

DOWNTOWN PHOENIX HOTEL CORPORATION

AN ARIZONA NONPROFIT CORPORATION

A COMPONENT UNIT OF THE CITY OF PHOENIX, ARIZONA



2015 ANNUAL FINANCIAL REPORT

FOR THE FISCAL YEARS ENDED DECEMBER 31, 2015 AND 2014



Downtown Phoenix Hotel Corporation
An Arizona Nonprofit Corporation
(A Component Unit of the City of Phoenix, Arizona)

Annual Financial Report
For the Fiscal Years Ended December 31, 2015 and 2014

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Downtown Phoenix Hotel Corporation
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(A Component Unit of the City of Phoenix, Arizona)

ADMINISTRATIVE ORGANIZATION

Board Members

Milton Dohoney
President

Dick Snell
Director

Paul Blue
Vice President

Denise Olson
Treasurer

John Chan
Secretary

City of Phoenix Administrative Staff

Milton Dohoney
Assistant City Manager

Denise Olson
Chief Financial Officer

Jeremy Legg
Special Projects Manager



INDEPENDENT AUDITORS' REPORT

Board of Directors
Downtown Phoenix Hotel Corporation
Phoenix, Arizona

Report on the Financial Statements

We have audited the accompanying statements of net position of the Downtown Phoenix Hotel Corporation (the "Corporation" and a component unit of the City of Phoenix, Arizona), as of December 31, 2015 and 2014, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Corporation'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.

Auditors' 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 auditors' 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 Corporation'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 Corporation'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 Downtown Phoenix Hotel Corporation (a component unit of the City of Phoenix, Arizona) as of December 31, 2015 and 2014, and the changes its in financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 5 through 9 be presented to supplement the basic financial statements. Such 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 financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



CliftonLarsonAllen LLP

Phoenix, Arizona
May 25, 2016

Management's Discussion and Analysis

As management of the Downtown Phoenix Hotel Corporation (the Corporation), a component unit of the City of Phoenix, Arizona (the City) we offer the readers of the Corporation's basic financial statements, this narrative overview and analysis of the financial activities of the Corporation for the fiscal years ended December 31, 2015 and 2014.

Downtown Phoenix Hotel Corporation

The Downtown Phoenix Hotel Corporation is an Arizona nonprofit corporation duly organized and existing under the laws of the State. The Corporation was formed in January 2005 for the sole purpose of owning, acquiring, constructing, equipping, operating, financing and taking any other actions that an Arizona nonprofit corporation may take with respect to a full-service downtown hotel.

The City Council of the City of Phoenix (the Council) appoints the Corporation's Board of Directors (the Board). Although the Corporation is legally separate from the City, governmental accounting standards require the Corporation to be reported as a discretely presented component unit of the City for financial reporting purposes because of the City Council's and City Management's relationship to the Corporation.

The Downtown Phoenix Hotel (the Hotel) is an approximately 1 million square foot, 1,000 room full service, first class, downtown hotel located at the northwest corner of 3rd Street and Van Buren Street approximately one block north of the Phoenix Convention Center. The Hotel primarily serves the Convention Center and opened October 1, 2008.

Authorization to Market the Hotel

On December 2, 2015, the Council authorized the Board to amend the Articles of Incorporation to allow the Corporation to facilitate the marketing of and negotiations for a possible sale of the Hotel.

Note Payable

On August 12, 2015, the Corporation entered into an agreement with the City to refinance all outstanding revenue bonds related to the Hotel that were issued in December 2005. The amount of the note payable was \$305,940,000 and the debt service payments will be funded by the Hotel's operations.

Corporation Contracts for Hotel Operations and Development

To act on behalf of the Corporation in the management and operations of the Hotel, the Corporation entered into a Hotel Operating Agreement with Starwood Hotels & Resorts Management Company, Inc. (Hotel Operator), a Delaware company and a direct subsidiary of Starwood Hotels & Resorts Worldwide, Inc., (Starwood), a Maryland corporation. The Hotel Operating Agreement is for a term of fifteen years, subject to certain occurrences, including performance standards by the Hotel Operator.

CHMWarnick, LLC, (Warnick), an Arizona Limited Liability Company, acts as the consultant to the Corporation to assist staff with efforts to facilitate the development of the Hotel and general support to the Corporation. Warnick also acts as the asset manager on behalf of the Corporation.

