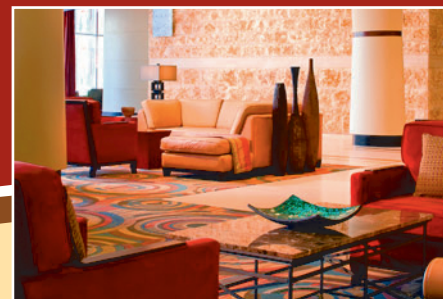


# DOWNTOWN PHOENIX HOTEL CORPORATION AN ARIZONA NONPROFIT CORPORATION

A Component Unit of the City of Phoenix, Arizona



## 2009 ANNUAL FINANCIAL REPORT

For the Fiscal Years Ended December 31, 2009 and 2008

**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, 2009 and 2008

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

**ADMINISTRATIVE ORGANIZATION**

**Board Members**

*David Krietor*  
*President*

*Dick Snell*  
*Director*

*Gary Verburg*  
*Vice President*

*Ruth Osuna*  
*Treasurer*

*John Chan*  
*Secretary*

**City of Phoenix Administrative Staff**

*David Cavazos*  
*City Manager*

*Jeff DeWitt*  
*Finance Director*

*Jerry Harper III*  
*Project Manager*





## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Downtown Phoenix Hotel Corporation  
Phoenix, Arizona

We have audited the accompanying basic financial statements of Downtown Phoenix Hotel Corporation (a Component Unit of the City of Phoenix, Arizona) as of and for the years ended December 31, 2009 and 2008, as listed in the table of contents. These basic financial statements are the responsibility of the Downtown Phoenix Hotel Corporation's management. Our responsibility is to express opinions on these basic 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Downtown Phoenix Hotel Corporation as of December 31, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 5 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Clifton Gunderson LLP*

Phoenix, Arizona  
May 19, 2010

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## **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, 2009 and 2008.

### **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 appoints the Corporation's Board of Directors. 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 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 3<sup>rd</sup> 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.

### **Corporation Revenue Bonds**

In December of 2005, the Corporation issued \$350,000,000 in revenue bonds to finance the planning, design, engineering, construction, equipping, furnishing and opening of the Hotel. The bonds are special revenue obligations of the Corporation, payable from gross operating revenues from the operation of the Hotel. The Corporation issued both Senior and Subordinate Revenue Bonds. The Senior Bonds in the amount of \$156,710,000 are payable solely from gross revenues, while the Subordinate Bonds in the amount of \$193,290,000 are also secured by a portion of non-general fund City hotel excise (sales) taxes and rental car sales taxes. Principal payments on the Bonds are not scheduled to begin until 2012. The bonds are insured by the Financial Guaranty Insurance Company (FGIC). In 2008, Standard & Poor's, Moody's, and Fitch all withdrew their ratings from FGIC. In September, 2008, FGIC entered into a reinsurance agreement with National Public Finance Guaranty Corporation (formerly MBIA Insurance Corporation) with respect to the Corporation's Subordinate Bonds. Detailed information on the bonds is presented in Note 4 to the basic financial statements.

### **Corporation Contracts for Hotel 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.

Warnick & Company, 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 Assets and the Statements of Revenues, Expenses and Changes in Net Assets are included in this Management's Discussion and Analysis (MD&A).

The *Statements of Net Assets* present information on all of the Corporation's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of changes in the Corporation's financial position.

The *Statements of Revenues, Expenses and Changes in Net Assets* present information showing how the Corporation's net assets changed during the most recent fiscal years. All changes in net assets 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, capital and related financing activities, or 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 14-24 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).

### Net Assets

Summary of net assets (in thousands):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current and other assets	\$ 72,995	\$ 79,013	\$ 160,487
Capital assets	269,661	274,332	205,765
Total assets	<u>342,656</u>	<u>353,345</u>	<u>366,252</u>
Current liabilities	23,323	23,529	26,136
Long-term liabilities	337,737	337,374	337,000
Total liabilities	<u>361,060</u>	<u>360,903</u>	<u>363,136</u>
Net assets			
Invested in capital assets, net of related debt	(8,919)	(1,729)	-
Restricted for debt service	31,835	37,379	55,359
Restricted for capital projects	23,970	25,868	88,281
Unrestricted	(65,290)	(69,076)	(140,524)
Total net assets (deficit)	<u>\$ (18,404)</u>	<u>\$ (7,558)</u>	<u>\$ 3,116</u>

The current assets are comprised primarily of bond proceeds held by the trustee bank for operating and debt service reserves.

