

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2006**

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Supervisors
Sterling Hill Community Development District
Hernando County, Florida


We have audited the accompanying financial statements of the governmental activities and each major fund of Sterling Hill Community Development, Hernando County, Florida (the "District") as of and for the fiscal year ended September 30, 2006, 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 opinions 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 the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the District as of September 30, 2006, and the respective changes in financial position thereof for the fiscal year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated February 16, 2007, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management's discussion and analysis and budgetary comparison information are not a required part of the basic financial statements but are 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.



February 16, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Sterling Hill Community Development District, Hernando County, Florida (the "District") provides a narrative overview of the District's financial activities for the fiscal year ended September 30, 2006. Please read it in conjunction with the District's Independent Auditor's Report, basic financial statements, accompanying notes and supplementary information to the basic financial statements.

FINANCIAL HIGHLIGHTS

- The assets of the District exceeded its liabilities at the close of the fiscal year ended September 30, 2006 by \$11,316,336 (net assets) of this amount; \$210,245 is unrestricted net assets which may be used to meet the District's ongoing obligations.
- The District's net assets increased by \$11,548,416 in comparison with the prior year. The key components of the District's net assets and change in net assets are reflected in the table in the following section.
- At September 30, 2006, the District's governmental funds reported combined ending fund balance of \$18,193,190, an increase of \$5,894,779 in comparison with the prior year. Of the total fund balance, \$9,948,593 is reserved for debt service and other items, \$8,050,351 is reserved for capital projects and \$194,246 is unreserved, undesignated fund balance which is available for spending at the District's discretion.

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as the introduction to the District's 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 other supplementary information in addition to the basic financial statements themselves.

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. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

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 government-wide financial statements include all governmental activities that are principally supported by assessments. The District does not have any business-type activities. The governmental activities of the District include the general government (management), maintenance and culture and recreational activities.

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 has one fund category: governmental funds.

OVERVIEW OF FINANCIAL STATEMENTS (Continued)

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 District'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 District's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The District maintains three individual governmental funds. Information is presented separately in the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances for the general fund, debt service fund and capital projects fund. All of the funds are considered to be major funds.

The District adopts an annual appropriated budget for its general fund. A budgetary comparison schedule has been provided for the general fund to demonstrate compliance with the budget.

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.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by \$11,316,336 (net assets) at the close of the fiscal year ended September 30, 2006.

\$2,005,108 of the District's net assets reflects in investment in capital assets (e.g. land, land improvements, and infrastructure), less any related debt used to acquire those assets that is still outstanding. These assets are used to provide services to residents; consequently, these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the District's net assets of \$9,100,983 represents resources that are subject to external restrictions on how they may be used. They are funds set aside for debt service under the Bond Indenture. The remaining balance of unrestricted net assets of \$210,245 may be used to meet the District's obligations.

GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)

Key elements of the net assets are as follows:

NET ASSETS SEPTEMBER 30,		
	2006	2005
Assets, excluding capital assets	\$ 19,744,094	\$ 13,553,804
Capital assets not being depreciated	30,657,665	26,341,276
Total assets	<u>50,401,759</u>	<u>39,895,080</u>
Liabilities, excluding long-term liabilities	1,460,423	1,362,160
Long-term liabilities	37,625,000	38,765,000
Total liabilities	<u>39,085,423</u>	<u>40,127,160</u>
Net Assets		
Invested in capital assets, net of related debt	2,005,108	(6,507,551)
Restricted for:		
Debt service	9,100,983	6,233,648
Unrestricted	210,245	41,823
Total net assets	<u>\$ 11,316,336</u>	<u>\$ (232,080)</u>

At September 30, 2006 the District is able to report positive balances in all categories of net assets, both for the government as a whole, as well as for its separate governmental activities.

