

***PACIFIC HOSPITAL PRESERVATION
AND DEVELOPMENT AUTHORITY***

Financial Statements

For the Years Ended December 31, 2012 and 2011

Table of Contents

	<i>Page</i>
Independent Auditors' Report	1 - 2
Management's Discussion and Analysis	3 - 7
Financial Statements:	
Balance Sheets	8
Statements of Revenues, Expenses, and Changes in Net Position	9
Statements of Cash Flows	10
Notes to Financial Statements	11 - 16

Independent Auditors' Report***To the Governing Council
Pacific Hospital Preservation and Development Authority
Seattle, Washington***

We have audited the accompanying financial statements of the Pacific Hospital Preservation and Development Authority (the Pacific Hospital PDA), as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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 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 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 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 Pacific Hospital PDA as of December 31, 2012 and 2011, and its change in net position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

CLARK NUBER

Report on Management's Discussion and Analysis

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 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.

Clark Nuber P.S.

Certified Public Accountants

June 11, 2013

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Management's Discussion and Analysis For the Years Ended December 31, 2012 and 2011

Management's Discussion and Analysis (MD&A) presents a narrative overview and analysis of the financial activities of the Pacific Hospital Preservation and Development Authority (the Pacific Hospital PDA) for the years ended December 31, 2012 and 2011. The MD&A is designed to assist readers of financial statements in focusing on significant financial activities and issues and to identify any significant changes. As this information is presented in summary form, it should be read in conjunction with the financial statements as a whole.

The Authority

The Pacific Hospital PDA is a public development authority established under Seattle Municipal Code 3.110 and a 501(c)(3) organization. Pursuant to Revenue Procedure 95-48, the Pacific Hospital PDA is not required to file a Form 990. The mission of the Pacific Hospital PDA is to champion effective health care for the vulnerable and disadvantaged in the Puget Sound area, with an emphasis on the Seattle-King County region. The Pacific Hospital PDA works to close gaps in health care access.

In 1981, the City of Seattle chartered the Pacific Hospital PDA, placing in its trust the U.S. Public Health Service Hospital and its campus. Subsequently, the property was designated a historic Seattle landmark. The Pacific Hospital PDA currently leases out the property and the lease revenues are used to support effective health care for the vulnerable residents of Seattle-King County.

The Pacific Hospital PDA is overseen by a nine-member Governing Council. Four members are appointed by the Mayor of Seattle, one by the King County Executive, and four by the Pacific Hospital PDA's Governing Council. The Seattle City Council confirms all appointments.

The Pacific Hospital PDA has the following goals:

- To decrease disparities in access to health resources for the Puget Sound's vulnerable populations.
- To improve the health outcomes of vulnerable populations by increasing the capability of the health care system.
- To improve the long-term financial stability and grant-making capacity of the Pacific Hospital PDA while advancing both the value of the property and its benefit to the community.

Overview of the Financial Statements

The Pacific Hospital PDA's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America as applied to special-purpose governments involved in business-type activities. The accompanying financial statements cover the years ended December 31, 2012 and 2011.

The balance sheet, statement of revenues, expenses, and changes in net position, and statement of cash flows provide an indication of the Pacific Hospital PDA's financial health. The balance sheet includes all of the Pacific Hospital PDA's assets and liabilities, using the accrual basis of accounting. The statement of revenues, expenses, and changes in net position report all of the revenues and expenses during the time period indicated.