The decrease in total assets for 2009 is due, in part, to the increase in interest expense. In the prior fiscal year, \$9.4 million of interest was capitalized; however, \$0 was capitalized in the current year. In addition, there was a decrease in restricted debt service accounts which were established to make debt service payments for the Hotel until it became operational. The final funds in these accounts were expended in fiscal year 2009. The decrease is also due to full-year depreciation of capital assets.

The decrease in total assets for 2008 is primarily due to the payment of pre-opening expenses and the initial operating costs for the Hotel. The reduction in current assets related to payment of construction costs is offset by the increase in capital assets.

The long-term liabilities are comprised of bonds payable net of unamortized issuance costs and premium and will not change significantly until 2012 which is the first year that principle is due on the bonds.

### Capital Assets

The Corporation's investment in capital assets as of December 31, 2009, amounts to \$269,661,000 (net of accumulated depreciation). This investment in capital assets includes buildings, improvements, and equipment. The total decrease in the Corporation's investment in



capital assets for the current fiscal year was 1.70 percent, and is due to the year's depreciation of Hotel assets.

The Corporation's investment in capital assets as of December 31, 2008, amounts to \$274,332,000 (net of accumulated depreciation). This investment in capital assets includes buildings, improvements, and equipment. The total increase in the Corporation's investment in capital assets for the current fiscal year was 33 percent and is due to the completion of the construction of the Hotel.

### Changes in Net Assets

#### Summary of changes in net assets (in thousands):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Hotel operating revenues	\$ 49,378	\$ 7,866	\$ -
Investment income	507	1,123	2,519
Other	-	18	-
Contributions	-	-	5,000
Total revenues	<u>49,885</u>	<u>9,007</u>	<u>7,519</u>
Hotel operating expenses	42,941	8,822	-
Pre-opening expenses	-	5,527	2,136
Debt issuance costs	626	626	626
Trustee fees	16	300	19
Interest on long-term debt	17,148	4,406	641
Total expenses	<u>60,731</u>	<u>19,681</u>	<u>3,422</u>
Increase (decrease) in net assets	<u>(10,846)</u>	<u>(10,674)</u>	<u>4,097</u>
Ending net assets (deficit)	<u>\$ (18,404)</u>	<u>\$ (7,558)</u>	<u>\$ 3,116</u>

The decrease in ending net assets as of December 31, 2009 is primarily due to the payment of interest on long-term debt and the depreciation of capital assets.

The decrease in ending net assets as of December 31, 2008 is primarily due to the payment of pre-opening expenses, start-up costs, and interest on long-term debt. The interest on long-term debt is no longer being capitalized due to the opening of the Hotel on October 1, 2008. After initial start-up, results of operations are expected to cover the debt service costs and recover the losses from the pre-opening and initial start-up phases.

### 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 Finance Director, City of Phoenix, Calvin C. Goode Municipal Building, Ninth Floor, 251 West Washington, Phoenix, Arizona, 85003.

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## Downtown Phoenix Hotel Corporation

### Statements of Net Assets

December 31, 2009 and 2008

(in thousands)

	<u>2009</u>	<u>2008</u>
<b>ASSETS</b>		
Current Assets		
Cash and Cash Equivalents	\$ 2,605	\$ 1,804
Accounts Receivable, Net of Allowance for Doubtful Accounts (2009, \$20 and 2008, \$3)	1,058	2,069
Inventories	247	253
Prepaid Expenses	232	247
Total Current Assets	<u>4,142</u>	<u>4,373</u>
Current Restricted Assets		
Debt Service		
Cash and Cash Equivalents	8,707	19,869
Investments	23,128	17,510
Receivables		
Accrued Interest	292	292
Operating Reserve		
Cash and Cash Equivalents	2,655	10,952
Investments	10,002	-
Capital Projects		
Cash and Cash Equivalents	10,411	12,871
Receivables		
Accrued Interest	-	51
Investments	13,560	12,996
Total Current Restricted Assets	<u>68,755</u>	<u>74,541</u>
Noncurrent Assets		
Other	98	99
Capital Assets		
Buildings	275,786	274,953
Improvements Other Than Buildings	537	537
Equipment	2,257	571
Less: Accumulated Depreciation	(8,919)	(1,729)
Total Capital Assets, Net	<u>269,661</u>	<u>274,332</u>
Total Noncurrent Assets	<u>269,759</u>	<u>274,431</u>
Total Assets	<u>342,656</u>	<u>353,345</u>

