



200603140137
Skagit County Auditor

3/14/2006 Page 1 of 22 3:08PM

When Recorded Return To:

Donald W. Black
OGDEN MURPHY WALLACE, P.L.L.C.
1601 Fifth Avenue, Suite 2100
Seattle, Washington 98101-1686

CHICAGO TITLE IC31157

**OPTION TO PURCHASE REAL PROPERTY
AND
RIGHT OF FIRST REFUSAL**

Reference Number(s)
of Related Documents:

Additional Reference #s on page: N/A

Grantor (Last, First, M.I.): CHALLENGE DEVELOPMENTS II, L.L.C., a Washington state
limited liability company

Additional Grantors on page: N/A

Grantee (Last, First, M.I.): SKAGIT COUNTY PUBLIC HOSPITAL DISTRICT NO. 2 (d/b/a
Island Hospital), a Washington state public hospital district

Additional Grantees on page: N/A

Legal Description (abbreviated): Ptn. E1/2 SE1/4 Sec. 24-35N-01E, AND Units 101 and 102,
ISLAND MEDICAL CENTER CONDOMINIUM, a condominium

Additional Legal on page: 22

Assessor's Tax
Account Number:

350124-0-139-0103, 96128, 9100698

SKAGIT COUNTY WASHINGTON
REAL ESTATE EXCISE TAX

MAR 14 2006

Amount Paid \$
By Skagit Co. Treasurer
Deputy

OPTION TO PURCHASE REAL PROPERTY
AND RIGHT OF FIRST REFUSAL
{MGW597638.DOC;10/06989.045011/}

**OPTION TO PURCHASE REAL PROPERTY
AND
RIGHT OF FIRST REFUSAL**

THIS OPTION TO PURCHASE REAL PROPERTY AND RIGHT OF FIRST REFUSAL (the "Option Agreement") is made and entered into as of the 13th day of March, 2006, by and between **CHALLENGE DEVELOPMENTS II, L.L.C.**, a Washington limited liability company, including its successors and assigns, ("Seller") and **SKAGIT COUNTY PUBLIC HOSPITAL DISTRICT No. 2 (d/b/a ISLAND HOSPITAL)**, a Washington State public hospital district, including its successors or assigns ("Purchaser").

RECITALS

WHEREAS, Seller owns (or will soon own) two condominium units and related rights in land and improvements more specifically described in Paragraph 1 below (collectively, the "Property") and commonly known as Condo Units #101 and #102 in the Island Medical Center Building located at 1213 24th Street in Anacortes, Washington ("IMC Building");

WHEREAS, as a condition to the purchase of other property rights related to the Property and the grant of a revised ground lease and other agreements, Purchaser desires an option and right of first refusal to acquire the Seller's interest in the Property on and subject to the terms of this Option Agreement; and

WHEREAS, in order to meet the Purchaser's conditions and in consideration of its own best interests, Seller is willing to grant the Purchaser an option and right of first refusal and to sell and convey its interest in the Property to Purchaser on and subject to the terms, covenants and conditions hereof.

NOW, THEREFORE, for value received and in consideration of the mutual promises set forth in this Option Agreement, the parties agree as follows:

1. OPTION TO PURCHASE PROPERTY. On the Effective Date, Seller hereby grants Purchaser an option ("Option") to purchase from Seller all of its rights and interest in the Property, now existing or hereafter acquired (including any interest of Seller's successors or assigns), on the terms and conditions set forth in this Option Agreement. The "Property" consists of:

a. Seller's interest in the lessee's interest in that Ground Lease between the Seller and Purchaser (as owners of condominium units), as Lessee, and Purchaser, as Lessor, ("Ground Lease"), and all other rights or interests Seller may have, concerning the land described on Exhibit A attached hereto (the "Land");



b. Seller's fee ownership interest in Condominium Units #101 and #102 ("Condo Units") and all rights and interests Seller may have in the related limited and common elements and improvements situated on the Land (the "Improvements"), including without limitation the Seller's membership interest in the IMC Building Condominium Association ("Condo Association"), all as more specifically described in that Declaration Establishing the Island Medical Center Condominium and the related survey map and plans, each dated and recorded in the real property records of Skagit County, Washington, as of the date of this Option Agreement;

c. Seller's interest in the personal property located in the Condo Units, the Improvements or on the Land; and

d. All of Seller's rights in all of the following intangible property now or hereafter existing with respect to the Land, Condo Units or the Improvements (the "Intangible Property"):

(1) All leases, licenses and other agreements to use or occupy all or any part of the Land, Condo Units or Improvements, together with, and subject to the manner in which the same are to be prorated under this Option Agreement, all rents, charges, deposits and other sums due, accrued or to become due there-under, and all guaranties by third parties of any tenant's or other party's obligations under such leases, licenses and other agreements;

(2) All plans and specifications, all building permits and other permits required in connection with the construction of the Condo Units and/or the Improvements and all warranties, guaranties and sureties now or hereafter received in connection with the construction of or the installation of equipment in the Condo Units and/or Improvements, including, without limitation, all rights of Seller under any plans, specifications, drawings and permits and all architectural, engineering or construction contracts with respect to the Condo Units and/or the Improvements and all existing and planned additions and alterations thereto;

(3) All licenses, permits, approvals, certificates of occupancy and franchises relating to the zoning, land use, ownership, operation, occupancy, construction or maintenance of the Land, the Condo Units and the Improvements running to or in favor of the Seller, the Land, the Condo Units or the Improvements, and all deposits delivered to governmental authorities or utilities relating to the Seller, the Land, the Condo Units or the Improvements; and

(4) All service and maintenance contracts and equipment leases in connection with or used by the Seller in the operation of the Condo Units and the Improvements and which are accepted by Purchaser.