Overview of the Basic Financial Statements

This discussion and analysis is intended to serve as an introduction to the Corporation's separate basic financial statements. The Corporation's basic financial statements are comprised of the following two components:

- Financial statements
- Notes to the financial statements

Financial statements. The *financial statements* are designed to provide readers with a broad overview of the Corporation's finances, in a manner similar to a private-sector business. These statements are presented on pages 10-13 of this report. Summarized versions of the Statements of Net Position and the Statements of Revenues, Expenses and Changes in Net Position are included in this Management's Discussion and Analysis (MD&A).

The *Statements of Net Position* presents information on all of the Corporation's assets, deferred outflows of resources, liabilities, and deferred inflows of resources with the difference between the components as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of changes in the Corporation's financial position.

The *Statements of Revenues, Expenses and Changes in Net Position* presents information showing how the Corporation's net position changed during the most recent fiscal years. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future periods e.g., accounts payable. This is the accrual method of accounting.

The *Statements of Cash Flows* provide information about the receipts and payments of the Corporation that result in changes to Cash and Cash Equivalents. The cash flows are classified as operating activities, noncapital financing activities, capital and related financing activities, and investing activities.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the basic financial statements can be found on pages 14-21 of this report.

Condensed Financial Information and Analysis of Overall Financial Position

The following tables and analysis discuss the financial position and changes to the financial position for the Corporation as a whole, as of and for the years ended December 31, (in thousands):

Summary of net position (in thousands):

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Current and other assets	\$ 22,151	\$ 67,003	\$ 62,360
Capital assets	<u>229,762</u>	<u>236,056</u>	<u>244,058</u>
Total assets	<u>251,913</u>	<u>303,059</u>	<u>306,418</u>
Deferred outflows of resources	<u>5,834</u>	<u>-</u>	<u>-</u>
Current liabilities	11,790	31,243	31,752
Noncurrent liabilities	<u>306,251</u>	<u>335,119</u>	<u>340,998</u>
Total liabilities	<u>318,041</u>	<u>366,362</u>	<u>372,750</u>
Deferred inflows of resources	<u>-</u>	<u>-</u>	<u>-</u>
Net position			
Net investment in capital assets	(76,178)	(38,397)	(35,910)
Restricted for debt service	729	26,383	26,367
Restricted for capital projects	10,234	8,337	7,259
Unrestricted	<u>4,921</u>	<u>(59,626)</u>	<u>(64,048)</u>
Total net position	<u>\$ (60,294)</u>	<u>\$ (63,303)</u>	<u>\$ (66,332)</u>

Net Position

The current and other assets are comprised primarily of cash reserves held by the trustee bank. As of December 31, 2015, the Senior Capital Expenditure Reserve was \$10.2 million and the Operating Reserve was \$4.0 million. The decrease of \$44.9 million, or 67.0%, during 2015 is directly related to the refinancing of the bonds payable into a note payable when the reserve accounts were used to pay down the bonds payable.

The Corporation's capital assets as of December 31, 2015, amounts to \$229.8 million (net of accumulated depreciation). Capital assets include land, buildings, improvements, equipment, construction in progress, and intangible assets. The total decrease in the Corporation's capital assets for the current fiscal year was 2.67%, and is due to the year's depreciation of Hotel assets.

The Corporation's capital assets as of December 31, 2014, amounts to \$236.1 million (net of accumulated depreciation). Capital assets include land, buildings, improvements, equipment, construction in progress, and intangible assets. The total decrease in the Corporation's capital assets for the current fiscal year was 3.28%, and is due to the year's depreciation of Hotel assets and the Ramada land sale.

The deferred outflows of resources as of December 31, 2015 amounts to \$5.8 million and is comprised entirely of the deferred loss on refinancing of the outstanding bonds into a note payable.

Current liabilities are comprised of accounts payable, accrued expenses, advance deposits, and deposits held in trust as of December 31, 2015. Current liabilities decreased in 2015 from 2014 because there is no interest payable on the note payable since all interest expenses were paid during 2015. There is also no current portion of the capital debt due until 2021.

Noncurrent liabilities are comprised of a note payable and advance payments as of December 31, 2015. Noncurrent liabilities decreased in 2015 from 2014 due to the refinancing of the outstanding bonds into a note payable, as well as the write-off of the unamortized bond premiums.

Noncurrent liabilities are comprised of bonds payable and unamortized premiums as of December 31, 2014. Noncurrent liabilities decreased in 2014 primarily due to bonds payable due in one year of \$5.6 million.

Net position in 2015 changed from 2014 primarily due to the refinancing. Net investment in capital assets decreased because of the additional cash reserves used in the refinancing. Restricted for debt service decreased due to lower interest on capital debt and no principal being due until 2021 under the note payable. Restricted for capital projects increased due to higher room revenues and significantly lower debt service reserve requirements after the refinancing allowing for more to flow into the Senior Capital Expenditure Reserve. Unrestricted net position increased due to the above – see also next page for explanations related to changes in net position.

