

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2010**

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

TABLE OF CONTENTS

	<u>Page</u>
INDEPENDENT AUDITOR'S REPORT	1-2
MANAGEMENT'S DISCUSSION AND ANALYSIS	3-6
BASIC FINANCIAL STATEMENTS	
Government-Wide Financial Statements:	
Statement of Net Assets	7
Statement of Activities	8
Fund Financial Statements:	
Balance Sheet – Governmental Funds	9
Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets	10
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds	11
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities	12
Notes to the Financial Statements	13-21
REQUIRED SUPPLEMENTARY INFORMATION	
Schedule of Revenues, Expenditures and Changes in Fund Balance – Budget and Actual – General Fund	22
Notes to Required Supplementary Information	23
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	24-25
MANAGEMENT LETTER REQUIRED BY CHAPTER 10.550 OF THE RULES OF THE AUDITOR GENERAL OF THE STATE OF FLORIDA	26-29



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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 District, Hernando County, Florida ("District") as of and for the fiscal year ended September 30, 2010, 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.

Management has not included the blended component unit Special Revenue Fund – Special Purpose Entity 1 (Maxcy Development Group Holdings – Sterling Hill, Inc. "SPE 1") in the Sterling Hill Community Development District's financial statements. Accounting principles generally accepted in the United States of America require the Special Revenue Fund to be presented as a major governmental fund and financial information about the Special Revenue Fund to be part of the governmental activities, thus increasing that activity's assets, liabilities, revenues, and expenses, and changing its net assets. The amount by which this departure would affect the assets, liabilities, net assets, revenues, and expenses of the governmental activities and the omitted major fund is not reasonably determinable.

In our opinion, because of the omission of the Special Revenue Fund, as discussed above, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of the Special Revenue Fund of the Sterling Hill Community Development District, Hernando County, as of September 30, 2010, or the changes in financial position thereof for the year then ended.

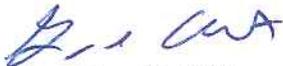
In addition, in our opinion, except for the effects of not including financial information for the Special Revenue Fund as part of the governmental activities, as described above, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities and each major fund of the District, as of September 30, 2010, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 6 and 7 to the basic financial statements, the District has declared an event of default on the Series 2006 Bonds as a result of non-payment of certain scheduled debt service payments. In addition, certain debt service payments were made using reserve funds during the fiscal year ended September 30, 2010. As a result of the event of default, the Bondholders created SPE 1 to foreclose on delinquent landowners.

In addition, an event of default was declared on the Series 2003 Bonds as the principal payment for the Series 2003B Bonds that was due on November 1, 2010 could not be made as sufficient funds were not collected from landowners through the assessment process.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2011, 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, 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 assessing the results of our audit.

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

A handwritten signature in blue ink, appearing to be "D. J. ...", is written above the date.

December 19, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Sterling Hill Community Development District, Hernando County, Florida ("District") provides a narrative overview of the District's financial activities for the fiscal year ended September 30, 2010. 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, 2010 resulting in a net asset balance of \$4,892,278.
- The change in the District's total net assets in comparison with the prior fiscal year was (\$1,083,164), a decrease. The key components of the District's net assets and change in net assets are reflected in the table in the government-wide financial analysis section.
- At September 30, 2010, the District's governmental funds reported combined ending fund balances of \$2,697,773, a decrease of (\$147,207) in comparison with the prior fiscal year. A portion of fund balance is reserved for debt service and other items and the remainder is unreserved 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 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 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 special assessment revenues. The District does not have any business-type activities. The governmental activities of the District include the general government (management), public safety, roads and streets, physical environment and parks and recreation functions.

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 governmental funds for external reporting. 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 which 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 at the close of the most recent fiscal year.

Key components of the District's net assets are reflected in the following table:

NET ASSETS SEPTEMBER 30,		
	2010	2009
Assets, excluding capital assets	\$ 3,613,390	\$ 4,040,552
Capital assets, not being depreciated	21,679,529	22,872,676
Total assets	25,292,919	26,913,228
Liabilities, excluding long-term liabilities	600,641	562,786
Long-term liabilities	19,800,000	20,375,000
Total liabilities	20,400,641	20,937,786
Net Assets		
Invested in capital assets, net of related debt	2,681,475	3,336,332
Restricted for debt service	1,686,273	1,390,535
Unrestricted	524,530	1,248,575
Total net assets	\$ 4,892,278	\$ 5,975,442

The District's net assets reflects its 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;

GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)

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.

The restricted portion of the District's net assets represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets may be used to meet the District's other obligations.