1A. "EFFECTIVE DATE". This Agreement shall become fully binding and enforceable upon the execution hereof by both the Seller and the Purchaser. However, as used in this Agreement, the "Effective Date" shall be the same as the Closing Date, or the extended Closing Date, of the purchase of the Island Medical Center Building ("IMC Building") by the Seller and



Purchaser, in accordance with that Purchase and Sale Agreement, between the present owners of the IMC Building, and Seller and Purchaser, dated as of December 30, 2005 (the "Purchase and Sale Agreement"). In the event the Purchase and Sale Agreement is terminated prior to that Closing Date, or in the event the purchase of the IMC Building fails to close, then this Agreement shall be terminated and be of no further force or effect, and the Effective Date shall never have occurred.

1B. SUBORDINATE TO SELLER'S LENDER'S SECURITY INTEREST IN THE PROPERTY. Seller and Purchaser hereby agree that the rights granted to each of them hereunder is subordinate to the security interests of Whidbey Island Bank, its successors and assigns ("Lender"), granted to Lender by Seller in accordance with that deed of trust, security agreement, assignment of leases and rents and fixture filing (collectively, as those documents may be modified, supplemented, extended, restated or replaced, the "Security Instruments") which encumber Seller's interests in the Property to secure a loan by Lender to the Seller ("Loan") dated as of the Effective Date of this Option Agreement and will be subordinate to the security interests of any subsequent lender that provides a loan to refinance the Loan to Seller by the Lender. Notwithstanding the foregoing, the Lender has granted Purchaser certain rights pursuant to a Ground Lessor's Estoppel Certificate, Consent and Agreement ("Estoppel Agreement"), dated as of the Effective Date of this Option Agreement, which affects the Lender's exercise of its rights under the Security Instruments as set forth in that Estoppel Agreement.

2. INITIAL PAYMENT AND CREDIT. On the Effective Date, Purchaser shall pay to Seller the sum of Three Hundred Thousand and no/one-hundredths Dollars (\$300,000.00) (the "Initial Payment"), as additional consideration for the rights granted to Purchaser in this Option Agreement. Upon exercise by Purchaser of the Option or Right of First Refusal described herein, or in the event the Seller exercises its Put (as hereinafter described), when such transaction closes, Purchaser shall have a credit against the amount otherwise payable by Purchaser in any of the foregoing events equal to the Initial Payment, plus interest thereon from the Effective Date to date of payment on closing at the rate of six percent per annum (6%) simple interest (the "Credit").

3. OPTION PURCHASE PRICE. In the event of exercise of its Option granted herein, and subject to the terms and conditions set forth herein, Purchaser shall pay Seller the following (the "Purchase Price"), less the amount of the Credit, as described in Paragraph 2 of this Option Agreement, on the Closing Date (as hereinafter defined):

a. An amount, in cash or cash equivalents, on closing equal to the greater of the Minimum Price (as hereinafter defined) or the Fair Market Value (as hereinafter defined) of the Property (including, but not limited to, both of the Condo Units).

b. (i) As used in Paragraph 3a. of this Option Agreement, "Fair Market Value" of the Property shall be as agreed by Seller and Purchaser within ten (10) days after Purchaser shall give its notice of intent to exercise the Option granted herein (the "Initial Notice"). If Purchaser and Seller cannot reach such agreement within the time herein provided, then each party shall select a



qualified, MAI real estate appraiser within five (5) days thereafter. If one of the parties does not select a qualified appraiser within the required time period, the decision of the appraiser selected by the other party shall be binding upon both parties. If two appraisers are selected by the parties, those appraisers shall each conduct an appraisal of the Property (with each party paying the expense of its own appraisal) which shall be completed no later than sixty (60) days after the Initial Notice. The Seller shall provide the appraisers with access to the Property and access (and copies, as requested) to all leases and other agreements, books and records related to the Property which the appraisers may reasonably request during the conduct of their appraisals. The Fair Market Value will be the average of the two appraisal valuations; provided, however, that if the difference determined by subtracting the lower appraisal from the higher appraisal is greater than ten percent (10%) of the lower appraisal, the Fair Market Value shall be determined as follows:

(ii) The appraisers selected by each party shall agree on a third, qualified, MAI real estate appraiser. In absence of agreement on the third appraiser within sixty (60) days of the date of the Initial Notice, either party may make application to the Superior Court for Skagit County for appointment of a qualified MAI real estate appraiser by the Presiding Judge of such Court. The third appraiser selected, by either method provided herein, shall determine the Fair Market Value of the Property, as of the date of the Initial Notice, within ninety (90) days of the date of the Initial Notice, which determination shall be binding upon both Purchaser and Seller; provided, the Fair Market Value set by the third appraiser may be no higher or lower than the highest and lowest prices set by the first two appraisers. Each party shall bear the cost of its own appraiser and shall share equally in the cost of the third appraiser, plus the amount of any court costs and attorneys' fees if application to the Skagit County Superior Court is required, as set forth herein.

(iii) Seller and Purchaser agree that, as an element in determining the Fair Market Value, such valuation shall be based, not upon actual rents then being paid by existing tenants of the Property, but upon average rents payable for the same size offices in similar medical office space in the Anacortes, Mt. Vernon and Oak Harbor, Washington, areas.

c. As used in Paragraph 3.a. of this Option Agreement, the "Minimum Price" for the Property shall be an amount equal to: (a) the sum of (i) the amount originally paid by the Seller for the purchase of Condo Unit #101; (ii) the amount expended by Seller to construct Condo Unit #102; and (iii) the amount of any Capital Expenditures (as defined in accordance with generally accepted accounting principles) paid by Seller prior to the Closing Date to improve or to replace portions of the Condo Units; less (b) the sum of amounts reasonably estimated by Purchaser to be required to cure any defaults by Seller under the Ground Lease, the Condominium Association Agreement or under any lease by Seller of portions of the Condo Units.

