

**Lancaster County Convention
Center Authority**

Financial Statements with
Supplementary Information

Years Ended December 31, 2012 and 2011
with Independent Auditor's Report

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

YEARS ENDED DECEMBER 31, 2012 AND 2011

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Independent Auditor's Report

Board of Directors
Lancaster County Convention Center Authority

Report on the Financial Statements

We have audited the accompanying basic financial statements of the Lancaster County Convention Center Authority (Authority), a component unit of the County of Lancaster, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

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 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2012 and 2011, and the changes in net position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

The Authority has not presented a management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of the financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's financial statements as a whole. The accompanying supplementary information on pages 28 and 29 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

Maher Duessel

Harrisburg, Pennsylvania
August 22, 2013

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

BALANCE SHEETS

DECEMBER 31, 2012 AND 2011

	<u>2012</u>	<u>2011</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 1,580,768	\$ 619,296
Receivables:		
Taxes	529,375	558,489
Other	15,994	17,870
Due from Interstate Hotels & Resorts	26,881	37,966
Inventory	11,067	10,513
Other prepaid expenses	<u>40,925</u>	<u>57,832</u>
Total current assets	<u>2,205,010</u>	<u>1,301,966</u>
Restricted assets:		
Cash and investments	<u>5,624,248</u>	<u>6,102,170</u>
Total restricted assets	<u>5,624,248</u>	<u>6,102,170</u>
Capital assets:		
Land	1,579,621	1,579,621
Building	75,078,380	75,059,135
Furniture, fixtures, and equipment:		
Convention Center	4,051,093	4,047,916
Penn Square Condominium Association	404,324	399,184
Office	<u>37,411</u>	<u>37,411</u>
Less: accumulated depreciation	<u>81,150,829</u>	<u>81,123,267</u>
	<u>8,705,505</u>	<u>6,280,976</u>
Net capital assets	<u>72,445,324</u>	<u>74,842,291</u>
Other assets:		
Bond issuance costs - net of amortization of \$253,037 and \$203,464	<u>1,333,991</u>	<u>1,383,564</u>
Total other assets	<u>1,333,991</u>	<u>1,383,564</u>
Total Assets	<u>\$ 81,608,573</u>	<u>\$ 83,629,991</u>

(Continued)

	2012	2011
Liabilities and Net Position		
Liabilities:		
Current liabilities:		
Accounts payable	\$ 47,930	\$ 66,237
Accrued payroll and payroll expense	4,307	4,270
Arbitrage payable	73,061	-
Other accrued expenses	239,242	181,639
Current portion of note payable	350,000	-
Unearned revenue	39,651	35,106
Developer's fee payable	34,800	34,800
Total current liabilities	<u>788,991</u>	<u>322,052</u>
Current liabilities (payable from restricted assets):		
Accrued interest payable	<u>290,270</u>	<u>252,937</u>
Total current liabilities (payable from restricted assets)	<u>290,270</u>	<u>252,937</u>
Long-term liabilities:		
Reimbursement for contingency payable	705,245	705,245
Developer's fee payable	34,800	69,600
Bonds payable	63,590,000	63,590,000
Note payable	400,000	750,000
Interest rate swap liability	2,667,740	3,186,679
Swap borrowing, net of accumulated amortization of \$827,033 and \$165,406	<u>20,975,990</u>	<u>21,637,617</u>
Total long-term liabilities	<u>88,373,775</u>	<u>89,939,141</u>
Total Liabilities	<u>89,453,036</u>	<u>90,514,130</u>
Net Position:		
Net investment in capital assets	13,811,344	16,301,990
Restricted	956,361	841,575
Unrestricted	<u>(22,612,168)</u>	<u>(24,027,704)</u>
Total Net Position	<u>(7,844,463)</u>	<u>(6,884,139)</u>
Total Liabilities and Net Position	<u>\$ 81,608,573</u>	<u>\$ 83,629,991</u>
		(Concluded)

The accompanying notes are an integral part of these financial statements.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

STATEMENTS OF REVENUES, EXPENSES, AND CHANGE IN NET POSITION YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Operating Revenues:		
Conference services	\$ 1,492,657	\$ 1,427,948
Concession	121,688	153,580
Other	30,700	3,551
Total operating revenues	<u>1,645,045</u>	<u>1,585,079</u>
Operating Expenses:		
Departmental expenses	670,166	677,540
Undistributed operating expenses	1,439,024	1,506,055
Management fees	195,000	168,000
Fixed charges	92,325	77,036
Administrative expenses	394,245	338,258
Depreciation	2,424,529	2,431,926
Capital/development costs	31,079	42,207
Total operating expenses	<u>5,246,368</u>	<u>5,241,022</u>
Operating Loss	<u>(3,601,323)</u>	<u>(3,655,943)</u>
Non-Operating Revenues (Expenses):		
Hotel room rental tax income	4,795,310	3,696,653
Investment income (net of arbitrage rebate)	146,191	219,064
Other income	3,665	4,694
Interest expense, net of amortization of swap borrowing of \$661,627 and \$165,406	(2,773,533)	(2,927,125)
Change in fair value of interest rate swap	518,939	(3,186,679)
Amortization	(49,573)	(39,124)
Total non-operating revenues (expenses)	<u>2,640,999</u>	<u>(2,232,517)</u>
Change in Net Position before Special Item	<u>(960,324)</u>	<u>(5,888,460)</u>
Special Item:		
Investment loss on swap termination	-	(21,803,023)
Change in Net Position	<u>(960,324)</u>	<u>(27,691,483)</u>
Net Position:		
Beginning of period	<u>(6,884,139)</u>	<u>20,807,344</u>
End of period	<u>\$ (7,844,463)</u>	<u>\$ (6,884,139)</u>