The District's net assets decreased during the most recent fiscal year. The majority of the decrease is the result of non-payment of a significant portion of the fiscal year 2010 assessments which resulted in the cost of operations and depreciation expense exceeding ongoing program revenues.

Key elements of the change in net assets are reflected in the following table:

	CHANGES IN NET ASSETS	
	FOR THE FISCAL YEAR ENDED SEPTEMBER 30,	
	2010	2009
Revenues:		
Program revenues		
Charges for services	\$ 2,317,670	\$ 2,954,905
Operating grants and contributions	100	7,073
Capital grants and contributions	210	8,601
General revenues	2,260	404,808
Total revenues	<u>2,320,240</u>	<u>3,375,387</u>
Expenses:		
General government	150,261	192,908
Public safety	42,195	29,374
Roads and streets	620,486	545,690
Physical environment	650,471	2,575,192
Culture and recreation	656,026	422,139
Interest	1,283,965	1,341,619
Total expenses	<u>3,403,404</u>	<u>5,106,922</u>
Change in net assets	<u>(1,083,164)</u>	<u>(1,731,535)</u>
Net assets - beginning	<u>5,975,442</u>	<u>7,706,977</u>
Net assets - ending	<u>\$ 4,892,278</u>	<u>\$ 5,975,442</u>

As noted above and in the statement of activities, the cost of all governmental activities during the fiscal year ended September 30, 2010 was \$3,403,404. The costs of the District's activities were primarily funded by program revenues. As in the prior year, program revenues are comprised primarily of assessments. The majority of the decrease from the prior year is the result of a decrease in assessment revenue in comparison to prior year.

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. Actual expenditures in the general fund did not exceed appropriations during the fiscal year ended September 30, 2010.

The variance between budgeted and actual general fund revenues for the 2010 fiscal year is partially the result of less discounts being taken by landowners therefore; net assessment collections were higher than anticipated. The actual general fund expenditures for the 2010 fiscal year were lower than budgeted amounts due primarily to anticipated costs which were not incurred in the current fiscal year.

ECONOMIC FACTORS AND NEXT YEARS EVENTS

In fiscal year 2012, a second Special Purpose Entity (MDGH – Sterling Hills 2, Inc. “SPE 2”) was created as a result of default assessments for the Series 2003 Bonds. See Note 13 – Subsequent Events for additional details.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At September 30, 2010, the District had \$25,911,782 invested in land, infrastructure and other improvements. In the government-wide financial statements depreciation of \$4,232,253 has been taken, which resulted in a net book value of \$21,679,529. More detailed information about the District’s capital assets is presented in the notes of the financial statements.

Capital Debt

At September 30, 2010, the District had \$19,800,000 in Bonds outstanding for its governmental activities. More detailed information about the District’s capital debt is presented in the notes of the financial statements.

CONTACTING THE DISTRICT’S FINANCIAL MANAGEMENT

This financial report is designed to provide homeowners, 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.

FINANCIAL STATEMENTS

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
STATEMENT OF NET ASSETS
SEPTEMBER 30, 2010**

	<u>Governmental Activities</u>
ASSETS	
Cash	\$ 492,143
Investments	5,758
Assessment receivable	62,949
Due from SPE	20,553
Prepays	28,322
Restricted assets:	
Temporarily restricted	
Investments	2,201,719
Deferred charges	801,946
Capital assets:	
Nondepreciable	1,500,000
Depreciable, net	20,179,529
Total assets	<u>25,292,919</u>
LIABILITIES	
Accounts payable	22,231
Accrued interest payable	486,970
Due to Bondholder	91,440
Non-current liabilities:	
Due within one year	4,785,000
Due in more than one year	15,015,000
Total liabilities	<u>20,400,641</u>
NET ASSETS	
Invested in capital assets, net of related debt	2,681,475
Restricted for debt service	1,686,273
Unrestricted	524,530
Total net assets	<u>\$ 4,892,278</u>

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2010**

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue and Changes in Net Assets</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	<u>Governmental Activities</u>
Primary government:					
Governmental activities:					
General government	\$ 150,261	\$ 150,261	\$ -	\$ -	\$ -
Public safety	42,195	-	-	-	(42,195)
Roads and streets	620,486	-	-	-	(620,486)
Physical environment	650,471	-	-	-	(650,471)
Culture and recreation	656,026	1,031,146	-	210	375,330
Interest and costs on long-term debt	1,283,965	1,136,263	100	-	(147,602)
Total governmental activities	3,403,404	2,317,670	100	210	(1,085,424)
General revenues:					
Investment earnings					2,260
Total general revenues					2,260
Change in net assets					(1,083,164)
Net assets - beginning					5,975,442
Net assets - ending					\$ 4,892,278