Changes in Net Position

Summary of changes in net position (in thousands):

	<u>2015</u>	<u>2014</u>	<u>2013</u>
Operating revenues	\$ 61,923	\$ 53,887	\$ 50,647
Investment income	10	34	68
Contributions	<u>3,523</u>	<u>12,704</u>	<u>12,707</u>
Total revenues	<u>65,456</u>	<u>66,625</u>	<u>63,422</u>
Operating expenses	50,662	49,685	48,835
Trustee fees	1	8	8
Interest on capital debt	11,784	16,512	16,766
Loss on disposal of capital assets	-	491	-
Gain on extinguishment of debt	-	(3,100)	-
Total expenses	<u>62,447</u>	<u>63,596</u>	<u>65,609</u>
Changes in net position	3,009	3,029	(2,187)
Net position, January 1	<u>(63,303)</u>	<u>(66,332)</u>	<u>(64,145)</u>
Net position, December 31	<u>\$ (60,294)</u>	<u>\$ (63,303)</u>	<u>\$ (66,332)</u>

Operating revenues increased by \$8.0 million, or 14.9%, during 2015. This is primarily due to higher room revenues driven by a 7.6% increase in room occupancy.

Operating revenues increased by \$3.2 million, or 6.4%, during 2014. This is primarily due to higher room revenues driven by a 6.5% increase in room occupancy.

Contributions decreased \$9.2 million, or 72.3%, during 2015. This is directly related to the refinancing of the bonds payable into a note payable since contributions from the City's Sports Facilities Tax Fund is no longer required under the note payable.

Operating expenses increased by \$1.0 million, or 2.0%, during 2015. The increase is primarily due to an increase in room expenses driven by a 7.6% increase in room occupancy.

Operating expenses increased by \$0.9 million, or 1.8%, during 2014. The increase is primarily due to an increase in room expenses driven by a 6.5% increase in room occupancy.

Interest on capital debt decreased by \$4.7 million, or 28.7%, during 2015. The decrease is due to the refinancing of the bonds payable into a note payable.

Loss on disposal of capital assets during 2014 was related to the disposition of the Ramada land sale.

Gain on extinguishment of debt during 2014 was related to the elimination of accrued and unpaid subordinate management and centralized services fees per the Amended Operating Agreement.

The increase in ending net position as of December 31, 2015 is primarily due to lower interest expense of \$5.0 million as a result of the refinancing of the Hotel's long-term debt.

The increase in ending net position as of December 31, 2014 is primarily due to higher room revenues driven by an increase in room occupancy and the elimination of accrued and unpaid subordinate management and centralized services fees.

Requests for Financial Information

This financial report is designed to provide a general overview of the Downtown Phoenix Hotel Corporation's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Chief Financial Officer, City of Phoenix, Calvin C. Goode Municipal Building, Ninth Floor, 251 West Washington, Phoenix, Arizona, 85003.

Downtown Phoenix Hotel Corporation
Statements Of Net Position
December 31, 2015 and 2014
(in thousands)

	<u>2015</u>	<u>2014</u>
ASSETS		
Current Assets		
Cash and Cash Equivalents	\$ 2,441	\$ 3,562
Accounts Receivable, Net of Allowance for Doubtful Accounts (2015, \$4 and 2014, \$1)	3,091	2,512
Inventories	260	253
Prepaid Expenses	1,085	806
Total Current Assets	<u>6,877</u>	<u>7,133</u>
Current Restricted Assets		
Debt Service		
Cash and Cash Equivalents	729	17,699
Investments	-	22,605
Receivables		
Accrued Interest	-	5
Operating Reserve		
Cash and Cash Equivalents	4,046	10,924
Capital Projects		
Cash and Cash Equivalents	10,234	8,337
Total Current Restricted Assets	<u>15,009</u>	<u>59,570</u>
Noncurrent Assets		
Other	265	300
Capital Assets		
Buildings	277,617	276,552
Improvements Other Than Buildings	537	537
Equipment	4,379	3,913
Intangible	209	177
Construction in Progress	-	321
Less: Accumulated Depreciation	(52,980)	(45,444)
Total Capital Assets, Net	<u>229,762</u>	<u>236,056</u>
Total Noncurrent Assets	<u>230,027</u>	<u>236,356</u>
Total Assets	<u>251,913</u>	<u>303,059</u>
DEFERRED OUTFLOWS OF RESOURCES		
Total Deferred Outflows of Resources	<u>5,834</u>	<u>-</u>

