

Cornerstone Metropolitan District No. 2

Annual Financial Report

December 31, 2011

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**Haynie &
Company**

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Report of Independent Certified Public Accountants

To the Board of Directors
Cornerstone Metropolitan District No. 2

We have audited the accompanying financial statements of the governmental activities and the major funds of Cornerstone Metropolitan District No. 2 as of and for the year ended December 31, 2011, which collectively comprise the District's basic financial statements as listed in the Table of Contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and in accordance with the Colorado Local Government Audit Law. 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 audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major funds of Cornerstone Metropolitan District No. 2 as of December 31, 2011, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis 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 audit 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.

Our audit was conducted for the purpose of forming our opinion on the financial statements that collectively comprise the District's financial statements as a whole. The Supplementary Information is presented for purposes of additional analysis and are not a required part of the financial statements. The Statement of Revenue, Expenditures and Changes in Fund Balance – Actual and Budget – Governmental Fund Type – Debt Service Fund is the responsibility of management and has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Haynie & Co.

Littleton, Colorado
September 20, 2012

Cornerstone Metropolitan District No. 2 Management's Discussion and Analysis December 31, 2011

As management of Cornerstone Metropolitan District No. 2 (the "District"), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended December 31, 2011.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of three components: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the financial statements. This report also contains additional supplementary information in addition to the basic financial statements and notes.

Government-wide financial statements

The government-wide financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The Statement of Net Assets presents information on all the District's assets and liabilities, with the difference between the two reported as net assets.

The Statement of Activities presents information showing how the government'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 fiscal periods.

The governmental activities of the District relate to satisfying an intergovernmental agreement with Cornerstone Metropolitan District No. 1 and to service the District's long-term debt requirements. The government-wide financial statements can be found on pages 1 and 2 of this report.

Fund financial statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The District currently has one fund, the Debt Service Fund.

Governmental funds

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. The governmental funds provide a reconciliation to facilitate this comparison between governmental funds and governmental activities. The governmental funds financial statements are located on pages 3 and 4 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The Notes to the Financial Statements can be found starting on page 6 of this report.

Government-wide Financial Analysis

The following table shows a condensed statement of net assets as of December 31, 2011, derived from the government-wide financial statements.

Cornerstone Metropolitan District No. 2 Net Assets

	Governmental Activities 2011	Governmental Activities 2010
	<u>2011</u>	<u>2010</u>
Assets:		
Current assets	\$ 4,021,664	\$ 3,253,432
Other assets	644,948	496,105
Total Assets	<u>4,666,612</u>	<u>3,749,537</u>
Liabilities:		
Current liabilities	841,785	871,113
Long-term and other liabilities	30,779,701	30,093,127
Total Liabilities	<u>31,621,486</u>	<u>30,964,240</u>
Net Assets:		
Restricted	3,378,572	2,402,548
Unrestricted	(30,333,446)	(29,617,251)
Total Net Assets	<u>\$ (26,954,874)</u>	<u>\$ (27,214,703)</u>

The District is the “taxing district” in a dual district structure whereby the District has and will continue to finance the construction and operation of the infrastructure for Cornerstone subdivision. The District has entered into a District Facilities Construction and Service Agreement with Cornerstone Metropolitan District No. 1. Under the agreement, District No. 1 (the “operating district”) is responsible for managing the construction of all facilities and improvements and for the operation and maintenance of all improvements not conveyed to another public entity. District No. 2 is responsible for providing the funding for all infrastructure improvements and the revenue needed to support the ongoing operation and maintenance of the improvements and public facilities. Cornerstone Metropolitan District No. 2 will ultimately pay off the “capital obligation” for construction costs as well as the “service obligation” for the excess costs of operating and maintaining the facilities.

At the end of the current fiscal year, the District has negative unrestricted net assets which is primarily a result of the issuance of the Series 2010 A and B Bonds to finance the construction of infrastructure assets owned and reported by District No 1.

The following table shows a condensed statement of activities, derived from the government-wide financial statements.