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
BALANCE SHEET
GOVERNMENTAL FUNDS
SEPTEMBER 30, 2010**

	Major Funds			Total Governmental Funds
	General	Debt Service	Capital Projects	
ASSETS				
Cash and cash equivalents	\$ 492,143	\$ -	\$ -	\$ 492,143
Investments	5,758	2,201,719	-	2,207,477
Assessment receivable	20,538	42,411	-	62,949
Due from SPE	-	20,553	-	20,553
Prepays	28,322	-	-	28,322
Total assets	<u>\$ 546,761</u>	<u>\$ 2,264,683</u>	<u>\$ -</u>	<u>\$ 2,811,444</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	\$ 22,231	\$ -	\$ -	\$ 22,231
Due to Bondholders	-	91,440	-	91,440
Total liabilities	<u>22,231</u>	<u>91,440</u>	<u>-</u>	<u>113,671</u>
Fund balances:				
Reserved for:				
Debt service	-	2,173,243	-	2,173,243
Other	28,322	-	-	28,322
Unreserved, designated:				
Designated for maintenance	185,287	-	-	185,287
Unreserved, reported in:				
General fund	310,921	-	-	310,921
Total fund balances	<u>524,530</u>	<u>2,173,243</u>	<u>-</u>	<u>2,697,773</u>
Total liabilities and fund balances	<u>\$ 546,761</u>	<u>\$ 2,264,683</u>	<u>\$ -</u>	<u>\$ 2,811,444</u>

See notes to the financial statements

**STERLING HILL COMMUNITY DEVELOPMENT DISTRICT
HERNANDO COUNTY, FLORIDA
RECONCILIATION OF THE BALANCE SHEET –
GOVERNMENTAL FUNDS TO THE STATEMENT OF NET ASSETS
SEPTEMBER 30, 2010**

Total fund balances - governmental funds		\$ 2,697,773
Amounts reported for governmental activities in the statement of net assets are different because:		
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 net assets of the government as a whole.		
Cost of capital assets	25,911,782	
Accumulated depreciation	<u>(4,232,253)</u>	21,679,529
Bond issuance costs are not financial resources and, therefore, are not reported as assets in the governmental funds. The statements of net assets includes these costs, net of amortization.		
Bond issuance costs	1,174,734	
Accumulated amortization	<u>(372,788)</u>	801,946
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 financial statements.		
Accrued interest payable	(486,970)	
Bonds payable	<u>(19,800,000)</u>	<u>(20,286,970)</u>
Net assets of governmental activities		<u><u>\$ 4,892,278</u></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, 2010**

	Major Funds			Total Governmental Funds
	General	Debt Service	Capital Projects	
REVENUES				
Assessments	\$ 1,170,890	\$ 1,090,963	\$ -	\$ 2,261,853
Assessments - prepayments	-	334,449	-	334,449
Interest	2,260	100	210	2,570
Miscellaneous revenue	10,517	-	-	10,517
Total revenues	<u>1,183,667</u>	<u>1,425,512</u>	<u>210</u>	<u>2,609,389</u>
EXPENDITURES				
Current:				
General government	150,261	-	-	150,261
Public safety	42,195	-	-	42,195
Roads and streets	107,827	-	-	107,827
Physical environment	358,084	-	-	358,084
Culture and recreation	267,925	-	-	267,925
Debt Service:				
Principal	-	575,000	-	575,000
Interest	-	1,193,515	-	1,193,515
Foreclosure related costs	-	61,789	-	61,789
Total expenditures	<u>926,292</u>	<u>1,830,304</u>	<u>-</u>	<u>2,756,596</u>
Excess (deficiency) of revenues over (under) expenditures	257,375	(404,792)	210	(147,207)
OTHER FINANCING SOURCES (USES)				
Transfers in	210	24	-	234
Transfers (out)	-	-	(234)	(234)
Total other financing sources (uses)	<u>210</u>	<u>24</u>	<u>(234)</u>	<u>-</u>
Net change in fund balances	257,585	(404,768)	(24)	(147,207)
Fund balances - beginning	<u>266,945</u>	<u>2,578,011</u>	<u>24</u>	<u>2,844,980</u>
Fund balances - ending	<u>\$ 524,530</u>	<u>\$ 2,173,243</u>	<u>\$ -</u>	<u>\$ 2,697,773</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, 2010**