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

	<u>2015</u>	<u>2014</u>
LIABILITIES		
Current Liabilities Payable from Current Assets		
Accounts Payable	741	2,181
Accrued Expenses	3,182	3,762
Advance Deposits	1,056	950
Total Current Liabilities Payable from Current Assets	<u>4,979</u>	<u>6,893</u>
Current Liabilities Payable from Restricted Assets		
Debt Service		
Bonds Payable	-	5,595
Interest Payable	-	8,331
Operating Reserve		
Accounts Payable	34	103
Deposits in Trust	6,777	10,321
Total Current Liabilities Payable from Restricted Assets	<u>6,811</u>	<u>24,350</u>
Noncurrent Liabilities		
Bonds Payable	-	329,720
Note Payable	305,940	-
Advance Payments	311	-
Unamortized Premium	-	5,399
Total Noncurrent Liabilities	<u>306,251</u>	<u>335,119</u>
Total Liabilities	<u>318,041</u>	<u>366,362</u>
DEFERRED INFLOWS OF RESOURCES		
Total Deferred Inflows of Resources	<u>-</u>	<u>-</u>
NET POSITION		
Net Investment in Capital Assets	(76,178)	(38,397)
Restricted for Debt Service	729	26,383
Restricted for Capital Projects	10,234	8,337
Unrestricted	4,921	(59,626)
Total Net Position	<u>\$ (60,294)</u>	<u>\$ (63,303)</u>

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

Downtown Phoenix Hotel Corporation
Statements of Revenues, Expenses
and Changes in Net Position

For the Fiscal Years Ended December 31, 2015 and 2014
(in thousands)

	<u>2015</u>	<u>2014</u>
Operating Revenues		
Rooms	\$ 37,974	\$ 30,846
Food and Beverage	21,771	20,028
Other	2,178	3,013
Total Operating Revenues	<u>61,923</u>	<u>53,887</u>
Operating Expenses		
Rooms	9,820	8,800
Food and Beverage	14,488	14,236
General and Administrative Costs	18,092	18,138
Depreciation	7,535	7,373
Trustee Fees	1	8
Other	727	1,138
Total Operating Expenses	<u>50,663</u>	<u>49,693</u>
Operating Income	11,260	4,194
Non-Operating Revenues (Expenses)		
Investment Income		
Net Increase (Decrease) in Fair Value of Investments	(9)	(4)
Interest	19	38
Contributions	3,523	12,704
Interest on Capital Debt	(11,784)	(16,512)
Loss on Disposal of Capital Assets	-	(491)
Gain on Extinguishment of Debt	-	3,100
Total Non-Operating Expenses	<u>(8,251)</u>	<u>(1,165)</u>
Changes in Net Position	3,009	3,029
Net Position, January 1	(63,303)	(66,332)
Net Position, December 31	<u>\$ (60,294)</u>	<u>\$ (63,303)</u>

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

Downtown Phoenix Hotel Corporation
Statements of Cash Flows

For the Fiscal Years Ended December 31, 2015 and 2014
(in thousands)

	<u>2015</u>	<u>2014</u>
Cash Flows from Operating Activities		
Cash Received from Customers	\$ 61,451	\$ 52,703
Payments to Suppliers	(27,065)	(21,801)
Payment of Staff and Administrative Expenses	(18,092)	(18,139)
Net Cash Provided by Operating Activities	<u>16,294</u>	<u>12,763</u>
Cash Flows from Noncapital Financing Activities		
Contribution from City of Phoenix	<u>3,523</u>	<u>12,704</u>
Net Cash Provided by Noncapital Financing Activities	<u>3,523</u>	<u>12,704</u>
Cash Flows from Capital and Related Financing Activities		
Proceeds from Note Payable	305,940	-
Principal Paid on Capital Debt	(346,774)	(5,230)
Interest Paid on Capital Debt	(19,888)	(16,930)
Receipt of Deposits Held in Trust	13	26
Return of Deposits Held in Trust	(3,549)	(11)
Acquisition and Construction of Capital Assets	(1,242)	(522)
Proceeds from Sales of Capital Assets	-	659
Net Cash Used by Capital and Related Financing Activities	<u>(65,500)</u>	<u>(22,008)</u>
Cash Flows from Investing Activities		
Purchases of Investment Securities	-	(10,315)
Proceeds from Sales and Maturities of Investment Securities	22,590	18,300
Interest on Investments	21	41
Net Cash Provided (Used) by Investing Activities	<u>22,611</u>	<u>8,026</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>(23,072)</u>	<u>11,485</u>
Cash and Cash Equivalents, January 1	40,522	29,037
Cash and Cash Equivalents, December 31	<u>\$ 17,450</u>	<u>\$ 40,522</u>
Reconciliation of Operating Income to		
Net Cash Provided by Operating Activities		
Operating Income	\$ 11,260	\$ 4,194
Adjustments		
Depreciation	7,537	7,373
(Increase) Decrease in Assets		
Accounts Receivable	(578)	(1,210)
Inventories	(7)	(14)
Prepaid Expenses	(280)	255
Other Non-Current Assets	34	(195)
Increase (Decrease) in Liabilities		
Accounts Payable	(1,510)	1,588
Accrued Expenses	(579)	746
Advance Deposits	106	26
Advance Payments	311	-
Net Cash Provided by Operating Activities	<u>\$ 16,294</u>	<u>\$ 12,763</u>
Noncash Transactions Affecting Financial Position		
Increase (Decrease) in Fair Value of Investments	\$ (9)	\$ (4)
Loss on Refinancing of Long-term Debt	(6,060)	-
Gain on Extinguishment of Debt	-	3,100
Total Noncash Transactions Affecting Financial Position	<u>\$ (6,069)</u>	<u>\$ 3,096</u>