The District's net assets increased by \$11,548,416 during the fiscal year ended September 30, 2006. The increase is a result of an increase in program revenues. Key elements of this change are as follows:

CHANGES IN NET ASSETS FOR THE FISCAL YEAR ENDED SEPTEMBER 30,		
	2006	2005
Revenues:		
Program revenues	\$ 14,082,802	\$ 4,128,493
General revenues	11,733	50
Total revenues	<u>14,094,535</u>	<u>4,128,543</u>
Expenses:		
General government	138,138	138,841
Maintenance and operations	253,604	53,674
Culture and recreation	110,169	
Interest	2,044,208	2,279,936
Total expenses	<u>2,546,119</u>	<u>2,472,451</u>
Change in net assets	<u>\$ 11,548,416</u>	<u>\$ 1,656,092</u>

Program revenues, comprised primarily of assessments, increased by \$9,954,309 during the fiscal year; the majority of the increase is the result of lot sales.

FINANCIAL ANALYSIS OF GOVERNMENTAL FUNDS

The District uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. 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 financing requirements. In particular, unreserved fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

The general fund is the operating fund of the District and includes all activities related to providing management and operating services.

In the table below we have presented the cost of the largest functions/programs as a percentage of total governmental funds.

	FOR THE FISCAL YEAR ENDED SEPTEMBER 30;			
	2006		2005	
General government	\$ 138,138	1%	\$ 138,841	1%
Maintenance and operations	253,604	2%	53,674	1%
Culture and recreation	110,169	1%		
Capital outlay	4,316,389	25%	7,270,759	73%
Bond issue costs	271,101	2%		
Principal and interest on long-term debt	11,415,355	69%	2,462,980	25%
	<u>\$ 16,504,756</u>	<u>100%</u>	<u>\$ 9,926,254</u>	<u>100%</u>

As noted above, principal and interest on debt and capital outlay comprises the majority of expenditures for total governmental activities.

GENERAL BUDGETING HIGHLIGHTS

An operating budget was adopted and maintained by the governing board for the District pursuant to the requirements of Florida Statutes. The budget is adopted using the same basis of accounting that is used in preparation of the fund financial statements. The legal level of budgetary control, the level at which expenditures may not exceed budget is in the aggregate. Any budget amendments that increase the aggregate budgeted appropriations must be approved by the Board of Supervisors.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At September 30, 2006, the District had \$30,657,665 invested in land, land improvements and infrastructure under construction. The project is not being depreciated as the construction has not been completed. More detailed information about the District's capital assets is presented in the notes to the financial statements.

Long-Term Debt

At September 30, 2006, the District had \$37,785,000 Bonds outstanding, a decrease of approximately 3% from prior year. The District issued \$8,305,000 of new debt during the year. More detailed information about the District's long-term debt is presented in the notes to the financial statements.

Contacting the District's Financial Management

This financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the financial resources it manages and the stewardship of the facilities it maintains. If you have questions about this report or need additional financial information, contact the Sterling Hill Community Development District's Finance Department at 3434 Colwell Avenue, Suite 200, Tampa Florida, 33614.

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2006**

	Governmental Activities
ASSETS	
Cash	\$ 9,525
Assessments receivable	276,799
Accrued interest receivable	41,025
Prepays	15,999
Deferred charges	1,082,092
Restricted assets:	
Temporarily restricted	
Investments	18,318,654
Capital assets:	
Capital assets not being depreciated	30,657,665
Total assets	50,401,759
LIABILITIES	
Accounts payable	22,923
Contracts and retainage payable	425,179
Accrued interest payable	852,321
Non-current liabilities:	
Due within one year	160,000
Due in more than one year	37,625,000
Total liabilities	39,085,423
NET ASSETS	
Invested in capital assets, net of related debt	2,005,108
Restricted for debt service	9,100,983
Unrestricted	210,245
Total net assets	\$ 11,316,336

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006**

Functions/Programs Primary government:	Program Revenues			Net (Expense) Revenue and Changes in Net Assets
	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental activities:				
General government	\$ 138,138	\$ -	\$ -	\$ -
Maintenance and operations	253,604		160,662	160,662
Culture and recreation	110,169	257,475		147,306
Interest on long-term debt	2,044,208	12,502,816	770,107	11,228,715
Total governmental activities	2,546,119	13,152,033	770,107	11,536,683
General revenues:				
Unrestricted investment earnings				11,733
Total general revenues				11,733
Change in net assets				11,548,416
Net assets - beginning				(232,080)
Net assets - ending				\$ 11,316,336