The accompanying notes are an integral part of these financial statements.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Cash Flows From Operating Activities:		
Operating receipts	\$ 1,651,466	\$ 1,630,391
Payments to suppliers for operating expenses	(2,504,205)	(2,645,632)
Payments to suppliers for project development costs	(31,079)	(42,207)
Payments to employees	<u>(184,969)</u>	<u>(182,436)</u>
Net cash used in operating activities	<u>(1,068,787)</u>	<u>(1,239,884)</u>
Cash Flows From Capital and Related Financial Activities:		
Purchase of capital assets	(62,377)	(18,292)
Bond restructuring costs	-	(369,981)
Payments of developer's fee	(34,800)	(34,800)
Proceeds from note payable	-	750,000
Receipts from hotel room revenue tax	4,828,089	3,676,523
Released from restrictions	521,835	-
Interest expense paid	<u>(3,397,827)</u>	<u>(2,868,299)</u>
Net cash provided by capital and related financing activities	<u>1,854,920</u>	<u>1,135,151</u>
Cash Flows From Investing Activities:		
Proceeds from the sale of investments	11,349,540	9,936,985
Purchase of investments	(11,393,453)	(9,738,285)
Interest income received	219,252	219,064
Net cash provided by investing activities	<u>175,339</u>	<u>417,764</u>
Net Increase in Cash and Cash Equivalents	961,472	313,031
Cash and Cash Equivalents:		
Beginning of period	619,296	306,265
End of period	<u>\$ 1,580,768</u>	<u>\$ 619,296</u>

(Continued)

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2012 AND 2011
(Continued)

	<u>2012</u>	<u>2011</u>
Reconciliation of Operating Loss to Net Cash Used in Operating Activities:		
Operating loss	\$ (3,601,323)	\$ (3,655,943)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation	2,424,529	2,431,926
(Increase) decrease in:		
Other receivables	1,876	67,164
Due from Interstate Hotels & Resorts	11,085	(15,546)
Inventory	(554)	3,768
Other prepaid expenses	16,907	(5,956)
Increase (decrease) in:		
Accounts payable	16,508	(73,740)
Accrued payroll and payroll taxes	37	45
Other accrued expenses	57,603	30,250
Unearned revenue	4,545	(21,852)
Total adjustments	<u>2,532,536</u>	<u>2,416,059</u>
Net cash used in operating activities	<u>\$ (1,068,787)</u>	<u>\$ (1,239,884)</u>

(Concluded)

The accompanying notes are an integral part of these financial statements.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

1. SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Lancaster County Convention Center Authority (Authority), a component unit of the County of Lancaster (County), was formed on September 15, 1999, under the Municipal Authority Act of 1945 and the Third Class County Convention Center Authority Act. The purpose of the Authority is to provide financing and arrange for the development and construction and to run the operation of a convention center facility for the public purpose of promoting, attracting, stimulating, developing, and expanding business, industry, commerce, and tourism in the Commonwealth of Pennsylvania.

As required by accounting principles generally accepted in the United States of America, the financial statements of the reporting entity include those of the Authority and any component units. Component units are separate legal entities that (1) governing officials of a primary government are financially accountable for the entity or (2) the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete.

The Authority is part of the County's reporting entity based on the above criteria. These are the separate component unit financial statements of the Authority. No other entities need to be included based on the above criteria.

A business plan was developed, which allowed the construction of the Lancaster County Convention Center and the Lancaster Marriott at Penn Square. The plan was the result of a complex and cooperative effort among government and community leaders and public and private partners. Throughout 2007 – 2009, the Authority incurred construction costs associated with the project.

The Lancaster County Convention Center and the Lancaster Marriott at Penn Square opened for operations on June 19, 2009.

The Lancaster County Convention Center began operations on June 19, 2009 under the Qualified Convention Center Management Agreement, dated January 23, 2002, between the Authority and Interstate Hotels & Resorts (IHR). The Qualified Convention Center Management Agreement is for a period commencing with the opening of the convention center and expiring on June 19, 2019.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Basis of Accounting

The Authority's financial statements are presented using the accrual basis of accounting, under which revenues are recorded in the period that they are earned and expenses are recorded when the liability is incurred.

The accounting and financial reporting treatment applied to the Authority is determined by its measurement focus. The Authority measures and reports all assets, liabilities, revenues, expense, gains, and losses using the economic resources measurement focus and accrual basis of accounting. Net position (i.e., total assets net of total liabilities) is segregated into "Net Investment in Capital Assets"; "Restricted for" various purposes; and "Unrestricted" components.

The Authority is a member of the Penn Square Condominium Association, which is represented by two ownership groups. The other ownership group is Penn Square Partners, a private entity. Each ownership group has their own business operation with revenues and expenses, as described in their development agreements. Where tracking actual expenses would become too costly, approved allocation methodologies have been incorporated. These allocations are described in the IHR Operational Expense Guidelines (Guidelines). The Guidelines only interpret the governing documents and do not rewrite them.

Cash and Cash Equivalents

The Authority considers all highly liquid debt instruments and certificates of deposit purchased with a maturity of three months or less to be cash equivalents.

Investments

With the exception of guaranteed investment contracts which are at contract value, the Authority accounts for investments at fair value. The fair value of the Authority's investments is based upon values provided by external investment managers and quoted market prices.

Restricted Assets

Certain proceeds of revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited by applicable trust indentures or other agreements.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Bond Issuance Costs

Bond issuance costs represent expenses incurred in the process of issuing or refinancing bonds and are amortized over the life of the related bond issue, using the effective interest method.

Capital Assets

Capital assets are carried at cost, if purchased or constructed. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Building, furniture, fixtures, and equipment are depreciated over the estimated useful lives using the straight-line method.

The useful lives for purposes of computing depreciation are as follows:

Buildings	40 years
Furniture, fixtures, and equipment	5-10 years

Major outlays for capital assets and improvements are capitalized as projects are constructed. A portion of the interest incurred during the construction phase of capital assets is included as part of the capitalized value of the asset constructed.

Net Position

Net position comprises the various net earnings from operating and non-operating revenues and expenses and contributions of capital. Net position is classified in the following three components: Net investment in capital assets; restricted for various purposes; and unrestricted net position.

The net investment in capital assets component of net position consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at the end of the reporting period, the portion of the debt attributable to the unspent amount is not included in the calculation of net investment in capital assets. Instead, that portion of the debt is included in the same net position component (restricted or unrestricted) as the unspent amount.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

The restricted component of net position consists of restricted assets reduced by liabilities related to those assets. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported.

