation of any law protecting the confidentiality of health information, employee information, or any other information. Upon prior written request of the Office, the District shall give the Office, prior to any such meetings, the same notice of such meetings as it gives to its board members and shall give the Office a copy of all documents given to its board members at the same time they give the documents to its board members, and shall give the Office copies of any other documents presented at such meetings.

N. Prohibition of Forward Purchase Agreements. Notwithstanding any other provision in this Regulatory Agreement or the Indenture, the District shall not enter into or instruct the Trustee to enter into any agreement, including, without limitation, any investment or sale agreement involving the sale of future interest income or forward delivery agreement or forward purchase contract or forward purchase supply contract, which provides for an upfront payment to the District, in connection with the investment of any of the funds or accounts established under the Indenture and held by the Trustee.

O. Provision of Essential Governmental Services. The District and the Office hereby confirm that the District is presently providing, and the District hereby covenants to continue to provide, essential governmental services such that the District meets the requirements of the Federal Emergency Management Agency (FEMA) to be eligible for relief for disasters to the maximum extent allowed by law, including 44 Code of Federal Regulations, Chapter 1.

SECTION III Negative Covenants

The District shall not, without the prior written consent of the Office:

A. Alter Facilities. Remodel, reconstruct, or demolish any part of the Facilities (except in the Ordinary Course of Business) or subtract from any real property of the District except for the maintenance described in the regulations of the relevant State licensing agencies, which may be accomplished without limitation.

B. Pay Officers or Directors. Pay any compensation or make any distribution of income or other assets to any of its officers or directors other than as compensation to such persons in their capacities as officers, directors, employees, contractors or suppliers of the District or the reimbursement of ordinary out-of-pocket expenses.

C. Affiliations. Except for affiliations or contracts with public agencies, health maintenance organizations and other health care plans and providers entered into by the District

in its Ordinary Course of Business, establish, maintain, or affiliate with a Person in conjunction with which the District will carry on its activities; transfer control of any of the Facilities to any other Person; or assume, either directly, indirectly or through intermediaries, the management or control of any other Person, unless in each such case

1. the Contract of Insurance remains in full force and effect after such act, and

2. no event of default under this Regulatory Agreement has occurred and is continuing or will, as a result of such act, occur.

D. Cease to Operate as a Health Facility. Cease to operate the Facilities such that the Facilities no longer qualify as a “health facility” as defined in Insurance Law Section 129010, except to the extent permitted by the Insurance Law.

SECTION IV Maintenance of the Facilities

The District shall maintain the Facilities in good and substantial repair and condition; provided that, in the event all or any of the Facilities shall be destroyed or damaged by fire or other casualty, the money derived from any insurance on the property shall be applied in accordance with the terms of this Regulatory Agreement and the Indenture.

SECTION V Bankruptcy; Insolvency; Receiver

A. The District shall not file any petition in bankruptcy or in insolvency, or for a receiver or reorganization or composition; or make any assignment for the benefit of creditors or to a trustee for creditors; or permit an adjudication in bankruptcy, the taking possession of the Facilities or any part thereof by a receiver, or the seizure and sale of the Facilities or any part thereof under judicial process or pursuant to any power of sale (except as provided in the Deed of Trust) and fail to have such adverse actions set aside within forty-five (45) days.

B. The District immediately shall give notice to the Office of the filing of any petition, or commencement of any proceedings, in bankruptcy, or for a receiver or insolvency or for reorganization or composition, or any assignment for the benefit of creditors to a trustee for the benefit of creditors, relating to the District or the Facilities.

C. If the District, or its creditors, file a petition alleging insolvency, requesting reorganization or a composition of creditors, or for an assignment for the benefit of creditors, in any court, the Office shall have the right to participate in, or vote on, any plan or reorganization, agreement for a composition of creditors, and on any assignment for the benefit of creditors. If there is a proceeding to effect a receivership for the District, the Office shall have the right to select the receiver.

So long as the Contract of Insurance is in full force and effect and the Office is not in default thereunder, the Office shall represent Bondholders in all bankruptcy proceedings and may take such action or consent to any agreement on behalf of Bondholders, provided that any

such action or consent shall in no way impair the rights and benefits due Bondholders under the Contract of Insurance.

SECTION VI
Maintenance of Existence; Affiliation, Merger, Consolidation,
Sale or Transfer Under Certain Conditions

A. The District shall maintain its existence as a local health care district of the State, operating a health facility, and shall not dissolve, sell or otherwise dispose of all or substantially all of its assets or affiliate with, consolidate with or merge into another Person or permit one or more other Persons to affiliate with, consolidate with or merge into it; provided, that the District may, without violating the covenants contained in this Section, affiliate with, consolidate with or merge into another Person, or permit one or more other Persons to affiliate with, consolidate with or merge into it, or sell or otherwise transfer to another Person such assets, if:

1. The District obtains the written consent of the Office to such transaction and a Statement of the Office to the effect that the Contract of Insurance remains in full force and effect after such transaction;

2. The District, the Office and the Trustee shall have received an Opinion of Bond Counsel to the effect that such affiliation, merger, consolidation, sale or other transfer will not cause the interest on any Tax-Exempt Bonds to be included in gross income for federal income tax purposes under Section 103 of the Code;

3. The surviving, resulting or transferee Person:

(a) assumes in writing, if such Person is not the District, all of the obligations of the District under this Regulatory Agreement, the Contract of Insurance and the Indenture, and agrees to fulfill and comply with the terms, covenants and conditions thereof;

(b) is not, after such transaction, otherwise in default under any provision of this Regulatory Agreement or the Indenture;

(c) is a local health care district, a political subdivision of the State or an organization meeting the requirements of Section 501(c)(3) of the Code, or a corresponding provision of the federal income tax laws then in effect; and

(d) shall have net assets at least equal to the net assets of the District prior to such transaction;

4. The Trustee and the Office shall have received the report of a Management Consultant to the effect that Net Income Available for Debt Service of the surviving, resulting or transferee Person (after giving effect to such merger, consolidation, sale or other transfer) for each of the first two full Fiscal Years following such merger, consolidation, sale or other transfer is forecasted to be not less than the greater of Net Income Available for Debt Service of the District for each of the two most recent Fiscal Years for which audited financial statements are available, as certified by an Accountant;

5. The Trustee and the Office shall have received a report of an Accountant to the effect that the net worth of the surviving, resulting or transferee Person, after giving effect to such merger, consolidation, sale or other transfer, is at least equal to 100 percent of the net assets of the District immediately prior to such merger, consolidation, sale or other transfer; and

6. The Trustee and the Office shall have received an Opinion of Counsel to the effect that the Indenture and this Regulatory Agreement constitute the legal, valid and binding obligations of the surviving, resulting or transferee Person, as the case may be, enforceable against such Person in accordance with their respective terms.

B. Notwithstanding the foregoing, the District may, without complying with the provisions of Subsection A of this Section, transfer substantially all of its assets to an Affiliate provided that:

1. The District obtains the written consent of the Office to such transaction and the Contract of Insurance remains in full force and effect after such transaction;

2. The Office, the District and the Trustee shall have received an Opinion of Bond Counsel to the effect that such proposed transfer(s) will not cause the interest on any Tax-Exempt Bonds to be included in gross income for federal income tax purposes under Section 103 of the Code;

3. Such Affiliate agrees to become a co-obligor and jointly and severally liable with the District under this Regulatory Agreement and the Indenture; and

4. After such transaction, the District and the Affiliate are in compliance with the provisions of this Regulatory Agreement and the Indenture.

In the event of such a transfer to an Affiliate, references in this Regulatory Agreement to Indebtedness of the District shall apply to the combined Indebtedness of the District and the Affiliate, and references to the financial condition or forecasted results of operations of the District shall apply to the consolidated financial condition or results of operations of the District and the Affiliate.

C. If an affiliation, merger, consolidation, sale or other transfer is effected, as provided in this Section, the provisions of this Section shall continue in full force and effect, and no further affiliation, merger, consolidation, sale or transfer shall be effected except in accordance with the provisions of this Section.

SECTION VII

Rates and Charges; Debt Coverage; Current Ratio; Days Cash On Hand

A. The District shall operate the Facilities as revenue producing health care facilities. The District shall fix, charge and collect, or cause to be fixed, charged and collected, subject to applicable requirements or restrictions imposed by law, such rates, fees and charges which, together with all other receipts and revenues of the District and any other funds available therefor, are reasonably projected to be sufficient in each Fiscal Year (commencing with the

Fiscal Year beginning July 1, 2017) to produce Net Income Available for Debt Service equal to at least 1.25 times Maximum Aggregate Annual Debt Service for such Fiscal Year.

B. The District shall maintain, as of the end of each Fiscal Year, commencing with the Fiscal Year ending June 30, 2017, a current ratio (a ratio of current assets to current liabilities, as determined in accordance with generally accepted accounting principles and as shown on the District's audited financial statements for such Fiscal Year) of at least 1.50:1.0.

C. The District shall maintain, as of the end of each Fiscal Year, commencing with the Fiscal Year ending June 30, 2017, at least thirty (30) Days Cash on Hand, as shown on the District's audited financial statements for such Fiscal Year. For purposes of this requirement, "Days Cash on Hand" shall mean, for any Fiscal Year, the quotient obtained by dividing (1) the District's cash and cash equivalents (including board-designated funds, including funded depreciation) as of the end of such Fiscal Year by (2) the quotient of dividing (a) the District's operating expenses (including interest on Indebtedness, but excluding depreciation, amortization, allowance for bad debts, and any other noncash expenses) for such Fiscal Year by (b) the number of days in such Fiscal Year.

D. Within one hundred fifty (150) days after the end of each Fiscal Year (commencing with the Fiscal Year ending June 30, 2017), the District shall compute (1) the Net Income Available for Debt Service and Maximum Aggregate Annual Debt Service, (2) the current ratio and (3) the Days Cash on Hand for such Fiscal Year and promptly furnish to the Trustee and the Office a Statement setting forth the results of such computation. The District further covenants and agrees that if, at the end of such Fiscal Year, the Net Income Available for Debt Service, the current ratio or the Days Cash on Hand shall have been less than as required by Subsections A, B or C, respectively, of this Section VII, it will promptly employ a Management Consultant to make recommendations as to a revision of the rates, fees and charges of the District or the methods of operation of the District which will result in producing Net Income Available for Debt Service, a current ratio and Days Cash on Hand as required by Subsections A, B and C, respectively, of this Section VII in the current Fiscal Year; provided, however, the District need not so employ a Management Consultant if the Office consents, in writing, to a waiver of said covenant to employ a Management Consultant. Copies of the recommendations of the Management Consultant shall be filed with the Trustee and the Office. The District shall, to the extent feasible, promptly upon its receipt of such recommendations, subject to applicable requirements or restrictions imposed by law, revise its rates, fees and charges or its methods of operation or collections and shall take such other action as shall be in conformity with such recommendations; provided, however, the District need not make such revisions or take such actions in conformity with such recommendations if the Board makes a good faith determination that such recommendations, in whole or in part, are not in the best interests of the District and the Office gives its written consent to the effect that the District need not comply, in whole or in part, with such recommendations. If the District fails to comply with the recommendations of the Management Consultant, the Office may replace existing management with new management, which shall be chosen unilaterally by the Office.

If the District complies in all material respects with the reasonable recommendations of the Management Consultant in respect to said rates, fees, charges and methods of operation or collection, the District will be deemed to have complied with the covenants contained in this

Section VII for such Fiscal Year, notwithstanding that Net Income Available for Debt Service, the current ratio or the Days Cash on Hand shall be less than the amount required under Subsections A, B or C of this Section VII; provided that this sentence shall not be construed as in any way excusing the District from taking any action or performing any duty required under this Regulatory Agreement or be construed as constituting a waiver of any other event of default under this Regulatory Agreement.

E. Notwithstanding the foregoing, the District may permit the rendering of service at, or the use of, the Facilities without charge or at reduced charges, at the discretion of the Board, to the extent necessary for maintaining its tax-exempt status or to establish or maintain its eligibility for grants, loans, subsidies or payments from the United States of America, any instrumentality thereof, or the State or any political subdivision or instrumentality thereof, or in compliance with any recommendation for free services that may be made by the Management Consultant.

SECTION VIII

Limitation on Encumbrances

The District shall not create, assume or suffer to exist and shall immediately satisfy or release any mortgage, deed of trust, pledge, security interest, encumbrance, lien, attachment or charge of any kind (including the charge upon property purchased under conditional sales or other title retention agreements) upon the Facilities or the Gross Revenues; *provided, however*, that notwithstanding the foregoing provision, the District may create, assume or suffer to exist Permitted Encumbrances.