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

DOWNTOWN PHOENIX HOTEL CORPORATION
An Arizona Nonprofit Corporation
(A Component Unit of the City of Phoenix, Arizona)

NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended December 31, 2015 and 2014

The Downtown Phoenix Hotel Corporation (the Corporation) is a non-profit corporation established in January 2005 to facilitate the financing, development, construction, and operation of a full-service hotel in downtown Phoenix (Hotel). The Hotel began operations in October 2008. The Hotel is operated by Starwood Hotels & Resorts Management Company, Inc. (Hotel Operator), a direct subsidiary of Starwood Hotels & Resorts Worldwide, Inc., (Starwood).

1. Summary of Significant Accounting Policies

The accompanying financial statements of the Corporation have been prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) as applied to governmental units. The following is a summary of the significant accounting policies:

a. Reporting Entity

The City Council of the City of Phoenix (the City) appoints the Corporation’s Board of Directors, approves the annual budget, provides financial support, and approves amendments to the Articles of Incorporation and Bylaws. Upon future dissolution of the Corporation, remaining assets will revert to the City. Accordingly, the Corporation is considered to be a governmental unit for financial reporting purposes. Although the Corporation is legally separate from the City, governmental accounting standards require the Corporation to be reported as a discretely presented component unit of the City for financial reporting purposes because of the City Council’s relationship to the Corporation. The Corporation prepares financial statements for use by the Board of Directors and other interested parties.

b. Basic Financial Statements

The basic financial statements constitute the core of the financial section of the Corporation’s Annual Financial Report. The basic financial statements include the financial statements and the accompanying notes to these financial statements.

The financial statements (Statements of Net Position; Statements of Revenues, Expenses and Changes in Net Position; and Statements of Cash Flows) report on the Corporation as a whole. All activities are reported in the financial statements using the economic resources measurement focus and the accrual basis of accounting, which includes long-term assets and receivables and deferred outflows of resources, as well as long-term debt, obligations, and deferred inflows of resources. The financial statements focus more on the sustainability of the Corporation as an entity and the change in aggregate financial position resulting from the activities of the fiscal period.

The Statements of Net Position report all financial resources of the entity and are displayed in a format of assets plus deferred outflows of resources less liabilities plus deferred inflows of resources equals net position, with the assets and liabilities shown in order of their relative liquidity. Net position is displayed in three components: 1) net investment in capital assets, 2) restricted and 3) unrestricted. Net investment in capital assets, are capital assets net of accumulated depreciation and reduced by outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Restricted components of net position are those with constraints placed on their use. Those constraints are either 1) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments, or 2) imposed by law through constitutional provisions or enabling legislation. All components of net position not otherwise classified

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NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended December 31, 2015 and 2014

as restricted are shown as unrestricted. Generally, the Corporation would first apply restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net position is available. Reservations or designations of net position imposed by the reporting entity, whether by administrative policy or legislative actions of the reporting entity, are not shown on the accompanying financial statements.

The Statements of Revenues, Expenses and Changes in Net Position present information showing how the Corporation's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future periods e.g., accounts payable. This is the accrual method of accounting.