The unrestricted component of net position is the net amount of the assets and liabilities that are not included in the determination of net investment in capital assets or the restricted components of net position.

Use of Estimates

The process of preparing financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues, and expenses. Accordingly, upon settlement, actual results may differ from estimated amounts.

Operating Revenues and Expenses

The Authority distinguishes operating revenues and expenses from non-operating items. Revenues and expenses from operations include departmental operating revenues, departmental operating expenses, undistributed operating expenses, management fees, and fixed charges. The principal operating revenues of the Authority are conference services revenue and concession revenue. The principal operating expenses include energy, repairs and maintenance, conference service, and sales and marketing expenses. All revenues and expenses not meeting the definition are reported as non-operating revenues and expenses.

Restricted Resources

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use restricted resources first, if available, and then unrestricted resources as they are needed.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

2. HOTEL ROOM RENTAL TAX

The County receives a 3.9% hotel room rental tax and a 1.1% excise tax from the operators of each hotel within the County. Of the total 3.9% tax, 20% is allocated to the Pennsylvania Dutch Convention and Visitors Bureau (PDCVB) to be used to promote tourism in the County, and 80% is received by the Authority to be used for the construction and operation of the convention center facility. Should the Authority encounter an event of default on the Hotel Room Rental Tax Revenue Bonds, Series of 2003 or the Hotel Room Rental Tax Revenue Bonds, Series of 2007, (collectively, the Bonds) the 20% allocated to the PDCVB would be diverted to the trustee of the Authority's Bonds. Revenue is recognized in the period to which the County attributes collection.

As discussed in Note 12, during the year ended December 31, 2012, the Authority failed to meet certain financial covenants of the Bonds. As a result, the 20% of hotel room rental tax allocated to the PDCVB was diverted to the Trustee Bank of the Authority's Bonds and recognized as additional revenue for the months of April 2012 through December 2012.

3. LEASE AGREEMENT – LANCASTERHISTORY.ORG

In December 2010, the Authority entered into a lease agreement with LancasterHistory.Org (LHO) for the lease of the Thaddeus Stevens House, Kleiss Saloon, Underground Historic Area, and other areas immediately outside the Stevens House, the Kleiss Saloon, and associated with the Underground Historic Area. LHO intends to develop a national historic exhibition on a portion of these properties. The remaining portion of the properties will be renovated and utilized by LHO. The lease commenced on December 21, 2010, for a period of twenty years. LHO is responsible for insurance and real property taxes. The basic rent for the leased properties is one dollar. Until LHO commences construction of the improvements, LHO shall pay monthly the sum of two hundred fifty dollars (\$250.00) for common area charges. After construction begins, these fees will be adjusted every three years based on actual charges.

4. DEPOSITS AND INVESTMENTS

Pennsylvania statutes provide for investment of governmental funds into certain authorized investment types including U.S. Treasury bills, other short-term U.S. and Pennsylvania government obligations, insured or collateralized time deposits, and certificates of deposits. The statutes do not prescribe regulations related to demand deposits; however, they do allow the pooling of governmental funds for investment purposes.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Deposits

Custodial credit risk - Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of December 31, 2012, the book balance of the Authority was \$1,782,898 and the bank balance was \$1,583,592. At December 31, 2012, the book balance included \$202,130 and the bank balance included \$202,130 of cash held with a trustee or others that is presented as restricted cash and investments on the balance sheet. As of December 31, 2011, the book balance of the Authority was \$834,114 and the bank balance was \$963,389. At December 31, 2011, the book balance included \$214,818 and the bank balance included \$214,818 of cash held with a trustee or others that is presented as restricted cash and investments on the balance sheet. Of the bank balances, \$500,000 and \$413,495 was covered by federal depository insurance at December 31, 2012 and 2011, respectively. At December 31, 2012 and 2011, the remainder of the bank balance was collateralized under Act No. 72 (Act) of the 1971 Session of the Pennsylvania General Assembly, in which financial institutions were granted the authority to secure deposits of public bodies by pledging a pool of assets, as defined in the Act, to cover all public funds deposited in excess of federal depository insurance limits.

Investments

Restricted investments of the Authority at December 31 were as follows:

	2012	2011
Money market funds	\$ 1,310,989	\$ 1,776,223
Guaranteed investment contracts	<u>4,111,129</u>	<u>4,111,129</u>
	<u><u>\$ 5,422,118</u></u>	<u><u>\$ 5,887,352</u></u>

Custodial Credit Risk – Custodial credit risk is the risk that the counterparty to an investment transaction will fail and the Authority will not recover the value of the investment or collateral securities that are in possession of an outside party. The Authority does not have a formal policy for custodial credit risk. All of the Authority's investments are held by the trustee in the Authority's name.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Concentration of Credit Risk - The Authority places no limit on the amount the Authority may invest in any one issuer. At December 31, 2012 and 2011, more than five percent of the Authority's investments are held as follows:

<u>December 31, 2012</u>	<u>Contract Value</u>	<u>% of Total</u>	<u>Yield</u>
Guaranteed investment contracts:			
Citigroup Financial Product	\$ <u>4,111,129</u>	75.82%	5.315%
<u>December 31, 2011</u>	<u>Contract Value</u>	<u>% of Total</u>	<u>Yield</u>
Guaranteed investment contracts:			
Citigroup Financial Product	\$ <u>4,111,129</u>	69.83%	5.315%

Credit Risk – The Authority has no investment policy that would limit its investment choices to certain credit ratings. As of December 31, 2012 and 2011, the Authority's investment in money market funds were rated AAAm by Standard & Poor's. As of December 31, 2012 and 2011, the guaranteed investment contracts were unrated.