SECTION IX

Limitation on Indebtedness

A. The District shall not incur any Indebtedness or financial obligations, including without limitation, by borrowing money, by assuming or guaranteeing the obligations of others, and by entering into installment purchase contracts or leases required to be capitalized in accordance with generally accepted accounting principles, except the District may incur the following:

1. Obligations and liabilities under this Regulatory Agreement or the Indenture, including any supplements or amendments thereto or hereto in connection with the issuance of any additional series of Bonds;

2. Contractual liabilities (other than liabilities for borrowed money or liabilities which would otherwise be considered indebtedness under generally accepted accounting principles) for which moneys are available in the Project Fund under the Indenture or otherwise;

3. Short-Term Indebtedness with the prior written consent of the Office and provided that no amount of Short-Term Indebtedness shall be outstanding for a period of thirty (30) consecutive days during each Fiscal Year. The aggregate amount incurred by the District under this Subsection shall not exceed at the time of incurrence ten percent (10%) of the

District's Adjusted Annual Operating Revenues for the most recent Fiscal Year for which audited financial statements are available;

4. Liabilities for contributions to self-insurance programs;

5. Long-Term Indebtedness (which may be Parity Debt) incurred for the purpose of refinancing outstanding Long-Term Indebtedness provided that

(a) the Office has consented in writing to the incurring of such indebtedness, and

(b) the issuance of such Long-Term Indebtedness does not increase Maximum Aggregate Annual Debt Service by more than ten percent (10%), as certified by a written report of an Accountant which shall be filed with the Trustee and the Office;

6. Long-Term Indebtedness (which may be Parity Debt), provided that

(a) the Office has consented in writing to the incurring of such Indebtedness, and

(b) (1) Net Income Available for Debt Service, as certified by a written report of an Accountant which shall be filed with the District, the Trustee and the Office for the most recent Fiscal Year for which audited financial statements are available immediately preceding the date of incurrence of such Long-Term Indebtedness was at least equal to 1.10 times Maximum Aggregate Annual Debt Service on all outstanding Long-Term Indebtedness and the Long-Term Indebtedness proposed to be incurred, or

(2) (i) Net Income Available for Debt Service, as certified by a written report of an Accountant which shall be filed with the District, the Trustee and the Office, for the most recent Fiscal Year for which audited financial statements are available immediately preceding the date of incurrence of such Long-Term Indebtedness was at least equal to 1.10 times Maximum Aggregate Annual Debt Service on all Long-Term Indebtedness then outstanding, and

(ii) Net Income Available for Debt Service, as shown in a written feasibility report prepared by a Management Consultant and filed with the District, the Trustee and the Office, for each of the first two Fiscal Years following the incurrence of such Long-Term Indebtedness (or, if such Long-Term Indebtedness is incurred to finance additional facilities, in each of the first three Fiscal Years following the Fiscal Year when it is proposed that such Facilities will be completed and placed in service) is forecasted to be at least 1.10 times Maximum Aggregate Annual Debt Service on all Long-Term Indebtedness proposed to be outstanding at the end of each such Fiscal Year;

7. Long-Term Indebtedness (which may be Parity Debt), incurred to complete the Project or any other project if the Board certifies that the District cannot complete such project unless such Long-Term Indebtedness is incurred, provided that

(a) the Office has consented in writing to the incurring of such Indebtedness, and

(b) in the case of a project other than the Project, the aggregate principal amount of such indebtedness does not exceed ten percent (10%) of the principal amount of Long-Term Indebtedness incurred to finance such project;

8. Long-Term Indebtedness (excluding Parity Debt) provided that

(a) the Office has consented in writing to the incurring of such Indebtedness, and

(b) the aggregate amount incurred by the District under this Subsection, Subsection 3 and Subsection 9 and outstanding shall not exceed at the time of incurrence ten percent (10%) of the District's Adjusted Annual Operating Revenues for the most recent Fiscal Year for which audited financial statements are available;

9. Liabilities under capitalized lease agreements for the lease of, or Indebtedness for money borrowed or liabilities under instruments evidencing deferred payment arrangements for the purchase of, equipment, tangible personal property or real property; provided that the aggregate amount incurred by the District under this Subsection, Subsection 3 and Subsection 8 and outstanding shall not exceed at the time of incurrence ten percent (10%) of the District's Adjusted Annual Operating Revenues for the latest Fiscal Year for which audited financial statements are available;

10. Nonrecourse Indebtedness, provided that the Office has approved in writing the incurrence of such indebtedness and such indebtedness does not encumber the Facilities;

11. Repayment obligations under reimbursement or similar agreements with banks or insurance companies relating to letters or lines of credit or other credit facilities used to secure Long-Term Indebtedness;

12. Indebtedness, not for borrowed money, incurred in the Ordinary Course of Business; and

13. Any Indebtedness or obligations of the District consented to in writing by the Office.

SECTION X

Limitations on Disposition of Property

A. Disposition of Cash. The District shall not dispose of any cash or cash equivalents unless

1. the disposition is made in the Ordinary Course of Business and the District receives an asset or service of reasonably equivalent value for such cash or cash equivalents; or

2. prior to such disposition, there is filed with the Office and the Trustee a Statement of the District to the effect that either

(a) the ratio of Net Income Available for Debt Service to Maximum Aggregate Annual Debt Service for the most recent Fiscal Year for which audited financial statements are available next preceding such disposition would not be reduced or, if reduced, would not be reduced below a ratio of 1.25:1.0 (such calculation to be made assuming such disposition had occurred at the beginning of such Fiscal Year), or

(b) the average ratio of Net Income Available for Debt Service to Maximum Aggregate Annual Debt Service, as forecasted in such Statement of the District for the two Fiscal Years immediately following such disposition, will be not less than a ratio of 1.25:1.0; or

3. such disposition has been consented to by the Office, in writing.

B. Disposition of Real Property. The District shall not sell, lease, sublease, assign, transfer, encumber or otherwise dispose of all or any part or parts of the real property described in Exhibit A, including the buildings and structures thereon and fixtures and improvements of such real property, without the prior written consent of the Office.

C. Disposition of Personal Property. The District shall not sell, lease, sublease, assign, transfer, encumber or otherwise dispose of all or any part or parts of the Facilities not included in the preceding subsections A and B, other than in the "Ordinary Course of Business," unless the Office gives its prior written consent to such disposition.

Except as provided in Section VI of this Regulatory Agreement concerning a disposition of substantially all of the District's assets, in no event shall the District dispose of any part or parts of its Facilities in any Fiscal Year aggregating in excess of two and one-half percent (2-1/2%) of the District's net property, plant and equipment (as shown on the District's most recent audited financial statements), unless the Office gives its prior written consent to such disposition.

D. Execution of Releases. In connection with a disposal of property, including cash, permitted by this Section, upon receipt of such consent by the Office or Statement of the District required by this Section, the Office and the Trustee shall execute and deliver releases from security interests or other documents reasonably requested by the District.

SECTION XI

Limitation on Acquisition of Property, Plant and Equipment

The District shall not acquire additional property, plant and equipment (except (1) in the Ordinary Course of Business, (2) with the proceeds of Indebtedness permitted by Section IX of this Regulatory Agreement, or (3) as part of a merger or consolidation permitted by Section VI of this Regulatory Agreement) by gift (other than gifts of cash or personal property or gifts of real property if either (i) its use is residential or (ii) it is subject of a phase I report indicating no contaminants), purchase, construction, merger or consolidation, unless the Office gives its prior written consent to such acquisition.

SECTION XII

Parity Debt

The District may incur Parity Debt, subject, however to compliance with Section IX of this Regulatory Agreement and the following conditions:

1. The Trustee, or any successor to the Trustee as provided in the Indenture, shall act as trustee for the Parity Debt;
2. The agreement under which Parity Debt is issued shall require that:
 - (a) An Event of Default under the Indenture shall constitute an event of default under such agreement and this Regulatory Agreement;
 - (b) Rights and obligations of the holders of Parity Debt shall be substantially the same as the rights and obligations of the Holders of Bonds under the Indenture, except that if the Parity Debt is not covered under the Contract of Insurance, the holders of Parity Debt shall have no rights under the Contract of Insurance for payments made with respect thereto; and
 - (c) Remedies upon an event of default shall be substantially the same as the remedies provided in the Indenture and this Regulatory Agreement, and, prior to exercising any such remedies, the holders of such Parity Debt (or a trustee representing their interest) shall be required to cooperate with the Trustee to the end that the interests of such holders and the Bondholders shall be equally protected;
3. Any collateral given or to be given to secure Parity Debt shall also secure the Bonds on a *pari passu* basis; provided that the Bond Reserve Account shall only secure the Bonds and the District may but need not establish similar reserve accounts for debt service of Parity Debt;
4. The Parity Debt shall be prepayable in accordance with terms substantially in the form of and under the conditions prescribed in Section 4.01(A) of the Indenture; and
5. The Parity Debt shall be insured by the Office under the Insurance Law, or if the Parity Debt can be issued as such without being insured under the Insurance Law, with the consent of the Office.

SECTION XIII

Compliance with Law; Maintenance of Facilities

A. In Accordance with the Law. The District shall operate and maintain the Facilities in material accordance with all applicable governmental laws, ordinances, approvals, rules, regulations and requirements including, without limitation, such zoning, sanitary, pollution and safety ordinances and laws, including the Insurance Law, and such rules and regulations thereunder as may be binding upon the District. The District shall make all disclosures required by the Securities and Exchange Commission and shall indemnify the Office for any costs, fees, fines, or other penalties imposed on the Office which arise from, or are incurred from, the

District's negligent or other failure to disclose annual financial and operating information as required by the Securities and Exchange Commission.

B. In Good Repair. The District shall maintain and operate the Facilities and all engines, boilers, pumps, machinery, apparatus, fixtures, fittings and equipment of any kind in or that shall be placed in any building or structure now or hereafter at any time constituting part of the Facilities, in good repair, working order and condition, and the District shall from time to time make or cause to be made all needful and proper replacements, repairs, renewals and improvements; in each case to the extent necessary so that the efficiency and value of the Facilities shall not be impaired.

SECTION XIV Taxes, Assessments and Governmental Charges

The District shall pay and discharge all taxes, assessments, governmental charges of any kind whatsoever, water rates, meter charges and other utility charges which may be or have been assessed or which may have become liens upon the Facilities, the Gross Revenues or the interests therein of the Trustee or of the Holders of the Bonds, and will make such payments or cause such payments to be made, respectively, in due time to prevent any delinquency thereon or any forfeiture or sale of the Facilities or any part thereof, and, upon request, shall furnish to the Trustee receipts for all such payments, or other evidences satisfactory to the Trustee; *provided, however,* that the District shall not be required to pay any tax, assessment, rate or charge as herein provided as long as it shall in good faith contest the validity thereof, provided that the District shall have set aside adequate reserves with respect thereto.

SECTION XV Insurance

A. Maintain Insurance. The District shall keep the Facilities and their operations adequately insured at all times, and, shall carry and maintain, or cause to be carried and maintained, and will pay, or cause to be paid, in timely fashion the premiums for, at least the following coverages with the limits as stated. The following coverages and limits may be varied only with the prior written consent of the Office.

1. *Property Insurance.*

(a) **Buildings and Structures.** All buildings and structures constituting part of the Facilities shall, at a minimum, be insured using a form at least as broad as the most recent revision of the Property Special Form coverage adopted by the Insurance Services Office (ISO), subject to a reasonable deductible per occurrence, and in an amount equal to at least the lesser of the full replacement value of the property insured, or the aggregate principal amount of the Outstanding Bonds and Parity Debt. The replacement value of the Facilities shall be determined from time to time at the request of the District or the Trustee (but not less frequently than once in every twenty-four months) by an architect, contractor, appraiser or appraisal company selected by the District or its insurance company and acceptable to the Office. The Office and the Trustee shall be loss payees on all policies maintained pursuant to

this subdivision. The policy form shall also include a Joint Loss Endorsement as respects Boiler & Machinery insurance.

(b) **Business Personal Property.** All business personal property, including computers and electronic data processing equipment, at any location forming part of the Facilities shall be insured using a form at least as broad as the most recent revision of the Property Special Form coverage adopted by the ISO, subject to a reasonable deductible per occurrence and in an amount equal to at least the lesser of the full replacement value of the property insured or the aggregate principal amount of the Outstanding Bonds and Parity Debt. The Office and the Trustee shall be loss payees on all policies maintained pursuant to this subsection.

(c) **Earthquake.** All buildings, structures, and the contents thereof, shall be insured against damage resulting from earthquake and related perils in an amount equal to at least the lesser of the full replacement value of the Facilities or the aggregate principal amount of Outstanding Bonds and Parity Debt then outstanding, subject to reasonable deductibles. The District shall acquire earthquake insurance unless the Office agrees in writing to waive earthquake insurance. The Office and the Trustee shall be loss payees on all policies maintained pursuant to this subsection.

(d) **Flood.** As to those portions of the Facilities located within a Special Flood Hazard Area, as determined by the Federal Emergency Management Agency (or an equivalent designation by a successor agency), or where no such determination has been made (un-mapped), all buildings, structures, and the contents thereof, shall be insured against damage resulting from flood and rising water in an amount equal to at least the lesser of the full replacement value of such Facilities or the aggregate principal amount of Outstanding Bonds and Parity Debt then outstanding, subject to reasonable deductibles. The Corporation shall acquire such flood insurance unless the Office agrees in writing to waive the requirement for flood insurance.

2. *Builder's Risk.* During the course of any substantial addition, extension, alteration, or improvement to the Facilities, the District shall maintain or cause to be maintained builder's risk insurance in the amount of the full completed value of such construction work, subject to reasonable deductibles per occurrence, covering all risk of physical loss or damage with such exclusions as are acceptable to the Office. The Office and the Trustee shall be loss payees on all policies maintained pursuant to this subsection.

3. *Boiler and Machinery Insurance.* The District shall maintain boiler and machinery insurance providing coverage against loss of property and liability for damage to persons or property from explosion of, or accident to, boilers, tanks, pipes, pressure vessels, engines, wheels, electrical machinery, or apparatus connected therewith or operating thereby in an amount not less than \$1,000,000, subject to deductibles not exceeding \$10,000 per occurrence. The policy form shall also include Joint Loss Endorsement.

4. *Commercial General Liability Insurance.* The District shall maintain Commercial General Liability Insurance for bodily injury and property damage in a form at least as broad as the most recent revision of the Commercial General Liability Policy adopted by the

(ISO), including non-owned and hired automobile coverage, with limits no less than with \$1,000,000 per occurrence and annual aggregate limits equal to \$3,000,000.