Cornerstone Metropolitan District No. 2
Change in Net Assets

	Governmental Activities	Governmental Activities
	2011	2010
	<u> </u>	<u> </u>
Revenues:		
Charges for services	\$ -	\$ -
Property taxes	753,075	763,609
Interest and other income	4,710	1,156
Operating grants and contributions	-	15,779
Capital grants and contributions	1,586,000	217,383
Total Revenues	<u>2,343,785</u>	<u>997,927</u>
Expenses:		
General government	19,909	20,119
Intergovernmental agreement	949,999	1,673,347
Interest expense	1,114,048	51,418
Total Expenses	<u>2,083,956</u>	<u>1,744,884</u>
Change in Net Assets	259,829	(746,957)
Net Assets- Beginning	<u>(27,214,703)</u>	<u>(26,467,746)</u>
Net Assets- Ending	<u>\$ (26,954,874)</u>	<u>\$ (27,214,703)</u>

The primary reason for the increase in net assets during 2011 is the receipt of development fees and other revenues in excess of debt service and additions to obligations owed to District No. 1.

Financial Analysis of the District's Funds

As mentioned earlier, the District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds

The focus of the District's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the District's financing requirements. In particular, unrestricted fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

Debt Service Fund revenues were \$2,343,785 in 2011 and consisted of property and specific ownership tax and development fee revenues. Development fees were extraordinarily high due to a bulk sale of property from one developer to another.

Debt Service Fund expenditures totaled \$1,367,761 in 2011 and were primarily related to interest and letter of credit fees on the 2010A and B Bonds.

As of the end of 2011, the District's governmental fund reported an ending fund balance of \$3,378,572. This balance is restricted for future debt service.

Budget variances

The District expenditures were similar to budgeted results with the exception of the excess development fees received as discussed above. The Debt Service Fund budget to actual report can be found in the Supplementary Information section of this report, on page 18.

Long-term debt

As of December 31, 2011 the Series 2010 A and B Bonds principal balance remained at \$22,200,000 as no principal payments were due during 2011. Details regarding the District's long-term debt are located in Note 5 starting on page 12 of this report.

Economic Conditions and Outlook:

The County Assessor reassessed the value of the property in the District effective January 1, 2012 which are used to set 2011 property taxes payable in 2012. The valuations reflect a reduction in the District's assessed value of 32%. For the 2012 budget the District increased the mill levy rate from 39 mills to 52 mills to offset the reduction in assessed values. However, if further declines are experienced in future the years the District is only able to increase the mill levy to a maximum of 55 mills which may result in shortfalls in funding for debt service and/or operational funding to District No. 1.

The District is dependent on the timely payment of property taxes by the District constituents and due to delinquencies on payment by the Developer and Club, was required to draw on the Reserve Fund on June 1, 2012 to fund the shortfall in the interest payment due on the Series 2010A Bonds. See Note 11 on page 17 for additional information.

Request for Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Cornerstone Metropolitan District No. 2, c/o Robertson & Marchetti, P.C., 28 Second Street, Suite 213, Edwards, CO 81632, (970) 926-6060.

Basic Financial Statements

Cornerstone Metropolitan District No. 2
Statement of Net Assets
December 31, 2011

Assets	Governmental Activities
Investments in pooled cash - unrestricted	\$ 2,588
Investments in pooled cash - restricted	3,534,683
Due from treasurer	3,471
Bond issue costs, net of amortization	480,922
Property tax receivable	<u>644,948</u>
Total assets	<u>4,666,612</u>
Liabilities	
Intergovernmental payable	5,658
Accrued expenses	154,005
Deferred property tax revenue	644,948
Accrued interest payable	37,174
Non-current capital and service obligations due to Cornerstone Metro Dist. No. 1	8,579,701
Bonds payable	<u>22,200,000</u>
Total liabilities	<u>31,621,486</u>
Net Assets	
Restricted for debt service	3,378,572
Unrestricted	<u>(30,333,446)</u>
Total Net Assets	<u>(26,954,874)</u>
Total Liabilities and Net Assets	<u>\$ 4,666,612</u>

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

Cornerstone Metropolitan District No. 2
Statement of Activities
For the Year Ended December 31, 2011