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

	<u>2009</u>	<u>2008</u>
<b>LIABILITIES</b>		
Current Liabilities Payable from Current Assets		
Accounts Payable	1,250	737
Accrued Expenses	2,445	2,041
Advance Deposits	352	421
Total Current Liabilities Payable from Current Assets	<u>4,047</u>	<u>3,199</u>
Current Liabilities Payable from Restricted Assets		
Debt Service		
Interest Payable	8,706	8,706
Operating Reserve		
Accounts Payable	176	54
Capital Projects		
Accounts Payable	92	1,222
Deposits in Trust	10,302	10,348
Total Current Liabilities Payable from Restricted Assets	<u>19,276</u>	<u>20,330</u>
Noncurrent Liabilities		
Bonds Payable	350,000	350,000
Unamortized Debt Issuance Costs	(19,090)	(19,716)
Unamortized Premium	6,827	7,090
Total Noncurrent Liabilities	<u>337,737</u>	<u>337,374</u>
Total Liabilities	<u>361,060</u>	<u>360,903</u>
<b>NET ASSETS (DEFICIT)</b>		
Invested In Capital Assets, Net of Related Debt	(8,919)	(1,729)
Restricted for Debt Service	31,835	37,379
Restricted for Capital Projects	23,971	25,868
Unrestricted	(65,291)	(69,076)
Net Deficit	<u>\$ (18,404)</u>	<u>\$ (7,558)</u>

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

For the Fiscal Years Ended December 31, 2009 and 2008  
(in thousands)

	<u>2009</u>	<u>2008</u>
Operating Revenues		
Rooms	\$ 29,567	\$ 4,129
Food and Beverage	16,603	3,406
Other	3,208	331
Total Operating Revenues	<u>49,378</u>	<u>7,866</u>
Operating Expenses		
Rooms	7,248	1,229
Food and Beverage	12,386	2,847
General and Administrative Costs	14,559	3,017
Depreciation	7,190	1,729
Pre-Opening Expenses	-	5,527
Debt Issuance Costs	626	626
Trustee Fees	16	-
Other	1,558	300
Total Operating Expenses	<u>43,583</u>	<u>15,275</u>
Operating Income (Loss)	5,795	(7,409)
Non-Operating Revenues (Expenses)		
Investment Income		
Net Decrease in Fair Value of Investments	(456)	(133)
Interest	963	1,256
Interest on Capital Debt	(17,148)	(4,406)
Other	-	18
Total Non-Operating Expenses	<u>(16,641)</u>	<u>(3,265)</u>
Change in Net Assets	(10,846)	(10,674)
Net Assets (Deficit), January 1	<u>(7,558)</u>	<u>3,116</u>
Net Deficit, December 31	<u>\$ (18,404)</u>	<u>\$ (7,558)</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, 2009 and 2008  
(in thousands)

	<b>2009</b>	<b>2008</b>
Cash Flows from Operating Activities		
Cash Received from Customers	\$ 50,321	\$ 6,217
Payments to Suppliers	(20,149)	(7,702)
Payment of Staff and Administrative Expenses	(14,559)	(3,018)
Net Cash Provided (Used) by Operating Activities	<u>15,613</u>	<u>(4,503)</u>
Cash Flows from Capital and Related Financing Activities		
Interest Paid on Capital Debt	(17,412)	(17,412)
Receipt of Deposits Held in Trust	3	-
Return of Deposits Held in Trust	(48)	(172)
Acquisition and Construction of Capital Assets	(3,649)	(66,532)
Net Cash Used by Capital and Related Financing Activities	<u>(21,106)</u>	<u>(84,116)</u>
Cash Flows from Investing Activities		
Purchases of Investment Securities	(33,856)	-
Proceeds from Sales and Maturities of Investment Securities	17,217	16,039
Interest on Investments	1,014	4,929
Net Cash Provided (Used) by Investing Activities	<u>(15,625)</u>	<u>20,968</u>
Net Decrease in Cash and Cash Equivalents	<u>(21,118)</u>	<u>(67,651)</u>
Cash and Cash Equivalents, January 1	45,496	113,147
Cash and Cash Equivalents, December 31	<u>\$ 24,378</u>	<u>\$ 45,496</u>
Reconciliation of Operating Loss to		
Net Cash Provided (Used) by Operating Activities		
Operating Income (Loss)	\$ 5,795	\$ (7,409)
Adjustments		
Depreciation	7,190	1,729
(Increase) Decrease in Assets		
Accounts Receivable	1,012	(2,069)
Inventories	4	(253)
Prepaid Expenses	15	(247)
Other Non-Current Assets	1	(99)
Increase (Decrease) in Liabilities		
Accounts Payable	635	757
Accrued Expenses	403	2,041
Advance Deposits	(68)	421
Unamortized Debt Issuance Costs	626	626
Net Cash Provided (Used) by Operating Activities	<u>\$ 15,613</u>	<u>\$ (4,503)</u>
Noncash Transactions Affecting Financial Position		
Decrease in Fair Value of Investments	\$ (456)	\$ (133)
Total Noncash Transactions Affecting Financial Position	<u>\$ (456)</u>	<u>\$ (133)</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, 2009 and 2008

