

HERKIMER TOBACCO
ASSET SECURITIZATION
CORPORATION (a
Component Unit of the
County of Herkimer, New
York)

For the Year Ended
December 31, 2016

FINANCIAL STATEMENTS

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

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Independent Auditor's Report

To the Board of Directors of
Herkimer Tobacco Asset Securitization Corporation

Report on the Financial Statements

We have audited the accompanying financial statements of Herkimer Tobacco Asset Securitization Corporation (a nonprofit organization), a component unit of the County of Herkimer, New York, which comprise the statements of financial position as of December 31, 2016 and 2015, 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 audit to obtain reasonable assurance about whether the financial statements are free from 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.

Adoption of New Accounting Standard

In April 2015, the FASB issued ASU No. 2015-03, "Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs." This ASU requires debt issuance costs to be presented in the balance sheet as a reduction of the corresponding liability rather than as an asset. HTASC has adopted the ASU during the year ended December 31, 2016 and applied it on a retroactive basis. The adoption of this ASU resulted in the reclassification in the balance sheet for 2016 and 2015 of unamortized debt issuance costs from intangible assets to long term debt and the reclassification of the expense from amortization expense to interest expense. Other than the reclassification, the adoption of the ASU did not have an impact on our financial position, results of operations and cash flows.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Herkimer Tobacco Asset Securitization Corporation as of December 31, 2016 and 2015, 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 15, 2017

Rome, New York

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

STATEMENTS OF FINANCIAL POSITION

December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Assets		
Cash and Cash Equivalents	\$ 109,389	\$ 92,438
Deposits Held With Trustees	1,189,930	1,158,700
Bond Discounts and Escrow Deposits, Net	389,130	401,682
Prepaid Insurance	<u>3,530</u>	<u>3,541</u>
Total Assets	<u>\$ 1,691,979</u>	<u>\$ 1,656,361</u>
Liabilities and Unrestricted Net (Deficit)		
Liabilities		
Accrued Interest and Other Expenses	\$ 51,372	\$ 55,278
Long-Term Debt	<u>22,687,221</u>	<u>23,159,674</u>
Total Liabilities	<u>22,738,593</u>	<u>23,214,952</u>
Unrestricted Net (Deficit)	<u>(21,046,614)</u>	<u>(21,558,591)</u>
Total Liabilities and Unrestricted Net (Deficit)	<u>\$ 1,691,979</u>	<u>\$ 1,656,361</u>

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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Revenue		
Tobacco Settlement Rights (TSR)	\$ 1,947,569	\$ 964,202
Interest Income	<u>3,381</u>	<u>1</u>
Total Revenue	<u>1,950,950</u>	<u>964,203</u>
Program Expenses		
Bond Interest Expense	1,411,195	1,406,716
Professional Fees	15,750	16,700
Director Insurance	4,247	3,362
Bond Trustee Fee	6,966	10,754
Director Fees and Expenses	500	500
Telephone and Rent	62	1,081
Liability Insurance	<u>253</u>	<u>253</u>
Total Expenses	<u>1,438,973</u>	<u>1,439,366</u>
Change in Net Income (Deficit)	511,977	(475,163)
Unrestricted Net (Deficit), Beginning of Year	<u>(21,558,591)</u>	<u>(21,083,428)</u>
Unrestricted Net (Deficit), End of Year	<u>\$ (21,046,614)</u>	<u>\$ (21,558,591)</u>

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, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash Flows from (Used by) Operating Activities		
Change in Net Income (Deficit)	\$ 511,977	\$ (475,163)
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	558,428	520,841
Increase (Decrease) in Assets		
Prepaid Insurance	11	(673)
(Decrease) in Liabilities		
Accrued Interest and Other Expenses	<u>(3,906)</u>	<u>(3,656)</u>
Net Cash Flows from Operating Activities	<u>1,088,181</u>	<u>63,020</u>
Cash Flows from (Used by) Investing Activities		
Deposits with Trustees	<u>(31,230)</u>	<u>2,671</u>
Net Cash Flows from (Used by) Investing Activities	<u>(31,230)</u>	<u>2,671</u>
Cash Flows from (Used by) Financing Activities		
Payments of Long-Term Debt	<u>(1,040,000)</u>	<u>(55,000)</u>
Net Cash (Used by) Financing Activities	<u>(1,040,000)</u>	<u>(55,000)</u>
Net Increase in Cash	16,951	10,691
Cash and Cash Equivalents, Beginning of Year	<u>92,438</u>	<u>81,747</u>
Cash and Cash Equivalents, End of Year	<u>\$ 109,389</u>	<u>\$ 92,438</u>

Supplemental Cash Flow Disclosures

Cash Paid During the Year For:		
Interest	<u>\$ 844,121</u>	<u>\$ 867,860</u>

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.