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government Governmental Activities
Primary government:					
Governmental activities:					
General government	\$ 19,909	\$ -	\$ -	\$ -	\$ (19,909)
Intergovernmental agreement	949,999	-	-	-	(949,999)
Interest and related costs on long term debt	1,114,048	-	-	1,586,000	471,952
	<u>2,083,956</u>	<u>-</u>	<u>-</u>	<u>1,586,000</u>	<u>(497,956)</u>
General revenues:					
Property taxes					714,148
Specific ownership taxes					38,927
Investment income					4,710
Total general revenues and transfers					<u>757,785</u>
Change in net assets					259,829
Net assets - beginning of year					<u>(27,214,703)</u>
Net assets - end of year					<u>\$ (26,954,874)</u>

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

Cornerstone Metropolitan District No. 2
Governmental Funds Balance Sheet
and Reconciliation of Fund Balances to Net Assets
December 31, 2011

	Debt Service Fund
Assets	
Investments in pooled cash - unrestricted	\$ 2,588
Investments in pooled cash - restricted	3,534,683
Due from treasurer	3,471
Property taxes receivable	644,948
Total assets	\$ 4,185,690
Liabilities	
Intergovernmental payable	5,658
Accrued expenses	156,512
Deferred property tax revenue	644,948
Total liabilities	807,118
Fund Balances	
Restricted for debt service	3,378,572
Total Fund Balances	3,378,572
Total Liabilities and Fund Balance	\$ 4,185,690
Total governmental fund balance per above	\$ 3,378,572
Amounts reported for governmental activities in the statement of net assets excluded from the governmental fund balance because:	
Other long-term assets are not available to pay for current period expenditures, and therefore, are not reported in the funds.	
Bond issue costs, net of amortization	480,922
Long term liabilities not payable in the current year are excluded as liabilities in the governmental funds. Interest on long-term debt is recognized as an expenditure in governmental funds when due. These liabilities consist of:	
Capital and service obligations due to Cornerstone Metro Dist. No. 1	(8,579,701)
Bonds payable	(22,200,000)
Accrued interest payable	(34,667)
Net assets of governmental activities	\$ (26,954,874)

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

Cornerstone Metropolitan District No. 2
Governmental Fund Revenues, Expenditures,
and Changes in Fund Balances
For the Year Ended December 31, 2011

	Debt Service
Revenues:	
Property taxes	\$ 714,148
Specific ownership taxes	38,927
Investment income	4,710
Development fees	<u>1,586,000</u>
Total General Revenues	<u>2,343,785</u>
Expenses:	
General government	
Operations transfer to	
Cornerstone Metro Dist. No. 1	263,425
Treasurer's fees	19,909
Debt service	
Letter of credit fees	610,406
Treasurer's fees	
Remarketing fees	24,178
Bond interest	438,303
Wire, trustee and rating agency fees	<u>11,540</u>
Total Expenditures	<u>1,367,761</u>
Excess (Deficiency) of Revenues over expenditures	<u>976,024</u>
Net change in fund balance	976,024
Fund balances:	
Beginning of the year	<u>2,402,548</u>
End of the year	<u>\$ 3,378,572</u>

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

Cornerstone Metropolitan District No. 2
Reconciliation of the Statement of Revenues, Expenditures
and Changes in Fund Balances of Governmental Funds
to the Statement of Activities
For the Year Ended December 31, 2011

Amounts reported for governmental activities in the statement of activities are different because:

Net change in fund balance—total governmental funds	\$	976,024
<p>Long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities.</p>		
Amortization of bond issue costs		(15,183)
Accrued interest expense		(14,438)
<p>Capital and service obligations reported in the Statement of Activities do not provide or consume current financial resources and, therefore, are not reported as revenues or expenditures in governmental funds.</p>		
		<u>(686,574)</u>
Change in net assets of governmental activities	\$	<u>259,829</u>