4. EXERCISE OF OPTION.

a. Normal Exercise of Option. Purchaser may exercise its Option by notifying Seller in writing that it intends to purchase Seller's interest in the Property pursuant to this Option



Agreement. Purchaser shall have sixty (60) days after determination of the Purchase Price, as determined in accordance with Paragraph 3 of this Option Agreement, to close the purchase of the Property in accordance with the terms of this Option Agreement. The Purchaser shall have the one-time right, without additional payment to Seller, to extend the closing for an additional thirty (30) days upon written notice to Seller at least five (5) days prior to expiration of the initial sixty day period referenced in the first sentence of this Paragraph. The Purchaser may exercise its Option at any time after ten (10) years following the Effective Date of this Option Agreement, but prior to the expiration of the Ground Lease. Notwithstanding the foregoing, if, after determination of the Purchase Price in accordance with Paragraph 3 of this Option Agreement, Purchaser decides, in its sole and absolute discretion, not to complete the purchase of the Property at that time and at that Purchase Price, then, by written notice to Seller prior to the scheduled Closing Date, the Purchaser may rescind its exercise of the Option, the purchase of the Property will not close at that time and the Purchaser's Option rights set forth in this Option Agreement shall be reinstated, with the Purchaser having the right to exercise such Option at any time thereafter (with new Purchase Price to be determined at that time in accordance with the terms of this Option Agreement). In the event that the Purchaser decides to rescind its exercise of the Option, Purchaser shall reimburse Seller's appraisal and other costs which may have been reasonably incurred by Seller in order to meet the requirements of Paragraph 3 hereof.

b. Exercise of Option to Avoid Foreclosure. Notwithstanding any terms to the contrary set forth in this Option Agreement, in the event of the commencement of foreclosure of any lien or encumbrance against the Property, if the Seller does not cure the default which caused the foreclosure to be commenced or otherwise does not obtain termination (or stay pending litigation concerning such lien, encumbrance or foreclosure action) of the foreclosure process prior to sixty (60) days prior to the scheduled foreclosure sale, the Purchaser shall have the option to purchase all of the Seller's interest in the Property for the amount required to satisfy and obtain the release of the subject lien or encumbrance plus any other existing encumbrances on the Property which, in the aggregate (with the encumbrance being foreclosed) comply with the requirements of Paragraph 9.a. of this Option Agreement, with such amount to be paid directly to the holder(s) of such lien(s) or encumbrance(s). In the event the Purchaser exercises this option to purchase, the Seller shall be required to meet all other terms of this Option Agreement applicable to close of sale pursuant to Purchaser's Option rights, including, at the time Purchaser pays the foregoing amount, meeting the title requirements of Paragraph 8.a. hereof, and the execution and delivery by Seller to Purchaser of all deeds, bills of sale, assignments or other documents in such form as Purchaser may reasonably require to transfer all of Seller's rights, titles and interests in the Property to Purchaser.

5. RIGHT OF FIRST REFUSAL.

a. Notice of Election to Sell the Condo Units. The Seller shall provide Purchaser thirty (30) days written notice of its decision to offer both Condo Units for sale to a third-party purchaser, prior to beginning to actively market or list the Condo Units for sale. Provided, that the Seller may not sell just one of the Condo Units, or any portion thereof or interest therein, but must sell all interests in both Condo Units and the Property if any sale is pursued. The



Purchaser's Right of First Refusal, including all notice provisions herein, shall also apply to any proposed sale or transfer of fifty percent (50%) or more of the equity/ownership interests in Seller (or any sales or transfers of smaller portions of such equity/ownership interests which, in the aggregate, equal fifty percent or more of the total equity/ownership interests in Seller) to one or more parties other than the members of Seller who hold such interests on the Effective Date of this Option Agreement.

b. Offer to Purchase. In the event that the Seller receives a bona fide offer from a third-party for purchase of the Property or of equity interests in the Seller ("Offer"), which Seller determines it would otherwise accept, that offer must be put forth in writing, signed by the third party agreeing to be bound thereby, stating the price, terms and conditions upon which the purchase is to be made. The price and terms shall be stated in U.S. Dollars and shall not include any other property or in-kind items. The Seller shall give written notice ("Offer Notice") to Purchaser of the Offer, which shall have a copy of the Offer attached and include the name and address of the offeror.

c. Purchaser's Right of First Refusal. Upon receipt of the Offer Notice, the Purchaser shall have the right, but not the obligation, to purchase the Property or equity interests in the Seller at the price and in accordance with the payment terms set forth in the Offer ("Right of First Refusal"), less the amount of the Credit described in Paragraph 2 of this Option Agreement. The Purchaser shall exercise its right to purchase by giving notice (the "Exercise Notice") to Seller within thirty (30) days following its receipt of the Offer Notice.

d. Closing. The purchase of the Property or equity interests in the Seller pursuant to the exercise of the Purchaser's Right of First Refusal shall be closed within forty-five (45) days after the Seller's receipt of the Exercise Notice, unless additional time is provided in the Offer (in which case, the later time shall apply). The purchase shall be subject to and the Purchaser shall have the benefit of all terms and conditions set out in the Offer and in this Option Agreement; provided, however, at a minimum, Seller must deliver title to the Property or equity interests free of all liens and encumbrances, in accordance with Paragraph 8 hereof, and Seller shall make the representations to Purchaser as are set out in Paragraph 10 of this Option Agreement. The Purchaser shall have the right, without additional payment to Seller, to extend the closing date by thirty (30) days by written notice to Seller issued at least five (5) days prior to expiration of the original 45 day period set forth in the first sentence of this sub-paragraph or the closing date set forth in the Offer.