5. *Automobile Insurance.* The District shall maintain insurance for vehicles owned, non-owned or hired by the District with at least a \$1,000,000 per accident limit.

6. *Professional Liability.* The District shall maintain professional liability insurance with per occurrence and general aggregate limits equal to \$10,000,000, subject to reasonable deductibles or self-insured retention, unless otherwise agreed to in writing by the Office.

7. *Fidelity Bonds.* The District shall maintain fidelity bonds or other insurance covering dishonesty, including computer fraud, covering all District officers and employees who collect or have custody of or access to revenues, receipts or income of the District, with limits equal to \$5,000,000, unless otherwise agreed to in writing by the Office.

8. *Business Interruption.* The District shall maintain business interruption insurance covering actual losses to the District of gross operating earnings which result directly from the necessary interruption of business caused by damage to or destruction of any real or personal property constituting part of the Facilities from risks covered by the insurance required above under subsection 1. Property Insurance, less charges and expenses which do not necessarily continue during such interruption of business, for such period of time as may be required, with exercise of due diligence and dispatch, to reconstruct, repair or replace such damages or destroyed property, with limits equal to at least Maximum Aggregate Annual Debt Service.

9. *Extra Expense.* The District shall maintain extra expense insurance covering additional expenses for continuing operations or to resume normal business incurred by the District which result directly from damage to or destruction of any real or personal property constituting part of the Facilities from the risks covered by the insurance required above under subsection 1, Property Insurance, with limits equal to at least Maximum Aggregate Annual Debt Service.

10. *Directors and Officers.* The District shall maintain insurance to cover wrongful acts of the directors and officers, including entity coverage, to the extent available in a non-profit directors and officers policy form in an amount not less than \$10,000,000, unless otherwise agreed to by the Office in writing.

B. Risk Management Consultant. The District shall employ a Risk Management Consultant to review the insurance requirements of the District from time to time (but not less frequently than once every twenty-four (24) months). If the Risk Management Consultant makes recommendations for the increase of any of the coverage required by Subsection A of this Section, the District shall increase such coverage in accordance with such recommendations, subject to a good faith determination of the Board that such recommendations, in whole or in part, are in the best interests of the District. Notwithstanding anything in this Section to the contrary, the District shall have the right, without giving rise to an event of default under this Regulatory Agreement solely on such account,

1. with the prior written consent of the Office, to maintain insurance coverage below that required by Subsection A of this Section, provided further that the District shall furnish to the Trustee and the Office a Statement of the Risk Management Consultant or other evidence, satisfactory to the Office, that the insurance so provided affords the greatest amount of coverage available for the risk being insured against at rates which in the judgment of the Risk Management Consultant are reasonable in connection with reasonable and appropriate risk management, or

2. with the prior written consent of the Office, to adopt alternative risk management programs which the Board determines to be reasonable and which shall not have a material adverse impact on the District's reimbursement from third party payers, including, without limitation, to self-insure in whole or in part, to participate in programs of captive insurance companies, to participate with other health care institutions in mutual or other cooperative insurance or other risk management programs, to participate in state or federal insurance programs, to take advantage of state or federal laws now or hereafter in existence limiting medical and malpractice liability, or to establish or participate in other alternative risk management programs;

all as may be approved in writing as reasonable and appropriate risk management by the Risk Management Consultant. A copy of any such approval shall be furnished to the Trustee and the Office.

SECTION XVI

Workers' Compensation and Insurance Law

The District shall at all times comply with California's Workers' Compensation, Insurance and Safety Act, including the Workers' Compensation and Insurance Law at Division 4 of the California Labor Code, or any successor statute or statutes, and shall maintain insurance or self-insurance for workers' compensation claims as required by Labor Code section 3700 *et seq.*

SECTION XVII

Insurers; Policy Forms and Loss Payees

The District shall obtain such insurance coverage as is required by this Regulatory Agreement only from insurers admitted to do business in the State by the Department of Insurance of the State, unless the Office gives its prior written consent. All policies shall name the District, the Office and the Trustee, as insured parties, beneficiaries or loss payees as their interest may appear. Each policy shall be in such form and contain such provisions as are generally considered standard for the type of insurance involved, subject to the specific requirements of Section XV above, and shall contain (a) a provision to the effect that the insurer shall not cancel or substantially modify the policy provisions without first giving at least thirty (30) days written notice thereof to the District, the Office, and the Trustee and (b) a severability of interests (cross liability) provision. Nothing herein shall preclude more than one coverage or class of insurance from being included in a single policy. The District shall file at least annually on or before July 1 of each year with the Trustee and the Office, a Statement setting forth the coverages maintained pursuant to this Regulatory Agreement, the names of the insurers and

insured parties, the amounts of such insurance and applicable deductibles, the risks covered thereby and the expiration dates thereof and a similar description of any self-insurance or alternative risk management program adopted by the District, and stating whether the insurance described therein satisfies the requirements of this Regulatory Agreement. The Trustee shall be protected in relying upon such Statement without independent investigation into the matters covered therein. The District also shall file with the Trustee and the Office a copy of any insurance review or recommendations received by the District from the Risk Management Consultant pursuant to Section XV of this Regulatory Agreement.

SECTION XVIII

Title Insurance

The District shall obtain, at its own cost and expense, an ALTA policy of title insurance, with such endorsements as may be required by the Office, at the time of and dated as of the date of delivery of the Bonds or Parity Debt, in sufficient amount, when combined with the policies previously delivered and remaining available in aggregate to the Office in connection with the issuance of outstanding Parity Debt, to equal not less than the aggregate principal amount of the Bonds and Parity Debt to be outstanding after the issuance of such Bonds or Parity Debt, payable to the Trustee and the Office, insuring the title of the District to the site of the Facilities, subject only to Permitted Encumbrances, issued by a title insurance company admitted to do business in the State by the Department of Insurance of the State, and which is acceptable to the Office.

SECTION XIX

Disposition of Insurance and Condemnation Proceeds

A. The proceeds of property and builders risk insurance maintained by the District against loss or damage pursuant to subsections one and two of Section XV above, the proceeds of any title insurance obtained pursuant to Section XVIII and the proceeds of any condemnation awards with respect to the Facilities, shall be paid immediately upon receipt by the District or other named insured parties to the Trustee, for deposit in a special fund which the Trustee shall establish and maintain and hold in trust, to be known as the "Insurance and Condemnation Proceeds Fund." In the event the District elects to repair or replace the property damaged, destroyed or taken, it shall furnish to the Trustee and the Office plans of the contemplated repair or replacement, accompanied by a Statement of an architect or other qualified expert satisfactory to the Office estimating the reasonable cost of such repair or replacement and a Statement of the District stating that amounts in the Insurance and Condemnation Proceeds Fund, together with investment income reasonably expected to be received with respect thereto and any other funds available or reasonably expected to become available therefor (and which the District shall agree to deposit in said fund when so available), shall be sufficient to repair or replace the property damaged, destroyed or taken in accordance with said plans. After deducting therefrom the reasonable charges and expenses of the Trustee in connection with the collection and disbursement of such moneys, moneys in the Insurance and Condemnation Proceeds Fund shall be disbursed by the Trustee for the purpose of repairing or replacing the property damaged, destroyed or taken in the manner and subject to the conditions set forth in the Indenture with respect to disbursements from the Project Fund to the extent the provisions thereof may reasonably be made applicable. In the event that the proceeds of any loss or damage to or condemnation of the Facilities shall be less than one and one-half percent (1-1/2%) of the

District's Adjusted Annual Operating Revenues (as shown on the District's most recent audited financial statements), and so long as an event of default under this Regulatory Agreement has not occurred and is not then continuing, the Trustee shall pay over such proceeds to the District without requiring any of the documents referred to in this Subsection and without any formality whatsoever.

B. In the event the District, with the consent of the Office, shall elect not to repair or replace the property damaged, destroyed or taken, as provided in Subsection A of this Section, the Trustee shall transfer all amounts in the Insurance and Condemnation Proceeds Fund on account of such damage, destruction or condemnation to the Special Redemption Account in order to prepay the Loan Repayments and redeem Bonds; provided that if any Parity Debt is then outstanding, any such transfer from the Insurance and Condemnation Proceeds Fund shall be deposited in part in the Special Redemption Account and in part in such other fund or account as may be appropriate (and used for the retirement of such Parity Debt) in the same proportion which the aggregate principal amount of Outstanding Bonds then bears to the aggregate unpaid principal amount of such Parity Debt.

C. If all amounts in the Insurance and Condemnation Proceeds Fund and any special redemption account for the retirement of Parity Debt exceed one and one-half percent (1-1/2%) of the District's Adjusted Annual Operating Revenues (as shown on the District's most recent audited financial statements) but are not sufficient to retire all Bonds and Parity Debt then outstanding, the Trustee shall not transfer said amounts to the Special Redemption Account unless the District shall file with the Trustee a report of a Management Consultant showing that projected Net Income Available for Debt Service will be sufficient to pay Aggregate Debt Service for the three full Fiscal Years immediately following such transfer after giving effect to the retirement of such Bonds and Parity Debt. In the event such report of a Management Consultant shows that projected Net Income Available for Debt Service will not be sufficient to pay Aggregate Debt Service for the three full Fiscal Years immediately following such transfer after giving effect to the retirement of such Bonds and Parity Debt, the District shall apply all amounts in the Insurance and Condemnation Proceeds Fund to the repair or replacement of the property damaged, destroyed or taken, as provided in Subsection A of this Section, unless the District shall file a further report of a Management Consultant showing that even after making such repair and replacement, projected Net Income Available for Debt Service will not be sufficient to pay Aggregate Debt Service for the three Fiscal Years immediately following such repair and replacement, in which event the Trustee shall transfer all moneys in the Insurance and Condemnation Proceeds Fund to the Special Redemption Account and/or such other trust account for the retirement of Bonds and Parity Debt, as provided in Subsection B of this Section XIX.

SECTION XX

Operation of the Facilities

A. Income and Expenses from Other Businesses or Activities. If the District has any business or activity other than the operation of the Facilities, it shall maintain accurate and complete accounting records which segregate all income and expenses of the Facilities from any other income and expenses of the District and from any other income and expenses of any other

Person. Income and other funds of the District shall be expended only for the purposes of the District.

B. Management of the Facilities. The District shall provide for the management of the Facilities in a manner satisfactory to the Office.

1. So long as the District is not in default under this Regulatory Agreement, it may enter into a contract with a Management Agent, which is not an independent contractor, without the prior written consent of the Office, so long as such contract contains the following provisions regarding benefits or payments (including payments over time) to the Management Agent upon severance of employment:

ALL BENEFITS OR PAYMENTS RESULTING FROM TERMINATION OR SEVERANCE OF THE EMPLOYMENT PROVIDED FOR IN THIS CONTRACT, WHICH ARE, OR MAY BE, PAID AFTER THE TERMINATION OR SEVERANCE OF SUCH EMPLOYMENT, MAY BE VOIDED OR TERMINATED BY THE OFFICE OF STATEWIDE HEALTH PLANNING AND DEVELOPMENT (OFFICE) SHOULD THE EMPLOYER DEFAULT IN THE DUE AND PUNCTUAL PAYMENT OF ANY INSTALLMENT OF INTEREST, PRINCIPAL OR REDEMPTION PRICE, IF ANY, OF ANY BOND INSURED BY THE OFFICE. THE OFFICE MAY VOID OR TERMINATE ANY CONTRACT PROVISION PROVIDING FOR THE PAYMENT OF SUCH BENEFITS OR PAYMENTS IN ITS SOLE DISCRETION, WHETHER PRIOR TO, OR SUBSEQUENT TO SEVERANCE OF THE EMPLOYMENT PROVIDED FOR IN THIS CONTRACT.

2. The District shall not enter into any contract with a Management Agent which is an independent contractor without the prior written consent of the Office.

3. The District shall not enter into or terminate any contract with a Management Agent, without the prior written consent of the Office. The District's present contract with the following Management Agent is hereby approved by the Office:

Bob Edwards, Chief Executive Officer

4. If the District is in default under the terms and conditions of this Regulatory Agreement, it shall not enter into, or terminate any contract with a Management Agent without the prior written consent of the Office.

5. Any contract entered into by the District with a Management Agent, whether or not such Management Agent is an independent contractor, shall contain a provision that it shall be subject to termination, with or without cause and without penalty upon thirty (30) days' written notice of termination by the Office to the District and the Management Agent. Provided, however, that so long as the District is not in default under any obligation, term, or condition of this Regulatory Agreement to be performed by it, the Office will not exercise its right to replace such Management Agent without cause.

6. The District shall not enter into any contract with a Management Agent, whether or not such Management Agent is an independent contractor, which compensates the Management Agent on a basis of a percentage of revenue.

C. Examinations and Inspections by the Office. The Facilities, equipment, buildings, plans, office apparatus, devices, books, contracts, records (except for patient records, credentialing records and peer review records that are confidential attorney/client communications and records that, if disclosed, would violate to federal, State or local law), documents, and other papers relating thereto or to the District shall be subject to examination and inspection at any reasonable time by the Office or its duly authorized agents; the District shall keep copies of all written contracts or other instruments which affect the Facilities, all or any of which may be subject to inspection and examination by the Office or its duly authorized agents.

D. Maintain License. The District shall at all times, where required by the laws of the jurisdiction, maintain in full force and effect the applicable licenses to operate the Facilities from the State and/or other licensing authority. The District shall notify the Office if any such licensing authority makes any determination which may affect the licensing of the Facilities. The District shall at all times maintain in full force and effect all other governmental approvals, permits, qualifications and certificates necessary for the efficient functioning of the Facilities.

