HERKIMER TOBACCO
ASSET SECURITIZATION
CORPORATION

For the Year Ended
December 31, 2013

FINANCIAL STATEMENTS

# HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

## TABLE OF CONTENTS


| | Page |
|---|---|
| INDEPENDENT AUDITOR'S REPORT | 1-2 |
| FINANCIAL STATEMENTS | |
| Statements of Financial Position | 3 |
| Statements of Activities | 4 |
| Statements of Cash Flows | 5 |
| Notes to Financial Statements | 6-11 |

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# Independent Auditor's Report

To the Board of Directors of
Herkimer County Tobacco Asset Securitization Corporation

## Report on the Financial Statements

We have audited the accompanying financial statements of Herkimer County Tobacco Asset Securitization Corporation (a nonprofit organization) which comprise the statements of financial position as of December 31, 2013 and 2012, and the related statements of activities and cash flows for the years 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 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 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. Those standards require that we plan and perform the audits 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 Organization'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 Organization'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 financial statements referred to above present fairly, in all material respects, the financial position of Herkimer County Tobacco Asset Securitization Corporation as of December 31, 2013 and 2012, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

D'Arcangelo + Co., LLP

March 28, 2014

Utica, New York

## HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

## STATEMENTS OF FINANCIAL POSITION

### December 31, 2013 and 2012

| | 2013 | 2012 |
|---|---|---|
| **Assets** | | |
| Cash | $ 121,438 | $ 112,370 |
| Deposits Held With Trustees | 1,158,043 | 1,157,366 |
| Bond Issuance Costs, Net | 310,030 | 319,149 |
| Bond Discounts and Escrow Deposits, Net | 426,786 | 439,338 |
| Prepaid Insurance | 3,540 | 3,578 |
| **Total Assets** | $ 2,019,837 | $ 2,031,801 |
| **Liabilities and Unrestricted Net (Deficit)** | | |
| **Liabilities** | | |
| Accrued Interest and Other Expenses | $ 59,569 | $ 65,327 |
| Long-Term Debt | 22,706,897 | 22,325,181 |
| Total Liabilities | 22,766,466 | 22,390,508 |
| **Unrestricted Net (Deficit)** | | |
| Unreserved | (20,746,629) | (20,358,707) |
| Total Unrestricted Net (Deficit) | (20,746,629) | (20,358,707) |
| **Total Liabilities and Unrestricted Net (Deficit)** | $ 2,019,837 | $ 2,031,801 |

The Accompanying Notes are an Integral Part of These Financial Statements.

## HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

## STATEMENTS OF ACTIVITIES

### For the Years Ended December 31, 2013 and 2012

| | 2013 | 2012 |
|---|---|---|
| **Revenue** | | |
| Tobacco Settlement Rights (TSR) | $ 995,920 | $ 996,543 |
| Interest Income | 266 | 398 |
| Total Revenue | 996,186 | 996,941 |
| **Expenses** | | |
| Bond Interest Expense | 1,345,160 | 1,318,137 |
| Amortized Bond Issuance Costs | 9,119 | 9,119 |
| Professional Fees | 16,100 | 15,850 |
| Director Insurance | 4,281 | 4,286 |
| Bond Trustee Fee | 7,630 | 10,055 |
| Director Fees and Expenses | 500 | 500 |
| Telephone and Rent | 1,090 | 1,091 |
| Liability Insurance | 228 | 929 |
| Total Expenses | 1,384,108 | 1,359,967 |
| **Change in Net (Deficit)** | (387,922) | (363,026) |
| **Unrestricted Net (Deficit), Beginning of Year** | (20,358,707) | (19,995,681) |
| **Unrestricted Net (Deficit), End of Year** | $ (20,746,629) | $ (20,358,707) |

The Accompanying Notes are an Integral Part of These Financial Statements.

## HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

## STATEMENTS OF CASH FLOWS

### For the Years Ended December 31, 2013 and 2012

| | 2013 | 2012 |
|---|---|---|
| **Cash Flows from (Used by) Operating Activities** | | |
| Change in Net (Deficit) | $ (387,922) | $ (363,026) |
| Adjustments for Noncash Transactions | | |
| Amortized Bond Discount Fees and Escrow Deposits | 12,552 | 12,552 |
| Amortized Bond Issuance Costs | 9,119 | 9,119 |
| Accreted Bond Interest | 451,716 | 420,242 |
| (Increase) Decrease in Assets | | |
| Prepaid Insurance | 38 | (8) |
| Increase (Decrease) in Liabilities | | |
| Accrued Interest and Other Expenses | (5,758) | (5,533) |
| Net Cash Flows from Operating Activities | 79,745 | 73,346 |
| **Cash Flows from (Used by) Investing Activities** | | |
| Deposits with Trustees | (677) | 32,634 |
| Net Cash Flows from (Used by) Investing Activities | (677) | 32,634 |
| **Cash (Used by) Financing Activities** | | |
| Payments of Long-Term Debt | (70,000) | (70,000) |
| Net Cash (Used by) Financing Activities | (70,000) | (70,000) |
| **Net Increase (Decrease) in Cash** | 9,068 | 35,980 |
| **Cash, Beginning of Year** | 112,370 | 76,390 |
| **Cash, End of Year** | $ 121,438 | $ 112,370 |

### Supplemental Cash Flow Disclosures

| | | |
|---|---|---|
| Cash Paid During the Year For: | | |
| Interest | $ 886,650 | $ 890,876 |
| Taxes | $ 0 | $ 0 |

The Accompanying Notes are an Integral Part of These Financial Statements.

## HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

## NOTES TO FINANCIAL STATEMENTS

### NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Background and Operations**

Herkimer Tobacco Asset Securitization Corporation (HTASC) is a not-for-profit corporation formed exclusively for the purpose of acquiring from the County of Herkimer, New York (County) all or any of the rights, titles, and interest of the County under the Master Settlement Agreement (MSA) with respect to tobacco related litigation among various settling states and participating manufacturers. HTASC is an instrumentality of, but separate and apart from, the County. In accordance with the Government Accounting Standards Board, financial activity of HTASC is presented as a blended component unit in the County of Herkimer's Annual Financial Statements.

In lieu of receiving the Tobacco Settlement Rights (TSR), HTASC, in conjunction with the New York Counties Tobacco Trust I, Trust IV, and Trust V issued Tobacco Settlement Pass-Through Bonds. The bonds have been issued to the Trust pursuant to an indenture between HTASC and Manufacturers and Traders Trust Company (the Trustee).

HTASC is primarily dependent on the future proceeds from the TSR to meet future obligations under the indenture agreement.

**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 amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Basis of Presentation**

The financial statements of HTASC have been prepared in conformity with accounting principles generally accepted in the United States of America and follows the guidance set forth by the Governmental Accounting Standards Board.

**Revenue Recognition**

Interest earnings are recognized in the year earned. TSR's are recorded as income in the year they are received.

## NOTE 2 TAX STATUS

HTASC is a tax-exempt organization whereby its income is deemed exempt under the provisions of Section 115(1) of the Internal Revenue Code and utilizes December 31 as its fiscal year end.

## NOTE 3 BOND ISSUANCE COSTS

HTASC has incurred costs associated with the Series 2005 and Series 2000 bond issues. Such costs are deferred and amortized using the straight-line method over the remaining life of the related debt. Amortization expense on bond issuance costs was $9,119 for both of the years ended December 31, 2013 and 2012, respectively. Bond issuance costs net of accumulated amortization at December 31, 2013 and 2012, were as follows:

| | 2013 | 2012 |
|---|---|---|
| Bond Issuance Costs | $ 610,511 | $ 610,511 |
| Accumulated Amortization | (300,481) | (291,362) |
| Bond Issuance Costs (Net) | $ 310,030 | $ 319,149 |

The estimated aggregate amortization expense for each of the five succeeding years is approximately $9,119.