Lease payments comprise the primary revenue source for the Pacific Hospital PDA. The Pacific Hospital PDA uses lease monies to fund health care services and programs for the vulnerable residents of King County. In 1998, the Pacific Hospital PDA entered into a lease with WRC.Com Tower LLC for the former Pacific Medical

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Management's Discussion and Analysis For the Years Ended December 31, 2012 and 2011

Overview of the Financial Statements (Continued)

Center hospital building known as the "Tower." An additional lease agreement with WRC.Com Development LLC was signed for the north parking lot area. The leases include renewal clauses which, if exercised, would extend the lease for 149 years from the commencement date. During the year ended December 31, 2012, WRC.Com Tower LLC defaulted on the lease agreement for the Tower and on September 30, 2012, the Pacific Hospital PDA, WRC.Com Tower LLC, and Wright Runstad entered into a formal lease termination agreement ending the long-term lease for the Tower building. Since October 1, 2012, the Pacific Hospital PDA is currently searching for a new tenant for the space previously occupied by WRC.Com Tower LLC. The lease agreement with WRC.Com Development LLC remains in effect. The Pacific Hospital PDA also has a lease agreement, through November 2021, with PacMed Clinics (doing business as Pacific Medical Centers (PMC)) for the campus' "Quarters" buildings, the east parking structure, and the ground floor and basement of the Tower (where a medical clinic is located). All leases are triple net leases and, under the terms of these leases, the lessees fully reimburse the Pacific Hospital PDA for their proportionate share of leasehold excise taxes, property taxes, and other costs. Both the revenues and expenses for these taxes are reflected in Table A-2.

A second revenue source for the Pacific Hospital PDA is a grant from the Washington State Health Care Authority (HCA, previously administered by the Department of Social and Health Services or DSHS) for interpreter services to Medicaid patients with limited English proficiency or hearing impairment. This funding is provided under the Federal Medicaid Administrative Match Program. The Pacific Hospital PDA sub-contracts with PMC to provide these services. The current contract with HCA extends through June 2016 and the sub-contract with PMC extends through June 30, 2013, with an extension being negotiated as of the report date. Under the PHPDA-HCA agreement, the Pacific Hospital PDA matches the federal Medicaid monies.

Financial Analysis and Highlights

Summaries of financial information of the Pacific Hospital PDA for the years ended December 31, 2012, 2011, and 2010, are presented in the tables below.

Table A-1 Balance Sheets

	<i>As of December 31,</i>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Current assets	\$ 3,368,064	\$ 2,899,889	\$ 1,937,146
Capital assets, net	11,070,904	11,914,753	12,809,584
Noncurrent assets	200,000	200,000	200,000
Total Assets	14,638,968	15,014,642	14,946,730
Current Liabilities	190,784	480,646	736,067
Invested in capital assets, net of related debt	\$ 11,070,904	\$ 11,914,753	\$ 12,809,584
Unrestricted	3,377,280	2,619,243	1,401,079
Total Net Position	\$ 14,448,184	\$ 14,533,996	\$ 14,210,663

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

**Management's Discussion and Analysis
For the Years Ended December 31, 2012 and 2011**

Financial Analysis and Highlights (Continued)

There is \$6,692 in grants receivable under current assets. This represents grant payments from HCA for 2012 Interpreter Service payments, which will be received in 2013. The other current assets consist of \$762 in cash and cash equivalents, \$3,156,010 in short-term investments, \$118,809 in other current assets, and \$85,791 in tenant receivables. Noncurrent assets represent \$200,000 of reserve funds held in demand deposits.

As of December 31, 2012, the largest components of current liabilities include \$55,208 for pre-paid rent, \$34,203 for fourth quarter taxes, \$21,119 to the City of Seattle for utilities, and \$12,892 in accounts payable to PMC for interpreter services for 2012.

Table A-2 Statements of Revenues, Expenses, and Changes in Net Position

	<i>For the Years Ended December 31,</i>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Rent revenue	\$ 2,077,396	\$ 2,950,693	\$ 2,943,424
Grant revenue	47,150	111,633	85,661
Other revenue	29,616	1,664	1,127
Total Operating Revenues	2,154,162	3,063,990	3,030,212
Tower operating expenses	369,735		
Charity care contributions and grants	214,929	923,739	2,010,879
Interpreter services	90,173	199,966	163,737
General operating expenses	730,810	730,808	695,367
Total Operating Expenses	1,405,647	1,854,513	2,869,983
Operating Income Before Depreciation	748,515	1,209,477	160,229
Depreciation	843,849	894,831	961,379
Operating Income (Loss)	(95,334)	314,646	(801,150)
Nonoperating revenues	9,522	8,687	9,817
Change in Net Position	(85,812)	323,333	(791,333)
Net position, beginning of year	14,533,996	14,210,663	15,001,996
Net Position, End of Year	\$ 14,448,184	\$ 14,533,996	\$ 14,210,663