E. Equip the Facilities. The District shall, pursuant to applicable licensing regulations from time to time in effect, suitably equip the Facilities to facilitate its overall operations. The District shall perform all obligations of any chattel mortgage, conditional sale, lease or lease purchase agreement, or other type of financing arrangement designed to acquire equipment if failure to perform such obligations might have consequences that would materially and adversely affect the financial conditions, assets, properties or operations of the District.

F. Acquisition of Services, Supplies and Materials. The District shall make no payment from the Project Fund established under the Indenture for services, supplies or materials without the prior written consent of the Office and such services are rendered and such supplies and materials are delivered for the construction and acquisition of the Facilities and are reasonably necessary for their completion or operation.

G. Indebtedness on Default. During the continuance of a default under this Regulatory Agreement or an Event of Default under the Indenture, the District shall not incur any additional Indebtedness or make any additional capital acquisition without the prior written consent of the Office.

H. Lien on Future Acquired Real Property. If the District acquires any real property to be used or usable in connection with the operation of the Facilities while this Regulatory Agreement is in effect, such acquired real property ("Acquired Property") shall be deemed to fall within the definition of Facilities and therefore shall be subject to this Regulatory Agreement. The District shall convey an interest (which need not give the Office a first lien position) in the Acquired Property for the benefit of the Office under the Deed of Trust, unless such requirement is waived in writing by the Office.

SECTION XXI
Remedies Upon Default

A. Notice and Declaration of a Default under this Regulatory Agreement. Upon a violation of any of the provisions of this Regulatory Agreement by the District, the Office may give written notice thereof to the District by registered or certified mail, addressed to the address stated in this Regulatory Agreement, or such other address as may subsequently, upon appropriate written notice thereof to the Office, be designated by the District as its legal business address. If such violation is not corrected to the satisfaction of the Office within thirty (30) days, or in the event the default is the result of the failure of the District to make a payment required to be made to the Trustee or the result of the loss of or threatened loss of the license of the District, five (5) days after the date such notice is mailed or within such further time as the Office determines in the Office's sole discretion is necessary to correct the violation, without further notice the Office may declare a default under this Regulatory Agreement effective on the date of such declaration of default.

B. Office Directives to the District. Upon an event of default under this Regulatory Agreement, the Deed of Trust or the Indenture, the Office shall have the remedies provided by California Health and Safety Code section 129173, which are incorporated herein, as well as the following. The Office may conduct an evaluation of, and direct the District with respect to, the management and operation of the Facilities and the expenses of the Office or any consultants associated with such evaluation and direction shall be reimbursed by the District. The District shall follow all such directives, which may at the option of the Office include immediately terminating and replacing the existing Management Agent with a new Management Agent selected by the Office at the expense of the District. In the event of any such termination, the Management Agent shall not be entitled to compensation for more than thirty (30) days from the date of such termination. The Office may retain attorneys and consultants to assist in such evaluation and the District shall pay the reasonable fees and expenses of such attorneys and consultants and any other expenses incurred by the Office in that connection. These remedies are in addition to those provided under Insurance Law Section 129173. The Office reserves its rights to exercise all its remedies under Insurance Law Section 129173.

C. Payment from the Health Facility Construction Loan Insurance Fund.

1. In any case in which an Event of Default under the Indenture shall have occurred and the Trustee shall have given notice to the Office at least 30 days prior to an interest payment date, or principal payment date:

(a) that available moneys in the Principal and Interest Accounts held by the Trustee pursuant to the Indenture will be insufficient to pay in full the next succeeding payment of interest and/or principal when due to the Bondholders under the Indenture, and

(b) the amount by which the obligation to make such payment exceeds the amount available (the "Shortfall"),

the Office shall cause an amount equal to the Shortfall to be deposited into the Principal Account and/or Interest Account at least three (3) Business Days prior to the date on which said payment is due, as provided in the following Subsections 2 and 3.

2. Said deposit shall be made by the Office directing the Trustee to transfer an amount equal to the Shortfall out of the Bond Reserve Account into the Principal Account and/or Interest Account. (However, if there are insufficient funds in the Bond Reserve Account at the time the Office receives such notice of the Shortfall from the Trustee, nothing contained in this Subsection C.2 shall prevent the Office from then determining pursuant to Insurance Law Section 129145 that the lender and borrower have exhausted all reasonable means of curing the Event of Default and that it would be in the best interest of the State, the borrower and the lender to pay a portion or all of the Shortfall from the Health Facility Construction Loan Insurance Fund instead of the Bond Reserve Account, and from paying such amount from the Health Facility Construction Loan Insurance Fund.)

3. If the Office, pursuant to Insurance Law Section 129145, determines, in the event the funds in the Bond Reserve Account are insufficient to meet the Shortfall as provided in the preceding Subsection C.2, that

(a) the lender and borrower will have exhausted all reasonable means of curing the Event of Default, and

(b) a payment or payments from the Health Facility Construction Loan Insurance Fund to cure the Event of Default is now and will be at the time of the Event of Default in the best interest of the State, the borrower and the lender,

the Office may pay such amount required to meet the Shortfall from the Health Facility Construction Loan Insurance Fund to the Principal Account and/or Interest Account for the benefit of the lender within the time as provided in Subsection C.1.

4. Any payment made by the Office from the Health Facility Construction Loan Insurance Fund shall be secured pursuant to Insurance Law Section 129145 through the Deed of Trust and all applicable UCC-1s, and, upon such payment, the District shall become liable for repayment of the amount thereof to the Office upon demand and shall be liable for interest on the unpaid balance thereof at the rate of ten percent (10%) per annum.

5. If the principal of all Bonds at the time Outstanding, and the interest accrued thereon have been declared immediately due and payable pursuant to the terms of the Indenture, the Office shall make payment from the Health Facility Construction Loan Insurance Fund, or, if the fund is insufficient to make such payment, or if the Office determines it to be in the best interest of the State, the District and the Office shall request issuance of debentures as provided in subsection D of this Section.

D. Issuance of Debentures.

1. In any case in which

(a) the Office shall have directed the foreclosure and taking possession of the Facilities under the Deed of Trust and under applicable statutes,

(b) the Office, shall have otherwise acquired the Facilities from the District after default,

(c) the Office shall have received a satisfactory conveyance of title and transfer of possession of the Facilities directly from the District, or other appropriate grantor, or

(d) it has been determined that debentures should be issued pursuant to subsection C above,

the Trustee shall be entitled to receive the benefit of the insurance as provided in Insurance Law Sections 129125 through 129160, upon

(a) the prompt conveyance to the Office of title to the Facilities or, with the consent of the Office, the security interest created by the Deed of Trust,

(b) the assignment to the Office of all claims of the Trustee against the Corporation or others arising out of the sale of the Bonds, the loan transaction or the foreclosure proceedings, except such claims as may have been released with the consent of the Office, and

(c) surrender to the Office of each Bond which has been surrendered to the Trustee, which Bond shall be returned to the Trustee upon issuance of debentures and canceled by the Trustee.

2. Upon such conveyance, assignment and surrender, the Office shall request the State Treasurer to issue to the Trustee for the benefit of the Bondholders so surrendered, a debenture or debentures having a total face value of and bearing interest at the rate on the respective surrendered Bonds which they replace and additional debentures equal to all additional amounts due under the Indenture as provided by Insurance Law Sections 129125 through 129160.

E. Additional Remedies Available to the Office. Notwithstanding any other provision in this Regulatory Agreement or provision of law relating to the acquisition, management or disposal of real property by the State, the Office shall have the power to do any or all of the following:

1. Possess, operate, complete, lease, rent, renovate, modernize, insure, or sell for cash or credit, in its sole discretion, any properties conveyed to it in exchange for debentures as provided in the Insurance Law;

2. Pursue to final collection by way of compromise or otherwise all claims against the District assigned by the Trustee to the Office; or

3. Convey and execute in the name of the Office deeds of conveyance, deeds of release, assignments and satisfactions of the Deed of Trust, and any other written instrument relating to real or personal property or any interest therein acquired by the Office.

F. Remedies Not Exclusive; No Waiver of Rights. No remedy herein conferred upon or reserved to the Office is intended to be exclusive of any other available remedy or remedies, but each and every such remedy, to the extent permitted by law, shall be cumulative and shall be in addition to every other remedy given under this Regulatory Agreement, Loan Agreement and the Deed of Trust, or now or hereafter existing at law or in equity or otherwise. In order to entitle the Office to exercise any remedy, to the extent permitted by law, reserved to it contained in this Regulatory Agreement, it shall not be necessary to give any notice, other than such notice as may be herein expressly required.

No delay in exercising or omitting to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or an acquiescence therein. Furthermore, the waiver of any provision by the Office shall not be construed as a waiver of any subsequent default. Every such right and power may be exercised from time to time and as often as may be deemed expedient.

In the event a receiver is appointed for the District at the request of the Office, such receiver, if so requested by the Office, shall serve without bond.

SECTION XXII No Discrimination

The District shall comply fully with the provisions of any applicable federal, state or local laws prohibiting discrimination in employment or housing on the basis of race, color, creed, sex or national origin. Upon failure or refusal to comply with such provision, the Office may take such corrective action as it may deem necessary to effect compliance, including, but not limited to, any remedy at law or in equity.

SECTION XXIII Financial Statements

A. The District shall deliver to the Office within thirty (30) days of the receipt by the District of its audited financial statements, and in any event within one hundred fifty (150) days after the end of each Fiscal Year, two copies of its audited financial statements as of the end of such year (including a balance sheet, a statement of revenues and expenses, a statement of changes in net assets, a statement of changes in financial position and other financial reports and schedules as may have been delivered to the District in connection with such financial statements), together with (1) the report and opinion of an Accountant stating that the financial statements have been prepared in accordance with generally accepted accounting principles (with such exceptions as are not objected to by the Office) and that such Accountant's examination was performed in accordance with generally accepted accounting standards, and (2) a Certificate of the chief financial officer of the District stating that no event constitutes an Event of Default

(as that term is defined in the Indenture) or which with the giving of notice or the passage of time or both would constitute an Event of Default has occurred and is continuing as of the end of such Fiscal Year, or specifying the nature of such event and the actions taken and proposed to be taken by the District to cure such default. The District also shall deliver to the Office within forty-five (45) days after the end of each quarter one copy of its quarterly unaudited financial statements, all prepared with reasonably due diligence, and satisfactory in scope to the Office. The District also shall deliver to the Office within thirty (30) days of receipt by the District, one copy of any management letter submitted to the District by an Accountant in connection with each annual or interim audit of accounts of the District made by such Accountant. The District shall also provide the Office with copies of all action letters prepared in response to any auditors' management letters.

B. The District shall prepare a preliminary budget not later than twenty (20) days prior to the close of its Fiscal Year in which the District shall set forth its estimated revenues and expenses anticipated for the ensuing Fiscal Year. The budget shall be approved by the governing bodies of the District not later than five (5) days before the close of the Fiscal Year. Within thirty (30) days after the approval of its budget by the governing boards of the District, the District shall deliver a copy of its approved budget to the Office.

C. If the District fails to provide audited financial statements to the Office as provided in this Section, the Office may, at the District's expense, cause an audit to be performed and audited financial statements to be prepared.

SECTION XXIV Capital Replacement Fund

A. The District shall certify to the Office, on an annual basis, that the District's Board of Directors has discussed current and projected funding requirements which would be necessary to appropriately maintain the District's physical plant and equipment. Such a certification shall be signed by the chief executive officer of the District and by the President of the District's Board of Directors and shall include:

1. the minutes of the meeting at which the discussion took place;
2. a capital replacement budget covering the ensuing five year period; and
3. a brief description of the source of the funding.

B. From time to time (but not less frequently than once every five years), the District shall perform or cause to be performed a formal inspection of its physical plant resulting in a written report by a qualified professional recommending maintenance and repairs necessary to appropriately maintain the physical plant and equipment. Such report must include a discussion as to the implementation of recommendations made in the prior report. Such report shall be provided to the District's Board of Directors and forwarded to the Office along with the certified report required in paragraph A above.

SECTION XXV
Debt Coverage Ratio Reporting

Within forty-five (45) days after each March 31, June 30, September 30 and December 31, (each three-month period ending on each such date being referred to herein as a “Fiscal Quarter”) commencing with the Fiscal Quarter ending on September 30, 2016, the District shall compute the Net Income Available for Debt Service for such Fiscal Quarter and for the twelve-month period ending on the last day of such Fiscal Quarter (“Running Twelve-Month Period”) and promptly furnish to the Office a Statement setting forth the results of such computation. If at the end of such Fiscal Quarter the Net Income Available for Debt Service shall have been less than 1.25 times Maximum Aggregate Annual Debt Service for such Running Twelve-Month Period, the District shall, upon the request of the Office, employ a Management Consultant to make recommendations as to a revision of the rates, fees and charges of the Facilities or the methods of operation of the Facilities which will result in producing Net Income Available for Debt Service equal to at least 1.25 times Maximum Aggregate Annual Debt Service for such Fiscal Quarter. Copies of the recommendations of the Management Consultant shall be provided to the Office. The Office also may retain attorneys and consultants to assist in an evaluation of the operation and management of the Facilities and the District shall pay the reasonable fees and expenses of such attorneys and consultants and any expenses incurred by the Office in that connection.

SECTION XXVI
Environmental Disclosure and Inspection

A. The District shall exercise all due diligence in order to comply and cause all Persons on or occupying the Facilities to comply with all Environmental Laws.