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
BALANCE SHEET
GOVERNMENTAL FUNDS
SEPTEMBER 30, 2006**

	Major Funds			Total Governmental Funds
	General	Debt Service	Capital Projects	
ASSETS				
Cash	\$ 9,525	\$ -	\$ -	\$ 9,525
Investments	200,644	9,637,437	8,480,573	18,318,654
Accrued interest receivable	-	39,068	1,957	41,025
Assessments receivable	-	276,799	-	276,799
Prepays	15,999	-	-	15,999
Total assets	<u>\$ 226,168</u>	<u>\$ 9,953,304</u>	<u>\$ 8,482,530</u>	<u>\$ 18,662,002</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ 15,923	\$ -	\$ 7,000	\$ 22,923
Contracts and retainage payable	-	-	425,179	425,179
Accrued interest	-	20,710	-	20,710
Total liabilities	<u>15,923</u>	<u>20,710</u>	<u>432,179</u>	<u>468,812</u>
Fund balances:				
Reserved for:				
Debt service	-	9,932,594	-	9,932,594
Capital projects	-	-	8,050,351	8,050,351
Other	15,999	-	-	15,999
Unreserved, reported in:				
General fund	194,246	-	-	194,246
Total fund balances	<u>210,245</u>	<u>9,932,594</u>	<u>8,050,351</u>	<u>18,193,190</u>
Total liabilities and fund balances	<u>\$ 226,168</u>	<u>\$ 9,953,304</u>	<u>\$ 8,482,530</u>	<u>\$ 18,662,002</u>

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

Fund balance - governmental funds	\$ 18,193,190
Capital assets used in governmental activities are not financial resources and, therefore, are not reported as assets in the governmental funds. The statement of net assets includes those capital assets in the assets of the government as a whole.	
Cost of capital assets	30,657,665
Other long-term assets are not available to pay for current-period expenditures and, therefore, are expensed in the governmental funds.	
Bond issuance costs	1,174,734
Accumulated amortization	<u>(92,642)</u>
Liabilities not due and payable from current available resources are not reported as liabilities in the governmental fund statements. All liabilities, both current and long-term, are reported in the government-wide statements.	
Accrued interest payable	(831,611)
Bonds payable	<u>(37,785,000)</u>
Net assets of governmental activities	<u>\$ 11,316,336</u>

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006**

	Major Funds			Total Governmental Funds
	General	Debt Service	Capital Projects	
REVENUES				
Assessments	\$ 649,217	\$ 12,502,816	\$ -	\$ 13,152,033
Developer revenues	-	488,302	-	488,302
Interest and other revenues	11,733	281,805	160,662	454,200
Total revenues	<u>660,950</u>	<u>13,272,923</u>	<u>160,662</u>	<u>14,094,535</u>
EXPENDITURES				
Current:				
General government	128,755	9,101	282	138,138
Maintenance and operations	253,604	-	-	253,604
Culture and recreation	110,169	-	-	110,169
Debt Service:				
Principal	-	9,285,000	-	9,285,000
Interest	-	2,130,355	-	2,130,355
Bond issuance costs	-	-	271,101	271,101
Capital outlay	-	-	4,316,389	4,316,389
Total expenditures	<u>492,528</u>	<u>11,424,456</u>	<u>4,587,772</u>	<u>16,504,756</u>
Excess (deficiency) of revenues over (under) expenditures	168,422	1,848,467	(4,427,110)	(2,410,221)
OTHER FINANCING SOURCES				
Bond proceeds	-	900,332	7,404,668	8,305,000
Total other financing sources	<u>-</u>	<u>900,332</u>	<u>7,404,668</u>	<u>8,305,000</u>
Net change in fund balances	168,422	2,748,799	2,977,558	5,894,779
Fund balances - beginning	<u>41,823</u>	<u>7,183,795</u>	<u>5,072,793</u>	<u>12,298,411</u>
Fund balances - ending	<u>\$ 210,245</u>	<u>\$ 9,932,594</u>	<u>\$ 8,050,351</u>	<u>\$ 18,193,190</u>