The Statements of Cash Flows provide information about the receipts and payments of the Corporation that result in changes to cash and cash equivalents. The cash flows are classified as operating activities, noncapital financing activities, capital and related financing activities, or investing activities.

c. Basis of Accounting

The Corporation's activities are accounted for as an enterprise fund and the accounting records are maintained on the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when incurred. The Corporation applies all Governmental Accounting Standards Board pronouncements in accounting and reporting for its proprietary operations.

The Corporation distinguishes operating revenues and expenses from non-operating items. Operating revenues are primarily derived from hotel operations including the rental of rooms and food and beverage sales. Revenue is recognized when rooms are occupied and services have been rendered. Operating expenses for the Corporation include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Restricted assets on the Statements of Net Position primarily consist of investments for debt service. Cash with fiscal agent/trustee and accrued interest receivables are restricted for debt service, operating reserve, and capital projects.

d. Cash and Cash Equivalents

Cash and cash equivalents are defined as highly liquid investments (including restricted cash and investments) with a maturity of three months or less from the date of purchase.

e. Investments

The Corporation's investments are governed by the underlying bond documents. The corporation reports all investments, deposits and associated risks in accordance with Governmental Accounting Standards Board Statements No. 31, "*Accounting and Financial Reporting for Certain Investments and for External Investment Pools*" and No. 40, "*Deposit and Investment Risk Disclosures*."

DOWNTOWN PHOENIX HOTEL CORPORATION
An Arizona Nonprofit Corporation
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NOTES TO THE FINANCIAL STATEMENTS
For the Fiscal Years Ended December 31, 2015 and 2014

f. Accounts Receivable

Accounts receivable are reported net of an allowance for doubtful accounts. The allowance for doubtful accounts is based on management's assessment of the potential for losses, taking into account historical experience and currently available information.

g. Inventories

Inventories include food and beverage inventory items which are generally valued at the lower of FIFO cost (first-in, first-out) or market.

h. Capital Assets

Capital assets are defined as assets with an initial, individual cost of more than \$5,000 and an estimated useful life greater than two years. Capital assets are recorded at cost if purchased or constructed.

Major outlays for capital assets and improvements are capitalized as the projects are constructed. Interest incurred during the construction phase of projects is reflected in the capitalized value of the asset constructed. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Major improvements are capitalized and depreciated over the remaining useful lives of the related capital assets.

Depreciable capital assets are depreciated or amortized using the straight-line method and the following estimated useful lives:

Buildings and improvements	5 to 40 years
Equipment	5 to 25 years
Intangible assets	5 to 20 years

Gain or loss is recognized when assets are retired from service or are otherwise disposed of.

i. Noncurrent Liabilities

In the financial statements, long-term debt and other long-term obligations are reported as liabilities in the statements of net position. Bond premiums and discounts are deferred and amortized over the life of the bonds using the interest method.

j. 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 a number of 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 reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

k. Advertising Costs

Advertising costs are expensed when incurred.

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I. Income Taxes

The Corporation is an Arizona nonprofit corporation and a component unit of the City of Phoenix, a governmental agency, and is exempt from federal and state income taxes.

2. Cash and Investments

Operating cash is maintained in a separate bank account. All other cash and investments of the Corporation are held by the trustee. The contract with the trustee calls for these deposits to be fully covered by collateral held in the trustee's trust department but not in the Corporation's name. The trust department pledges a pool of collateral against all trust deposits.

Cash and cash equivalents at December 31, was comprised of the following (in thousands):

	<u>2015</u>	<u>2014</u>
Cash	\$ 2,441	\$ 3,562
Short-term money market accounts	15,009	36,960
Total cash and cash equivalents	<u>\$ 17,450</u>	<u>\$ 40,522</u>

At December 31, 2015 and 2014, the Hotel's reported cash deposits were \$2,391,292 and \$3,512,048, respectively. The bank balances related to these deposits were \$2,701,405 and \$4,029,854, respectively.

Investments at December 31, was comprised of the following (in thousands):

<u>2015</u>	<u>Credit Quality Rating</u>	<u>Fair Value</u>	<u>Weighted Average Maturity (Years)</u>
U.S. Treasury Securities	N/A (1)	\$ -	N/A
 <u>2014</u>			
U.S. Treasury Securities	N/A (1)	\$ 22,605	0.395

(1) U.S. Government Guaranteed

Interest Rate Risk

The Corporation manages its exposure to interest rate risk by attempting to match investment maturities with anticipated expenses, and by limiting maturities in reserve funds to five years or less.

Credit Risk

The Corporation limits its investments to the top ratings issued by nationally recognized statistical rating organizations such as Standard & Poor's ("S&P") and Moody's Investors Service ("Moody's"). The portfolio is invested in U.S. Treasury Securities.