B. The Office may, from time to time and in its reasonable discretion, retain, at the District’s expense, an independent professional consultant to review any report relating to Hazardous Material prepared by or for the District and to conduct its own investigation of the Facilities. The District hereby grants to the Office, its agents, employees, consultants and contractors the right, upon reasonable notice and during reasonable hours, to enter into or onto the Facilities to perform such tests on such property as are reasonably necessary to conduct such a review and/or investigation.

C. The District shall promptly advise the Office in writing and in reasonable detail of

1. any Release of any Hazardous Material required to be reported to any federal, state or local governmental or regulatory agency under any applicable Environmental Laws,

2. any and all written communications with respect to Environmental Claims or any Release of Hazardous Material required to be reported to any federal, state or local governmental or regulatory agency,

3. any remedial action taken by the District or to the District’s knowledge, by any other person in response to

(a) any Hazardous Material on, under or about any Facilities, the existence of which could result in an Environmental Claim having a material adverse effect upon the business, operations, properties, assets, or condition (financial or otherwise) of the District, or

(b) any Environmental Claim that could have a material adverse effect upon the business, operations, properties, assets, or condition (financial or otherwise) of the District,

4. the District's discovery of any occurrence or condition on any real property adjoining or in the vicinity of the Facilities that could cause the Facilities or any part thereof to be classified as "border-zone property" or to be otherwise subject to any restrictions on the ownership, occupancy, transferability or use thereof under any Environmental Laws, and

5. any request for information from any governmental agency that indicates such agency is investigating whether the District may be potentially responsible for a Release of Hazardous Materials.

D. The District shall promptly notify the Office of any proposed acquisition of stock, assets, or property by the District, that could reasonably be expected to expose the District to, or result in, Environmental Claims that could have a material adverse effect upon the business, operations, properties, assets, or condition (financial or otherwise) of the District, and any proposed action to be taken by the District to commence manufacturing, industrial or other operations not in the Ordinary Course of Business as conducted prior to the date of recording of this Regulatory Agreement that could reasonably be expected to subject the District to additional laws, rules or regulations, including, without limitation, laws, rules and regulations requiring additional environmental permits or licenses.

E. The District shall execute, on the effective date of this Regulatory Agreement and from time to time as requested by the Office or the Trustee, Environmental Indemnities in the form attached hereto as Exhibit C.

SECTION XXVII Notice of Default

The District shall immediately give notice to the Office and the Trustee of any notice of default given by the holder of any indebtedness of the District.

SECTION XXVIII Cancellation of Insurance

No default by the District under this Regulatory Agreement or failure by the Trustee to enforce compliance by the District herewith shall result in cancellation of the insurance of the Bonds under the Insurance Law, except as provided in Insurance Law Sections 129175 to 129185 or the Contract of Insurance.

SECTION XXIX
Office Consent Discretionary

The District agrees that if provisions of this Regulatory Agreement, the Contract of Insurance or the Indenture require the consent of the Office as a condition to certain actions by the District, the Office shall conduct an independent evaluation of such actions as a basis for granting such consent and such consent need not be given despite compliance of the District with the other stated conditions to such actions, including compliance with projected or historical financial condition tests. Such consent shall be in the sound and reasonable discretion of the Office.

SECTION XXX
Contrary Agreements Superseded

The District warrants that it has not executed, and will not execute any other agreement with provisions contradictory of, or in opposition to, the provisions hereof, and that, in any event, the requirements of this Regulatory Agreement are paramount and controlling as to the rights and obligations set forth and supersede any other requirements in conflict therewith except as may be set forth in the Contract of Insurance.

SECTION XXXI
Specific Performance

The Office or the State (or, as to Sections VII and XIII through XIX of this Regulatory Agreement, the Trustee) may apply to any court for the specific performance of this Regulatory Agreement or the Contract of Insurance or for an injunction against any violation of this Regulatory Agreement or the Contract of Insurance or for such other relief as may be appropriate since the injury to the Office, the State or the Trustee, arising from a default under any of the terms of this Regulatory Agreement or the Contract of Insurance would be irreparable and the amount of damage would be difficult to ascertain.

SECTION XXXII
Waiver of Personal Liability

No employee, officer or agent of the Office shall be individually or personally liable for any injury caused by their acts or omissions relating in any way whatsoever to the transaction resulting in this Regulatory Agreement and the Contract of Insurance. The District hereby releases each and every employee, officer and agent of the Office of and from any personal or individual liability for negligence under this Regulatory Agreement or the Contract of Insurance.

The employees and officers of the Office shall not be liable for any of their acts hereunder except as provided by California statutes concerning the liability of State employees and officers.

SECTION XXXIII

Notices

All notices, requests or communications required or permitted to be given in this Regulatory Agreement or in the Contract of Insurance shall be in writing and mailed or delivered to the party whom notice is to be given either (i) by personal delivery (in which case such notice shall be deemed to have been duly given on the date of delivery if delivered before 4:00 p.m., and if after 4:00 p.m., it shall be deemed to have been duly given on the next Business Day after delivery of the notice), (ii) by Federal Express or other similar air courier service (in which case notice shall be deemed to have been duly given on the next Business Day after delivery of the notice to the air courier service), or (iii) by United States mail, first class, postage prepaid, registered or certified (in which case such notice shall be deemed to have been duly given on the third (3rd) business day following the date of mailing), and properly addressed as follows:

Office: Office of Statewide Health Planning and Development
400 R Street, Room 470
Sacramento, CA 95811
Attention: Deputy Director
Cal-Mortgage Loan Insurance Division
cminsure@oshpd.ca.gov

District: Mendocino Coast District Hospital
700 River Drive
Fort Bragg, CA 95437
Attention: Chief Executive Officer

Trustee: The Bank of New York Mellon Trust Company, N.A.
100 Pine Street, Suite 3150
San Francisco, CA 94111
Attention: Corporate Trust Department

A duplicate copy of each notice or communication given hereunder by either the Office or the District to the other shall also be given to the Trustee. The District, the Office and the Trustee may, by notice given hereunder, designate any further or different address to which subsequent notices, Statements and other communications shall be sent.

SECTION XXXIV
Successors Bound

This Regulatory Agreement shall bind, and the benefits shall inure to, the respective parties hereto, their legal representatives, successors in office or interest, and assigns (other than the Trustee) as owners or operators of the Facilities, so long as the Contract of Insurance continues in effect, and if the Trustee receives the benefit of the Insurance, so long as the Office holds a security interest under the Deed of Trust.

SECTION XXXV
Severability Of Invalid Provisions

The invalidity of any clause, part, or provision of this Regulatory Agreement shall not affect the validity of the remaining portions hereof so long as the insurance remains in effect.

SECTION XXXVI
Agreement Represents Complete Agreement; Amendments

Except as otherwise provided herein, this Regulatory Agreement represents the entire contract among the parties. This Regulatory Agreement may be amended, changed, modified or terminated by the written agreement of the Office and the District.

SECTION XXXVII
Headings And References

The headings or titles of the Sections hereof, and any table of contents hereof, shall be solely for convenience of reference and shall not affect the meaning, construction or affect of this Regulatory Agreement. All references herein to “Sections,” “Subsections” and other subdivisions are to the corresponding Sections, Subsections or subdivisions of this Regulatory Agreement; the words “herein,” “hereof,” “hereby,” “hereunder” and other words of similar import refer to this Regulatory Agreement as a whole and not to any particular Section, Subsection or subdivision hereof; and words of the masculine gender shall mean and include words of the feminine and neuter genders.

SECTION XXXVIII
Governing Law; Venue

The laws of the State shall govern this Regulatory Agreement, the interpretation thereof and any right or liability arising hereunder. Any action or proceeding to enforce or interpret any provision of this Regulatory Agreement shall be brought, commenced or prosecuted in the Superior Court of the State of California for Sacramento County, California.

SECTION XXXIX
Attorneys’ Fees

In the event of any action at law or in equity between the parties hereto to interpret or enforce any of the provisions of this Regulatory Agreement, the nonprevailing party or parties to such litigation shall pay to the prevailing party or parties all costs and expenses, including actual

attorneys' fees, incurred therein by such prevailing party or parties; and if such prevailing party or parties shall recover judgment in any such action or proceeding, such costs, expenses and attorneys' fees may be included in and as part of such judgment. The prevailing party shall be the party who is entitled to recover its costs of suit, whether or not the suit proceeds to final judgment. A party not entitled to recover its costs of suit shall not recover attorneys' fees.

SECTION XL
EXECUTION IN COUNTERPARTS

This Regulatory Agreement may be executed in any number of counterparts, each of which shall be deemed for all purposes to be an original and all of which together shall constitute but one and the same instrument.

MENDOCINO COAST HEALTH CARE
DISTRICT

By _____
Chief Executive Officer

OFFICE OF STATEWIDE HEALTH PLANNING
AND DEVELOPMENT OF THE STATE OF
CALIFORNIA

By: Robert P. David, Director

By _____
Jeremy P. Marion
Deputy Director

[illegible]

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

[Seal]

A NOTARY PUBLIC OR OTHER OFFICER COMPLETING THIS CERTIFICATE VERIFIES ONLY THE IDENTITY OF THE INDIVIDUAL WHO SIGNED THE DOCUMENT TO WHICH THIS CERTIFICATE IS ATTACHED, AND NOT THE TRUTHFULNESS, ACCURACY, OR VALIDITY OF THAT DOCUMENT.

STATE OF CALIFORNIA)
) ss:
COUNTY OF MENDOCINO)

On _____ before me, _____ (insert name of the officer),
Notary Public, personally appeared _____ who proved to me on the basis of
satisfactory evidence to be the person(s) whose name(s) is/are subscribed to the within
instrument and acknowledged to me that he/she/they executed the same in his/her/their
authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or
the entity upon behalf of which person(s) acted, executed the instrument.

I certify under PENALTY OF PERJURY under the laws of the State of California that the foregoing paragraph is true and correct.

WITNESS my hand and official seal.

_____ [Seal]

EXHIBIT A
REAL PROPERTY DESCRIPTION

EXHIBIT B

PERSONAL PROPERTY DESCRIPTION

All equipment used by the District in connection with the operation of the Facilities, whether moveable or not or hereafter affixed to the real property described in Exhibit A, now owned or hereafter acquired by the District, together with all improvements, restorations, replacements, repairs, additions, accessions or substitutions thereto or therefor, including, without limitation, all machinery, equipment, material, furnishings and appliances for generation or distribution of air, water, heat, electricity, light, fuel or refrigeration, for purposes of ventilation, sanitation or drainage, for exclusion of vermin or insects, for removal or disposal of dust, refuse or garbage; all elevators, awnings, window coverings, floor covering, laundry equipment, kitchen equipment, cabinets, furniture and furnishings; all fixed and moveable equipment now or hereafter installed or placed on said premises for use in health care, treatment, diagnosis and services or for other health care uses; the products and proceeds from any and all such property; all the estate, interest, right, title, property or other claim or demand of every nature whatsoever, in and to such property, including specifically, but without limitation, all deposits made with or other security given to utility companies by the District with respect to such property and claims or demands relating to insurance or condemnation awards which the District now has or may hereafter acquire.

EXHIBIT C

ENVIRONMENTAL INDEMNITY

This ENVIRONMENTAL INDEMNITY (“Indemnity”) is entered into as of July 1, 2016, by MENDOCINO COAST HEALTH CARE DISTRICT, a local health care district of the State of California (“Indemnitor”), for the benefit of the Office of Statewide Health Planning and Development of the State of California (“Office”), and its successors and assigns, and the directors, officers, agents, attorneys, and employees (each of which shall be referred to hereinafter individually as an “Indemnitee” and collectively as the “Indemnitees”).

RECITALS

A. The Office and the Indemnitor have entered into a Contract of Insurance, dated as of August 1, 1996, a Contract of Insurance, dated as of October 1, 2009 (the “2009 Contract of Insurance”), a Contract of Insurance, dated as of July 1, 2010 (the “2010 Contract of Insurance”) and a Contract of Insurance, dated as of July 1, 2016 (the “2016 Contract of Insurance” and, together with the 1996 Contract of Insurance, the 2009 Contract of Insurance and the 2010 Contract of Insurance, the “Contract of Insurance”) and an Amended and Restated Regulatory Agreement of even date herewith (“Regulatory Agreement”). The obligations of the Indemnitor arising out of the Contract of Insurance and the Regulatory Agreement are to be secured by, among other things, that certain Deed of Trust of even date herewith executed by the Indemnitor as trustor, to Chicago Title Insurance Company, as trustee, in favor of the Office as beneficiary (“Deed of Trust”), which Deed of Trust encumbers the real property described on Exhibit A attached hereto (“Premises”), a copy of which is attached hereto, and the improvements constructed or to be constructed thereon (which improvements, together with the Premises, shall hereinafter be referred to as “Project”).

B. As a result of the exercise of the Office’s rights and remedies under the Regulatory Agreement, an Indemnitee may hereafter become the owner of the Project pursuant to a foreclosure sale or deed in lieu thereof. In such event, one or more of the Indemnitees may thereafter incur or suffer certain liabilities, costs, and expenses in connection with the Project relating to Hazardous Materials (as defined in the Regulatory Agreement). The Office has therefore made it a condition of the Office’s entering into the Contract of Insurance that this Indemnity be executed and delivered by the Indemnitor in order to protect the Indemnitees from any such liabilities, costs, and expenses and all other Post-Foreclosure Transfer Environmental Losses (as hereinafter defined).

AGREEMENT

In consideration of the foregoing and of the Office executing and delivering the Contract of Insurance, and other valuable consideration, the receipt of which is hereby acknowledged, the Indemnitor agrees as follows.