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006**

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

Net change in fund balances - total governmental funds	\$ 5,894,779
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is eliminated and capitalized as capital assets.	4,316,389
Repayment of long-term liabilities are reported as expenditures in the governmental fund statement but such repayments reduce liabilities in the statement of net assets and are eliminated in the statement of activities.	9,285,000
Governmental funds report the effect of issuance of costs, premiums, discounts and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities.	271,101
Amortization of deferred charges is not recognized in the governmental fund statement but is reported as an expense in the statement of activities.	(32,390)
Proceeds of bonds issued are shown as a financing source on the fund financial statements; however, amounts are shown as liabilities on the statement of net assets.	(8,305,000)
Change in accrued interest from current period to prior period affects the change in net assets as reported on the statement of activities; however, accrued interest is not reported on the fund financial statements.	<u>118,537</u>
Change in net assets of governmental activities	<u>\$ 11,548,416</u>

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
NOTES TO FINANCIAL STATEMENTS**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Sterling Hill Community Development District ("District") was created on March 20, 2003, pursuant to the Uniform Community Development District Act of 1980, otherwise known as Chapter 190, Florida Statutes, by Hernando County Ordinance 2003-04. The Act provides among other things, the power to manage basic services for community development, power to borrow money and issue bonds, and to levy and assess non-ad valorem assessments for the financing and delivery of capital infrastructure.

The District was established for the purposes of financing and managing the acquisition, construction, maintenance and operation of a portion of the infrastructure necessary for community development within the District.

The District is governed by the Board of Supervisors ("Board"), which is composed of five members. The Supervisors are elected by the owners of the property within the District. The Board of Supervisors of the District exercise all powers granted to the District pursuant to Chapter 190, Florida Statutes. Three of the Board members are affiliated with the Developer "DEVCO V, LLC" which is developing Phase I and II of the project. Hernando Developers, LLC are developing Phase III and IV of the project. The District paid an entity related to DEVCO V, LLC \$45,000 related to the management of the recreational facilities. The District is economically dependent on the Developer.

The Board has the final responsibility for:

1. Assessing and levying maintenance taxes and special assessments.
2. Approving budgets.
3. Exercising control over facilities and properties.
4. Controlling the use of funds generated by the District.
5. Approving the hiring and firing of key personnel.
6. Financing improvements.

The financial statements were prepared in accordance with Governmental Accounting Standards Board ("GASB") Statement 14, and Statement 39, an amendment of GASB Statement 14. Under the provisions of those standards, the financial reporting entity consists of the primary government, organizations for which the District Board of Supervisors is considered to be financially accountable, and other organizations for which the nature and significance of their relationship with the District are such that, if excluded, the financial statements of the District would be considered incomplete or misleading. There are no entities considered to be component units of the District; therefore, the financial statements include only the operations of the District.

Government-Wide and Fund Financial Statements

The basic financial statements include both government-wide and fund financial statements.

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the non-fiduciary activities of the primary government. For the most part, the effect of interfund activity has been removed from these statements.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is 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 who purchase, use or directly benefit from goods, services or privileges provided by a given function or segment; 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment and 3) operating-type special assessments that are treated as charges for services (including assessments for maintenance and debt service). Other items not included among program revenues are reported instead as *general revenues*.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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. Assessments are recognized as revenues in the year for which they are levied. Grants and similar items are to be recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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. Expenditures are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Assessments

Assessments are non-ad valorem assessments on all platted lots within the District. Assessments are levied each November 1 on property as of the previous January 1 to pay for the operations and maintenance of the District. The fiscal year for which annual assessments are levied begins on October 1 with discounts available for payments through February 28 and become delinquent on April 1. For debt service assessments, amounts collected as advance payments are used to prepay a portion of the Bonds outstanding. Otherwise, assessments are collected annually to provide funds for the debt service on the portion of the Bonds which are not paid with prepaid assessments.

Assessments and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the District.

The District reports the following major governmental funds:

General Fund

The general fund is the general operating fund of the District. It is used to account for all financial resources except those required to be accounted for in another fund.

Debt Service Fund

The debt service fund is used to account for the accumulation of resources for the annual payment of principal and interest on long-term debt.

Capital Projects Fund

This fund accounts for the financial resources to be used for the acquisition or construction of major infrastructure within the District.

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

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Assets or Equity

Deposits and Investments

The District's cash on hand and demand deposits are considered to be cash and cash equivalents.