Net change in fund balances - total governmental funds	\$	(147,207)
Amounts reported for governmental activities in the statement of activities are different because:		
Depreciation of capital assets is not recognized in the governmental fund statements but is reported as an expense in the statement of activities.		(1,193,147)
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		575,000
Certain revenues recognized in the prior year on the statement of activities are uncollectible. As such, these amounts are netted against current year revenue on the statement of activities.		(289,149)
Amortization of deferred charges is not recognized in the governmental fund statements but is reported as an expense in the statement of activities.		(36,710)
The change in accrued interest on long-term liabilities between the current and prior fiscal year is recorded in the statement of activities but not in the fund financial statements.		<u>8,049</u>
Change in net assets of governmental activities	\$	<u><u>(1,083,164)</u></u>

See notes to the financial statements

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

NOTE 1 – NATURE OF ORGANIZATION AND REPORTING ENTITY

Sterling Hill Community Development District ("District") was established 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 is governed by the Board of Supervisors ("Board"), which is composed of five members. The Supervisors are elected on an at large basis by the owners of the property within the District. Ownership of land within the District entitles the owner to one vote per acre. The Board of Supervisors of the District exercise all powers granted to the District pursuant to Chapter 190, Florida Statutes. At September 30, 2010 all of the Board members are affiliated with DEVCO, LLC ("Developer").

The Board has the final responsibility for:

1. Assessing and levying 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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. Operating-type special assessments for maintenance and debt service are treated as charges for services. and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Other items not included among program revenues are reported instead as *general revenues*.

NOTE 2 – 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, including debt service assessments and operation and maintenance assessments, are non-ad valorem assessments imposed on all lands located within the District and benefited by the District's activities. Assessments are levied by the District prior to the start of the fiscal year which begins October 1st and ends on September 30th. Operation and maintenance special assessments are imposed upon all benefited lands in the District. Debt service special assessments are imposed upon certain lots and lands described in each resolution imposing the special assessment for each series of Bonds issued by the District.

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 the Series 2003 and Series 2006 Bonds.

Capital Projects Fund

This fund accounts for the financial resources to be used for the acquisition or construction of major infrastructure within the District. The fund was closed during the current fiscal year.

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 District's policy to use restricted resources first for qualifying expenditures, then unrestricted resources as they are needed.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Assets or Equity

Restricted Assets

These assets represent cash and investments set aside pursuant to Bond covenants or other contractual restrictions.

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 as specified 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 asset lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Property, plant and equipment of the District are depreciated using the straight-line method over the following estimated useful lives:

<u>Assets</u>	<u>Years</u>
Roadways and streetlights	20
Water management control	25
Security and landscaping	15
Equipment	10
Vehicle	5
Recreational facilities	30

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Assets or Equity (Continued)

Capital Assets (Continued)

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.

Deferred Charges

In a prior year, in connection with the issuance of certain debt, the District incurred costs totaling \$1,174,734. In the government-wide financial statements that amount has been capitalized and amortized over the estimated life of the Bonds. At September 30, 2010 the District reported accumulated amortization of \$372,788.

Deferred Revenue

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned.

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 ratably over the life of the Bonds. Bonds payable are reported net of applicable premiums or discounts.

In the fund financial statements, governmental fund types recognize premiums and discounts, as well as 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 capital projects fund 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 financial 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 or other contractual restrictions.

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 3 – 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) A public hearing is conducted to obtain public 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.
- f) Unused appropriation for annually budgeted funds lapse at the end of the year.

NOTE 4 – DEPOSITS AND INVESTMENTS

Deposits

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, 2010:

	Fair Value	Credit Risk	Weighted Average Maturities
US Bank Money Market Account - Managed	\$ 2,201,719	N/A	N/A
Florida Prime	2,675	S&P AAAM	52 days
Investment in Fund B Surplus Funds Trust Fund	3,083	Not rated	7.49 years
Total Investments	<u>\$ 2,207,477</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 investments are not evidenced by securities that exist in physical or book entry form.

Credit risk – For investments, credit risk is generally the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Investment ratings by investment type are included in the preceding summary of investments.

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.

The Bond indenture limits the type of investments held using unspent Bond proceeds.