SECTION 1. Unless the context clearly otherwise requires, all capitalized terms not defined below and used in this Indemnity shall have the meanings assigned to such terms in the Regulatory Agreement:

a. “*Foreclosure Transfer*” means the transfer of title to all or any part of the Premises or the Project at a foreclosure sale under the Deed of Trust, either pursuant to judicial decree or the power of sale contained in the Deed of Trust, or by deed in lieu of such foreclosure.

b. “*Losses*” means any and all losses, liabilities, damages, demands, claims, actions, judgments, causes of action, assessments, penalties, costs and expenses (including, without limitation, the reasonable fees and disbursements of outside legal counsel and accountants and the reasonable charges of in-house legal counsel and accountants), and all foreseeable and unforeseeable consequential damages.

c. “*Post-Foreclosure Transfer Environmental Losses*” means Losses suffered or incurred, following a Foreclosure Transfer, by any Indemnitee, arising out of or as a result of:

(1) the occurrence, prior to a Foreclosure Transfer, of any Hazardous Material Activity;

(2) any violation, prior to such Foreclosure Transfer, of any applicable Environmental Laws relating to the Premises or the Project or to the ownership, use, occupancy or operation thereof;

(3) any investigation, inquiry, order, hearing, action, or other proceeding by or before any governmental agency in connection with any Hazardous Material Activity occurring or allegedly occurring prior to a Foreclosure Transfer; or

(4) any claim, demand or cause of action, or any action or other proceeding, whether meritorious or not, brought or asserted against any Indemnitee which directly or indirectly relates to, arises from or is based on any of the matters described in Subsections (1), (2), or (3), or any allegation of any such matters.

SECTION 2. The Indemnitor shall, to the extent permitted by law, indemnify, defend, and hold harmless Indemnitees, and each of them, from and against any and all Post-Foreclosure Transfer Environmental Losses.

SECTION 3. The Indemnitor shall not have any liability hereunder prior to a Foreclosure Transfer, and no claim may be made hereunder by any Indemnitee prior thereto. This Indemnity is given solely to protect the Office and the other Indemnitees against Post-Foreclosure Transfer Environmental Losses, and not as additional security for, or as a means of repayment of, the Indemnitor’s obligations under the Regulatory Agreement. The obligations of the Indemnitor under this Indemnity are independent of, and shall not be measured or affected by:

a. any amounts at any time paid with respect to the Contract of Insurance or owing with respect to the Contract of Insurance, the Regulatory Agreement and/or the Deed of Trust, or secured by the Deed of Trust,

b. the sufficiency or insufficiency of any collateral (including, without limitation, the Project) given to the Office to secure repayment of any amounts owing with respect to the Contract of Insurance, the Regulatory Agreement and/or the Deed of Trust,

c. the consideration given by the Office or any other party in order to acquire the Premises or the Project, or any portion thereof,

d. the modification, expiration or termination of the Contract of Insurance, the Regulatory Agreement or any other document or instrument relating thereto, or

e. the discharge or repayment in full of amounts owing with respect to the Contract of Insurance, the Regulatory Agreement and/or the Deed of Trust (including, without limitation, by amounts paid or credit bid at a foreclosure sale or by discharge in connection with a deed in lieu of foreclosure).

Notwithstanding the provisions of any document or instrument, none of the obligations of the Indemnitor hereunder shall be in any way secured by the lien of the Deed of Trust or any other document or instrument securing the obligations under the Regulatory Agreement.

SECTION 4. The Indemnitor's obligations hereunder shall survive the sale or other transfer of the Premises or the Project prior to a Foreclosure Transfer. The rights of each Indemnatee under this Indemnity shall be in addition to any other rights and remedies of such Indemnatee against the Indemnitor under any other document or instrument now or hereafter executed by the Indemnitor, or at law or in equity (including, without limitation, any right of reimbursement or contribution pursuant to CERCLA, as defined in the Regulatory Agreement), and shall not in any way be deemed a waiver of any of such rights.

SECTION 5. All obligations of the Indemnitor hereunder shall be payable upon written demand to the Indemnitor by any Indemnatee. Such written demand shall be accompanied by a statement explaining the Post-Foreclosure Transfer Losses claimed and shall set forth the amounts demanded therefor. Any amount due and payable hereunder to any Indemnatee by the Indemnitor which is not paid within thirty (30) days after the receipt by the Indemnitor of such written demand from an Indemnatee shall bear interest from the date of such demand at ten percent; *provided, however*, an Indemnatee shall not be entitled to any such interest if the Indemnitor:

(a) a. contests said obligations, and

(b) b. prevails in said contest action.

SECTION 6. The Indemnitor shall pay to each Indemnatee all costs and expenses (including, without limitation, the reasonable fees and disbursements of any Indemnatee's outside legal counsel and the reasonable charges of any Indemnatee's in-house legal counsel) incurred by such Indemnatee in connection with this Indemnity or the enforcement hereof.

SECTION 7. This Indemnity shall be binding upon the Indemnitor, its heirs, representatives, administrators, executors, successors and assigns and shall inure to the benefit of and shall be enforceable by each Indemnatee, its successors, endorsees and assigns. As used herein, the singular shall include the plural and the masculine shall include the feminine and neuter and vice versa, if the context so requires. If this Indemnity is executed by more than one person or entity, the liability of the undersigned hereunder shall be joint and several.

SECTION 8. This Indemnity shall be governed and construed in accordance with the laws of the State of California. Any action or proceeding to enforce or interpret any provision of this Indemnity shall be brought, commenced or prosecuted in Sacramento County, California.

SECTION 9. Every provision of this Indemnity is intended to be severable. If any provision of this Indemnity or the application of any provision hereof to any party or circumstance is declared to be illegal, invalid or unenforceable for any reason whatsoever by a court of competent jurisdiction, such invalidity shall not affect the balance of the terms and provisions hereof or the application of the provision in question to any other party or circumstance, all of which shall continue in full force and effect.

SECTION 10. No failure or delay on the part of any Indemnatee to exercise any power, right or privilege under this Indemnity shall impair any such power, right or privilege, or be construed to be a waiver of any default or an acquiescence therein, nor shall any single or partial exercise of such power, right or privilege preclude other or further exercise thereof or of any other right, power or privilege. No provision of this Indemnity may be changed, waived, discharged or terminated except by an instrument in writing signed by the party against whom enforcement of the change, waiver, discharge or termination is sought.

IN WITNESS WHEREOF, this Indemnity is executed as of the day and year first written above.

MENDOCINO COAST HEALTH CARE DISTRICT

By [FORM ONLY – NOT TO BE EXECUTED]
Chief Executive Officer

EXHIBIT A TO EXHIBIT C
DESCRIPTION OF THE PREMISES

EXHIBIT D

EXISTING LIENS AND ENCUMBRANCES

All liens and encumbrances shown as exceptions to the title insurance policy delivered in connection with the issuance of the 2016 Bonds.

EXHIBIT E
COLLATERAL PLEDGED

All right, title and interest that the District, now has or may hereafter acquire in:

(i) All buildings, structures, improvements, fixtures, equipment and appurtenances now and hereafter owned, constructed, located, erected, installed or affixed by or on behalf of the District upon or appurtenant to the Land as described in Exhibit A of this Regulatory Agreement and all replacements and substitutions therefor (“Facilities”);

(ii) All appurtenances, improvements, easements, pipes, transmission lines or wires and other rights used in connection with said Land or as a means of access thereto, whether now or hereafter owned or constructed or placed upon or in the Land or Facilities (“Appurtenances”);

(iii) All equipment used by the District in connection with the operation of the Facilities, whether moveable or not or hereafter affixed to the Land, now owned or hereafter acquired by the District, together with all improvements, restorations, replacements, repairs, additions, accessions or substitutions thereto or therefor, including, without limitation, all machinery, equipment, material, furnishings and appliances for generation or distribution of air, water, heat, electricity, light, fuel or refrigeration, for purposes of ventilation, sanitation or drainage, for exclusion of vermin or insects, for removal or disposal of dust, refuse or garbage; all elevators, awnings, window coverings, floor covering, laundry equipment, kitchen equipment, cabinets, furniture and furnishings; all fixed and moveable equipment now or hereafter installed or placed on said premises for use in health care, treatment, diagnosis and services or for other health care uses; the products and proceeds from any and all such property; all the estate, interest, right, title, property or other claim or demand of every nature whatsoever, in and to such property, including specifically, but without limitation, all deposits made with or other security given to utility companies by the District with respect to such property and claims or demands relating to insurance or condemnation awards which the District now have or may hereafter acquire. (Equipment);

(iv) All leases or subleases with respect to the Land, Facilities, Appurtenances and Equipment (“Leases”);

(v) All rentals or other payments which may now or hereafter accrue or otherwise become payable under the Leases to or for the benefit of the District together with all other income, rents, revenues, issues, profits, reserves, and royalties produced by the Land, Facilities, Appurtenances and Equipment or by all management or service contracts or other contracts affecting the Property, including but not limited to security deposits (collectively the “Rents”);

(vi) All earnings, products, damages, indemnifications, insurance proceeds and any other proceeds from any and all of such Land, Facilities, Appurtenances, Equipment, Leases, Rents and Accounts including specifically, but without limitation, all deposits made with or other security given to utility companies and claims or demands relating to insurance or condemnation awards which the District now has or may hereafter acquire, including all advance payments of insurance premiums made by the District with respect thereto (Proceeds);

(vii) All accounts, accounts receivable and other rights to payment of money now owned or hereafter acquired by the District, whether due or to become due and whether or not earned by performance (“Accounts”), including without limitation the following:

(a) A right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of, (ii) for services rendered or to be rendered, (iii) for a secondary obligation incurred or to be incurred, (iv) arising out of the use of a credit or charge card or information contained on or for use with the card;

(b) Any and all Accounts arising from any source, including without limitation operations of the District or its agents at the Facilities, and at any other health facility or office; and

(c) Any and all Accounts accruing from in-patient, out-patient, day treatment, and any other programs run by and operations of the District or its agents.

For purposes hereof, “Accounts” covered hereby shall include without limitation accounts, chattel paper, deposit accounts and instruments as defined by the California Commercial Code, health care insurance receivables and any amounts receivable from third party payors (including insurance companies, Medicare and Medicaid, including without limitation any Medicare and/or Medi-Cal losses paid on recapture, unless otherwise prohibited by law), and excluding any donor restricted gifts, grants, bequests, donations, contributions or tax revenue in connection with the foregoing;

(viii) All right, title and interest of the District in all the District’s inventory, raw materials, work in process, finished goods and goods held for sale or lease or furnished under contracts of service, and all returned and repossessed goods, and all goods covered by documents of title, including warehouse receipts, bills of lading and all other documents of every type covering all or any part of the Property, now owned or hereafter acquired, whether held by the District or any third party, which is located on, appurtenant to, relating to, or used by or useful in connection with the Property (Inventory);

(ix) “Gross Revenues” of the Debtor, which means all revenues, income, receipts and money received in any period by the Debtor (other than donor-restricted gifts, grants, bequests, donations, contributions and tax revenues), including, but without limiting the generality of the foregoing, the following:

(a) gross revenues derived from its operation and possession of and pertaining to its properties;

(b) proceeds with respect to, arising from, or relating to its properties and derived from (1) insurance (including business interruption insurance) or condemnation proceeds (except to the extent such proceeds are required by the terms of this Regulatory Agreement or other agreements with respect to the Indebtedness which the Debtor is permitted to incur pursuant to the terms of this Regulatory Agreement) to be used for purposes inconsistent with their use for the payment of debt service on Bonds or similar payments with respect to Parity Debt, (2) accounts, including, but not limited to, accounts receivable, (3) securities and other

investments, (4) inventory and intangible property, (5) payment/reimbursement programs and agreements, and (6) contract rights, accounts, instruments, claims for the payment of moneys and other rights and assets now or hereafter owned, held or possessed by or on behalf of the Debtor, and

(c) rentals received from the lease of the Debtor's properties or space in its facilities.

including, but not limited to, future interest on any and all revenues or incomes of any nature or kind which accrue to the District.

(x) All personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software (General intangibles)

(xi) A negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in Ordinary Course of Business is transferred by delivery with any necessary endorsement or assignment. The term does not include (i) investment property, (ii) letters of credit, or (iii) writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card (Instrument)

(xii) Any record or records that evidence both a monetary obligation and a security interest in specific goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used in the goods. In this paragraph, "monetary obligation" means a monetary obligation secured by the goods or owed under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does not include (i) charters or other contracts involving the use or hire of a vessel or (ii) records that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card. If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken together constitutes chattel paper (Chattel Paper)

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APPENDIX D

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This CONTINUING DISCLOSURE CERTIFICATE (this “Disclosure Certificate”) is executed and delivered by the Mendocino Coast Health Care District (the “District”) in connection with the execution and delivery of its Mendocino Coast Health Care District (Mendocino County, California) Insured Health Facility Refunding Revenue Bonds, Series 2016 (the “Bonds”). The Bonds are being executed and delivered pursuant to an Indenture, dated as of July 1, 2016 (the “Indenture”) by and between the District and The Bank of New York Mellon Trust Company, N.A., as trustee.

The District covenants and agrees as follows:

Section 1. Purpose of the Disclosure Certificate. This Disclosure Certificate is being executed and delivered by the District for the benefit of the holders and beneficial owners of the Bonds and in order to assist the Participating Underwriter in complying with S.E.C. Rule 15c2-12(b)(5).