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

Cornerstone Metropolitan District No. 2

Notes to Financial Statements

December 31, 2011

1. Definition of Reporting Entity

Cornerstone Metropolitan District No. 2 (the District), a quasi-municipal corporation and political subdivision of the State of Colorado, was organized concurrently with Cornerstone Metropolitan District No. 1 (collectively the Districts) by District Court Order on November 15, 2004, as amended December 22, 2004, and is governed pursuant to provisions of the Colorado Special District Act (Title 32). The Districts' service area is located in both Montrose County and in Ouray County. The Districts operate under a Consolidated Service Plan to provide financing for the design, acquisition, construction and installation of essential public purpose facilities including streets, water, storm drainage, sanitary sewer, parks and recreation, transportation, television relay, mosquito control and fire protection, and the operation and maintenance of the Districts. Under the Service Plan, the District is intended to be the Taxing District related to Cornerstone Metropolitan District No. 1, the Operating District.

The District follows the Governmental Accounting Standards Board (GASB) accounting pronouncements which provide guidance for determining which governmental activities, organizations and functions should be included within the financial reporting entity. GASB pronouncements set forth the financial accountability of a governmental organization's elected governing body as the basic criterion for including a possible component governmental organization in a primary government's legal entity. Financial accountability includes, but is not limited to, appointment of a voting majority of the organization's governing body, ability to impose its will on the organization, a potential for the organization to provide specific financial benefits or burdens and fiscal dependency.

The District has no employees and contracts for all of its management and professional services.

The District is not financially accountable for any other organization, nor is the District a component unit of any other primary governmental entity.

2. Summary of Significant Accounting Policies

The more significant accounting policies of the District are described as follows:

Government-wide and Fund Financial Statements

The government-wide financial statements include the statement of net assets and the statement of activities. These financial statements include all of the activities of the District.

Cornerstone Metropolitan District No. 2

Notes to Financial Statements (continued)

December 31, 2011

2. Summary of Significant Accounting Policies (continued)

Governmental activities are normally supported by property taxes collected. Both statements distinguish between governmental activities, which normally are supported by taxes and business-type activities, which rely to a significant extent on fees and charges for support.

The statement of net assets reports all financial and capital resources of the District. The difference between the assets and liabilities of the District is reported as net assets. Since District No. 1 is ultimately responsible for owning and operating the infrastructure of the community, and District No. 2 is ultimately responsible to provide funding for such, the net assets of the District show a negative balance as District No. 1 reports the capital assets financed in part by District No. 2.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use, or directly benefit from goods, services or privileges provided by a given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Expenditures for redemption of bonds are recorded as a reduction in liabilities.

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. The major sources of revenue susceptible to accrual are property taxes. All other revenue items are considered to be measurable and available only when cash is received by the District. Expenditures, other than interest on long-term obligations, are recorded when the liability is incurred or the long-term obligation paid.

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

2. Summary of Significant Accounting Policies (continued)

The District reports the following major governmental funds:

The Debt Service Fund accounts for the resources accumulated and payments made for principal and interest on long-term debt and contractual obligations to District No. 1.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

Amounts reported as program revenues include 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes received from other governmental activities.

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

Budgets

In accordance with the State Budget Law, the District's Board of Directors holds public hearings in the fall each year to approve the budget and appropriate the funds for the ensuing year. The appropriation is at the total fund expenditures level and lapses at year end. The District's Board of Directors can modify the budget by line item within the total appropriation without notification. The appropriation can only be modified upon completion of notification and publication requirements. The budget includes each fund presented on the modified accrual basis of accounting.

Fund Equity

Fund balance for governmental funds should be reported in classifications that comprise a hierarchy based on the extent to which the government is bound to honor constraints on the specific purposes for which spending can occur. Governmental funds report up to five classifications of fund balance: nonspendable, restricted, committed, assigned, and unassigned. Because circumstances differ among governments, not every government or every governmental fund will present all of these components. The following classifications describe the relative strength of the spending constraints:

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

2. Summary of Significant Accounting Policies (continued)

- *Nonspendable fund balance* - The portion of fund balance that cannot be spent because it is either not in spendable form (such as prepaid amounts or inventory) or legally or contractually required to be maintained intact.
- *Restricted fund balance* - The portion of fund balance that is constrained to being used for a specific purpose by external parties (such as bondholders), constitutional provisions, or enabling legislation.
- *Committed fund balance* - The position of fund balance that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority, the Board of Directors. The constraint may be removed or changed only through formal action of the Board of Directors.
- *Assigned fund balance* - The position of fund balance that is constrained by the government's intent to be used for specific purposes, but is neither restricted nor committed. Intent is expressed by the Board of Directors to be used for a specific purpose. Constraints imposed on the use of assigned amounts are more easily removed or modified than those imposed on amounts that are classified as committed.
- *Unassigned fund balance* - The residual portion of fund balance that does not meet any of the criteria described above. If more than one classification of fund balance is available for use when an expenditure is incurred, it is the District's policy to use the most restrictive classification first.

Fund Balance Classifications

The total fund balance of the governmental funds was \$3,374,572 as of December 31, 2011. Of which the entire balance was restricted for the payment of future debt service principal, interest and related costs, as well as operational funding to District No. 1.

3. Cash and Investments

The Colorado Public Deposit Protection Act (PDPA) requires that all units of local government deposit cash in eligible public depositories. Eligibility is determined by state regulators. Amounts on deposit in excess of federal insurance levels must be collateralized. The eligible collateral is determined by the PDPA. PDPA allows the institution to create a single collateral pool for all public funds.

Cornerstone Metropolitan District No. 2

Notes to Financial Statements (continued)

December 31, 2011

3. Cash and Investments (continued)

The pool for all the uninsured public deposits as a group is to be maintained by another institution or held in trust. The market value of the collateral must be at least equal to 102% of the aggregate uninsured deposits.

The State Commissioners for banks and financial services are required by statute to monitor the naming of eligible depositories and reporting of the uninsured deposits and assets maintained in the collateral pools.

A portion of the funds on hand in the Debt Service Fund are assigned for future debt service.

As of December 31, 2011, the District's cash deposits had a bank balance of \$0 and a carrying balance of \$0.

Investments

The District has not adopted a formal investment policy, however, the District follows state statutes regarding investments.

The District generally limits its concentration of investments to those noted with an asterisk (*) below, which are believed to have minimal credit risk, minimal interest rate risk and no foreign currency risk. Additionally, the District is not subject to concentration risk disclosure requirements or subject to investment custodial credit risk for investments that are in the possession of another party.

Colorado revised statutes limit investment maturities to five years or less unless formally approved by the Board of Directors. Such actions are generally associated with a debt service reserve or sinking fund requirements.

Colorado statutes specify investment instruments meeting defined rating and risk criteria in which local governments may invest which include:

- Obligations of the United States, certain U.S. government agency securities and the World Bank
- General obligation and revenue bonds of U.S. local government entities
- Bankers acceptances of certain banks
- Commercial paper

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

3. Cash and Investments (continued)

- Written repurchase agreements and certain reverse repurchase agreements collateralized by certain authorized securities
- Guaranteed investment contracts
- * Local government investment pools

The local government investment pools, which include the Colorado Surplus Asset Fund Trust (CSAFE) and the Colorado Local Government Liquid Asset Trust (Colostrust) are both rated AAAM by Standard & Poor's.

As of December 31, 2011, the District had the following investments:

Investment	Maturity	<u>Fair Value</u>
Colorado Surplus Asset Trust Fund (CSAFE)	Weighted average under 60 days	<u>\$ 3,537,271</u>

CSAFE

During 2011, the District invested in the Colorado Surplus Asset Fund Trust (CSAFE), which is an investment vehicle established by State statutes for local government entities to pool surplus funds. The State Securities Commission administers and enforces all State statutes governing the Trust. The Trust is similar to a money market fund with each share valued at \$1.00. CSAFE may invest in U.S. Treasury securities and repurchase agreements collateralized by U.S. Treasury securities. A designated custodial bank serves as custodian for CSAFE's investment portfolio and services as the depository in connection with direct investments and withdrawals. The custodian's internal records segregate investments owned by CSAFE. As of December 31, 2011, the District had \$3,537,271 invested in CSAFE.