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Management's Discussion and Analysis For the Years Ended December 31, 2012 and 2011

Financial Analysis and Highlights (Continued)

The Pacific Hospital PDA has two long term leases with annual lease payments of \$1,057,152. The North Lot lease increased to \$17,592 per month in late 2012 with an annual payment of \$211,104 (the previous rate was \$17,300 per month). The PMC lease is \$70,504 per month with an annual lease payment of \$846,048. At the time of the default, the Tower base lease was \$128,850 per month. Five months of lease payments were received before the default.

The tenants have triple net leases, under the terms of which the lessees fully reimburse the Pacific Hospital PDA for leasehold excise taxes and property taxes. The fiscal year 2012 rent revenue includes \$218,188 in leasehold excise taxes and \$9,923 in property tax payments. Also included are payments related to the tenants' shares of costs associated with the operations of the Tower building and grounds.

HCA Interpreter Services grant revenues for 2012 were lower than 2011. This is due to a combination of two factors: fewer Medicaid Limited English Proficient patients seen by PMC (the Pacific Hospital PDA's subcontractor) and use of interpreting services not covered by the contract (video and phone interpreters) by PMC. The 2012 grant was \$47,150, compared to \$111,633 in 2011, a decrease of 58% or \$64,483.

The Pacific Hospital PDA operating expenses before depreciation totaled \$1,405,647 for 2012.

The Pacific Hospital PDA's grant expenses of \$214,929 represent payments to Project Access Northwest (PANW), and to a partnership of several Washington State health funders.

The Pacific Hospital PDA's grant to PANW for medical case management totaled \$150,000 in 2012. In 2011, the Pacific Hospital PDA entered into a partnership with the Seattle-King County Dental Society (SKCDS) and the Seattle-King County Dental Foundation (SKCDF) to provide specialty dental care to uninsured patients, with each partner responsible to fund a different portion of the project. The Pacific Hospital PDA provided a \$51,000 grant to PANW to fund dental case management from May 2011 through April 2012, of which \$17,000 was expended for program costs in 2012. The Pacific Hospital PDA renewed the grant for May 2012 through April 2013 for \$68,143, of which \$45,429 was expended in 2012. As such, total grants awarded from the Pacific Hospital PDA to PANW were \$212,429 for 2012.

In 2012, the Pacific Hospital PDA expended \$90,173 for interpreter services. The contract for services to Pacific Medical Centers was \$89,037. Also reflected in the 2012 interpreter services expenses is a \$1,136 administrative fee paid to HCA. HCA invoices the Pacific Hospital PDA for these expenses, as it did in 2011. This fee is determined by totaling all administrative costs of HCA staff accrued for a certain billing period and dividing that total by the number of contractors that submitted billings.

Interest income was \$9,522 in 2012 compared to \$8,687 in 2011. This increase is due to improved interest rates paid on some investments as well as interest earned on a larger dollar amount of investments from the prior year.

The Pacific Hospital PDA uses the straight-line method of depreciation. In fiscal year 2012 depreciation expense was \$843,849.

The Pacific Hospital PDA approached cash expenditures in a conservative manner, and ended all years with unexpended funds. Due to taking over the operations of the Tower and the related expenses not covered by PMC, the Pacific Hospital PDA ended 2012 with a negative change in net position.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Management's Discussion and Analysis For the Years Ended December 31, 2012 and 2011

Budgetary Integrity, Accounting Systems, and Internal Controls

In the year ended December 31, 2012, operating expenses and revenues were under budget.