Section 2. Definitions. In addition to the definitions set forth above and in the Indenture, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section 2, the following capitalized terms shall have the following meanings:

“*Annual Report*” means any Annual Report provided by the District pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

“*Annual Report Date*” means the date that is not later than 150 days after the end of the District’s fiscal year (which currently ends on June 30).

“*Dissemination Agent*” means the District, or any successor Dissemination Agent designated in writing by the District and which has filed with the District a written acceptance of such designation.

“*Listed Events*” means any of the events listed in Section 5(a) of this Disclosure Certificate.

“*MSRB*” means the Municipal Securities Rulemaking Board, which has been designated by the Securities and Exchange Commission as the sole repository of disclosure information for purposes of the Rule, or any other repository of disclosure information that may be designated by the Securities and Exchange Commission as such for purposes of the Rule in the future.

“*Official Statement*” means the final official statement executed by the District in connection with the issuance of the Bonds.

“*Participating Underwriter*” means William Blair & Company, LLC, the original underwriter of the Bonds required to comply with the Rule in connection with offering of the Bonds.

“*Rule*” means Rule 15c2-12 adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as it may be amended from time to time.

Section 3. Provision of Annual Reports.

(a) The District shall, or shall cause the Dissemination Agent to, not later than the Annual Report Date, with the report for the 2015-16 fiscal year, provide to the MSRB, in an electronic format as prescribed by the MSRB, an Annual Report that is consistent with the requirements of Section 4 of this

Disclosure Certificate. Not later than 15 Business Days prior to the Annual Report Date, the District shall provide the Annual Report to the Dissemination Agent (if other than the District). If by 15 Business Days prior to the Annual Report Date the Dissemination Agent (if other than the District) has not received a copy of the Annual Report, the Dissemination Agent shall contact the District to determine if the District is in compliance with the previous sentence. The Annual Report may be submitted as a single document or as separate documents comprising a package, and may include by reference other information as provided in Section 4 of this Disclosure Certificate; provided that the audited financial statements of the District may be submitted separately from the balance of the Annual Report, and later than the Annual Report Date, if not available by that date. If the District's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(b). If the Dissemination Agent is other than the District shall provide a written certification with each Annual Report furnished to the Dissemination Agent to the effect that such Annual Report constitutes the Annual Report required to be furnished by the District hereunder.

(c) If the District does not provide (or cause the Dissemination Agent to provide) an Annual Report by the Annual Report Date, the District shall provide in a timely manner (or cause the Dissemination Agent to provide in a timely manner) to the MSRB, in an electronic format as prescribed by the MSRB, a notice in substantially the form attached as Exhibit A.

(d) With respect to each Annual Report, the Dissemination Agent shall:

(i) determine each year prior to the Annual Report Date, the then-applicable rules and electronic format prescribed by the MSRB for the filing of annual continuing disclosure reports; and

(ii) if the Dissemination Agent is other than the District, file a report with the District certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, and stating the date it was provided.

Section 4. Content of Reports.

(a) The District's Annual Report shall contain or incorporate by reference the District's audited financial statements prepared in accordance with generally accepted accounting principles as promulgated to apply to governmental entities from time to time by the Governmental Accounting Standards Board. If the District's audited financial statements are not available by the Annual Report Date, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.

(b) Unless otherwise provided in the audited financial statements filed on or before the Annual Report Date, the District's Annual Report shall contain or incorporate by reference financial information and operating data with respect to the District for the preceding fiscal year, substantially similar to that provided in the corresponding tables in the Official Statement:

- (i) Historical Utilization;
- (ii) Number of full time equivalent employees;
- (iii) Sources of Patient Revenue; and;
- (iv) Concentration of Credit Risk.

(c) In addition to any of the information expressly required to be provided under this Disclosure Certificate, the District shall provide such further material information, if any, as may be necessary to make the specifically required statements, in the light of the circumstances under which they are made, not misleading.

(d) Any or all of the items listed above may be included by specific reference to other documents, including official statements of debt issues of the District or related public entities, which are available to the public on the MSRB's Internet web site or filed with the Securities and Exchange Commission. The District shall clearly identify each such other document so included by reference.

Section 5. Reporting of Significant Events.

(a) The District shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds:

- (1) Principal and interest payment delinquencies.
- (2) Non-payment related defaults.
- (3) Unscheduled draws on debt service reserves reflecting financial difficulties.
- (4) Unscheduled draws on credit enhancements reflecting financial difficulties.
- (5) Substitution of credit or liquidity providers, or their failure to perform.
- (6) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the security, or other material events affecting the tax status of the security.
- (7) Modifications to rights of security holders, if material.
- (8) Bond calls, if material, and tender offers.
- (9) Defeasances.
- (10) Release, substitution, or sale of property securing repayment of the securities, if material.
- (11) Rating changes.
- (12) Bankruptcy, insolvency, receivership or similar event of the City or other obligated person.
- (13) The consummation of a merger, consolidation, or acquisition involving the City or an obligated person, or the sale of all or substantially all of the assets of the City or an obligated person (other than in the ordinary course of business), the entry into a definitive agreement to undertake such an action, or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material.

- (14) Appointment of a successor or additional trustee or the change of name of a trustee, if material.

(b) Whenever the District obtains knowledge of the occurrence of a Listed Event, the District shall, or shall cause the Dissemination Agent (if not the District) to, file a notice of such occurrence with the MSRB, in an electronic format as prescribed by the MSRB, in a timely manner not in excess of 10 business days after the occurrence of the Listed Event. Notwithstanding the foregoing, notice of Listed Events described in subsections (a)(8) and (9) above need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to holders of affected Bonds under the Indenture.

(c) The District acknowledges that the events described in subparagraphs (a)(2), (a)(7), (a)(8) (if the event is a bond call), (a)(10), (a)(13), and (a)(14) of this Section 5 contain the qualifier “if material” and that subparagraph (a)(6) also contains the qualifier “material” with respect to certain notices, determinations or other events affecting the tax status of the Bonds. The District shall cause a notice to be filed as set forth in paragraph (b) above with respect to any such event only to the extent that it determines the event’s occurrence is material for purposes of U.S. federal securities law. Whenever the District obtains knowledge of the occurrence of any of these Listed Events, the District will as soon as possible determine if such event would be material under applicable federal securities law. If such event is determined to be material, the District will cause a notice to be filed as set forth in paragraph (b) above.

(d) For purposes of this Disclosure Certificate, any event described in paragraph (a)(12) above is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent, or similar officer for the District in a proceeding under the United States Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the District, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement, or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the District.

Section 6. Identifying Information for Filings with the MSRB. All documents provided to the MSRB under the Disclosure Certificate shall be accompanied by identifying information as prescribed by the MSRB.

Section 7. Termination of Reporting Obligation. The District’s obligations under this Disclosure Certificate shall terminate upon the legal defeasance, prior redemption or payment in full of all of the Bonds. If such termination occurs prior to the final maturity of the Bonds, the District shall give notice of such termination in the same manner as for a Listed Event under Section 5(c).

Section 8. Dissemination Agent. The District may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under this Disclosure Certificate, and may discharge any Dissemination Agent, with or without appointing a successor Dissemination Agent. The initial Dissemination Agent shall be the District. Any Dissemination Agent may resign by providing 30 days’ written notice to the District.

Section 9. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the District may amend this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

- (a) if the amendment or waiver relates to the provisions of Sections 3(a), 4 or 5(a), it may only be made in connection with a change in circumstances that arises from a change in legal

requirements, change in law, or change in the identity, nature, or status of an obligated person with respect to the Bonds, or type of business conducted;

(b) the undertakings herein, as proposed to be amended or waived, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the primary offering of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) the proposed amendment or waiver either (i) is approved by holders of the Bonds in the manner provided in the Indenture for amendments to the Indenture with the consent of holders, or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the holders or beneficial owners of the Bonds.

If the annual financial information or operating data to be provided in the Annual Report is amended pursuant to the provisions hereof, the first annual financial information filed pursuant hereto containing the amended operating data or financial information shall explain, in narrative form, the reasons for the amendment and the impact of the change in the type of operating data or financial information being provided.

If an amendment is made to the undertaking specifying the accounting principles to be followed in preparing financial statements, the annual financial information for the year in which the change is made shall present a comparison between the financial statements or information prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles. The comparison shall include a qualitative discussion of the differences in the accounting principles and the impact of the change in the accounting principles on the presentation of the financial information, in order to provide information to investors to enable them to evaluate the ability of the District to meet its obligations. To the extent reasonably feasible, the comparison shall be quantitative.

A notice of the change in the accounting principles shall be filed in the same manner as for a Listed Event under Section 5(c).

Section 10. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the District from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the District chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the District shall have no obligation under this Disclosure Certificate to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Section 11. Default. If the District fails to comply with any provision of this Disclosure Certificate, the Participating Underwriter or any holder or beneficial owner of the Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the District to comply with its obligations under this Disclosure Certificate. A default under this Disclosure Certificate shall not be deemed an Event of Default under the Indenture, and the sole remedy under this Disclosure Certificate in the event of any failure of the District to comply with this Disclosure Certificate shall be an action to compel performance.

Section 12. Duties, Immunities and Liabilities of Dissemination Agent. (a) The Dissemination Agent shall have only such duties as are specifically set forth in this Disclosure Certificate, and the District agrees to indemnify and save the Dissemination Agent, its officers, directors, employees and

agents, harmless against any loss, expense and liabilities which they may incur arising out of or in the exercise or performance of its powers and duties hereunder, including the costs and expenses (including attorneys' fees) of defending against any claim of liability, but excluding liabilities due to the Dissemination Agent's negligence or willful misconduct. The Dissemination Agent shall have no duty or obligation to review any information provided to it by the District hereunder, and shall not be deemed to be acting in any fiduciary capacity for the District, the Bond holders or any other party. The obligations of the District under this Section shall survive resignation or removal of the Dissemination Agent and payment of the Bonds.

(b) The Dissemination Agent shall be paid compensation by the District for its services provided hereunder in accordance with its schedule of fees as amended from time to time, and shall be reimbursed for all expenses, legal fees and advances made or incurred by the Dissemination Agent in the performance of its duties hereunder.

Section 13. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the District, the Dissemination Agent, the Participating Underwriter and the holders and beneficial owners from time to time of the Bonds, and shall create no rights in any other person or entity.

Section 14. Counterparts. This Disclosure Certificate may be executed in several counterparts, each of which shall be regarded as an original, and all of which shall constitute one and the same instrument.

Date: _____, 2016

MENDOCINO COAST HEALTH CARE
DISTRICT

By: _____

Name: _____

Title: _____

EXHIBIT A

NOTICE OF FAILURE TO FILE ANNUAL REPORT

Name of Issuer: Mendocino Coast Heath Care District

Name of Issue: \$_____ Mendocino Coast Health Care District (Mendocino County, California) Insured Health Facility Refunding Revenue Bonds, Series 2016

Date of Issuance: _____, 2016

NOTICE IS HEREBY GIVEN that the District has not provided an Annual Report with respect to the above-named Bonds as required by the Continuing Disclosure Certificate executed by the District in connection with the Bonds. The District anticipates that the Annual Report will be filed by ____, 20__.

Dated: _____, 20__

DISSEMINATION AGENT:

By:_____

Its:_____

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APPENDIX E

FORM OF BOND COUNSEL OPINION

[Closing Date]

Mendocino Coast Health Care District
700 River Drive
Fort Bragg, California 95437

Re: \$_____ Mendocino Coast Health Care District (Mendocino County, California) Insured Health Facility Refunding Revenue Bonds, Series 2016

Ladies and Gentlemen:

We have acted as Bond Counsel in connection with the issuance by the Mendocino Coast Health Care District (the “District”) of its \$_____ Mendocino Coast Health Care District (Mendocino County, California) Insured Health Facility Refunding Revenue Bonds, Series 2016 (the “Bonds”). The Bonds will be issued by the District pursuant to and secured by an Indenture, dated as of July 1, 2016 (the “Indenture”), between the District and The Bank of New York Mellon Trust Company, N.A., as trustee (the “Trustee”) and under the provisions of Section 32127.2 of the Health and Safety Code of the State of California (the “Law”). Capitalized terms used herein and not otherwise defined shall have the meanings assigned to them in the Indenture.

As Bond Counsel, we have examined copies certified to us as being true and complete copies of the proceedings of the District in connection with the issuance of the Bonds and the Law. We have also examined a special report of Causey Demgen & Moore P.C. (the “Report”) and such certificates of officers of the District and others as we have considered necessary for the purposes of this opinion. This opinion is limited to the laws of the State of California and the federal laws of the United States of America.

Based upon the foregoing, we are of the opinion that:

1. The Bonds constitute valid and binding obligations of the District.
2. The Indenture has been duly and validly authorized, executed and delivered by the District and, assuming the Indenture constitutes a legal valid and binding obligation of the Trustee, constitutes a legal, valid and binding obligation of the District, enforceable against the District in accordance with its terms.
3. Under existing statutes, regulations, rulings and court decisions, interest on the Bonds is exempt from personal income taxes of the State of California and, assuming compliance with the covenants mentioned herein after the date hereof, interest on the Bonds is excluded pursuant to section 103(a) of the Internal Revenue Code of 1986 (the “Code”) from the gross income of the owners thereof for federal income tax purposes and will not be included in computing the federal alternative minimum taxable income of individuals or, except as hereinafter described, corporations. Interest on the Bonds owned by a corporation will be included in such corporation’s adjusted current earnings for purposes of calculating the federal alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate mortgage investment conduit, a real estate investment trust, or a financial asset securitization investment trust (“FASIT”). A corporation’s alternative minimum

taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code will be computed. The Code imposes certain requirements that must be met subsequent to the issuance and delivery of the Bonds for interest thereon to be and remain excluded pursuant to section 103(a) of the Code from the gross income of the owners thereof for federal income tax purposes. Non-compliance with such requirements could cause the interest on the Bonds to fail to be excluded from the gross income of the owners thereof retroactive to the date of issuance of the Bonds. Pursuant to the Indenture and a tax certificate pertaining to arbitrage and other matters under sections 103 and 141-150 of the Code being delivered by the District in connection with the issuance of the Bonds (the "Tax Certificate"), the District is making representations relevant to the determination of, and is undertaking certain covenants regarding or affecting, the exclusion of interest on the Bonds from the gross income of the owners thereof for federal income tax purposes.