The District has adopted a written investment policy, which complies with the requirements of Section 218.415 Florida Statutes. All investments comply with the requirements of the written investment policy. The District may invest any surplus public funds in the following:

- a) The Local Government Surplus Trust Funds, or any intergovernmental investment pool authorized pursuant to the Florida Interlocal Cooperation Act;
- b) Securities and Exchange Commission registered money market funds with the highest credit quality rating from a nationally recognized rating agency;
- c) Interest bearing time deposits or savings accounts in qualified public depositories;
- d) Direct obligations of the U.S. Treasury.
- e) Short term Bond Funds

In addition, surplus funds may be deposited into certificates of deposit which are insured. Any unspent proceeds are required to be held in investments allowed in the Bond indenture.

The District records all interest revenue related to investment activities in the respective funds and reports investments at fair value.

Inventories and Prepaid Items

Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Capital Assets

Capital assets, which include property, plant and equipment, and infrastructure assets (e.g., roads, sidewalks and similar items) are reported in the government activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 (amount not rounded) and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

No depreciation has been taken as all capital assets are under construction. In the governmental fund financial statements, amounts incurred for the acquisition of capital assets are reported as fund expenditures. Depreciation expense is not reported in the governmental fund financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Assets or Equity (Continued)

Deferred Charges

In connection with the issuance of certain debt, the District incurred costs totaling \$1,174,734. In the government-wide statements that amount has been capitalized and amortized over the estimated life of the Bonds. At September 30, 2006 the District reported accumulated amortization of \$92,642.

Long-Term Obligations

In the government-wide financial statements long-term debt and other long-term obligations are reported as liabilities in the statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of premiums or discounts.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Fund Equity/Net Assets

In the fund financial statements, governmental funds report reservations of fund balance for amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

Net assets in the government-wide statements are categorized as invested in capital assets, net of related debt, restricted or unrestricted. Invested in capital assets, net of related debt represents net assets related to infrastructure and property, plant and equipment, net of any related debt. Restricted net assets represent the assets restricted by the District's bond covenants.

Other Disclosures

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make 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 the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

NOTE 2 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Information

The District is required to establish a budgetary system and an approved Annual Budget. Annual Budgets are adopted on a basis consistent with generally accepted accounting principles for the general fund. All annual appropriations lapse at fiscal year end.

The District follows these procedures in establishing the budgetary data reflected in the financial statements.

- a) Each year the District Manager submits to the District Board a proposed operating budget for the fiscal year commencing the following October 1.
- b) Public hearings are conducted to obtain taxpayer comments.
- c) Prior to October 1, the budget is legally adopted by the District Board.
- d) All budget changes must be approved by the District Board.
- e) The budgets are adopted on a basis consistent with generally accepted accounting principles.

NOTE 3- CASH AND INVESTMENTS

Cash

The District's cash balances were entirely covered by federal depository insurance or by a collateral pool pledged to the State Treasurer. Florida Statutes Chapter 280, "Florida Security for Public Deposits Act", requires all qualified depositories to deposit with the Treasurer or another banking institution eligible collateral equal to various percentages of the average daily balance for each month of all public deposits in excess of any applicable deposit insurance held. The percentage of eligible collateral (generally, U.S. Governmental and agency securities, state or local government debt, or corporate bonds) to public deposits is dependent upon the depository's financial history and its compliance with Chapter 280. In the event of a failure of a qualified public depository, the remaining public depositories would be responsible for covering any resulting losses.

Investments

The District's investments were held as follows at September 30, 2006:

	<u>Fair Value</u>	<u>Credit Risk</u>	<u>Maturities</u>
Money Market Mutual Fund	\$ 11,299,959	S&P AAAM	Average of the fund portfolio: 23 days
Investment in Local Government Surplus Funds Trust Fund	200,644	First Tier	Average of the fund portfolio: 90 days
Federal Home Loan	299,315	Not Applicable	April 16, 2007
Federal Home Loan	105,033	Not Applicable	August 14, 2009
Federal Home Loan	245,154	Not Applicable	October 26, 2007
FNMA Debenture	239,925	Not Applicable	October 15, 2006
Wertz York The Core Fund			Weighted Average Maturity: 1.26 years
	5,928,624	S&P AAAf/S1+	
Total Investments	<u>\$ 18,318,654</u>		

Custodial risk – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. The District has no formal policy for custodial risk. The District's investments in the mutual funds and local government surplus funds trust fund are not evidenced by securities that exist in physical or book entry form. The U. S. Government and Agencies (Federal Home Loan and FNMA) are held by the trustee or agent but not in the District's name.