## NOTE 4 BOND DISCOUNTS AND ESCROW DEPOSITS

HTASC recorded unamortized bond discounts and escrow deposits of $426,786 and $439,338 at December 31, 2013 and 2012, respectively, in conjunction with the sale of the Series 2005 and advance refunding of the Series 2000 bonds. These costs have been capitalized and are being amortized as interest expense over the remaining life of the bonds. For both of the years ended December 31, 2013 and 2012, HTASC recorded $12,552 as interest expense associated with these costs, respectively.

## NOTE 5 DEPOSITS HELD WITH TRUSTEES

Deposits Held With Trustees represent a reserve that has been established pursuant to HTASC's indenture and was funded from the proceeds of the Series 2005 bonds. The reserve is required to be funded in an amount equal to the maximum annual debt service on the Series 2005 Bonds.

Deposits Held with Trustees at December 31, 2013 and 2012, are comprised of money market funds and invested cash which are considered cash and cash equivalents.

## NOTE 6 LONG-TERM DEBT

### Advanced Refunding

On December 7, 2000, the New York Counties Tobacco Trust (NYCTT) I, issued $227,130,000 aggregate principal amount of Tobacco Settlement Pass-Through Bonds, Series 2000. These bonds are special obligations of 17 different TASCs participating within the issue. The debt service is payable solely from pledged TSR and investment earnings on amounts on deposit as defined within each TASC's respective indenture. As a result of this borrowing, HTASC received $14,280,000 net of underwriter discount fees. According to the terms of the required amortization payments, HTASC is required to make annual debt service payments through December 31, 2042, with interest ranging from 5.000% to 6.625%.

On August 18, 2005 HTASC refunded and defeased in substance its outstanding 2000 Series bonds of $12,970,000 with a portion of the Series 2005A, 2005B and 2005C bonds. All of the issuance costs, and reserve amounts were funded from the bond proceeds. The net proceeds of $14,071,492 (after transfers of $3,962,598 to the residual trust) were deposited into an irrevocable trust to provide funding for the debt service on the 2000 Series bonds to the call date in the year 2010. The excess costs of $1,101,492 necessary to defease the 2000 Series bonds are being amortized as interest expense over the remaining life of the bonds (see Note 4).

The Series 2000 bonds were called during 2010.

### NYCTT IV - 2005 Series Bonds (Advance Refunding)

Bonds issued to complete the advanced refunding as described above have varying interest rates and maturity dates as follows:

| Issue | Maturity | Rate (%) | Outstanding Balance |
|---|---|---|---|
| 2005A | 6/01/2024 | 4.25 | $ 6,200,000 |
| 2005A | 6/01/2026 | 4.75 | 3,120,000 |
| 2005B | 6/01/2023 | 6.00 | 1,930,000 |
| 2005C | 6/01/2019 | 6.25 | 4,800,000 |
| Total | | | $ 16,050,000 |

At December 31, 2013 and 2012, HTASC recorded accrued interest of $61,229 and $64,238 on the outstanding bonds, respectively.

## NOTE 6 LONG-TERM DEBT (Continued)

The following schedule of projected turbo redemption payments is based upon the Global Insight Base Case Consumption Forecast as defined in New York Counties Tobacco Trust IV and V official statements:

| December 31, | Principal | Interest | Total |
|---|---|---|---|
| 2014 | $ 2,730,000 | $ 798,900 | $ 3,528,900 |
| 2015 | 700,000 | 694,125 | 1,394,125 |
| 2016 | 700,000 | 650,375 | 1,350,375 |
| 2017 | 800,000 | 603,500 | 1,403,500 |
| 2018 | 1,000,000 | 547,250 | 1,547,250 |
| 2019-2023 | 6,495,000 | 1,755,125 | 8,250,125 |
| 2024-2027 | 3,625,000 | 218,375 | 3,843,375 |
| Total | $ 16,050,000 | $ 5,267,650 | $21,317,650 |