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

Cash and Cash Equivalents

State statutes require that collateral be pledged at 100 percent of all deposits not covered by Federal Deposit Insurance Corporation insurance for demand deposits, time deposits, repurchase agreements, and certificates of deposit. Obligations of the United States Treasury and its agencies as well as obligations of New York State and its municipalities and Towns may be pledged. Investments are carried at market value.

HTASC's cash and cash equivalents consist of cash on hand, demand deposits, and short-term investments with original maturities of six months or less from date of acquisition. New York State law governs the Corporation's investment policies. Resources must be deposited in Federal Deposit Insurance Corporation (FDIC) insured commercial banks or trust companies located within the State. Permissible investments include obligations of the United States Treasury, United States Agencies, repurchase agreements and obligations of New York State or its localities.

Collateral is required for demand and time deposits and certificates of deposit not covered by FDIC insurance. Obligations that may be pledged as collateral are obligations of the United States and its agencies and obligations of the State and its municipalities and Districts.

Adoption of New Accounting Standard

In April 2015, the FASB issued ASU No. 2015-03, "Interest-Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs." This ASU requires debt issuance costs to be presented in the balance sheet as a reduction of the corresponding liability rather than as an asset. HTASC has adopted the ASU during the year ended December 31, 2016 and applied it on a retroactive basis. The adoption of this ASU resulted in the reclassification in the balance sheet for 2016 and 2015 of unamortized debt issuance costs from intangible assets to long term debt and the reclassification of the expense from amortization expense to interest expense. Other than the reclassification, the adoption of the ASU did not have an impact on our financial position, results of operations and cash flows.

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 DISCOUNTS AND ESCROW DEPOSITS

HTASC recorded unamortized bond discounts and escrow deposits of \$389,130 and \$401,682 at December 31, 2016 and 2015, respectively, in conjunction with the sale of the Series 2005 and advance refunding of the Series 2000 bonds. These costs have been

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

deferred and are being amortized as interest expense over the remaining life of the bonds. For both of the years ended December 31, 2016 and 2015, HTASC recorded \$12,552 as interest expense associated with these costs.

NOTE 4 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, 2016 and 2015, are comprised of money market funds and invested cash which are considered cash and cash equivalents.

NOTE 5 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%.

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:

<u>Issue</u>	<u>Maturity</u>	<u>Rate (%)</u>	<u>Outstanding Balance</u>
2005A	6/01/2024	4.25	\$ 6,200,000
2005A	6/01/2026	4.75	3,120,000
2005B	6/01/2023	6.00	630,000
2005C	6/01/2035	6.25	4,800,000
Total			<u>\$ 14,750,000</u>

At December 31, 2016 and 2015, HTASC recorded accrued interest of \$51,372 and \$54,198 on the outstanding bonds, respectively.

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

NOTE 5 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:

<u>December 31,</u>	<u>Amount</u>
2017	\$ 3,630,000
2018	1,000,000
2019	1,210,000
2020	1,200,000
2021	1,275,000
Thereafter	<u>6,435,000</u>
Total Minimum Principal Payments	14,750,000
Less: Unamortized Debt Issuance Costs	<u>(282,683)</u>
Carrying Value of Long Term Debt	<u>\$ 14,467,317</u>

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:

<u>Issue</u>	<u>Maturity</u>	<u>Rate</u>	<u>Accreted Balance Outstanding at January 1, 2016</u>	<u>Increase</u>	<u>Accreted Balance Outstanding at December 31, 2016</u>
Series 2005D	06/01/27	5.88%	\$ 1,554,227	\$ 92,709	\$ 1,646,936
Series 2005E	06/01/29	6.38%	1,482,406	95,969	1,578,375
Total			<u>\$ 3,036,633</u>	<u>\$ 188,678</u>	<u>\$ 3,225,311</u>

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.

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

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NOTES TO FINANCIAL STATEMENTS

NOTE 5 LONG-TERM DEBT (Continued)

<u>Year</u>	<u>Outstanding Principal</u>
2026	\$ 2,365,679
2027	1,671,710
2028	1,692,888
2029	<u>559,445</u>
Total	\$ <u>6,289,722</u>

NYCTT V –Series 2005S4B (Subordinate Bonds)

HTASC completed a 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:

<u>Issue</u>	<u>Maturity</u>	<u>Rate</u>	<u>Accreted Balance Outstanding at January 1, 2016</u>	<u>Increase</u>	<u>Accreted Balance Outstanding at December 31, 2016</u>
Series 2005S4B	2029-2040	7.85%	\$ <u>4,624,833</u>	\$ <u>369,750</u>	\$ <u>4,994,583</u>

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:

<u>Year</u>	<u>Total</u>
2029	\$ 1,139,560
2030	1,737,050
2031	1,758,244
2032	1,783,166
2033	1,800,720
Thereafter	<u>11,812,222</u>
Total	\$ <u>20,030,962</u>

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

NOTE 6 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 7 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 8 SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 15, 2017, the date on which the financial statements were available to be issued.