Budgetary control is exercised with each major type of expenditure with budget-to-actual performance being reported monthly to the Finance Committee of the Pacific Hospital PDA Governing Council and quarterly to the entire Governing Council. These financial reports include narrative description and explanation of significant deviations between actual expenses and the budget. On a quarterly basis, the Finance Committee also reviews the check register, all credit card expenditures, retirement plan contributions, and employment tax payments.

Capital Asset Activity

The Pacific Hospital PDA had no additions to capital assets during 2012.

The Pacific Hospital PDA has established two designated reserve funds. As of December 31, 2012, the Operating and Maintenance Reserve Funds were \$100,000 each. As of December 31, 2012, these reserve funds were held in a demand deposit account.

Additional Information

Questions and inquires may be directed to the Pacific Hospital Preservation and Development Authority, 1200 12th Avenue South, Quarters 2, Seattle, WA 98144, (206) 325-1357.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Balance Sheets
December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Assets		
Cash and cash equivalents	\$ 762	\$ 432,880
Short-term investments	3,156,010	2,342,939
Grants receivable	6,692	21,693
Tenant receivables	85,791	83,455
Other current assets	118,809	18,922
Total Current Assets	3,368,064	2,899,889
Reserve funds	200,000	200,000
Capital assets, net	11,070,904	11,914,753
Total Assets	\$ 14,638,968	\$ 15,014,642
Liabilities		
Accounts payable and accrued expenses	\$ 135,576	\$ 135,142
Deferred revenue	55,208	345,504
Total Liabilities	190,784	480,646
Net Position		
Invested in capital assets, net of related debt	11,070,904	11,914,753
Unrestricted	3,377,280	2,619,243
Total Net Position	14,448,184	14,533,996
Total Liabilities and Net Position	\$ 14,638,968	\$ 15,014,642

See accompanying notes.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

**Statements of Revenues, Expenses and Changes in Net Position
For the Years Ended December 31, 2012 and 2011**

	<u>2012</u>	<u>2011</u>
Operating Revenues:		
Rent revenue	\$ 2,077,396	\$ 2,950,693
Grant revenue	47,150	111,633
Other revenue	29,616	1,664
	<u>2,154,162</u>	<u>3,063,990</u>
Total Operating Revenues	2,154,162	3,063,990
Operating Expenses:		
Tower operating costs	369,735	
Charity care contributions and grants	214,929	923,739
Interpreter services	90,173	199,966
Other administrative costs	272,458	401,678
Salaries and benefits	243,198	193,822
Professional fees	215,154	135,308
	<u>1,405,647</u>	<u>1,854,513</u>
Total Operating Expenses	1,405,647	1,854,513
Operating Income Before Depreciation	748,515	1,209,477
Depreciation	843,849	894,831
	<u>(95,334)</u>	<u>314,646</u>
Operating (Loss) Income	(95,334)	314,646
Nonoperating Revenues:		
Interest income	9,522	8,687
	<u>(85,812)</u>	<u>323,333</u>
Change in Net Position	(85,812)	323,333
Net position, beginning of year	14,533,996	14,210,663
	<u>14,533,996</u>	<u>14,210,663</u>
Net Position, End of Year	\$ 14,448,184	\$ 14,533,996

See accompanying notes.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Statements of Cash Flows