e. Sale Following Waiver of Right of First Refusal. If, following receipt of an Offer Notice, Purchaser allows to expire, or waives in writing, its Right of First Refusal, the Seller may proceed with the proposed sale of the Property or equity interests, at the price and on the terms specified in the Offer; provided, however, it shall be a condition precedent to the effectiveness of any such sale that the sale must be on the same terms and conditions set forth in the Offer Notice. If the proposed sale described in the Offer Notice has not been closed within one hundred eighty (180) days after the date when the Right of First Refusal was waived or expired or if the terms of



the sale have changed in any respect, the proposed transaction may not be closed and the revised Offer, and any new offer to purchase the Property or equity interests, will again be subject to the Purchaser's Right of First Refusal as provided in this Paragraph 5 and its sub-paragraphs.

f. Survival of Purchaser's Option. On sale of the Property or equity interests in Seller, or any portion thereof, the Purchaser's Option to purchase the Property shall survive and be enforceable against any successor owner of the Property or equity interests, run with the title to the Property and any portion thereof, including the Condo Units, and remain subject to the Purchaser's right to exercise that Option at such time as the Purchaser may determine, in its sole discretion.

g. Sale/Assignment in Violation is Void. Any sale or assignment of any portion of Seller's interest in the Property or of equity interests in the Seller in violation of the terms of this Option Agreement shall be null and void.

6. **SELLER'S RIGHT TO REQUIRE THE PURCHASER TO PURCHASE THE PROPERTY (the "PUT").** In the event that, during the period which commences upon the five years anniversary date of the Effective Date and which ends on the ten years anniversary date of the Effective Date, Seller has been unable, after a good faith effort to find a replacement tenant for six (6) months after such tenant missed the first rent payment and ceased to pay any of its required monthly rent during that six (6) months period, to replace a tenant who has vacated space equaling or exceeding ten percent (10%) of the total rentable square footage of the Seller's Condo Units, provided that the tenant has not vacated its space in Seller's Condo Units because of Seller's default of any term of the subject tenant's lease, Seller may, by written notice delivered to Purchaser (the "Put Notice"), demand that Purchaser purchase all of Seller's right, title and interest in and to the Property at a price equaling the Minimum Price (as described in Paragraph 3.c. of this Option Agreement) as of the date of such Put Notice, less the amount of the Credit, as described in Paragraph 2 of this Option Agreement. Within sixty (60) days after Purchaser's receipt of such Put Notice, determination and verification (to Purchaser's reasonable satisfaction) of the Minimum Price and verification (to Purchaser's reasonable satisfaction) of the facts which are required by the terms of this Paragraph 6 (the "Closing Date"), the Purchaser shall purchase the Property for the foregoing price (less Credit), provided Seller shall be required to comply with all other terms of this Option Agreement otherwise applicable to close of sale following Purchaser's exercise of its Option rights as set forth herein. Purchaser shall have the right, without additional payment to Seller, to extend the Closing Date by thirty (30) days by written notice to Seller at least five (5) days prior to the original Closing Date as set forth herein.

7. **PURCHASER'S CONTINGENCY.** If Purchaser exercises its Option or Right of First Refusal as set forth herein, the Purchaser understands that there are no contingencies to closing other than as set forth in this Option Agreement and/or in the Offer referenced in Paragraph 5 hereof.

8. **SELLER'S TITLE TO THE PROPERTY.**



a. Title Report. Within five (5) business days after the exercise of the Option, Right of First Refusal or delivery of the Put Notice, Seller shall order a preliminary title report for an ALTA owner's policy of title insurance insuring fee interest in the Property in the amount of the Purchase Price (the "Title Report"). The Title Report shall be accompanied by legible copies of all special exceptions listed therein. Purchaser shall have fifteen (15) business days after the date of its receipt of the Title Report and such copies in which to notify Seller in writing of Purchaser's disapproval of any exceptions; provided, whether or not Purchaser makes any objection, any monetary liens or encumbrances shall be satisfied by Seller prior to or as of the Closing Date. In the event Purchaser notifies Seller within such period that Purchaser disapproves one or more exceptions to title, Seller shall notify Purchaser in writing within five (5) business days after receipt of Purchaser's notification as to whether Seller agrees to remove the exceptions so disapproved, and upon delivering such notice, Seller shall have until the Closing Date to cause such exceptions to be removed of record.

b. Rescission of Exercise of Option or Right of First Refusal or Termination of Seller's Put - Title Defects. If the Title Report referenced in Paragraph 8.a. hereof reflects exceptions objected to by Purchaser, but Seller elects not to or fails to eliminate such items, Purchaser may, at any time prior to Closing, elect to rescind Purchaser's exercise of its Option or Right of First Refusal, or terminate the Seller's Put. In such event, Purchaser's Option and/or Right of First Refusal rights shall be reinstated, subject to being exercised by Purchaser thereafter in accordance with the terms of this Option Agreement.

c. Alternative - Purchaser's Election to Close and Cure Title Defects. If Purchaser does not elect to rescind its exercise of its Option or Right of First Refusal, or Terminate the Seller's Put, for the reasons described in Paragraph 8.b. hereof, Purchaser's objections to the Title Report exceptions which Seller elects not to eliminate shall be deemed waived and the Property or equity interests in the Seller shall be conveyed to the Purchaser with such defects; provided, however, Purchaser may deduct the reasonable cost of curing such title defect(s) or an amount equal to the reasonable diminution in value of the Property because of such defect(s) from the purchase price otherwise payable to the Seller on the Closing Date.