In February 2009, pursuant to an agreement between the Authority and Citigroup Financial Products, Inc. (Citigroup), Citigroup entered into a custodial agreement with Manufacturers and Traders Trust Company, as Trustee, and The Bank of New York Mellon, as collateral agent for the Trustee, to hold investments, consisting of U.S. government direct obligations and U.S. agencies, for the purpose of collateralizing the Authority's guaranteed investment contract.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Interest Rate Risk – The Authority does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The following is a list of the Authority's investments and their related average maturities:

December 31, 2012

	Fair/ Contract Value	Investment Maturity	
		2013	2022
Money market funds	\$ 1,310,989	\$ 1,310,989	\$ -
Guaranteed investment contracts	4,111,129	-	4,111,129
Total	<u>\$ 5,422,118</u>	<u>\$ 1,310,989</u>	<u>\$ 4,111,129</u>

December 31, 2011

	Fair/ Contract Value	Investment Maturity	
		2012	2022
Money market funds	\$ 1,776,223	\$ 1,776,223	\$ -
Guaranteed investment contracts	4,111,129	-	4,111,129
Total	<u>\$ 5,887,352</u>	<u>\$ 1,776,223</u>	<u>\$ 4,111,129</u>

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

5. CAPITAL ASSETS

A summary of changes in capital assets for the year ending December 31 is as follows:

	Beginning Balance 1/1/2012	Additions	Disposals	Adjustments	Ending Balance 12/31/2012
Capital assets not being depreciated:					
Land	\$ 1,579,621	\$ -	\$ -	\$ -	\$ 1,579,621
Total capital assets not being depreciated	<u>1,579,621</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,579,621</u>
Capital assets being depreciated:					
Building	75,059,135	19,922	-	(677)	75,078,380
Furniture, fixtures, and equipment:					
Convention Center	4,047,916	3,177	-	-	4,051,093
Penn Square Condominium Association	399,184	5,140	-	-	404,324
Office	37,411	-	-	-	37,411
Total capital assets, being depreciated	<u>79,543,646</u>	<u>28,239</u>	<u>-</u>	<u>(677)</u>	<u>79,571,208</u>
Less accumulated depreciation for:					
Building	5,055,891	1,963,568	-	-	7,019,459
Furniture, fixtures, and equipment	1,225,085	460,961	-	-	1,686,046
Total accumulated depreciation	<u>6,280,976</u>	<u>2,424,529</u>	<u>-</u>	<u>-</u>	<u>8,705,505</u>
Total capital assets being depreciated, net	<u>73,262,670</u>	<u>(2,396,290)</u>	<u>-</u>	<u>(677)</u>	<u>70,865,703</u>
Total capital assets, net	<u>\$ 74,842,291</u>	<u>\$ (2,396,290)</u>	<u>\$ -</u>	<u>\$ (677)</u>	<u>\$ 72,445,324</u>

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

	Beginning Balance 1/1/2011	Additions	Disposals	Transfers	Ending Balance 12/31/2011
Capital assets not being depreciated:					
Land	\$ 1,579,621	\$ -	\$ -	\$ -	\$ 1,579,621
Total capital assets not being depreciated	<u>1,579,621</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,579,621</u>
Capital assets being depreciated:					
Building	75,062,414	5,962	-	(9,241)	75,059,135
Furniture, fixtures, and equipment:					
Convention Center	4,075,798	28,853	-	(56,735)	4,047,916
Penn Square Condominium Association	399,184	-	-	-	399,184
Office	37,411	-	-	-	37,411
Total capital assets, being depreciated	<u>79,574,807</u>	<u>34,815</u>	<u>-</u>	<u>(65,976)</u>	<u>79,543,646</u>
Less accumulated depreciation for:					
Building	3,092,616	1,963,275	-	-	5,055,891
Furniture, fixtures, and equipment	756,434	468,651	-	-	1,225,085
Total accumulated depreciation	<u>3,849,050</u>	<u>2,431,926</u>	<u>-</u>	<u>-</u>	<u>6,280,976</u>
Total capital assets being depreciated, net	<u>75,725,757</u>	<u>(2,397,111)</u>	<u>-</u>	<u>(65,976)</u>	<u>73,262,670</u>
Total capital assets, net	<u>\$ 77,305,378</u>	<u>\$ (2,397,111)</u>	<u>\$ -</u>	<u>\$ (65,976)</u>	<u>\$ 74,842,291</u>

6. CONTINGENCY AND DEVELOPER'S FEE PAYABLE

Per the second amendment to the Professional Services Development Agreement, the Authority is to pay the developer the remaining developer's fees and developer's expenses and reimbursable costs of \$328,000. The Authority paid the developer \$154,000 during May 2010, \$34,800 during the years ended December 31, 2012 and 2011, and is to make payments of \$34,800 annually through 2014.

Per the second amendment to the Joint Development Agreement among the Authority, the Redevelopment Authority of the City of Lancaster (RACL), and Penn Square Partners (PSP), the Authority is to pay \$705,245 to PSP to reimburse the RACL/PSP contingency provided under the agreement. RACL/PSP agree to use the funds received to either complete the Project or to be deposited into the Furniture, Fixtures and Equipment (FF&E) Reserve Fund for the hotel. The Authority is to make annual payments of \$50,000 beginning March 15, 2015.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

7. BONDS PAYABLE

During the year ending March 31, 2007, the Authority remarketed the Hotel Room Rental Tax Revenue Bonds, Series of 2003 (\$40,000,000) (Series of 2003 Bonds), and issued the Hotel Room Rental Tax Revenue Bonds, Series of 2007 (\$23,920,000) (Series of 2007 Bonds), (collectively, the Bonds) for the purpose of paying, together with other available funds, the costs of (i) funding the design, acquisition, construction, furnishing, and equipping of that certain Lancaster County Convention Center, as defined in the Indenture; (ii) funding necessary reserves for the project and the Bonds; (iii) the establishment of necessary reserves and other funds under the Indenture; (iv) payment of the costs and expenses of issuance of the Bonds; and (v) refunding certain outstanding indebtedness of the Issuer. The Bonds are secured by a pledge of all current and future revenue derived by the Authority from its share of Hotel Room Rental Tax and all monies and investments held by Trustee Bank under the Indenture and are initially secured by an irrevocable, direct pay letter of credit issued by Wachovia Bank, National Association.