For the Years Ended December 31, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities:		
Receipts from rent and grants	\$ 1,776,644	\$ 3,149,237
Payments to suppliers and others	(1,166,839)	(1,985,745)
Payments to employees for services	<u>(238,374)</u>	<u>(195,118)</u>
Net Cash Provided by Operating Activities	371,431	968,374
Cash Flows from Investing Activities:		
Net purchase of investments	(813,071)	(1,053,138)
Receipts of investment income	<u>9,522</u>	<u>8,687</u>
Net Cash Used in Investing Activities	<u>(803,549)</u>	<u>(1,044,451)</u>
Net Change in Cash and Cash Equivalents	(432,118)	(76,077)
Cash and equivalents balance, beginning of year	<u>432,880</u>	<u>508,957</u>
Cash and Equivalents Balance, End of Year	<u>\$ 762</u>	<u>\$ 432,880</u>
Reconciliation of Operating (Loss) Income to Net Cash Provided by Operating Activities:		
Operating (loss) income	\$ (95,334)	\$ 314,646
Adjustment to reconcile operating (loss) income to net cash provided by operating activities-		
Depreciation	843,849	894,831
Change in assets and liabilities:		
Grants receivable	15,001	30,778
Tenant receivables	(2,336)	(164)
Other current assets	(99,887)	(16,296)
Accounts payable and accrued expenses	434	(326,350)
Deferred revenue	<u>(290,296)</u>	<u>70,929</u>
Net Cash Provided by Operating Activities	<u>\$ 371,431</u>	<u>\$ 968,374</u>

See accompanying notes.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 1 - Operations and Summary of Significant Accounting Policies

Operations - The Pacific Hospital Preservation and Development Authority (the Pacific Hospital PDA) is organized as a public development authority pursuant to RCW 35.21.730 and by charter of the City of Seattle (the City), and is also a 501(c)(3) not-for-profit organization. The mission of the Pacific Hospital PDA is to champion effective health care for the vulnerable and disadvantaged in the Puget Sound community with an emphasis on the Seattle-King County region.

The Pacific Hospital PDA is governed by a nine-member Governing Council. Four members are appointed by the Mayor of Seattle, one by the King County Executive, and four by the Pacific Hospital PDA Council. The Seattle City Council confirms all appointments. The Pacific Hospital PDA is legally separate from the City, does not receive funds from the City, and does not impose a financial burden on, nor accrue any financial benefit to, the City. Accordingly, the Pacific Hospital PDA is not considered a component unit or related organization of the City under the definitions established by the Governmental Accounting Standards Board (GASB).

The Pacific Hospital PDA has a contract with PacMed Clinics (doing business as Pacific Medical Centers (PMC)), under which PMC provides interpreter services to Medicaid-eligible persons. PMC is reimbursed by the Pacific Hospital PDA for the cost of providing such services. The Pacific Hospital PDA has a Medicaid administrative match grant that provides 50% for adults and 75% for children of the payment to PMC (see Grants Receivable and Interpreter Services in Note 1). The current interpreter services contract with PMC expires June 30, 2013, with an extension being negotiated as of the report date.

Basis of Presentation - Financial statement presentation follows accounting principles defined for special-purpose governments involved only in business-type activities. The Pacific Hospital PDA is a government enterprise and follows all pronouncements of the GASB. These financials have been prepared using the economic resources measurement focus and the accrual basis of accounting.

Under the flow of economic resources measurement focus and accrual basis of accounting, revenues are recognized when earned and expenses are recorded when incurred when these activities are related to exchange and exchange-like activities. Expenses related to voluntary nonexchange transactions, which consist of grants made by the Pacific Hospital PDA, are recognized when eligibility requirements are met by the grantees. In addition, long-lived assets such as buildings and equipment are capitalized and depreciated over their estimated economic lives.

Use of Estimates - The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents - For purposes of reporting cash flows, the Pacific Hospital PDA considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents, except for funds held in Washington State's Local Government Investment Pool (LGIP).

The Pacific Hospital PDA's deposits are substantially covered by federal depository insurance (FDIC) or by collateral held in a multiple financial institution collateral pool administered by the Washington Public Deposit Protection Commission. The balance in the Pacific Hospital PDA's checking account may, from time to time, exceed the FDIC insurance limits throughout the year.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 1 - Continued

Grants Receivable and Interpreter Services - Receivables consist primarily of Washington State Health Care Authority (HCA) interpreter services reimbursement for expenses incurred by the Pacific Hospital PDA's subcontractor, PMC, in providing interpreter services to Medicaid-eligible persons. The reimbursement rate is 50% of expenses for Medicaid-eligible adults over 21 years of age and 75% of expenses for Medicaid-eligible children 21 years of age and younger. Interpreter services are provided for limited English speaking, deaf, deaf-blind, or hard of hearing clients who are accessing medical services covered by the Medicaid program. No administrative fee is charged to HCA by the Pacific Hospital PDA. No collateral and no allowance for uncollectible balances have been deemed necessary by management based upon the Pacific Hospital PDA's historical experience in the collection of balances due and the nature of the receivables.