Concentration risk – The District places no limit on the amount the District may invest in any one issuer.

Interest rate risk – The District does not have a formal policy that limits investment maturities as a means of managing exposure to fair value losses arising from increasing interest rates.

Except for the investments held in Local Government Surplus Funds Trust Fund, the investments above are held by the debt service fund and capital projects fund for unspent bond proceeds. The Bond Indenture limits the type of investments held using unspent bond proceeds.

NOTE 4 – CAPITAL ASSETS

Capital asset activity for the fiscal year ended September 30, 2006 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
<u>Governmental activities</u>				
Capital assets, not being depreciated				
Land and land improvements	\$ 1,500,000	\$ -	\$ -	\$ 1,500,000
Infrastructure under construction	24,841,276	4,316,389	-	29,157,665
Total capital assets, not being depreciated	<u>26,341,276</u>	<u>4,316,389</u>	<u>-</u>	<u>30,657,665</u>
Governmental activities capital assets, net	<u>\$ 26,341,276</u>	<u>\$ 4,316,389</u>	<u>\$ -</u>	<u>\$ 30,657,665</u>

The total projected cost of the infrastructure improvements has been estimated at approximately \$38.4 million. The land was acquired from the Developer in accordance with the acquisition agreement. The majority of the current year improvements relate to Phase III and IV of the project and have been acquired from the Developer of Phase III and IV (“Hernando Developers, LLC”). Certain improvements will be conveyed to other governments upon completion of the project.

NOTE 5 - LONG TERM LIABILITIES

Series 2003

On October 29, 2003, the District issued \$39,000,000 of Capital Improvement Revenue Bonds, consisting of \$4,765,000 Series 2003A Term Bonds due on May 1, 2023 with a fixed interest rate of 6.1%, \$7,770,000 Series 2003A Term Bonds due on May 1, 2035 with a fixed interest rate of 6.2% and \$26,465,000 Series 2003B Term Bonds due on May 1, 2010 with a fixed interest rate of 5.50%. The Bonds were issued to finance the acquisition and construction of certain improvements for the benefit of the District and to payoff the Bond Anticipation Notes. Interest is paid semiannually on each May 1 and November 1. Principal on the Series 2003A Bonds is paid serially commencing May 1, 2006 through May 1, 2035. Principal on the Series 2003B Bonds is due in one lump sum on May 1, 2010.

The Series 2003A Bonds are subject to redemption at the option of the District, in whole or in part at any time on or after May 1, 2013 at a redemption price as set forth in the Bond Indenture.

The Bonds are subject to extraordinary mandatory redemption prior to maturity in the manner determined by the Bond Registrar if certain events occurred as outlined in the Bond Indenture. This occurred during the fiscal year ended September 30, 2006 as the District collected assessments and prepaid \$9,135,000 of the Bonds. Subsequent to year end the District collected assessments and prepaid \$5,710,000 of the Series 2003 B Bonds.

The Bond Indenture requires that the District maintain adequate funds in a reserve account to meet the debt service reserve requirement as defined in the Indenture. The requirement has been met for fiscal year ended September 30, 2006.

The Bond Indenture has certain restrictions and requirements relating principally to the use of proceeds to pay for the infrastructure improvements and the procedures to be followed by the District on assessments to property owners. The District agreed to levy special assessments in annual amounts adequate to provide payment of debt service and to meet the reserve requirements. The District is in compliance with the requirements of the Bond Indenture.

NOTE 5 - LONG TERM LIABILITIES (Continued)

Series 2006

On July 12, 2006, the District issued \$8,305,000 of Capital Improvement Revenue Bonds, consisting of \$3,755,000 Series 2006A Term Bonds due on May 1, 2037 with a fixed interest rate of 5.5%, \$4,550,000 Series 2006B Term Bonds due on May 1, 2011 with a fixed interest rate of 5.1%. The Bonds were issued to finance the acquisition and construction of certain improvements for the benefit of the District. Interest is paid semiannually on each May 1 and November 1. Principal on the Series 2006A Bonds is paid serially commencing May 1, 2008 through May 1, 2037. Principal on the Series 2006B Bonds is due in one lump sum on May 1, 2011.