The Bonds initially bore interest at a Weekly Rate. During the Weekly Mode, interest on the Bonds was to be paid on the first business day of each calendar month, commencing on May 1, 2007. The Weekly Rate for the Bonds was computed by Wachovia Bank, National Association for each Weekly Rate Period. The Weekly Rate was not to exceed 12% per annum. At times specified in the Indenture, the Issuer had the ability to cause the Bonds to be converted to a Term Mode. The Bonds, if converted, were subject to mandatory purchase on the date of such conversion. The floating interest rate under the Weekly Mode was sixty-seven percent (67%) of USD-LIBOR-BBA on the agreed-upon payment dates.

The County has guaranteed to replenish the lesser of \$1,509,960 or fifty percent (50%) of the required reserve amount for the Series of 2003 Bonds in any fiscal year (\$2,610,270).

On October 3, 2011, the Bonds were restructured and the Authority entered into a continuing covenant agreement (Agreement) with Wells Fargo Bank (Bank). Under the Agreement, the Bank paid the purchase price of \$63,590,000 to M&T Bank (Trustee) for the Bonds. The Bonds will be held by the Bank until the mandatory purchase date of March 1, 2013, at which time the Bonds are subject to mandatory tender for purchase at an amount equal to 100% of the principal amount of the Bonds, plus accrued interest. On this date, the Authority may cause the Bonds to be remarketed to the Bank or to new investors at any of the interest rate options provided in the Agreement.

The Bank extended the mandatory purchase date related to the Bonds to January 2, 2014. All other provisions of the Agreement remain in effect through the mandatory purchase date.

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YEARS ENDED DECEMBER 31, 2012 AND 2011

Under the Agreement, the interest rate was converted from the Weekly Rate to the Index Interest Rate. The Bonds will bear interest at a per annum rate of interest equal to the sum of (i) the Index, defined as 67% of LIBOR, and (ii) the Applicable Spread, commencing October 3, 2011. The Applicable Spread effective from October 3, 2011 through February 28, 2012 was defined as 95 basis points on the Series of 2003 Bonds and 125 basis points on the Series of 2007 Bonds. Effective March 1, 2012, the Applicable Spread increased to 175 basis points on the Series of 2003 Bonds and 190 basis points on the Series of 2007 Bonds. The Applicable Spread can be reduced if the Authority is able to accomplish certain milestones as set forth in the Agreement. At December 31, 2012 and 2011, the Index Interest Rate on the Series of 2003 Bonds was 1.891 and 1.132 percent, respectively. At December 31, 2012 and 2011, the Index Interest Rate on the Series of 2007 Bonds was 2.041 percent and 1.432 percent, respectively.

At the option of the Authority, the Bonds may be optionally redeemed or converted to another interest rate mode to be effective on the interest payment date prior to the mandatory purchase date upon 60 days written notice to the Bank.

Long-term liability activity for the year ended was as follows:

December 31, 2012	Beginning of Year	Additions	Retirements	End of Year	Current Portion
Bonds payable:					
Series of 2003	\$ 39,670,000	\$ -	\$ -	\$ 39,670,000	\$ -
Series of 2007	<u>23,920,000</u>	<u>-</u>	<u>-</u>	<u>23,920,000</u>	<u>-</u>
Long-term liabilities	<u>\$ 63,590,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 63,590,000</u>	<u>\$ -</u>
December 31, 2011	Beginning of Year	Additions	Retirements	End of Year	Current Portion
Bonds payable:					
Series of 2003	\$ 39,670,000	\$ -	\$ -	\$ 39,670,000	\$ -
Series of 2007	<u>23,920,000</u>	<u>-</u>	<u>-</u>	<u>23,920,000</u>	<u>-</u>
Long-term liabilities	<u>\$ 63,590,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 63,590,000</u>	<u>\$ -</u>

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Debt service requirements, including interest at the rates in effect under the Swap agreement, including the Applicable Spread, through the January 2, 2014 maturity date, as of December 31, 2012, are as follows:

	Principal	Interest	Total
2013	\$ -	\$ 3,458,538	\$ 3,458,538
2014	<u>63,590,000</u>	<u>288,212</u>	<u>63,878,212</u>
	<u><u>\$ 63,590,000</u></u>	<u><u>\$ 3,746,750</u></u>	<u><u>\$ 67,336,750</u></u>

Interest expense consisted of the following for the year ended December 31:

	2012	2011
Letter of credit fees	\$ 5,804	\$ 519,402
Note payable	28,948	-
Interest - variable rate (net)	1,194,776	191,642
Interest rate - fixed rate	2,205,632	2,319,168
Remarketing fees	-	62,319
Amortization of swap borrowing	(661,627)	(165,406)
	<u><u>\$ 2,773,533</u></u>	<u><u>\$ 2,927,125</u></u>

As further described in Note 9, the Authority entered into a pay fixed, receive variable interest rate swap to synthetically fix the variable rate on the Series of 2003 Bonds and Series of 2007 Bonds to 3.67% and 3.57% plus the Applicable Spread, respectively, at December 31, 2012 and 2011.

8. NOTE PAYABLE

In October 2011, in conjunction with the restructuring of the Bonds, the Authority entered into a term note agreement with Wells Fargo Bank in the amount of \$750,000 for the purpose of paying for the costs associated with the restructuring of the Bonds, as discussed in Note 7. The note is secured by a pledge of all current and future revenue derived by the Authority from its share of hotel room rental tax. Interest is payable monthly at a fixed rate of 3.5%, commencing November 1, 2011 through the maturity date of December 1, 2014.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Note payable activity for the year ended was as follows:

December 31, 2012	Beginning of			End of Year	Current Portion
	Year	Additions	Retirements		
Note payable	\$ 750,000	\$ -	\$ -	\$ 750,000	\$ 350,000

December 31, 2011	Beginning of			End of Year	Current Portion
	Year	Additions	Retirements		
Note payable	\$ -	\$ 750,000	\$ -	\$ 750,000	\$ -

Future principal and interest payments under the note are as follows:

	Principal	Interest	Total
2013	\$ 350,000	\$ 25,229	\$ 375,229
2014	400,000	12,833	412,833
	<u>\$ 750,000</u>	<u>\$ 38,062</u>	<u>\$ 788,062</u>

9. DERIVATIVES – INTEREST RATE SWAP

Objective - As a means to lower its borrowing costs, when compared against fixed-rate bonds at the time of issuance in March 2007, the Authority entered into an interest-rate swap (Swap) in connection with the Bonds. The intention of the Swap was effectively to change the Authority's variable interest rate on the Bonds to a synthetic fixed rate of 3.65%. Pursuant to an amended and restated confirmation between the Authority and the Counterparty, Wells Fargo Bank, dated September 28, 2011, the amortization, maturity dates, and fixed payment rates on the Swap related to the Bonds were amended. Effective October 3, 2011, in conjunction with the Agreement disclosed in Note 7, the fixed payment on the Swap related to the Series of 2003 Bonds was 3.67% and the fixed payment on the Swap related to the Series of 2007 Bonds was 3.57%.