Reserve Funds - The Pacific Hospital PDA has established two designated reserve funds: an Operating Reserve Fund and a Maintenance Reserve Fund. As of December 31, 2012 and 2011, the Operating and Maintenance Reserve Funds (the Funds) were each \$100,000 and are included as noncurrent reserve funds in the balance sheets. The Funds were included in the Pacific Hospital PDA's operating account at December 31, 2012 and 2011.

Capital Assets - Capital assets are stated at cost. Contributed assets are stated at fair value at the date of donation. The Pacific Hospital PDA's policy is to capitalize building, improvements, and equipment with an acquisition cost greater than \$10,000.

Capitalized assets are depreciated using the straight-line method over the following estimated useful lives:

Buildings, including certain fixed equipment	10 - 40 years
Fixed equipment	5 - 25 years
Land improvements	2 - 20 years
Major moveable equipment	5 - 20 years
Minor equipment	3 - 5 years

Deferred Revenue - Deferred revenue consists of rental payments paid in advance to the Pacific Hospital PDA by tenants.

Operating and Nonoperating Revenue and Expenses - Operating activities include rental revenues derived from leases on the Pacific Hospital PDA's capital assets, expenses associated with operating the tower, grant revenues and expenses for interpreter services, and expenses associated with the implementation and delivery of charity medical care. Nonoperating activities consist of interest income.

Federal Income Taxes - The Pacific Hospital PDA has tax exempt status under 501(c)(3), as described under section 509(a)(1) and 170(b)(1)(A)(v) of the Internal Revenue Code and, accordingly, is exempt from federal income tax on income related to its exempt purposes. Pursuant to Revenue Procedure 95-48, the Pacific Hospital PDA is not required to file a Form 990 with the Internal Revenue Service.

Reclassifications - Certain reclassifications have been made to the 2011 financial statement presentation to conform to the 2012 presentation. Net position and changes in net position are unchanged due to these reclassifications.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 2 - Investments and Reserve Funds

As of December 31, 2012 and 2011, the Pacific Hospital PDA had funds invested in the LGIP representing a fair value of \$1,789,696 and \$962,320, respectively, and are included in short-term investments in the balance sheets.

The LGIP, created by the Washington State Legislature in 1986, is managed and operated solely by the Office of the State Treasurer (OST). The State Finance Committee administers the statute that created the pool and adopts appropriate rules. The State Treasurer established the LGIP Advisory Committee to provide advice on the pool's operation. The advisory committee includes twelve members selected from active pool participants. Eight members are appointed by participant associations and four are appointed by the State Treasurer. The investment activity is guided by an investment policy, approved by the State Treasurer and operates under the standard of the prudent investor. OST operates the LGIP for investing cash in excess of daily requirements. Among the investments authorized by statute are: U.S. Treasury and agency securities, banker's acceptances, repurchase agreements, reverse repurchase agreements, commercial paper, and certificates of deposit with qualified public depositories. As the LGIP is considered a 2a7-like pool under the Securities and Exchange Commission's Investment Company Act of 1940, the Pacific Hospital PDA's investment in the LGIP is determined based on the LGIP's quoted pool share price as of the measurement date. The fair value of the Pacific Hospital PDA's position in the LGIP as of December 31, 2012 and 2011, was the same as the value of the pool shares. As the LGIP is a 2a7-like pool, the value of the pool shares are based on amortized cost.