### NYCTT IV - Series 2005D and 2005E Bonds (Subordinate Bonds)

In conjunction with the advance refunding, HTASC completed the sale of Series 2005D and 2005E capital appreciation bonds carrying varying yields and were sold discounted (zero coupon). As required by generally accepted accounting principles, HTASC accretes the effective interest appreciation over the life of the bonds to maturity. Changes to the bond values during the year are as follows:

| Issue | Maturity | Rate | Accreted Balance Outstanding at January 1, 2013 | Increase | Accreted Balance Outstanding at December 31, 2013 |
|---|---|---|---|---|---|
| Series 2005D | 06/01/50 | 5.88% | $ 1,306,414 | $ 77,847 | $ 1,384,261 |
| Series 2005E | 06/04/55 | 6.38% | 1,227,889 | 79,548 | 1,307,437 |
| Total | | | $ 2,534,303 | $ 157,395 | $ 2,691,698 |

The Series 2005D and 2005E bonds are subordinate to the Series 2005 bonds in the advance refunding discussed above. No interest or principal will be paid on these bonds until all other series bonds of the corporation are redeemed. Funds expected to be used for redemption of these bonds will come from the Tobacco Settlement Receipts and payments are not anticipated until the year 2026.

## NOTE 6 LONG-TERM DEBT (Continued)

Redemption of the bonds based on the turbo redemption schedule is anticipated to mature as follows:

| Year | Outstanding Principal |
|---|---|
| 2026 | $ 2,365,679 |
| 2027 | 1,671,710 |
| 2028 | 1,692,888 |
| 2029 | 559,445 |
| Total | $ 6,289,722 |

### NYCTT V –Series 2005S4B (Subordinate Bonds)

HTASC completed a new bond issue of $2,224,416 in November 2005. The net proceeds of $2,096,082 (after issuance costs of $128,334) were transferred to the residual trust. These bonds noted as Series 2005S4B carry varying yields and were sold discounted (zero coupon) similar to Series 2005D and Series 2005E. Changes to the bond values are as follows:

| Issue | Maturity | Rate | Accreted Balance Outstanding at January 1, 2013 | Increase | Accreted Balance Outstanding at December 31, 2013 |
|---|---|---|---|---|---|
| Series 2005S4B | 2029-2040 | 7.85% | $ 3,670,878 | $ 294,321 | $ 3,965,199 |

The Series 2005S4B bonds are subordinate to all of the Series 2005 bonds issued in conjunction with NYCTT IV discussed above. No interest or principal will be paid on these bonds until all other series bonds of the corporation are redeemed. Funds expected to be used for redemption of these bonds will come from the Tobacco Settlement Receipts and payments are not anticipated until the year 2029.

Redemption of the bonds based on the turbo redemption schedule is anticipated to mature as follows:

| Year | Total |
|---|---|
| 2029 | $ 1,139,560 |
| 2030 | 1,737,050 |
| 2031 | 1,758,244 |
| 2032 | 1,783,166 |
| 2033 | 1,800,720 |
| 2034-2038 | 9,350,919 |
| 2039-2040 | 2,461,303 |
| Total | $ 20,030,962 |

## NOTE 7 RELATED PARTY

HTASC is a special purpose local development corporation and is considered by legal counsel to be bankruptcy-remote from the County of Herkimer. However, HTASC's board of directors is comprised of a majority of elected or appointed officials of the County of Herkimer. For financial reporting purposes, HTASC is considered a blended component unit of the County of Herkimer.

## NOTE 8 CONTINGENCIES

Future tobacco settlement revenues are subject to adjustment based upon tobacco consumption, inflation, and other potential reductions. Pursuant to the Purchase and Sale Agreement, these adjustments and other events could trigger additional reserve requirements or could have an impact on the valuation of the Tobacco Settlement Rights.

## NOTE 9 SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 28, 2014, the date on which the financial statements were available to be issued.