9. SELLER'S COVENANTS. For so long as this Option Agreement remains in effect, the Seller, and Seller's successors and assigns, agrees and covenants to Purchaser that:

a. Encumbrances. With the exception of voluntary encumbrances entered into by the Seller in accordance with the terms set forth herein, Seller shall not grant or permit any liens or encumbrances in the Condo Units or Property of any kind to be placed of record or to otherwise encumber title to the Property during the term of the Option Agreement, except upon the prior written approval of Purchaser, which approval shall be subject to Purchaser's absolute discretion. The Seller may not encumber the Condo Units or the Property with one or more liens or encumbrances which, in the aggregate, exceed eighty percent (80%) of the Fair Market Value of the Property. The Seller shall give written notice of any proposed borrowings and grant of lien or encumbrance, with copies of all loan and security documents and proof (to the reasonable



satisfaction of Purchaser) of the then Fair Market Value of the Property, at least thirty (30) days prior to the grant of any such lien or encumbrance, and prior to any material amendments, restatements, re-financings or other replacements of any previously approved liens, encumbrances or interests. In the event that, within fifteen (15) days after receipt of such notice and all required information, Purchaser delivers to Seller a written objection setting out the terms of such loan or security documents which are contrary to the terms of this Option Agreement, the Ground Lease or of the Condo Association rules or regulations, or if Purchaser reasonably disagrees with the proof of Fair Market Value provided by Seller, such lien or encumbrance shall not be granted in the Condo Units or Property, nor amendment, restatement or refinancing become effective, unless or until Seller gives Purchaser reasonable evidence that such terms have been changed or such Fair Market Value is accurate. (Unless the Seller delivers to Purchaser a copy of a recent MAI appraisal obtained for or by the proposed lender, Purchaser may require the Seller obtain an appraisal of the Condo Units or Property, in accordance with Paragraph 3.b. of this Option Agreement, at Seller's expense, in order to determine such Fair Market Value.) Any liens or encumbrances (or amendments or re-financings of the same) in the Condo Units or Property granted or permitted by Seller in violation of this provision shall be a material default of this Option Agreement and shall be void and of no effect. Notwithstanding the foregoing, Seller shall not be in violation of this Paragraph 9.a. if involuntary workers' or materialmen's liens are filed against the Property during permitted construction or remodeling, so long as such liens are cleared or satisfied by the Seller of record prior to foreclosure of any such liens.

b. Subordination of this Option Agreement to Only Permitted Liens or Encumbrances. Purchaser shall agree to subordinate its position under this Option Agreement to any voluntary lien or encumbrance in the Condo Units or Property obtained by Seller which comply with all terms of Paragraph 9.a. of this Option Agreement. Purchaser shall, upon request, execute and deliver to Seller or its lender such documentation, to the reasonable satisfaction of Purchaser and its legal counsel, required to effect such subordination to such permitted lien or encumbrance. Other than as set forth in this Paragraph 9.b., Purchaser's rights under this Option Agreement shall be prior to any other lien, encumbrance or interest in the Condo Units or the Property. Notwithstanding any term of this Option Agreement to the contrary, the Purchaser shall not be required to grant any lien, encumbrance, or interest in or to the Purchaser's rights as the owner of a Condo Unit and/or as Lessor under the Ground Lease or the Purchaser's fee title to the Land.

10. REPRESENTATIONS.

a. Seller's Representations. Seller represents to Purchaser as follows as of the Effective Date of this Option Agreement and shall restate the same as of the Closing Date of any purchase of the Property or equity interests in the Seller by Purchaser in accordance with the terms of this Option Agreement:

(1) No Litigation. Except as disclosed in writing by Seller to Purchaser, there is no pending or threatened litigation or administrative action with respect to the Property or



to the Seller's interest in the Property.

(2) No Breach of Leases, Condominium Association Agreement or Other Agreements. This Option Agreement and the exercise of the Purchaser's Option or Right of First Refusal, or of the Seller's Put rights, in accordance with the terms of this Option Agreement do not violate any lease of the Property, Ground Lease, Condominium Association Agreement or other agreement to which Seller is a party, or any law, statute or ordinance which is binding upon the Property or Seller. Seller is not in breach of any obligation arising under any lease of a portion of the Property, the Condominium Association Agreement or of any other agreement affecting the ownership, use or occupancy of the Property, or Seller shall disclose the same to Purchaser and cure such breach prior to the Closing Date.

(3) Authority of Seller. This Option Agreement is a valid and binding obligation of the Seller, enforceable against Seller in accordance with its terms. No authorizations or approvals, whether of governmental bodies or otherwise, will be necessary in order for Seller to enter into this Option Agreement and to perform its obligations as set forth herein. Neither the execution and delivery of this Option Agreement nor the consummation of the transactions contemplated hereunder will conflict with or result in the breach of any law, regulation, writ, injunction or decree of any court or governmental instrumentality applicable to Seller or to the Property.

(4) Non-foreign Status/At-Source Withholding. Seller warrants that it is not a "foreign person" as defined in Section 1445 of the Internal Revenue Code of 1954, as amended. Seller shall deliver to Purchaser at closing a Certificate of Non-foreign Status setting forth Seller's address and United States taxpayer identification number and certifying that it is not a foreign person as so defined.

(5) Completeness of Statements. To the best of Seller's knowledge, no representation or warranty by Seller in this Option Agreement or in any written material furnished by Seller to Purchaser pursuant to or in connection with this Option Agreement, contains any untrue statement of a material fact or omits to state a material fact necessary to make any statement herein or therein not misleading.

(6) No Encumbrances or Interests. Except as disclosed and permitted in accordance with Paragraph 8 of this Option Agreement, there are no liens, encumbrances, or interests in the Property or equity interests of Seller and none shall exist on or after Closing.

b. Purchaser's Representations. Purchaser represents to Seller as follows as of the Effective Date of this Option Agreement and as of the Closing Date:

(1) No Violation. Except as otherwise contemplated by this Option Agreement, no authorizations or approvals, whether of governmental bodies or otherwise will be necessary in order for Purchaser to enter into this Option Agreement. Subject to the receipt of any



required prior approval of the Purchaser's Board of Commissioners, neither the execution and delivery of this Option Agreement nor the consummation of the transactions contemplated hereunder will, to the best of Purchaser's knowledge, conflict with or result in the breach of any law, regulation, writ, injunction or decree of any court or governmental instrumentality applicable to Purchaser.