Legal Requirements - The Pacific Hospital PDA's investment activities are governed by the Washington State law under the Revised Code of Washington (RCW), Titles 35, 39, and 43. The RCWs define the types of securities authorized as appropriate investments and the conditions for making investment transactions. Investment transactions may be conducted only through qualified depositories, certified dealers, or directly with issuers of investment securities.

Interest Rate Risk - In order to minimize interest rate risk, investment of the Pacific Hospital PDA funds in certificates of deposit will not exceed 12 months unless approved by a motion of the Finance and Audit Committee.

At December 31, 2012, the Pacific Hospital PDA had \$914,839 invested in four 12 month certificate of deposit, and \$451,475 invested in two six-month certificates of deposit, which were included in short-term investments in the balance sheets as of December 31, 2012.

At December 31, 2011, the Pacific Hospital PDA had \$229,204 invested in one 12 month certificate of deposit, \$229,345 invested in one 9 month certificate of deposit, and \$676,476 invested in three six-month certificates of deposit, which were included in short-term investments in the balance sheet as of December 31, 2011. In addition, the Pacific Hospital PDA had \$245,594 held in a money market account included in short-term investments in the balance sheets as of December 31, 2011.

Credit Risk - The Pacific Hospital PDA's general investment policy is to apply the prudent-person rule: investments are made as a prudent person would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investments.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 3 - Capital Assets

Land, buildings, and equipment activity consisted of the following for 2012:

	<u>December 31, 2011</u>	<u>Additions</u>	<u>Disposals</u>	<u>December 31, 2012</u>
Land	\$ 1,100,000	\$ -	\$ -	\$ 1,100,000
Buildings and improvements	<u>41,605,798</u>			<u>41,605,798</u>
	42,705,798			42,705,798
Less accumulated depreciation	<u>(30,791,045)</u>	<u>(843,849)</u>		<u>(31,634,894)</u>
	<u>\$ 11,914,753</u>	<u>\$ (843,849)</u>	<u>\$ -</u>	<u>\$ 11,070,904</u>

Land, buildings, and equipment activity consisted of the following for 2011:

	<u>December 31, 2010</u>	<u>Additions</u>	<u>Disposals</u>	<u>December 31, 2011</u>
Land	\$ 1,100,000	\$ -	\$ -	\$ 1,100,000
Buildings and improvements	<u>41,605,798</u>			<u>41,605,798</u>
	42,705,798			42,705,798
Less accumulated depreciation	<u>(29,896,214)</u>	<u>(894,831)</u>		<u>(30,791,045)</u>
	<u>\$ 12,809,584</u>	<u>\$ (894,831)</u>	<u>\$ -</u>	<u>\$ 11,914,753</u>

A significant portion of capital assets of the Pacific Hospital PDA were committed under operating leases (see Note 4) at December 31, 2012 and 2011. The capital assets were assigned to the Pacific Hospital PDA in 1981 from the United States Government via a Quitclaim Deed. The Quitclaim Deed, and subsequent modification, requires the Pacific Hospital PDA to apply the net proceeds from the lease of its capital assets to the costs incurred in connection with the Pacific Hospital PDA's Community Healthcare Mission. The requirement expires November 24, 2021.

During the year ended December 31, 2012, the Pacific Hospital PDA assumed the capital assets previously controlled by WRC.Com Tower LLC due to the WRC.Com Tower LLC defaulting on the lease agreement with the Pacific Hospital PDA. These assets were recorded in the Pacific Hospital PDA's accounting system with a \$0 net book value.

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 4 - Operating Leases

The Pacific Hospital PDA leased virtually all of its Beacon Hill property to three entities- WRC.Com Tower LLC, WRC.Com Development LLC, and Pacific Medical Centers (PMC).