Cash and investments as of December 31, 2011 are classified in the accompanying financial statements as follows:

	<u>2011</u>
Equity in Pooled Cash - Unrestricted	\$ 2,588
Equity in Pooled Cash - Restricted	<u>3,534,683</u>
	<u>\$ 3,537,271</u>

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

4. Long-Term Capital and Service Obligations Receivable

Cornerstone Metropolitan District No. 2 is obligated under the Master Intergovernmental agreement between the Districts to provide funding for all public infrastructure improvements (capital obligation) to provide the revenue needed to support the ongoing operation and maintenance of the improvements and public facilities (service obligation). These items represent the portion of the obligations not yet reimbursed by Cornerstone Metropolitan District No. 1 as of December 31, 2011.

5. Long-Term Liabilities

On December 15, 2010, the District concurrently issued \$5,200,000 in Series 2010A Limited Tax General Obligation Refunding Bonds and \$17,000,000 in Series 2010B Subordinate Variable Rate Limited Tax General Obligation Refunding Bonds. The net proceeds of the bonds were transferred to Cornerstone Metropolitan District No. 1 and used to pay off the Series 2006 Bonds previously issued by Cornerstone Metropolitan District No. 1.

The following is an analysis of changes in the District's long-term debt for the year ended December 31, 2011:

	Balance December 31, 2010	Additions	Payments	Balance December 31, 2011	Due Within One Year
Series 2010A Bonds	\$ 5,200,000	\$ -	\$ -	\$ 5,200,000	\$ -
Series 2010B Bonds	<u>17,000,000</u>	<u>-</u>	<u>-</u>	<u>17,000,000</u>	<u>-</u>
	<u>\$ 22,200,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 22,200,000</u>	<u>\$ -</u>

The detail of the District's long-term debt outstanding at December 31, 2011 is as follows:

Series 2010A

The Series 2010A Bonds bear interest at a fixed rate of 8.0% with interest payments due semi-annually on June 1 and December 1 of each year. Principal payments are due on December 1 of each year beginning in 2015, continuing through final maturity in 2040. The Bonds are subject to redemption prior to maturity at the option of the District on or after December 1, 2021, without premium. The bonds are payable from the net pledged revenues, including ad valorem

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

5. Long-Term Liabilities (continued)

property taxes, specific ownership taxes, development fees and other legally available revenues. The property tax mill levy used to pay the bonds is required to be no less than 25 mills and not greater than 40 mills. The Bonds are also secured by a reserve fund in the amount of \$520,000, which was drawn on in the amount of \$3,282 on June 1, 2012 to fund the shortfall in the Series 2010A interest payment. See Note 11 for additional information.

Below is a summary of the future maturities of the Series 2010A Bonds:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ -	\$ 416,000	\$ 416,000
2013	-	416,000	416,000
2014	-	416,000	416,000
2015	5,000	416,000	421,000
2016	10,000	415,600	425,600
2017-2021	105,000	2,063,200	2,168,200
2022-2026	365,000	1,984,400	2,349,400
2027-2031	750,000	1,782,000	2,532,000
2032-2036	1,310,000	1,398,800	2,708,800
2037-2040	<u>2,655,000</u>	<u>669,200</u>	<u>3,324,200</u>
Total	<u>\$ 5,200,000</u>	<u>\$ 9,977,200</u>	<u>\$ 15,177,200</u>

Series 2010B

The Series 2010B Bonds bear interest at a variable rate which is currently reset on a weekly basis by the remarketing agent. Interest for the previous month is payable on the first business day of the following month. Principal payments are due on December 1 of each year beginning in 2023 and continuing through the final maturity date in 2046. The Bonds are subject to redemption prior to maturity at the option of the District at any time, without premium. The Bonds are subordinate to the Series 2010A Bonds and are payable from the remaining net pledged revenues, including ad valorem property taxes, specific ownership taxes and development fees. In the event that a mill levy of 25 mills (the minimum levy required by the 2010A Bonds), along with other available revenues, is insufficient to pay the debt service on the bonds, the total mill levy will be increased up to a maximum of 30 mills. The Series 2010B Bonds are also secured by an irrevocable direct pay letter of credit issued by the Bank of America, N.A. The letter of credit is available only to be used towards the Series 2010B Bonds, not the Series 2010A Bonds. The initial term of the letter of credit expired on

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

5. Long-Term Liabilities (continued)

December 1, 2011 but automatically extended and will continue to automatically extend annually unless terminated by the bank. The letter of credit fees are paid on a quarterly basis at a current annual rate of 3.50%. The letter of credit is secured by a reimbursement agreement with the original developer, Cornerstone Montrose, LLC and Hunt Realty Investments, Inc. which are jointly responsible for any draws and reimbursements on the letter of credit.