The Series 2006A Bonds are subject to redemption at the option of the District, in whole or in part at any time on or after May 1, 2015 at a redemption price as set forth in the Bond Indenture. The Bonds are subject to extraordinary mandatory redemption prior to maturity in the manner determined by the Bond Registrar if certain events occurred as outlined in the Bond Indenture.

The Bond Indenture requires that the District maintain adequate funds in a reserve account to meet the debt service reserve requirement as defined in the Indenture. The requirement has been met for fiscal year ended September 30, 2006.

The Bond Indenture has certain restrictions and requirements relating principally to the use of proceeds to pay for the infrastructure improvements and the procedures to be followed by the District on assessments to property owners. The District agreed to levy special assessments in annual amounts adequate to provide payment of debt service and to meet the reserve requirements. The District is in compliance with the requirements of the Bond Indenture.

Changes in long-term liability activity for the fiscal year ended September 30, 2006 were as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Governmental activities</u>					
Bonds payable:					
Series 2003	\$ 38,765,000	\$ -	\$ 9,285,000	\$ 29,480,000	\$ 160,000
Series 2006		8,305,000		8,305,000	
Governmental activity long-term liabilities	<u>\$ 38,765,000</u>	<u>\$ 8,305,000</u>	<u>\$ 9,285,000</u>	<u>\$ 37,785,000</u>	<u>\$ 160,000</u>

At September 30, 2006, the scheduled debt service requirements on the long - term debt were as follows:

Year ending September 30:	Governmental Activities	
	Principal	Interest
2007	\$ 160,000	2,068,959
2008	220,000	2,132,295
2009	235,000	2,119,175
2010	245,000	2,105,170
2011	21,910,000	1,620,443
2012-2016	1,575,000	4,336,325
2017-2021	2,120,000	3,804,330
2022-2026	2,875,000	3,085,240
2027-2031	3,885,000	2,102,585
2032-2036	4,310,000	769,225
2037	250,000	13,750
Total	<u>\$ 37,785,000</u>	<u>\$ 24,157,497</u>

NOTE 6 – DEVELOPER TRANSACTIONS

Developer revenue in the debt service fund for fiscal year ended September 30, 2006 was \$488,302.

NOTE 7 - MANAGEMENT COMPANY

The District has contracted with a management company to perform management advisory services, which include financial and accounting advisory services. Certain employees of the management company also serve as officers (Board appointed non-voting positions) of the District. Under the agreement, the District compensates the management company for management, accounting, financial reporting, and other administrative costs.

NOTE 8 - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters. The District has obtained commercial insurance from independent third parties to mitigate the costs of these risks; coverage may not extend to all situations. Settled claims from these risks have not exceeded commercial insurance coverage over the past three years.

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCE - BUDGET AND ACTUAL – GENERAL FUND
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2006**

	Budgeted Amount Original & Final	Actual Amounts	Variance with Final Budget - Positive (Negative)
REVENUES			
Assessments	\$ 642,771	\$ 649,217	\$ 6,446
Interest and other revenues		11,733	11,733
Total revenues	<u>642,771</u>	<u>660,950</u>	<u>18,179</u>
EXPENDITURES			
Current:			
General government	121,600	128,755	(7,155)
Maintenance and operations	521,171	253,604	267,567
Culture and recreation	-	110,169	(110,169)
Total expenditures	<u>642,771</u>	<u>492,528</u>	<u>150,243</u>
Excess (deficiency) of revenues over (under) expenditures	<u>\$ -</u>	168,422	<u>168,422</u>
Fund balances - beginning		<u>41,823</u>	
Fund balances - ending		<u>\$ 210,245</u>	

See notes to required supplementary information

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION**

The District is required to establish a budgetary system and an approved Annual Budget for the General Fund. The District's budgeting process is based on estimates of cash receipts and cash expenditures which are approved by the Board. The budget approximates a basis consistent with accounting principles generally accepted in the United States of America (generally accepted accounting principles).