(2) Pending Actions. To Purchaser's knowledge, there is no action, suit, arbitration, unsatisfied order or judgment, or proceeding pending against Purchaser which, if adversely determined, could individually or in the aggregate materially interfere with the Purchaser's consummation of the transactions contemplated by this Option Agreement.

11. CONDITIONS TO CLOSING.

a. Purchaser's Conditions. Purchaser's obligation to close the purchase of the Property or equity interests in the Seller in accordance with the terms of this Option Agreement is subject to the satisfaction of all of the following conditions in all material respects (as determined by the Purchaser, in its sole discretion):

(1) Exercise of Option or Right of First Refusal, or Seller's Put. Purchaser has exercised its Option or Right of First Refusal, or Seller has exercised its Put rights, in accordance with the terms of this Option Agreement;

(2) Seller's Compliance. Seller's fulfillment of each of its obligations under this Option Agreement in all material respects;

(3) Seller's Representations. The continuing accuracy of all of Seller's representations in this Option Agreement in all material respects;

(4) Status of Title. The absence of any monetary lien which will not be paid in full or otherwise eliminated from title by Seller upon the close of sale, the absence of any other material defect in title to the Property which was not permitted by this Option Agreement or approved by Purchaser, and the Title Company is irrevocably committed to issue the Title Policy pursuant to Paragraph 12.e., below; and

(5) Condition of the Property.

(i) Right to Inspect. At any time, and from time to time, during the term of this Option Agreement and prior to close of any purchase hereunder, Purchaser shall have the right to inspect (and the Seller shall provide reasonable access to) the Condo Units and the rest of the Property and the right to inspect all books and records, including copies of all leases and agreements, related to the ownership, construction, financing or occupancy of the Condo Units or the Property. The Purchaser will be responsible for the repair of any damage to the Property caused by its employees or agents in conducting such inspection;



(ii) Purchaser's Satisfaction as to the Condition of the Property. As a condition to any obligation of the Purchaser to complete the purchase of the Property or equity interests in the Seller pursuant to this Option Agreement, Purchaser must be satisfied, in its sole discretion, with the results of its inspection of the Property and of all books and records related thereto; and

(iii) Seller's Duty to Cure. Prior to close of the sale of the Property or equity interests in the Seller to the Purchaser hereunder, Seller shall correct any construction, structural or mechanical defect in the Property which may have arisen during its ownership of the same, fair wear and tear excepted, and shall cure any defaults by Seller of any lease or other agreement to be acquired or assumed by Purchaser as part of its purchase of the Property or equity interests. In the event that the Seller fails to correct any such defect or cure such default, Purchaser shall have the right, in the alternative, to: (a) rescind its decision to purchase the Property or equity interests at that time (with the Purchaser's Option or Right of First Refusal to continue to be effective and enforceable); (b) terminate the Seller's Put rights; or (c) agree to complete the purchase of the Property or equity interests, but with the right to deduct from the purchase price otherwise payable hereunder an amount equal to Purchaser's estimated cost to correct such defect or to cure such default (except to the extent such matters have already been deducted from the Purchase Price pursuant to Paragraph 3 of this Option Agreement).

b. Seller's Conditions. Seller's obligation to close the sale of the Property pursuant to this Option Agreement is subject to the satisfaction of all of the following conditions in all material respects:

(1) Exercise of Option or Right of First Refusal, or Seller's Put Rights. Purchaser shall have exercised its Option or Right of First Refusal, or Seller shall have exercised its Put rights, in accordance with the terms of this Option Agreement; and

(2) Payment of Purchase Price. Prior to or on the Closing Date Purchaser shall have deposited the total Purchase Price with escrow, in cash or cash equivalents.

12. CLOSING.

a. Closing Date. In accordance with the terms of Paragraph 4, or as otherwise provided in Paragraphs 5 or 6, of this Option Agreement, and subject to the other applicable terms and conditions hereof, purchase of the Property or equity interests in the Seller pursuant to Purchaser's Option or Right of First Refusal, or Seller's Put rights, will be closed within sixty (60) calendar days following the determination of the Purchase Price or a mutually agreed upon date. The Purchaser shall have the one-time right to extend the closing for an additional thirty (30) days upon written notice to Seller at least five (5) days prior to expiration of the initial sixty (60) days closing period. The date this transaction does so close, as evidenced by the recordation of Seller's deed to Purchaser, is referred to as the "Closing Date."



b. Manner and Place of Closing. This transaction will be closed by an escrow officer of Chicago Title Insurance Company in Mount Vernon, Washington, or at such other place as the parties may mutually agree to in writing. Closing shall take place in the manner and in accordance with the provisions set forth in this Option Agreement. The parties agree to execute any escrow agreement customarily required by the escrow officer, so long as that agreement is consistent with the terms of this Option Agreement.

c. Prorations; Adjustments (not applicable to purchase of equity interests in the Seller).

(1) All rents and expenses (including operating expenses, utilities, taxes and Condominium Association fees and expenses) related to the use and occupancy of the Property shall be allocated between Seller and Purchaser as of the Closing Date. To the extent all necessary information is not available on the Closing Date, such allocations shall be based upon reasonable estimates, with the Parties adjusting such payments as soon as possible after actual income and expense statements become available.

(2) Seller shall pay any real estate excise, documentary and/or transfer taxes, and one-half of the escrow and other closing fees charged by the escrow agent.

(3) Seller shall pay the premium for ALTA standard owner's title insurance in the amount of the purchase price and Purchaser shall pay for any extended coverage and endorsements required by Purchaser or its lender.

(4) Purchaser shall pay one-half of the escrow and closing fees charged by the escrow agent and all recording charges.

(5) Each party shall pay for its own attorneys and other professional fees incurred in assisting that party in meeting the terms of this Option Agreement.

d. Events of Closing. Provided the escrow agent has received the required documents and sums and is in a position to cause the title insurance policies to be issued as described below, this transaction will be closed on the Closing Date as follows:

(1) Seller shall provide Purchaser with a Certificate of Nonforeign Status.