Terms - The Bonds and the related Swap agreements mature on December 1, 2042 (Series of 2003 Bonds) and December 1, 2047 (Series of 2007 Bonds), and the Swap's notional amount of \$40,000,000 and \$23,920,000, respectively, is 100% of the total issue amount of the underlying bonds. The notional amount of the Swap agreement decreases as the outstanding principal amount of the corresponding Series of 2003 Bonds and Series of 2007 Bonds decrease through maturing principal. The Swap agreements were entered into at the same time the Bonds were issued, March 2007. Prior to October 3, 2011, under the Swap

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YEARS ENDED DECEMBER 31, 2012 AND 2011

agreements, the Authority paid the counterparty a fixed payment of 3.65% and received a variable payment computed as 67% of the one-month London Interbank Offered Rate (LIBOR). Conversely, the Bonds' variable-rate was based on the Weekly Rate determined by the remarketing agent. Effective October 3, 2011, the Authority pays the counterparty a fixed payment of 3.67% related to the Series of 2003 Bonds and 3.57% related to the Series of 2007 Bonds. Conversely, the Bonds' variable-rate is based on the Index Interest Rate as defined in Note 7.

Pursuant to the Swap agreements, the Authority pays or receives to/from the counterparty a monthly net swap payment. For the year ended December 31, 2012, the Authority paid \$1,390,884 and \$814,748 fixed and received \$56,028 and \$33,784 variable with respect to the Swap on the Series of 2003 Bonds and Series of 2007 Bonds, respectively. For the year ended December 31, 2011, the Authority paid \$1,449,277 and \$869,891 fixed and received \$61,295 and \$36,959 variable with respect to the Swap on the Series of 2003 Bonds and Series of 2007 Bonds, respectively.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair values of the Authority's financial statements. The Swap is highly sensitive to changes in interest rates; changes in the variable rate will have a material effect on the Swap's fair value.

Fair Value Risk - Fair value takes into consideration the prevailing interest rate environment, the specific terms and conditions of a given transaction, and any upfront payments that may have been received. The fair value is based upon mid-market quotations for the transactions. Mid-market quotations are based on bid/ask quotations shown on reliable electronic information screens as of close of business on the date specified. Such amount represents the present value difference between the floating rate receipt and fixed rate payment as of December 31, 2012 and the termination value fluctuates as the interest rates fluctuate.

Because the 2011 amendment and restatement changed the critical terms of the Swap agreements, the original Swap was effectively terminated upon amendment. At the date of amendment, the Swap had negative fair values of \$12,496,248 and \$9,306,775 for the Series of 2003 Bonds and Series of 2007 Bonds, respectively. As such, the deferred outflows were charged to investment loss on swap termination, a special item, on the statements of revenue, expenses, and change in net position, and the swap liability was reclassified to a swap borrowing on the balance sheet. Governmental accounting standards require that the swap borrowing be amortized to offset interest expense, straight-line, over the life of the bonds.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

The change in fair value for the interest rate swaps is as follows:

	January 1, 2012 -	Amortization of Swap Borrowing	Change in Fair Value Subsequent to Termination	December 31, 2012 -
Notional Amount	Fair Value			Fair Value
\$ 39,670,000	\$ (14,035,249)	\$ 403,105	\$ 50,533	\$ (13,581,611)
23,920,000	(10,789,047)	258,522	468,406	(10,062,119)
Total	\$ (24,824,296)	\$ 661,627	\$ 518,939	\$ (23,643,730)

	January 1, 2011 -	Change in Fair Value Prior to Termination	Value at Termination	Amortization of Swap Borrowing	Change in Fair Value Subsequent to Termination	December 31, 2011 -
Notional Amount	Fair Value	Termination	Date		Fair Value	Fair Value
\$ 39,670,000	\$ (6,553,488)	\$ (5,942,760)	\$ (12,496,248)	\$ 100,776	\$ (1,639,777)	\$ (14,035,249)
23,920,000	(4,507,137)	(4,799,638)	(9,306,775)	64,630	(1,546,902)	(10,789,047)
Total	\$ (11,060,625)	\$ (10,742,398)	\$ (21,803,023)	\$ 165,406	\$ (3,186,679)	\$ (24,824,296)

Subsequent Event – As of July 31, 2013, the Swap had negative fair values of \$8,893,831 and \$6,229,285 for the Series of 2003 Bonds and Series of 2007 Bonds, respectively.

Accounting and Risk Disclosures - As noted in the fair value table above, the effect of the termination of the original Swap resulted in a swap borrowing. At December 31, 2012 and 2011, current period changes in fair value for the Swap are accounted for as an investment and are recorded on the statement of revenues, expenses, and change in net position as change in fair value of interest rate swap. The fair value of the outstanding Swap as of December 31, 2012 and 2011 is reported on the statements of net position as a combination of interest rate swap liability and swap borrowing.

Credit Risk - As of December 31, 2012 and 2011, the Authority's Swap agreements were not exposed to credit risk, because they had a negative fair value. However, should interest rates change and the fair value of the Swap become positive, the Authority would be exposed to credit risk in the amount of the Swap agreement's fair value. At December 31, 2012 and 2011, the Bank was rated Aa3 by Moody's, AA- by Standard & Poor's, and AA- by Fitch.

Swap Payments and Associated Debt – The pending mandatory purchase date of March 1, 2013 has been extended to January 2, 2014. If, on the mandatory tender date associated with the Bonds, the Bank is no longer the owner of the Bonds, a settlement amount will be payable to the Bank equal to the market value on the date of termination, calculated in accordance with the ISDA Master Agreement and Schedule.