In reaching our opinions described in the immediately preceding paragraph, we have assumed the accuracy of and have relied upon such representations and the present and future compliance by the District with such covenants, and we have relied on the Report. Further, except as stated in the preceding paragraph, we express no opinion as to any federal, state, or local tax consequence of the receipt or accrual of interest on, or the ownership or disposition of, the Bonds. Furthermore, we express no opinion as to any federal, state or local tax law consequence with respect to the Bonds, or the interest thereon, if any action is taken with respect to the Bonds or the proceeds thereof predicated or permitted upon the advice or approval of other counsel. Ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, owners of an interest in a FASIT, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations.

The opinion expressed in paragraph 1 above is qualified to the extent the enforceability of the Bonds may be limited by applicable bankruptcy, insolvency, debt adjustment, reorganization, moratorium or similar laws or equitable principles relating to or limiting creditors' rights generally or as to the availability of any particular remedy. The enforceability of the Bonds is subject to the effect of general principles of equity, including, without limitation, concepts of materiality, reasonableness, good faith and fair dealing, to the possible unavailability of specific performance or injunctive relief, regardless of whether considered in a proceeding in equity or at law, and to the limitations on legal remedies against governmental entities in the State of California.

No opinion is expressed herein on the accuracy, completeness or fairness of the Official Statement or other offering material relating to the Bonds.

Our opinions are based on existing law, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

Respectfully submitted,

APPENDIX F

BOOK-ENTRY SYSTEM

The following description of the Depository Trust Company (“DTC”), the procedures and record keeping with respect to beneficial ownership interests in the Series 2016 Bonds, payment of principal, interest and other payments on the Series 2016 Bonds to DTC Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in the Series 2016 Bonds and other related transactions by and between DTC, the DTC Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the DTC Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters, but should instead confirm the same with DTC or the DTC Participants, as the case may be.

Neither the issuer of the Series 2016 Bonds (the “Issuer”) nor the trustee, fiscal agent or paying agent appointed with respect to the Series 2016 Bonds (the “Agent”) take any responsibility for the information contained in this Appendix.

No assurances can be given that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of interest, principal or premium, if any, with respect to the Series 2016 Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2016 Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2016 Bonds, or that they will so do on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix. The current “Rules” applicable to DTC are on file with the Securities and Exchange Commission and the current “Procedures” of DTC to be followed in dealing with DTC Participants are on file with DTC.

1. The Depository Trust Company (“DTC”), New York, NY, will act as securities depository for the securities (the “Securities”). The Securities will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Security certificate will be issued for each issue of the Securities, each in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount, and an additional certificate will be issued with respect to any remaining principal amount of such issue.

2. DTC, the world’s largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing

Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com. The information set forth on such website is not incorporated herein by reference.

3. Purchases of Securities under the DTC system must be made by or through Direct Participants, which will receive a credit for the Securities on DTC’s records. The ownership interest of each actual purchaser of each Security (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Securities are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Securities, except in the event that use of the book-entry system for the Securities is discontinued.

4. To facilitate subsequent transfers, all Securities deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Securities with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Securities; DTC’s records reflect only the identity of the Direct Participants to whose accounts such Securities are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

5. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Securities may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Securities, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of Securities may wish to ascertain that the nominee holding the Securities for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

6. Redemption notices shall be sent to DTC. If less than all of the Securities within an issue are being redeemed, DTC’s practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

7. Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Securities unless authorized by a Direct Participant in accordance with DTC’s MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to Issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.’s consenting or voting rights to those Direct Participants to whose accounts Securities are credited on the record date (identified in a listing attached to the Omnibus Proxy).

8. Redemption proceeds, distributions, and dividend payments on the Securities will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from Issuer or Agent, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, Agent, or Issuer, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of Issuer or Agent, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

9. DTC may discontinue providing its services as depository with respect to the Securities at any time by giving reasonable notice to Issuer or Agent. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered.

10. Issuer may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, Security certificates will be printed and delivered to DTC.

11. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that Issuer believes to be reliable, but Issuer takes no responsibility for the accuracy thereof.

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APPENDIX G

FORM OF CONTRACT OF INSURANCE

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CONTRACT OF INSURANCE

LOAN NO. ____

STATE OF CALIFORNIA
OFFICE OF STATEWIDE HEALTH PLANNING AND DEVELOPMENT

This **CONTRACT OF INSURANCE**, dated as of July 1, 2016, and effective as of July __, 2016, is by and between the **MENDOCINO COAST HEALTH CARE DISTRICT**, a local healthcare district (the “District”) and the **OFFICE OF STATEWIDE HEALTH PLANNING AND DEVELOPMENT OF THE STATE OF CALIFORNIA** (the “Office”).

WHEREAS, the Office is authorized to enter into this Contract of Insurance pursuant to California Health and Safety Code sections 127045 and 129105;

WHEREAS, the Director of the Office is authorized to enter into this Contract of Insurance on behalf of the Office pursuant to California Health and Safety Code section 127010 and California Government Code section 11150, *et seq.*;

WHEREAS, the undersigned Deputy Director of the Office was appointed by the Director of the Office to act on the Director’s behalf pursuant to Delegation Order ____ effective ____, and is so authorized by California Health and Safety Code section 7 and California Government Code sections 1194, 7 and 18572;

WHEREAS, the District is authorized to enter into this Contract of Insurance pursuant to a resolution adopted by the District on June 30, 2016;

WHEREAS, the District desires to issue its Mendocino Coast Health Care District Insured Health Facility Refunding Revenue Bonds, Series 2016 in the principal amount of \$____ (the “**Bonds**”), pursuant to an Indenture, dated as of July 1, 2016 (the “**Indenture**”), by and between the District and The Bank of New York Mellon Trust Company, N.A., as trustee (the “**Trustee**”), which shall be secured by a Deed of Trust delivered by the District (the “**Deed of Trust**”) on certain of the District’s property, and by a pledge of the District’s Gross Revenues (as such term is defined in the hereinafter defined Regulatory Agreement);

WHEREAS, the District desires to obtain the Health Facility Construction Loan Insurance (the “**Insurance**”) insuring the payment of the Bonds, and the Office is willing to extend the Insurance;

WHEREAS, the Office has reviewed the final form of the Bonds, the Indenture, the Deed of Trust, and the American Land Title Association title insurance policy issued by Chicago Title Insurance Company insuring the title to that property of the District which is subject to the Deed of Trust and naming the Trustee and the Office as beneficiaries, as their respective interests may appear;

WHEREAS, the Office has approved the District's application for insurance of the Bonds; and

WHEREAS, in consideration of the Insurance and in order to comply with the requirements of Chapter 1, Part 6, Division 107 of the Health and Safety Code of the State of California, cited as the "California Health Facility Construction Loan Insurance Law," as now in effect and as it may from time to time hereafter be amended or supplemented (the "**Insurance Law**"), the Office and the District have entered into an Amended and Restated Regulatory Agreement, dated as of July 1, 2016, and effective as of July __, 2016 (the "**Regulatory Agreement**"), regulating the terms and conditions of the Insurance of the Bonds;

NOW, THEREFORE, in consideration of these presents and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto mutually agree, and agree for the benefit of the Holders of the Bonds from time to time and the Trustee, as follows:

1. **Definitions.** Unless the context clearly otherwise requires, all capitalized terms used herein shall have the meanings assigned to such terms in the Regulatory Agreement, or, if not defined therein, the Indenture.

2. **Insurance.** The Office hereby declares and agrees that the Bonds are eligible for the Insurance under the Insurance Law and that the payment to the Trustee of the principal of and the accrued and unpaid interest on the insured principal of the Bonds and such other costs and expenses required under the Insurance Law is insured. However, payments from the Trustee to the Bondholders are not insured.

3. **Incontestability.** Pursuant to Insurance Law Section 129110, such Insurance shall be incontestable from the date of the execution of this Contract of Insurance, except in case of fraud or misrepresentation on the part of the lender (as defined in Insurance Law Section 129010(j)). Such Insurance shall be subject to the terms and conditions of the Regulatory Agreement, which are incorporated herein by reference.

4. **Approval of Documents.** The Office approves the execution and delivery of the Indenture and the Deed of Trust.

5. **Reserved.**

6. **Reserved.**

7. **Compliance with Law and Documents.** The District shall, to the extent they are respectively obligated thereunder, comply with the Insurance Law and the terms, conditions and covenants of the Bonds, the Indenture, the Deed of Trust, the Regulatory Agreement and this Contract of Insurance.

8. **Premium Payment.** The District has paid all premiums required for the Insurance on the effective date hereof. Insurance of the Bonds shall not be cancelled or terminated for any reason, including any failure by the District to comply with the provisions of the Regulatory Agreement or any other agreement or failure by the Trustee to enforce such compliance, except as provided in Section 9 hereof.

9. **Termination of Insurance.** The Insurance provided herein may be terminated by the Office only upon the occurrence of any of the following:

(a) **Payment of Insurance by the Office.** Upon the payment in full by the Office of the Insurance of the Bonds pursuant to the Insurance Law.

(b) **Payment of Bonds; Defeasance.** Upon the payment in full of the principal of and the accrued and unpaid interest on the Bonds (including defeasance of the Bonds) so that all principal and interest payments that have or may come due under the Loan Agreement are paid.

(c) **Joint Request.** Upon the joint written request of the District and all the Bondholders as provided in Insurance Law Section 129185.

(d) **Foreclosure or Conveyance; Surrender of Bonds.** If the Deed of Trust is judicially foreclosed as to such property and the District and the Trustee or the Bondholders non-judicially foreclose or otherwise acquire such property and the District and the Trustee do not execute and deliver to the Office a grant deed, trustee deed or quitclaim deed covering such property within sixty (60) days of such foreclosure or other acquisition; or if any Bonds are surrendered to the Trustee to be exchanged for debentures and such Bonds are not surrendered to the Office within sixty (60) days of receipt by the Trustee; provided that, if the required conveyance or surrender is restrained, enjoined, or otherwise prevented by any court or governmental body or agency, then the District and the Trustee shall have sixty (60) days to make the conveyance or surrender from the date such restraint or injunction is vacated, dismissed or discharged.

10. **Successors Bound.** This Contract of Insurance shall bind, and the benefits shall inure to, the respective parties hereto, their legal representatives, successors in office or interest, and assigns, and shall be directly enforceable by the Trustee. The Office hereby consents to the District's assignment of its rights under this Contract of Insurance to the Trustee.

11. **Severability of Invalid Provisions.** The invalidity of any clause, part, or provision of this Contract of Insurance shall not affect the validity of the remaining portions hereof so long as the Insurance remains in effect.

12. **Agreement Represents Complete Agreement; Amendments.** Except as otherwise provided herein, this Contract of Insurance represents the entire contract among the parties. This Contract of Insurance may be amended, changed or modified by the written agreement of the Office and the District, provided that such amendment, change or modification shall not materially adversely affect the Holders.

13. **Headings and References.** The headings or titles of the several sections, subsections and subdivisions hereof shall be solely for convenience of reference and shall not affect the meaning, construction or effect of this Contract of Insurance. All references herein to "sections," "subsections" and other subdivisions are to the corresponding sections, subsections or subdivisions of this Contract of Insurance. The words "herein," "hereof," "hereby," "hereunder" and other words of similar import refer to this Contract of Insurance as a whole and not to any particular section, subsection or subdivision hereof. Words of the masculine gender shall mean and include words of the feminine and neuter genders.

14. **Governing Law; Venue.** The laws of the State of California shall govern this Contract of Insurance, the interpretation hereof and any right or liability arising hereunder. Any action or proceeding to enforce or interpret any provision of this Contract of Insurance shall be brought, commenced or prosecuted in Sacramento County Superior Court, Sacramento County, California.

15. **Attorneys' Fees.** In the event of any action at law or in equity between the parties hereto, other than the District, to interpret or enforce any of the provisions of this Contract of Insurance, the nonprevailing party or parties to such litigation shall pay to the prevailing party or parties all costs and expenses, including actual attorneys' fees, incurred therein by such prevailing party or parties; and if such prevailing party or parties shall recover judgment in any such action or proceeding, such costs, expenses and attorneys' fees may be included in and as part of such judgment. The prevailing party shall be the party who is entitled to recover its costs of suit, whether or not the suit proceeds to final judgment. A party not entitled to recover its costs of suit shall not recover attorneys' fees.

16. **Execution in Counterparts.** This Contract of Insurance may be executed in any number of counterparts, each of which shall be deemed for all purposes to be an original and all of which shall together constitute but one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have duly executed this Contract of Insurance as of the day and year first above written.

MENDOCINO COAST HEALTH CARE DISTRICT

By: _____
Bob Edwards
Chief Executive Officer

OFFICE OF STATEWIDE HEALTH PLANNING
AND DEVELOPMENT OF THE STATE OF
CALIFORNIA

By: Robert P. David, Director

By: _____
Jeremy P. Marion
Deputy Director

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