Concentration of Credit Risk

There were no investments in any one issuer that represented 5% or more of total Corporation investments at fair value as of December 31, 2015 and 2014.

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3. Capital Assets

A summary of changes in capital assets for the years ended December 31, is as follows (in thousands):

	Beginning Balance	Increases	Decreases	Ending Balance
<u>2015</u>				
Non-depreciable assets:				
Construction in progress	\$ 321	\$ -	\$ (321)	\$ -
Intangible assets	95	-	-	95
Total non-depreciable assets	416	-	(321)	95
Depreciable assets:				
Buildings	276,552	1,065	-	277,617
Improvements	537	-	-	537
Equipment	3,913	466	-	4,379
Intangible assets	82	32	-	114
Total depreciable assets	281,084	1,563	-	282,647
Less accumulated depreciation for:				
Buildings	(43,184)	(7,029)	-	(50,214)
Improvements	(225)	(34)	-	(259)
Equipment	(1,970)	(447)	-	(2,417)
Intangible assets	(65)	(25)	-	(90)
Total accumulated depreciation	(45,444)	(7,535)	-	(52,980)
Total depreciable assets, net	235,640	(5,972)	-	229,667
Capital assets, at cost, net	\$ 236,056	\$ (5,972)	\$ (321)	\$ 229,762

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	Beginning Balance	Increases	Decreases	Ending Balance
<u>2014</u>				
Non-depreciable assets:				
Land	\$ 1,150	\$ -	\$ (1,150)	\$ -
Construction in progress	21	300	-	321
Intangible assets	95	-	-	95
Total non-depreciable assets	1,266	300	(1,150)	416
Depreciable assets:				
Buildings	276,488	64	-	276,552
Improvements	537	-	-	537
Equipment	3,755	158	-	3,913
Intangible assets	82	-	-	82
Total depreciable assets	280,862	222	-	281,084
Less accumulated depreciation for:				
Buildings	(36,234)	(6,949)	-	(43,184)
Improvements	(189)	(36)	-	(225)
Equipment	(1,597)	(373)	-	(1,970)
Intangible assets	(50)	(15)	-	(65)
Total accumulated depreciation	(38,070)	(7,373)	-	(45,444)
Total depreciable assets, net	242,792	(7,151)	-	235,640
Capital assets, at cost, net	\$ 244,058	\$ (6,851)	\$ (1,150)	\$ 236,056

There was no interest capitalized in fiscal years 2015 and 2014.

4. Long-Term Obligations

A summary of changes in noncurrent liabilities for the year ended December 31, 2015 is as follows (in thousands):

	Balances January 1	Additions	Reductions	Balances December 31
Bonds Payable	\$ 329,720	\$ -	\$ 329,720	\$ -
Note Payable	-	305,940	-	305,940
Advance Payments	-	311	-	311
Unamortized Premium	5,399	-	5,399	-
Total Noncurrent Liabilities	\$ 335,119	\$ 306,251	\$ 335,119	\$ 306,251

On December 20, 2005, the Corporation issued \$156,710,000 in Senior Revenue Bonds (Series 2005A), \$164,425,000 in Subordinate Revenue Bonds (Series 2005B), and \$28,865,000 in Subordinate Revenue Bonds Taxable (Series 2005C). The proceeds of the bonds were used to finance the planning, design, engineering, development, construction, equipping, furnishing and opening of an approximately 1,000 room, full-service, first-class downtown hotel. The total outstanding balance on the bonds payable was \$335,315,000 as of December 31, 2014.

On August 12, 2015, the City of Phoenix entered into a loan agreement ("Hotel Loan") with DNT Asset Trust, a subsidiary of JPMorgan Chase Bank, N.A., for \$305,940,000 from which

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the proceeds were used to extinguish the Corporation's Senior and Subordinate Revenue Bonds, Series 2005A, Series 2005B, and Series 2005C. Though the Corporation is not named in the Loan Agreement, the debt service payments for the Hotel Loan are funded from the Hotel's operations. The Corporation transfers these funds to the City and recognizes this obligation as a note payable. The outstanding balance on the note payable at December 31, 2015 is \$305,940,000.

As a result of the refinancing, the Corporation incurred a loss in the amount of \$6.1 million after paying off the remaining balance of the bonds payable and recognizing the remaining balance of the unamortized premiums. This loss has been recorded as a deferred outflow and will be amortized through 2025.