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NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Using rates as of December 31, 2012, debt service requirements of the Series of 2003 Bonds and Series of 2007 Bonds and net Swap payments, assuming current interest rates and floating rates under the Swap agreement remain the same for their term, were as follows. As these rates vary, interest payments on the Series of 2003 Bonds and Series of 2007 Bonds and net payments under the Swap agreements will vary:

Fiscal Year Ending December 31,	Series of 2003, Hotel Room Rental Tax Revenue Bonds			
	Principal	Interest	Swap Agreement Payments, Net	Total
2013	\$ -	\$ 750,253	\$ 1,399,861	\$ 2,150,114
2014	<u>39,670,000</u>	<u>62,521</u>	<u>116,655</u>	<u>39,849,176</u>
	<u>\$ 39,670,000</u>	<u>\$ 812,774</u>	<u>\$ 1,516,516</u>	<u>\$ 41,999,290</u>

Fiscal Year Ending December 31,	Series of 2007, Hotel Room Rental Tax Revenue Bonds			
	Principal	Interest	Swap Agreement Payments, Net	Total
2013	\$ -	\$ 488,264	\$ 820,160	\$ 1,308,424
2014	<u>23,920,000</u>	<u>40,689</u>	<u>68,347</u>	<u>24,029,036</u>
	<u>\$ 23,920,000</u>	<u>\$ 528,953</u>	<u>\$ 888,507</u>	<u>\$ 25,337,460</u>

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

10. RESTRICTED ASSETS

The restricted assets represent funds held at the Trustee Bank derived from the proceeds of the Bonds and other agreements. The funds are restricted for payment of construction costs, debt service payments, settlement costs, and operating and administrative expenses. Restricted assets at December 31 are as follows:

	2012	2011
Cash and investments with trustee:		
Debt service reserve fund	\$ 4,165,757	\$ 4,165,758
Bond fund	500,000	500,000
Operating expense fund	306,361	343,988
Agency fund	-	47,587
Rate stabilization fund	<u>450,000</u>	<u>450,000</u>
Total cash and investments with trustee	5,422,118	5,507,333
Cash and investments held by Authority:		
Construction fund	-	61,805
HRRT depository	2,130	2,130
Capital replacement fund	200,000	-
State project escrow	-	100
HPT construction	-	150,783
Settlement fund	-	380,019
Total restricted assets	<u>\$ 5,624,248</u>	<u>\$ 6,102,170</u>

11. RISK MANAGEMENT

The Authority maintains insurance contracts to mitigate the risk of loss arising from the following events: torts; theft of, damage to, or destruction of certain assets; wrongful acts by directors and officers; job-related illness or injuries to employees; acts of God; and losses resulting from providing medical benefits to employees and their dependents. Contracts are limited liability and limited to specific properties. Settled claims have not exceeded the commercial coverage insurance in any of the past three fiscal years.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

12. COMMITMENTS AND CONTINGENCIES

Arbitrage

As of December 31, 2012, the Authority earned more on its restricted and unrestricted yield investments of the Series of 2003 Bonds and Series 2007 Bonds proceeds than had such proceeds been invested at the bond yield, and thus, the Authority has accumulated an arbitrage liability in the amount of \$73,061 for the period October 3, 2011 to October 3, 2012. The arbitrage liability is due to the United States Treasury on or before October 3, 2016, unless the Authority enters into new debt issuances related to the debt. As of December 31, 2011, there was no arbitrage liability for the period March 29, 2007 to October 3, 2011.

Additional arbitrage reporting will be required in the future for the Bonds, because proceeds of such Bonds remain on deposit in the Series of 2003 Bonds and Series of 2007 Bonds Debt Service Reserve Funds.

Continuing Covenant Agreement

Under the continuing covenant agreement, the Authority is required to maintain certain minimum balances in the funds held at the Trustee Bank. Failure to meet this liquidity covenant for any quarterly period represents an event of default. During the year ended December 31, 2012, the Authority failed to meet this liquidity covenant for the quarters ending March 31, June 30, and September 30, 2012. As a result of the event of default, the Bank directed the County to divert the 20% of hotel room rental tax allocated to the PDCVB to the Trustee Bank of the Authority's Bonds for the months of February 2012 through October 2012, which was received in April 2012 through December 2012. As of December 31, 2012, the Authority has met all financial covenants required under the continuing covenant agreement, including the liquidity covenant, which requires a minimum balance of \$5,250,000 in funds held at the Trustee Bank. As a result, the Bank directed the County to remit the 20% of hotel room revenue tax to the PDCVB for the months of November 2012 and December 2012, which was received in January 2013 and February 2013, respectively.

Subsequent to the year ended December 31, 2012, the Authority failed to meet this liquidity covenant for the quarters ending March 31 and June 30, 2013. As a result of the event of default, the Bank directed the County to divert the 20% of hotel room rental tax allocated to the PDCVB to the Trustee Bank of the Authority's Bonds for the months of February 2013 through current, which was received in April 2013 through current.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

NEGATIVE NET POSITION

The Authority's negative net position, as shown on the statements of net position as of December 31, 2012 and 2011, is due to a GASB requirement for governmental entities to terminate hedge accounting when a termination event has occurred on a derivative instrument (interest rate swap). A termination event occurs when a significant change in a critical term of an interest rate swap is made.

On October 3, 2011, the Authority, as a part of its bond restructuring, modified terms to their existing interest rate swap agreement. These changes were deemed significant and, according to GASB standards, the interest rate swap agreement was terminated and a new interest rate swap agreement was put in place. The mark-to-market value at the time of termination was \$21,803,023, which was included in the statement of revenues, expenses, and change in net position as a special item during the year ended December 31, 2011, and is presented on the statements of net position as a swap borrowing. The \$21,803,023 liability is being amortized over the life of the bonds and will reduce interest expense for financial reporting purposes in future years. Additionally, the new interest rate swap agreement has been deemed to be ineffective and any changes in the mark-to-market value will flow through non-operating revenue/expense.