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. The hotel began operations in October 2008.

**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 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, 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 Assets; Statements of Revenues, Expenses and Changes in Net Assets; 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 as well as long-term debt and obligations. 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 Assets report all financial resources of the entity and are displayed in a format of assets less liabilities equals net assets, with the assets and liabilities shown in order of their relative liquidity. Net assets are displayed in two components: 1) restricted and 2) unrestricted. Restricted net assets 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 net assets not otherwise classified 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 assets are available. Reservations or designations of net assets imposed by the reporting entity, whether by administrative policy or legislative actions of the reporting entity, are not shown on the

**DOWNTOWN PHOENIX HOTEL CORPORATION**  
**An Arizona Nonprofit Corporation**  
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**NOTES TO THE FINANCIAL STATEMENTS**  
For the Fiscal Years Ended December 31, 2009 and 2008

accompanying financial statements.

The Statements of Revenues, Expenses and Changes in Net Assets present information showing how the Corporation's net assets changed during the most recent fiscal year. All changes in net assets 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, 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 applicable Financial Accounting Standards Board pronouncements issued prior to November 30, 1989, and 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.

**d. 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*."

**e. 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.

**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.

**DOWNTOWN PHOENIX HOTEL CORPORATION**  
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**NOTES TO THE FINANCIAL STATEMENTS**  
For the Fiscal Years Ended December 31, 2009 and 2008

**g. Inventories**

Inventory includes 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

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

**i. Long-Term Obligations**

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

**DOWNTOWN PHOENIX HOTEL CORPORATION**  
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**NOTES TO THE FINANCIAL STATEMENTS**  
For the Fiscal Years Ended December 31, 2009 and 2008

**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>2009</u>	<u>2008</u>
Cash	\$ 2,605	\$ 1,804
Short-term money market accounts	21,773	31,206
Short-term investments	-	12,486
Total Cash and Cash Equivalents	<u>\$ 24,378</u>	<u>\$ 45,496</u>

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

	<u>2009</u>		
	<b>Credit Quality Rating</b>	<b>Fair Value</b>	<b>Weighted Average Maturity (Years)</b>
U.S. Government Agency Securities			
FHLMC Notes	AAA	\$ 46,690	0.625
Total U.S. Government Agency Securities		<u>46,690</u>	
Total Investments		<u>\$ 46,690</u>	0.625

	<u>2008</u>		
Guaranteed Investment Contracts collateralized by U.S. Treasury Securities	Not Rated	\$ 12,486	0.003
U.S. Government Agency Securities			
FNMA Notes	AAA	17,337	0.375
FHLMC Notes	AAA	13,169	2.078
Total U.S. Government Agency Securities		<u>30,506</u>	
Total Investments		42,992	0.789
Less: Short-Term Investments		<u>(12,486)</u>	
Net Investments		<u>\$ 30,506</u>	

**DOWNTOWN PHOENIX HOTEL CORPORATION**  
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**NOTES TO THE FINANCIAL STATEMENTS**  
For the Fiscal Years Ended December 31, 2009 and 2008

**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 securities issued by the U.S. Government Agency Securities which carry long-term AAA ratings from both rating organizations.

**Concentration of Credit Risk**

Investments in any one issuer that represent 5% or more of total Corporation investments at fair value as of December 31 are as follows (in thousands).