(2) The escrow agent shall calculate the Prorations described in Paragraph 10.c. of this Option Agreement and provide such calculations to Seller and Purchaser for approval, and the parties shall be charged and credited accordingly.

(3) Purchaser shall pay into escrow the purchase price due to Seller as



set forth in this Option Agreement, adjusted for the charges and credits set forth herein.

(4) Seller shall convey the Land, Condo Units and Improvements to Purchaser by Statutory Warranty Deed and Bill of Sale, each in form as is acceptable to Purchaser, in Purchaser's reasonable discretion, free of all liens and encumbrances.

(5) Seller shall assign to Purchaser all leases of the Condo Units (and deliver or give Purchaser credit against the purchase price for any security or other tenant deposits held by Seller) and such other agreements related to the Property as the Purchaser shall elect, in its absolute discretion, to assume, and the Purchaser will assume the same all in accordance with assignment and assumption agreements in such form as are reasonably acceptable to Purchaser.

(6) The escrow agent shall record the deed to Purchaser and cause the Title Insurance Policy to be issued to Purchaser in accordance with Paragraph 10.e. herein.

e. Title Insurance. As a condition to Closing, the escrow agent shall confirm that a title company acceptable to Purchaser is irrevocably committed to issue to Purchaser an ALTA owner's policy of title insurance in the amount of the purchase price for the Property, which policy shall be in the form, and subject to only those exceptions, agreed to by Purchaser pursuant to Paragraph 8 of this Option Agreement.

13. DEFAULTS AND FAILURE TO CLOSE.

a. Seller's Remedies. Purchaser shall not be deemed to be in default under this Option Agreement until and unless Purchaser fails to remedy any failure to perform any obligation of Purchaser hereunder within five (5) business days (or to commence and diligently pursue cure of any default within that period) after written notice from Seller notifying Purchaser of such failure. In the event such default is not cured, Seller may, upon written notice, terminate the Purchaser's then-pending exercise of the Option or Right of First Refusal (provided, such termination shall not terminate or extinguish Purchaser's right to exercise its Option or Right of First Refusal in the future), or bring an action for specific performance to complete such purchase following exercise of Seller's Put rights as set forth in this Option Agreement. Except for such right of termination or action for specific performance, Seller shall have no other right or remedy against Purchaser related to any default under this Option Agreement, and specifically waives any claims or causes of action related to such default, including any claim for consequential or other damages.

b. Purchaser's Remedies. Seller shall not be deemed to be in default under this Option Agreement until and unless Seller fails to close any sale required hereunder or fails to remedy any failure to perform any other obligation of Seller hereunder within five (5) business days after written notice from Purchaser notifying Seller of such failure. In the event of Seller's default hereunder, Purchaser shall have the right to seek specific performance of Seller's obligations under this Option Agreement and/or to demand payment by Seller of any claim for consequential or other



damages and the right to pursue any other remedy allowed at law or in equity.

14. GENERAL PROVISIONS.

a. Time of Essence. Except as otherwise specifically provided in this Option Agreement, time is of the essence of each and every provision of this Option Agreement.

b. Assignments and Successors. Purchaser shall have the right to assign its rights under this Option Agreement to third parties without Seller's prior written consent. Seller shall only assign its rights under this Option Agreement to a purchaser (other than the Purchaser) or assignee of its interests in the Property, upon at least thirty (30) days prior written notice to Purchaser, such sale or assignment to be otherwise subject to the provisions of this Option Agreement. Any assignment by Seller in violation of the terms of this Sub-paragraph 14.b. shall be null and void.

c. Brokers Fees. Seller and Purchaser each represent that they have not dealt with any brokers or agents who will be entitled to any commission or other fee with respect to the transaction contemplated by this Option Agreement. Each party agrees to indemnify, defend and hold the other harmless from and with respect to any liability for fees or commissions owing to or claimed to be owing to any brokers, agents or other party by reason of the actions or omissions of such indemnifying party.

d. Notices. Notices under this Option Agreement shall be in writing and if personally delivered or telefaxed shall be effective when received. If sent by a commercially recognized overnight courier or mailed, a notice shall be deemed effective on the day after it is deposited with the overnight courier or three days after it is deposited in the U.S. Mail, as registered or certified mail, return receipt required, postage prepaid, directed to the other party. Notices shall be delivered, air couriered, mailed or telefaxed to the following address and telephone numbers:

"SELLER": Challenge Developments II, L.L.C.
12062 Marine Drive
Anacortes, WA 98221
Telephone: (360) 293-7338
Facsimile: (360) 293-7348
Attn: Jerry Zavalney

"PURCHASER": Skagit County Public Hospital District No. 2
(d/b/a Island Hospital)
1211 24th Street
Anacortes, WA 98221
Telephone: (360) 299-1327
Facsimile: (360) 299-1339
Attn: Chief Executive Officer



Either party may change its address for notices by at least five (5) days' advance written notice to the other.

e. Legal Relationships. This Option Agreement creates only the relationship of Seller and Purchaser and no joint venture, partnership, agency or other joint undertaking is intended hereby, and neither party hereto shall have any rights to make any representations or incur any obligations on behalf of the other. Neither party has authorized any agent to make any representations, admit any liability or undertake any obligation on its behalf. Neither party is executing this Option Agreement on behalf of an undisclosed principal, and no third party is intended to be benefited by this Option Agreement. The parties agree that this Option Agreement involves only the sale and purchase of real, personal and intangible property, that Purchaser is not acquiring any business or ongoing liability of Seller, and except to the limited extent assumed by Purchaser in writing, Purchaser shall have no successor liability under this Option Agreement to any employee, agent or other person with whom Seller has contracted or is liable.

f. Waiver. Failure of either party at any time to require performance of any provision of this Option Agreement shall not limit the party's right to enforce the provision at any other time. Waiver of any breach of any provision shall not be a waiver of any succeeding breach of the provision or a waiver of the provision itself or any other provision.