Since the 2008 national financial crises, the Authority has had a significant interest rate swap liability and understood that liability would be realized if, or when, the Authority refinanced its bonds or the hedge became ineffective. The October 2011 restructuring caused the Authority to account for the termination of hedge accounting as a liability on the balance sheet and recognize the swap loss during the year ended December 31, 2011 on the statement of revenues, expenses, and change in net position. The financial disclosures in prior audited financial statements and all public disclosure have always properly noted the existence of the swap liability and the impact that liability may have on the Authority's ability to refinance the bonds.

13. MANAGEMENT'S RESPONSE

Operational Improvements

In early 2012, the Authority engaged Convention, Sports & Leisure International to review and report on Convention Center operations, marketing and sales of the Convention Center, as well as Authority financial agreements. The Authority has implemented, or in the process of implementing Convention, Sports & Leisure International's report findings.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

Convention, Sports & Leisure International recognized the following operational initiatives that have been implemented by the Authority to achieve desired operational revenue and expense goals:

- 1) Analysis of energy costs with utility owning transformer, versus purchasing the transformer, entering a service agreement, soliciting proposals to assist in evaluating a fixed versus floating approach to electricity and gas purchase, and continuing to work with consultants/industry experts to analyze energy utilization and consumption strategies.
- 2) Decrease solar gain with window film installed on southwesterly windows (installed August 2012).
- 3) Continuing replacement (as needed) of light bulbs in Freedom Hall with bulbs that draw approximately 70kw less per bulb (started March 2012).
- 4) Efforts to improve Convention Center's operation profitability by investing in inventory of exhibit draping and exhibit hall portable carpeting in an effort to capture more revenue for these services. Success was achieved in both instances for the revenue for rental of these items exceeded the capital investment. Additionally, one exhibition event utilizing Freedom Hall A & B was retained due to the carpeting purchase (both carpet and draping purchased in January 2012). Sales and marketing has identified advertising mediums available for clients to purchase, thereby providing a new revenue source.

Convention, Sports & Leisure International's report also commented on sales and marketing of the Convention Center, believing that a more coordinated approach to the sales and marketing structure, policies and procedures could be beneficial in securing added event activity, and that the Authority could play a more direct role in this structure. The Authority is working on the recommended structure.

Noteworthy Authority positive financial events in 2012 included:

- Energy costs in 2012 were reduced by \$ 127,714 when compared to 2011.
- Funding of FF&E reserves of \$200,000 in December 2012.
- Hotel Room Rental Tax collections in 2012 grew by 8.77% when compared to 2011.
- Operations of the Convention Center enjoyed an improved profitability by \$63,468.

Financing

As previously detailed in Note 7, the Bonds could be tendered by Wells Fargo Bank, N.A. (Bank) on January 2, 2014. The Authority has been engaged in a process of educating the community and the stakeholders since early in 2012. Negotiations with the Bank have been ongoing since last summer.

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

NOTES TO FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2012 AND 2011

The goal of this process has been to convince stakeholders that additional sources of revenue are needed to satisfy the Bank to reduce the interest rate on the debt which is currently 80 basis points higher under the October 2012 restructuring than the March 2007 rates. This represents approximately \$500,000 of additional interest expense annually.

The Authority remains cautiously optimistic that a financing package can be negotiated with the Bank prior to January 2nd which satisfies their need for more revenues and the Authority's need for a lower interest rate. Once such a package is offered by the Bank, it is the Authority's hope that the stakeholders will cooperate to meet the requirements of the offer.

Other

While the Bank has the right to tender the bonds on January 2, 2014, the Authority has no indication that they intend to do so. The Bank has other remedies under the agreements or they could grant another continuance. In addition, the Authority has unrestricted assets outside the indenture which would allow the facility to operate until the end of the year and beyond.

The Authority has every intention of continuing to negotiate with the Bank and resolve the financing issue before January 2nd.

Supplementary Information

LANCASTER COUNTY CONVENTION CENTER AUTHORITY

SCHEDULE OF EXPENSES

YEARS ENDED DECEMBER 31, 2012 AND 2011

	2012	2011
Operating Expenses:		
Departmental expenses:		
Conference service	\$ 421,562	\$ 399,986
Concession	97,663	104,144
Event management	53,856	64,185
Public space	97,085	109,225
Total departmental expenses	670,166	677,540
Undistributed operating expenses:		
Administrative and general	327,136	274,100
Sales and marketing	297,855	273,335
Repairs and maintenance	387,382	406,305
Energy	391,223	518,937
Miscellaneous	35,428	33,378
Total undistributed operating expenses	1,439,024	1,506,055
Management fees	195,000	168,000
Fixed charges:		
Insurance	72,948	74,357
Furniture, fixtures, and equipment	19,377	2,679
Total fixed charges	92,325	77,036
Administrative expenses:		
Solicitor fees and expense	5,621	14,632
Property management	18,021	12,838
Employee compensation	185,006	182,481
Executive director expenses, employee mileage, and travel	2,361	1,637
Payroll taxes	14,048	14,400
Employee benefits	26,697	26,669
Office supplies and expense	2,998	3,154
Internet and computer service	7,695	6,429
Accounting fees	36,836	33,390
Business advisory fees	8,263	14,239
Operational consultant	56,679	-
Insurance	21,971	21,713
Telephone expense	2,040	1,690
Advertising notices	471	360
Architect consulting expense	-	602
Miscellaneous expense	5,538	4,024
Total administrative expenses	394,245	338,258

(Continued)

**LANCASTER COUNTY CONVENTION
CENTER AUTHORITY**

SCHEDULE OF EXPENSES

YEARS ENDED DECEMBER 31, 2012 AND 2011
(Continued)

	<u>2012</u>	<u>2011</u>
Depreciation	<u>2,424,529</u>	<u>2,431,926</u>
Capital/development costs:		
Legal fees - litigation and construction	-	21,808
Accounting	19,179	4,699
Trustee fees	11,900	15,700
Total capital/development costs	<u>31,079</u>	<u>42,207</u>
Total operating expenses	<u>\$ 5,246,368</u>	<u>\$ 5,241,022</u>

(Concluded)