Starting in 1998, the Pacific Hospital PDA leases the Beacon Hill Tower and an adjacent parking lot to WRC.com Tower LLC and WRC.Com Development LLC, respectively. The leases include renewal clauses which, if exercised, would extend the lease for 149 years after the commencement dates. The leases describe the timing and methodology of lease rate adjustments. During the year ended December 31, 2012, WRC.Com Tower LLC defaulted on the lease agreement with the Pacific Hospital PDA and the agreement was subsequently terminated. Effective October 1, 2012, the Pacific Hospital PDA assumed the responsibilities for operating the Beacon Hill Tower.

The Pacific Hospital PDA leases space on the Beacon Hill property to PMC under a lease agreement that expires in 2021. Annual lease payments are approximately \$846,000, and will be renegotiated for the change in the CPI during 2015.

The Pacific Hospital PDA leases an adjacent parking lot on the Beacon Hill property to WRC.Com Development LLC under a 99 year lease agreement with renewal clauses which, if exercised, would extend the lease for 149 years after the commencement date. Annual lease payments are approximately \$211,000 with annual CPI adjustments.

Under the terms of these leases, the lessees fully reimburse the Pacific Hospital PDA for leasehold excise taxes and property taxes. Leasehold excise taxes collected from the lessees and remitted to the Washington State Department of Revenue were approximately \$218,000 and \$333,000 for the years ended December 31, 2012 and 2011, respectively. Property taxes collected from the lessees and remitted to King County approximated \$10,000 and \$18,000 for the years ended December 31, 2012 and 2011, respectively. Reimbursements for leasehold excise taxes and property taxes are included in rent revenue in the statements of revenues, expenses, and changes in net position.

Annual lease revenues from WRC.com Tower LLC and WRC.Com Development LLC represented 44% and 65% of total revenue the years ended December 31, 2012 and 2011, respectively. Annual lease revenues from PMC represented 52% and 31% of total revenue for the years ended December 31, 2012 and 2011, respectively.

The following is a schedule by year of approximate minimum future rental revenue under these noncancelable operating leases excluding future CPI adjustments:

For the Year Ending December 31,

2013	\$ 1,057,152
2014	1,057,152
2015	1,057,152
2016	1,057,152
2017	1,057,152
Thereafter	<u>20,272,512</u>
	<u>\$ 25,558,272</u>

PACIFIC HOSPITAL PRESERVATION AND DEVELOPMENT AUTHORITY

Notes to Financial Statements

For the Years Ended December 31, 2012 and 2011

Note 5 - Commitments and Contingencies

Grant Commitments - The Pacific Hospital PDA has commitments for a conditional grant program totaling \$22,714 at December 31, 2012. As the remaining four months of conditions have not been met by the grant recipient as of December 31, 2012, the remaining commitment is not recorded as a liability and expense at December 31, 2012. This commitment was fully funded to the recipient upon issuance; however, as the grant term had four months remaining at year-end the Pacific Hospital PDA has included the remaining \$22,714 as prepaid grant expense in current assets on the balance sheets as of December 31, 2012.

The Pacific Hospital PDA also had a commitment for a conditional grant to assist in funding a capital asset purchase totaling \$10,000. As the conditions have not been met by the grant recipient as of December 31, 2012, the remaining commitment is not recorded as a liability or expense at December 31, 2012.

Note 6 - Retirement Plan

The Pacific Hospital PDA has a Defined Contribution Retirement Plan (the Plan) under Section 403(b) of the Internal Revenue Code. All employees are eligible for enrollment in the Plan. The Pacific Hospital PDA contributes an amount equal to 3% of the employee's gross salary. Total employer contributions for the years ended December 31, 2012 and 2011, were approximately \$5,981 and \$4,796, respectively. Employees may also elect to contribute to the Plan.

Note 7 - Risk Management

The Pacific Hospital PDA is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions, injuries to employees, and natural disasters. The Pacific Hospital PDA carries commercial insurance for risk of loss. The Pacific Hospital PDA did not have settled claims in excess of its commercial insurance coverage during the years ended December 31, 2012 and 2011. In addition, the long term lessee holds insurance on the assets they lease. The Pacific Hospital PDA is designated as additional insured on those insurance policies held by lessee.