Annual interest payments will be calculated based on a variable rate and continue to be paid until the remaining principal is paid in full. The Subordinate Series 2010B Bonds are also subject to a mandatory sinking fund redemption, in part, by lot, on December 1, 2023 and on each December 1 thereafter prior to the maturity date. Future estimated principal and interest payments are as follows, based on an estimated historical average interest rate of approximately 2.02%:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ -	\$ 343,400	\$ 343,400
2013	-	343,400	343,400
2014	-	343,400	343,400
2015	-	343,400	343,400
2016	-	343,400	343,400
2017-2021	-	1,717,000	1,717,000
2022-2026	940,000	1,689,528	2,629,528
2027-2031	1,575,000	1,561,763	3,136,763
2032-2036	2,060,000	1,384,003	3,444,003
2037-2041	3,480,000	1,152,511	4,632,511
2042-2046	<u>8,945,000</u>	<u>570,044</u>	<u>9,515,044</u>
Total	<u>\$ 17,000,000</u>	<u>\$ 9,791,849</u>	<u>\$ 26,791,849</u>

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

5. Long-Term Liabilities (continued)

Debt Authorization

On November 2, 2004, the District's electors authorized the issuance of indebtedness totaling \$787,500,000 at an interest rate not to exceed 12%. The following schedule shows the amounts authorized and issued as of December 31, 2011:

	<u>Authorized November 2, 2004</u>	<u>Authorization Used, Series 2010</u>	<u>Remaining at December 31, 2011</u>
Streets	\$ 60,000,000	\$ -	\$ 60,000,000
Traffic & safety	60,000,000	-	60,000,000
Water	60,000,000	-	60,000,000
Sanitary sewer and storm drainage	60,000,000	-	60,000,000
Parks and recreation	60,000,000	-	60,000,000
Transportation	60,000,000	-	60,000,000
Television relay	60,000,000	-	60,000,000
Mosquito control	60,000,000	-	60,000,000
Fire and ambulance	60,000,000	-	60,000,000
Operations and maintenance	60,000,000	-	60,000,000
Intergovernmental contracts	60,000,000	-	60,000,000
Reimbursement agreements	60,000,000	-	60,000,000
Management services	7,500,000	-	7,500,000
Refunding of debt	<u>60,000,000</u>	<u>22,200,000</u>	<u>37,800,000</u>
Total	<u>\$ 787,500,000</u>	<u>\$ 22,200,000</u>	<u>\$ 765,300,000</u>

However, pursuant to the Service Plan, the District will not issue more than \$30,000,000 in indebtedness.

6. Net Assets

Restricted assets include net assets that are restricted for use either externally imposed by grantors, contributors or laws and regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

The District's unrestricted net assets as of December 31, 2011 totaled \$(30,333,446).

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

7. Related Parties

The original Developer of the property which constitutes the District is Cornerstone Montrose LLC, a Delaware limited liability company, and a wholly-owned subsidiary of Hunt Realty Investments, Inc. (f.k.a. Hunt Realty Corp.). The members of the Board of Directors were officers, employees or associated with the Developer and may have conflicts of interest in dealing with the District.

8. Economic Dependencies

The District is dependent on the property taxes paid by District constituents, the majority of which are paid by the Developer and related club entity.

9. Risk Management

The District is exposed to various risks of loss related to torts, thefts of, damage to, or destruction of assets; errors or omissions; injuries to employees, or acts of God.