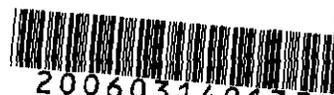
g. Attorneys' Fees. In the event suit or action is instituted to interpret or enforce the terms of this Option Agreement, the prevailing party (or non-debtor party in any bankruptcy or insolvency proceeding) shall be entitled to recover from the other party such sum as the court may adjudge reasonable as attorneys' fees in the preparation of its case at trial, on any appeal, in any bankruptcy or insolvency proceeding and on any petition for review, in addition to all other sums provided by law.

h. Prior Agreements. This Option Agreement supersedes and replaces all written and oral agreements previously made or existing between the parties concerning the subject matter hereof.

i. Applicable Law. This Option Agreement shall be construed, applied and enforced in accordance with the laws of the State of Washington. The parties agree that the venue for any action arising out of this Option Agreement shall be in Skagit County, Washington.

j. Subsequent Modifications. This Option Agreement and any of its terms may only be modified by a written instrument signed by both Seller and Purchaser, or their respective successors or assigns.

k. Indemnified Parties. Any indemnification contained in this Option Agreement for the benefit of a party shall extend to such party's employees, attorneys and agents and shall survive closing or the termination of this Option Agreement as the case may be.



1. Invalidity of Provisions. If any provision of this Option Agreement is declared invalid or is unenforceable for any reason, such provision shall be revised as the parties may agree or be deleted from this Option Agreement and shall not invalidate any other provision contained in the document.

m. Saturday, Sunday, and Legal Holidays. If the time for completion of performance of any of the terms, conditions and provisions hereof shall fall on a Saturday, Sunday or legal holiday, then the time for completion of such performance shall be extended to the next business day thereafter. "Business days" shall not include any Saturday, Sunday or legal holiday.

n. Survival. All of the representations, warranties and agreements of the parties hereto shall survive the Closing Date.

o. Like-Kind Exchange. Either or both of Seller and Purchaser may complete the transactions described herein as a part of a tax-deferred "like-kind" exchange pursuant to I.R.C. Sec. 1031. Seller and Purchaser shall cooperate with the other in connection with any such exchange and agree to execute such documentation as may be reasonably requested by the other in connection therewith; provided, however, neither party shall be required to incur any additional expense, liability or delay of performance required by this Option Agreement in connection with any such exchange.

p. Counterparts. This Option Agreement may be executed in one or more counterpart originals, the original signatures on which shall together constitute a single binding document.

q. Recordation of Memorandum. A memorandum summarizing and giving notice of this Option Agreement, in such form as Purchaser shall reasonably determine, shall be signed by both parties and shall be recorded in the real estate records of Skagit County, Washington.

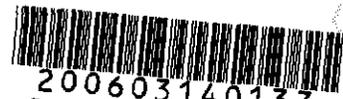
r. Covenant Running With the Property. The Purchaser's Option and Right of First Refusal set forth in this Option Agreement shall be deemed a covenant running with the land, for the benefit of Purchaser and of Purchaser's interests in the Land and interests in real property in the vicinity thereof, and shall survive any sale, assignment, or transfer of any other interest in the Property by Seller.

s. Duration. The Option and Right of First Refusal granted herein shall be enforceable for the remaining term of the Ground Lease or for so long as Purchaser, or its successor in interest, shall own or occupy Condo Unit #LL1 on the Land or shall own or occupy real property in the vicinity of the Land, whichever period is the last to expire. Seller and Purchaser agree that such restraints on the Seller's rights to alienate its title to the Property is a material consideration for other agreements entered into between Seller and Purchaser



concerning the Property and are reasonable because of the Purchaser's need to protect its interest in Condo Unit #LL1 and in its adjacent property.

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STATE OF WASHINGTON)

) ss.

COUNTY OF SKAGIT)

On this 13th day of march 2006, before me personally appeared Vincent C. Oliver to me known to be the CEO of Skagit County Public Hospital District No. 2, (d.b.a. Island Hospital), the municipal corporation that executed the within and foregoing instrument, and acknowledged said instrument to be the free and voluntary act and deed of said municipal corporation, for the uses and purposes therein mentioned, and on oath stated that he/she was authorized to execute said instrument.

IN WITNESS WHEREOF I have hereunto set my hand and affixed my official seal the day and year first above written.



Mary Mansfield
(Signature)

Mary Mansfield
(Name legibly printed or stamped)

Notary Public in and for the State of Washington,
residing at Clinton

My appointment expires 10-28-09



EXHIBIT A
LEGAL DESCRIPTION

(To be revised as may be required by survey of the Property or final title insurance commitment by Title Company.)

That portion of the Southeast Quarter of Section 24, Township 35 North, Range 1 East of the Willamette Meridian, described as follows:

Commencing at the East Quarter corner of said Section 24;
thence South 0°59'30" East, along the East line of said Section 24, 1,223.17 feet to an intersection with the South line of 24th Street;
thence South 89°58'48" West, along the South line of 24th Street, 396.27 feet to the true point of beginning;
thence South 0°01'35" East, 264.46 feet;
thence South 89°58'25" West, 358.50 feet to the East line of "M" Avenue;
thence North 0°01'35" West, along the East line of "M" Avenue, 264.50 feet to the South line of 24th Street;
thence North 89°58'48" East along the South line of 24th Street, 358.50 feet to the true point of beginning;

AND

Units 101 and 102, ISLAND MEDICAL CENTER CONDOMINIUM, a condominium, according to the Declaration thereof recorded March 14, 2006, under Auditor's File No. 200603140130 AND Survey Map and Plans thereof recorded March 14, 2006 under Auditor's File No. 200603140131, records of Skagit County, Washington.

Situate in Skagit County, Washington.

END OF EXHIBIT A