Fiscal Year Ending June 30	Principal	Interest	Total
2015 Hotel Loan (1)			
2016	\$ -	\$ 7,563,601	\$ 7,563,601
2017	-	8,583,147	8,583,147
2018	-	8,512,016	8,512,016
2019	-	8,512,016	8,512,016
2020	-	8,535,726	8,535,726
2021 - 2025	305,940,000	40,771,080	346,711,080
Total	<u>\$ 305,940,000</u>	<u>\$ 82,477,586</u>	<u>\$ 388,417,586</u>

Effective interest rate 2.84%

- (1) Reflects debt service amounts for the 10-year term of the Hotel Loan but does not include any additional prepayments that could be made at any time on or after July 1, 2018, including from excess net revenues of the Hotel or sale proceeds if the City decides to sell the Hotel.

Assumes the City will retire or refinance the Hotel Loan before July 1, 2025. If the Hotel Loan is not retired or refinanced before July 1, 2025, any unpaid principal remaining at that time will convert to a variable rate loan, at 9.2% per annum for a 180-day period and, thereafter, a variable rate with a maximum rate of 15% per annum. Additionally, principal payments will become due semi-annually until the final maturity of July 1, 2045, as long as no event of default has occurred.

5. Related Party Transactions

The City of Phoenix (the "City") acquired the land (the "Site") upon which the Hotel is located in March 2005. Pursuant to an amended ground lease dated as of August 12, 2015, between the City and the Corporation, the City will lease the Site and the Hotel constructed thereon to the Corporation. The term of the ground lease commenced as of the amended ground lease date and will terminate on the later of 1) the date on which the Hotel Loan or any obligation issued or incurred to refinance is no longer outstanding or 2) the date the Corporation is no longer party to a hotel management agreement for the Hotel. The City may not terminate the ground lease for any reason prior to the end of the term of the ground lease.

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The Corporation paid the City \$750 in both fiscal years 2015 and 2014 for permits, plan reviews and other construction related work performed by the City's Engineering and Architectural Services staff. The Corporation also paid the City \$206,804 and \$120,144 for administrative services in fiscal year 2015 and 2014, respectively.

As of December 31, 2015 and 2014, the Hotel had accounts receivable from Starwood Hotels and Resorts in the amount of \$0 and \$95,367, respectively.

The Corporation received \$3,523,446 and \$12,704,004 in contributions during the fiscal years 2015 and 2014, respectively, from the City's Sports Facilities Tax Fund.

6. Commitments and Contingencies

The Corporation has entered into a contract with Starwood Hotels and Resorts Management Company to operate the Hotel. The Original Operating Agreement was amended with an effective date of January 1, 2015, which resulted in an extinguishment of debt of \$3.1 million for the Corporation. The Amended Operating Agreement covers the fifteen years of operations includes a base management fee of \$1.63 million in the initial year of operations and increasing to \$2.87 million by the fifteenth year. Per the Operating Agreement all hotel personnel are employees of Starwood, and not the Corporation. Certain hotel personnel are members of the UNITE HERE union and have entered into a collective bargaining agreement with Starwood.

During October 2014, the Hotel experienced a fire in which the Hotel was shut down for approximately one week. The cost of the repairs and lost business was being reimbursed by an insurance company. The Hotel received approximately \$2.2 and \$1.2 million from the insurance company in 2015 and 2014, respectively. The remaining expenses incurred by the Hotel are expected to be reimbursed in 2016.

The Hotel is involved in various claims arising in the ordinary course of business, none of which, in the opinion of management, if determined adversely against the Hotel, will have a material adverse effect on the financial condition, results of operations, or liquidity of the Downtown Phoenix Hotel Corporation.

7. Employee Benefit Plan

Starwood sponsors various defined contribution plans, including the Starwood Hotels & Resorts Worldwide, Inc. Savings and Retirement Plan (the Plan), which is a voluntary defined contribution plan allowing participation by employees on U.S. payroll who meet certain age and service requirements. Hotel employees participate in the Plan.

Each participant may contribute on a pretax basis between 1% and 50% of his or her compensation to the Plan subject to certain maximum limits. The Plan also contains provisions for matching contributions to be made by the Hotel, which are based on a portion of a participant's eligible compensation. The Hotel contributions were \$385,359 in 2015 and \$300,509 in 2014.

8. Subsequent Event

On February 4, 2016, the City of Phoenix city council approved the sale of the Hotel to TLP Phoenix, an affiliate of the national investment firm Thayer Lodging Group. As of May 25, 2016, the sale of the hotel was not final.

The Corporation has evaluated subsequent events through May 25, 2016, the date the financial statements were available to be issued.

This information is an integral part of the accompanying financial statements.