<u>Issuer</u>	<u>Investment Type</u>	<u>2009</u>	<u>2008</u>
FNMA	U.S. Government Agency Securities	\$ -	\$ 17,337
FHLMC	U.S. Government Agency Securities	46,690	13,169

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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>2009</u>				
Depreciable assets:				
Buildings	\$ 274,953	\$ 833	\$ -	\$ 275,786
Improvements	537	-	-	537
Equipment	571	1,686	-	2,257
Total depreciable assets	276,061	2,519	-	278,580
Less accumulated depreciation for:				
Buildings	(1,711)	(6,903)	-	(8,614)
Improvements	(9)	(36)	-	(45)
Equipment	(9)	(251)	-	(260)
Total accumulated depreciation	(1,729)	(7,190)	-	(8,919)
Total depreciable assets, net	274,332	(4,671)	-	269,661
Capital assets, at cost, net	<u>\$ 274,332</u>	<u>\$ (4,671)</u>	<u>\$ -</u>	<u>\$ 269,661</u>
<u>2008</u>				
Non-depreciable assets:				
Construction-in-Progress	\$ 205,765	\$ 69,074	\$ (274,839)	\$ -
Depreciable assets:				
Buildings	-	274,953	-	274,953
Improvements	-	537	-	537
Equipment	-	571	-	571
Total depreciable assets	-	276,061	-	276,061
Less accumulated depreciation for:				
Buildings	-	(1,711)	-	(1,711)
Improvements	-	(9)	-	(9)
Equipment	-	(9)	-	(9)
Total accumulated depreciation	-	(1,729)	-	(1,729)
Total depreciable assets, net	-	274,332	-	274,332
Capital assets, at cost, net	<u>\$ 205,765</u>	<u>\$ 343,406</u>	<u>\$ (274,839)</u>	<u>\$ 274,332</u>

There was no capitalized interest in fiscal year 2009. The Corporation capitalized interest totaling \$9,400,134 in fiscal year 2008.



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**4. Bonds Payable**

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. Series 2005A and 2005B bonds maturing on or after July 1, 2016 are subject to redemption at the option of the Corporation, in whole or in part on any date on or after January 1, 2016. The Series 2005C bonds are subject to redemption at the option of the Corporation, in whole or in part on any date.

Debt service requirements, including principal and interest are as follows (in thousands).

Fiscal Year Ending December 31	Principal	Interest	Total
<b>Senior Revenue Bonds, Series 2005A</b>			
2010	\$ -	\$ 7,800,075	\$ 7,800,075
2011	-	7,800,075	7,800,075
2012	1,470,000	7,763,325	9,233,325
2013	1,635,000	7,685,700	9,320,700
2014	1,810,000	7,599,575	9,409,575
2015-2019	12,040,000	36,389,469	48,429,469
2020-2024	17,740,000	33,021,450	50,761,450
2025-2029	25,650,000	27,500,881	53,150,881
2030-2034	35,810,000	19,845,000	55,655,000
2035-2039	48,890,000	9,323,250	58,213,250
2040	11,665,000	291,625	11,956,625
	<u>\$ 156,710,000</u>	<u>\$ 165,020,425</u>	<u>\$ 321,730,425</u>

Coupon rates	<u>4.0 - 5.25%</u>
Effective interest rate	<u>5.29%</u>

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Fiscal Year Ending December 31	Principal	Interest	Total
<b>Subordinate Revenue Bonds, Series 2005B</b>			
2010	\$ -	\$ 8,102,069	\$ 8,102,069
2011	-	8,102,069	8,102,069
2012	-	8,102,069	8,102,069
2013	-	8,102,069	8,102,069
2014	-	8,102,069	8,102,069
2015-2019	905,000	40,491,678	41,396,678
2020-2024	25,515,000	37,412,081	62,927,081
2025-2029	32,445,000	30,327,850	62,772,850
2030-2034	41,050,000	21,458,750	62,508,750
2035-2039	52,405,000	9,831,875	62,236,875
2040	12,105,000	302,625	12,407,625
	<u>\$ 164,425,000</u>	<u>\$ 180,335,203</u>	<u>\$ 344,760,203</u>

Coupon rates	<u>4.125 - 5.0%</u>
Effective interest rate	<u>5.09%</u>

**Subordinate Revenue Bonds, Taxable Series 2005C**

2010	\$ -	\$ 1,509,485	\$ 1,509,485
2011	-	1,509,485	1,509,485
2012	3,095,000	1,430,098	4,525,098
2013	3,255,000	1,266,733	4,521,733
2014	3,420,000	1,094,005	4,514,005
2015-2019	19,095,000	2,534,896	21,629,896
	<u>\$ 28,865,000</u>	<u>\$ 9,344,701</u>	<u>\$ 38,209,701</u>

