

HERKIMER TOBACCO
ASSET SECURITIZATION
CORPORATION

For the Year Ended
December 31, 2011

FINANCIAL STATEMENTS

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

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D'Arcangelo & Co., LLP

Certified Public Accountants & Consultants

120 Lomond Court, Utica, N.Y. 13502-5950
315-735-5216 Fax: 315-735-5210

Independent Auditor's Report

Board of Directors

Herkimer Tobacco Asset Securitization Corporation

We have audited the accompanying statements of financial position of Herkimer Tobacco Asset Securitization Corporation (a nonprofit organization) as of December 31, 2011 and 2010, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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, 2011 and 2010, and the changes in its unrestricted net (deficit) and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

D'Arcangelo & Co., LLP

March 28, 2012

Utica, New York

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

STATEMENTS OF FINANCIAL POSITION

December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Assets		
Cash	\$ 76,390	\$ 96,823
Deposits Held With Trustees	1,190,000	1,156,915
Bond Issuance Costs, Net	328,268	337,387
Bond Discounts and Escrow Deposits	451,890	464,442
Prepaid Insurance	<u>3,570</u>	<u>3,658</u>
Total Assets	<u>\$ 2,050,118</u>	<u>\$ 2,059,225</u>
Liabilities and Unrestricted Net (Deficit)		
Liabilities		
Accrued Interest and Other Expenses	\$ 70,860	\$ 69,533
Long-Term Debt	<u>21,974,939</u>	<u>21,628,912</u>
Total Liabilities	<u>22,045,799</u>	<u>21,698,445</u>
Unrestricted Net (Deficit)		
Unreserved	<u>(19,995,681)</u>	<u>(19,639,220)</u>
Total Unrestricted Net (Deficit)	<u>(19,995,681)</u>	<u>(19,639,220)</u>
Total Liabilities and Unrestricted Net (Deficit)	<u>\$ 2,050,118</u>	<u>\$ 2,059,225</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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenue		
Tobacco Settlement Rights (TSR)	\$ 977,174	\$ 1,030,735
Interest Income	<u>152</u>	<u>151</u>
Total Revenue	<u>977,326</u>	<u>1,030,886</u>
Expenses		
Bond Interest Expense	1,292,591	1,565,767
Amortized Bond Issuance Costs	9,119	54,625
Professional Fees	15,650	21,700
Director Insurance	4,371	4,971
Bond Trustee Fee	10,441	17,989
Director Fees and Expenses	500	500
Telephone	<u>1,115</u>	<u>1,087</u>
Total Expenses	<u>1,333,787</u>	<u>1,666,639</u>
Change in Net (Deficit)	(356,461)	(635,753)
Unrestricted Net (Deficit), Beginning of Year	<u>(19,639,220)</u>	<u>(19,003,467)</u>
Unrestricted Net (Deficit), End of Year	<u>\$ (19,995,681)</u>	<u>\$ (19,639,220)</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, 2011 and 2010

	2011	2010
Cash Flows from (Used by) Operating Activities		
Change in Net (Deficit)	\$ (356,461)	\$ (635,753)
Adjustments for Noncash Transactions		
Amortized Bond Discount Fees and Escrow Deposits	12,552	298,647
Amortized Bond Issuance Costs, Net	9,119	54,624
Accreted Bond Interest	391,027	365,008
Decrease in Assets		
Prepaid Insurance	88	582
Increase (Decrease) in Liabilities		
Accrued Interest	1,327	(3,088)
Net Cash Flows from Operating Activities	57,652	80,020
Cash Flows from (Used by) Investing Activities		
Deposits with Trustees	(33,085)	20,427
Net Cash Flows from (Used by) Investing Activities	(33,085)	20,427
Cash (Used by) Financing Activities		
Payments of Long-Term Debt	(45,000)	(90,000)
Net Cash (Used by) Financing Activities	(45,000)	(90,000)
Net Increase (Decrease) in Cash	(20,433)	10,447
Cash, Beginning of Year	96,823	86,376
Cash, End of Year	\$ 76,390	\$ 96,823

Supplemental Cash Flow Disclosures

Cash Paid During the Year For:

Interest	\$ 887,685	\$ 943,300
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.

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

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 and \$54,624 for the years ended December 31, 2011 and 2010, respectively. Bond issuance costs net of accumulated amortization at December 31, 2011 and 2010, were as follows:

	<u>2011</u>	<u>2010</u>
Bond Issuance Costs	\$ 610,511	\$ 610,511
Accumulated Amortization	<u>(282,243)</u>	<u>(273,124)</u>
Bond Issuance Costs (Net)	<u>\$ 328,268</u>	<u>\$ 337,387</u>

NOTE 4 BOND DISCOUNTS AND ESCROW DEPOSITS

HTASC recorded unamortized bond discounts and escrow deposits of \$451,890 and \$464,442 at December 31, 2011 and 2010, 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 the years ended December 31, 2011 and 2010, HTASC recorded \$12,552 and \$298,647 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 are 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, 2011 and 2010, are comprised of money market funds and invested cash which are considered cash and cash equivalents.

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

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:

<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	6/01/2013	6.00	2,070,000
2005C	6/01/2019	6.25	4,800,000
Total			<u>\$ 16,190,000</u>

At December 31, 2011 and 2010, HTASC recorded accrued interest of \$69,354 and \$69,533 on the outstanding bonds, respectively.

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

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:

<u>December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 525,000	\$ 834,400	\$ 1,359,400
2013	555,000	803,950	1,358,950
2014	745,000	770,850	1,515,850
2015	1,045,000	734,750	1,779,750
2016	700,000	694,125	1,394,125
2017-2021	4,910,000	2,697,375	7,607,375
2022-2026	7,240,000	1,065,500	8,305,500
2027	470,000	11,750	481,750
Total	<u>\$ 16,190,000</u>	<u>\$ 7,612,700</u>	<u>\$ 23,802,700</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, 2011</u>	<u>Increase</u>	<u>Accreted Balance Outstanding at December 31, 2011</u>
Series 2005D	06/01/50	5.88%	\$ 1,163,577	\$ 69,354	\$ 1,232,931
Series 2005E	06/04/55	6.38%	1,083,023	70,243	1,153,266
Total			<u>\$ 2,246,600</u>	<u>\$ 139,597</u>	<u>\$ 2,386,197</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.

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

NOTE 6 LONG-TERM DEBT (Continued)

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

<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 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:

<u>Issue</u>	<u>Maturity</u>	<u>Rate</u>	<u>Accreted Balance Outstanding at January 1, 2011</u>	<u>Increase</u>	<u>Accreted Balance Outstanding at December 31, 2011</u>
Series 2005S4B	2029-2040	7.85%	<u>\$ 3,147,312</u>	<u>\$ 251,430</u>	<u>\$ 3,398,742</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
2034-2038	9,350,919
2039-2040	<u>2,461,303</u>
Total	<u>\$ 20,030,962</u>

HERKIMER TOBACCO ASSET SECURITIZATION CORPORATION

NOTES TO FINANCIAL STATEMENTS

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, 2012, the date on which the financial statements were available to be issued.