The District is a member of the Colorado Special Districts Property and Liability Pool (Pool). The Pool is an organization created by intergovernmental agreement to provide property, liability, public officials' liability, boiler and machinery and workers compensation coverage to its members. Settled claims have not exceeded this coverage in any of the past three fiscal years.

The District pays annual premiums to the Pool for liability, property and public officials' liability coverage. In the event aggregated losses incurred by the Pool exceed amounts recoverable from reinsurance contracts and funds accumulated by the Pool, the Pool may require additional contributions from the Pool members. Any excess funds which the Pool determines are not needed for purposes of the Pool may be returned to the members pursuant to a distribution formula.

Cornerstone Metropolitan District No. 2
Notes to Financial Statements (continued)
December 31, 2011

10. Intergovernmental Agreements

District Facilities Construction and Service Agreement

On December 16, 2004, the Districts entered into a Districts Facilities Construction and Service Agreement (the Master IGA). The Master IGA provides that the District is to finance the construction, maintenance and operations of the facilities constructed and operated by Cornerstone Metropolitan District No.1 as provided by the Consolidated Service Plan. The District is to finance such activities from their annual certification of a mill levy, specific ownership taxes and development fees. The mill levy is limited by the Service Plan wherein the combined maximum mill levy shall not exceed 55.000 mills, with the maximum operations mill levy not to exceed 20.000 mills, and the maximum debt mill levy not to exceed 40.000 mills.

11. Tax, Spending and Debt Limitations

Article X, Section 20 of the Colorado Constitution, commonly known as the Taxpayer's Bill of Rights (TABOR) contains tax, spending, revenue and debt limitations which apply to the State of Colorado and all local governments.

Spending and revenue limits are determined based on the prior year's Fiscal Year Spending adjusted for allowable increases based upon inflation and local growth. Fiscal Year Spending is generally defined as expenditures plus reserve increases with certain exceptions. Revenue in excess of the Fiscal Year Spending limit must be refunded unless the voters approve retention of such revenue.

TABOR requires local governments to establish Emergency Reserves. These reserves must be at least 3% of Fiscal Year Spending (excluding bonded debt service). At December 31, 2011, the District was not required to have an emergency reserve as all operations are performed by District No. 1.

On November 2, 2004, the District's voters authorized the District to increase property taxes \$60,000,000 annually, without limitation to rate, to pay the District's operations, maintenance and other expenses. The election also allows the District to collect, spend and retain all revenues without regard to the limitations contained within Article X, Section 20 of the Colorado constitution.

The District's management believes it is in compliance with the provisions of TABOR. However, TABOR is complex and subject to interpretation. Many of the provisions, including the interpretation of how to calculate Fiscal Year Spending limits will require judicial interpretation.

Supplementary Information

Cornerstone Metropolitan District No. 2
Statement of Revenue, Expenditures
and Changes in Fund Balance—Actual and Budget
Governmental Fund Type—Debt Service Fund
For the Year Ended December 31, 2011

	Original and Final Budget	Actual	Variance Favorable (Unfavorable)
Revenue:			
Property taxes	\$ 708,574	\$ 714,148	\$ 5,574
Specific ownership taxes	48,006	38,927	(9,079)
Investment income	13,215	4,710	(8,505)
Development fees	182,000	1,586,000	1,404,000
Total Revenue	951,795	2,343,785	1,391,990
Expenditures:			
General government			
Operations transfer to			
Cornerstone Metro Dist. No. 1	264,455	263,425	1,030
Treasurer's fees	19,884	19,909	(25)
Contingency	251,000	-	251,000
Debt service			
Letter of credit fees	595,000	610,406	(15,406)
Remarketing fees	34,000	24,178	9,822
Bond interest	501,000	438,303	62,697
Wire, trustee and rating agency fees	9,040	11,540	(2,500)
Total Expenditures	1,674,379	1,367,761	306,618
Excess Revenue Over (Under)			
Expenditures	(722,584)	976,024	1,698,608
Change in fund balance	(722,584)	976,024	1,698,608
Fund Balance—Beginning of year	2,443,349	2,402,548	(40,801)
Fund Balance—End of Year	\$ 1,720,765	\$ 3,378,572	\$ 1,657,807