Coupon rates	<u>5.13 - 5.31%</u>
Effective interest rate	<u>5.67%</u>

**Total Debt Service Requirements**

2010	\$ -	\$ 17,411,629	\$ 17,411,629
2011	-	17,411,629	17,411,629
2012	4,565,000	17,295,492	21,860,492
2013	4,890,000	17,054,501	21,944,501
2014	5,230,000	16,795,648	22,025,648
2015-2019	32,040,000	79,416,043	111,456,043
2020-2024	43,255,000	70,433,531	113,688,531
2025-2029	58,095,000	57,828,731	115,923,731
2030-2034	76,860,000	41,303,750	118,163,750
2035-2039	101,295,000	19,155,125	120,450,125
2040	23,770,000	594,250	24,364,250
	<u>\$ 350,000,000</u>	<u>\$ 354,700,329</u>	<u>\$ 704,700,329</u>

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**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 a ground lease dated as of December 1, 2005, between the City and the Corporation, the City will lease the Site and the Hotel to be constructed thereon to the Corporation. The term of the ground lease commenced as of the date of issuance of the Series 2005 Bonds and will terminate on December 1, 2040, or such later date as of which no Series 2005 Bonds or additional bonds maturing on or prior to December 1, 2040, are outstanding. The City may not terminate the ground lease for any reason prior to the end of the term of the ground lease. Under the ground lease, the Corporation will make lease payments to the City in the aggregate amount of \$3,600,000 (for amounts paid to acquire the Site and other related expenditures made by the City prior to the issuance of the Series 2005 Bonds) at the times and solely from amounts available for such purpose in the City Payments Account of the Excess Revenue Fund.

The Corporation paid the City \$81,194 in fiscal year 2008 for permits, plan reviews and other construction related work performed by the City's Engineering and Architectural Services staff. There were no monies paid to the City in fiscal year 2009 for construction related work. The City performs and absorbs significantly all administrative functions and costs on behalf of the Corporation.

**6. Deposit in Trust**

On the date of issuance of the Series 2005A Bonds, the City deposited \$10,300,000 to the Senior Special Debt Service Reserve Fund. The City will be repaid by the Corporation from the first amounts deposited to the Excess Revenue Fund.

**7. Commitments and Contingencies**

The Corporation has entered into a contract with Starwood Hotels and Resorts Management Company to operate the Hotel. The Operating Agreement covers the first fifteen years of operations and includes a base management fee of \$1.2 million in the initial year of operations and increasing to \$3.16 million by the fifteenth year. Per the Operating Agreement all Hotel Personnel are employees of Starwood, and not the Corporation.

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.

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**8. 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 Starwood 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 totaled \$193,534 in 2009 and \$21,160 in 2008.

**9. Net Assets**

To the extent that they are not used for capital project expenditures, the net assets restricted for capital projects will be moved to other restricted categories per the indenture of trust agreement.

**10. Subsequent Events**

**Bond Rating Agency Update**

In March 2010, Standard & Poor's Ratings Services (S&P) affirmed its BBB- rating for the Senior Revenue Bonds (Series 2005A) and revised the outlook to negative from stable. The Subordinate Revenue Bonds (Series 2005B) maintained an A- rating and stable outlook.

S&P's report discussed rating concerns and mitigating factors. The project has sufficient liquidity with a cash-funded Senior Debt Service Reserve equal to \$12.2 million, or maximum annual debt service. The project also has an Operating Reserve of \$10 million and a Special Debt Service Reserve of \$10.3 million.

S&P indicated that the Senior Revenue Bonds' rating could be lowered if the senior debt service coverage ratio (DSCR), based on hotel net revenues, is lower than 1.7x as a result of a prolonged economic slowdown or other competitive factors that reduce net hotel revenues for more than one year. The outlook could be changed to stable if the operating and financial performance generates a DSCR in excess of 1.7x for more than two years.

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**Hotel Unionization**

As part of the development process of the Hotel, the City of Phoenix, Arizona entered into a neutrality agreement with UNITE HERE, a union representing workers in the garment, textile and hospitality industries in the United States and Canada. The agreement allowed the union, upon the opening of the Hotel, to approach employees regarding unionization. UNITE HERE was successful in obtaining the requisite number of signatures to unionize the affected departments of the Hotel and entered into negotiations for a collective bargaining agreement with the Hotel Operator Starwood Hotels & Resorts Management Company, Inc. (Starwood). The collective bargaining agreement between Starwood and UNITE HERE Local 631 was finalized and signed on March 23, 2010. The agreement is retroactive to October 9, 2009, and extends through September 30, 2014, a five-year term.

The estimated financial impact of the agreement on the Hotel's 2010 operating budget is \$290,000, or approximately 0.66% of 2009 operating expenditures.