The legal level of budgetary control, the level at which expenditures may not exceed the budget is in the aggregate. Any budget amendments that increase the aggregate budgeted appropriations must be approved by the Board of Supervisors.

**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

To the Board of Supervisors
Sterling Hill Community Development District
Hernando County, Florida

We have audited the financial statements of the governmental activities and each major fund of Sterling Hill Community Development District, Hernando County, Florida ("District") as of and for the fiscal year ended September 30, 2006, which collectively comprise the District's basic financial statements and have issued our report thereon dated February 16, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.


Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Sterling Hill Community Development District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Sterling Hill Community Development District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the management, Board of Supervisors of Sterling Hill Community Development District, Hernando County, Florida and the Auditor General of the State of Florida and is not intended to be and should not be used by anyone other than these specified parties.



February 16, 2007

**MANAGEMENT LETTER PURSUANT TO THE RULES OF
THE AUDITOR GENERAL FOR THE STATE OF FLORIDA**

To the Board of Supervisors
Sterling Hill Community Development District
Hernando County, Florida

We have audited the accompanying basic financial statements of Sterling Hill Community Development District ("District") as of and for the fiscal year ended September 30, 2006, and have issued our report thereon dated February 16, 2007.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

In addition, we have issued our Report on Internal Control over Financial Reporting and Compliance and Other Matters dated February 16, 2007. Disclosures in that report should be considered in conjunction with this management letter.

The purpose of this letter is to comment on those matters required by Chapter 10.550 of the Rules of the Auditor General for the State of Florida. Accordingly, in connection with our audit of the financial statements of the District, as described in the first paragraph, we report the following:

- I. Current year findings and recommendations.**
- II. Status of prior year findings and recommendations.**
- III. Compliance with the Provisions of the Auditor General of the State of Florida.**

This report is intended for the information of the management, Board of Supervisors of Sterling Hill Community Development District, Hernando County, Florida and the Auditor General of the State of Florida and is not intended to be and should not be used by anyone other than these specified parties.

We wish to thank Sterling Hill Community Development District, Hernando County, Florida and the personnel associated with it, for the opportunity to be of service to them in this endeavor as well as future engagements and the courtesies extended to us.



February 16, 2007

REPORT TO MANAGEMENT

I. CURRENT YEAR FINDINGS AND RECOMMENDATIONS

None

II. PRIOR YEAR FINDINGS AND RECOMMENDATIONS

None

III. COMPLIANCE WITH THE PROVISIONS OF THE AUDITOR GENERAL OF THE STATE OF FLORIDA

1. Unless otherwise required to be reported in the auditor's report on compliance and on internal controls, the management letter shall include, but not be limited to a statement as to whether or not corrective actions have been taken to address significant findings and recommendations made in the preceding annual financial audit report. There were no significant findings and recommendations made in the preceding annual financial audit report for the fiscal year ended September 30, 2005.
2. The District complied with Section 218.415, Florida Statutes, regarding the investment of public funds.
3. There were no violations of laws, rules, regulations, and contractual provisions or abuse, that were not clearly inconsequential, that have occurred, or were likely to have occurred, that were discovered within the scope of the audit.
4. There were no illegal or improper expenditures that were not clearly inconsequential, discovered within the scope of the audit that may not materially affect the financial statements.
5. There were no deficiencies in internal control that are not reportable conditions, including but not limited to, improper or inadequate accounting procedures, failure to properly record financial transactions or other inaccuracies, shortages, defalcations, or instances of fraud discovered by, or that came to the attention of, the auditor.
6. The name and legal authority for the District are disclosed in the notes to the financial statements.
7. The District has not met one or more of the conditions described in Section 218.503(1), Florida Statutes.
8. The financial report filed with the Florida Department of Financial Services pursuant to Section 218.32(1)(a), Florida Statutes agrees with the September 30, 2006 financial audit report.
9. We applied financial condition assessment procedures pursuant to Rule 10.556(7) and no deteriorating financial conditions were noted. It is management's responsibility to monitor financial condition, and our financial condition assessment was based in part on representations made by management and the review of financial information provided by same.