NOTE 5 – CAPITAL ASSETS

Capital asset activity for the fiscal year ended September 30, 2010 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
<u>Governmental activities</u>				
Capital assets, not being depreciated				
Land	\$ 1,500,000	\$ -	\$ -	\$ 1,500,000
Total capital assets, not being depreciated	1,500,000	-	-	1,500,000
Capital assets, being depreciated				
Roadways and streetlights	10,253,189	-	-	10,253,189
Water management control	6,947,890	-	-	6,947,890
Security and landscaping	4,558,288	-	-	4,558,288
Equipment	107,207	-	-	107,207
Vehicle	18,750	-	-	18,750
Recreational facilities	2,526,458	-	-	2,526,458
Total capital assets, being depreciated	24,411,782	-	-	24,411,782
Less accumulated depreciation for:				
Roadways and streetlights	(1,537,979)	(512,659)	-	(2,050,638)
Water management control	(730,065)	(277,916)	-	(1,007,981)
Security and landscaping	(555,169)	(303,886)	-	(859,055)
Equipment	(13,501)	(10,721)	-	(24,222)
Vehicle	(4,575)	(3,750)	-	(8,325)
Recreational facilities	(197,817)	(84,215)	-	(282,032)
Total accumulated depreciation	(3,039,106)	(1,193,147)	-	(4,232,253)
Total capital assets, being depreciated, net	21,372,676	(1,193,147)	-	20,179,529
Governmental activities capital assets	\$ 22,872,676	\$ (1,193,147)	\$ -	\$ 21,679,529

Depreciation expense was charged to function/programs as follows:

Depreciation is charged to the following functions:	
Roads and streets	\$ 512,659
Maintenance and operations	292,387
Culture and recreation	388,101
Total depreciation expense	<u>\$ 1,193,147</u>

NOTE 6 – 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 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 November 1, 2010 with a fixed interest rate of 5.5%. 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 to be 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 November 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 their selected 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, 2010 as the District collected assessments and prepaid \$330,000 of the Series 2003B Bonds.

NOTE 6 – LONG-TERM LIABILITIES (Continued)

Series 2003 (Continued)

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 Bond Indenture. At September 30, 2010, the requirement was not met as funds held on deposit in the reserve accounts were used to pay costs related to the foreclosure process for delinquent landowners.

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 agrees to levy special assessments in annual amounts adequate to provide payment of debt service.

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 May 1, 2037 with a fixed interest rate of 5.5%, and \$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 to be 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 current year interest payments for the Series 2006 Bonds were made late on December 2, 2009 and June 4, 2010 and the principal due on the Series 2006A Bonds was not paid.

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, 2013 at a redemption price as set forth in the Bond Indenture. The Bonds are subject to extraordinary mandatory redemption prior to their selected 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 Bond Indenture. At September 30, 2010, the requirement was not met as funds held on deposit in the reserve accounts were used to partially pay the interest due on the Bond and for costs related to the event of default declared by the District.

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 agrees to levy special assessments in annual amounts adequate to provide payment of debt service.

Changes in long-term liability activity for the fiscal year ended September 30, 2010 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
<u>Governmental activities</u>					
Bonds payable:					
Series 2003A	\$ 11,875,000	\$ -	\$ 190,000	\$ 11,685,000	\$ 205,000
Series 2003B	4,555,000		330,000	4,225,000	4,225,000
Series 2006A	3,650,000		55,000	3,595,000	60,000
Series 2006B	295,000	-	-	295,000	295,000
Total	<u>\$ 20,375,000</u>	<u>\$ -</u>	<u>\$ 575,000</u>	<u>\$ 19,800,000</u>	<u>\$ 4,785,000</u>

The \$55,000 reduction to the Series 2006A Bonds represents an unpaid past due payment which is accrued and included in Due to Bondholder in the accompanying financial statements.

NOTE 6 – LONG TERM LIABILITIES (Continued)

At September 30, 2010, the scheduled debt service requirements on the long - term debt were as follows:

Year ending September 30:	Governmental Activities		
	Principal	Interest	Total
2011	\$ 4,785,000	\$ 1,052,538	\$ 5,837,538
2012	275,000	905,500	1,180,500
2013	295,000	889,085	1,184,085
2014	315,000	871,480	1,186,480
2015	335,000	852,685	1,187,685
2016-2020	1,995,000	3,938,540	5,933,540
2021-2025	2,710,000	3,263,125	5,973,125
2026-2030	3,655,000	2,339,000	5,994,000
2031-2035	4,950,000	1,029,035	5,979,035
2036-2037	485,000	101,655	586,655
	<u>\$ 19,800,000</u>	<u>\$ 15,242,643</u>	<u>\$ 35,042,643</u>

NOTE 7 – BOND DEFAULT AND SPECIAL PURPOSE ENTITY 1

On January 12, 2010, the District declared an event of default on the Series 2006 Bonds as a result of non-collection of assessments from landowners to make the necessary debt service payments. Pursuant to the Bond Indenture, the Trustee has access to the funds held on deposit in the trust accounts and SPE 1 was created to own and maintain the property subject to delinquent 2006 assessments. The SPE 1 accepted lots owned by the delinquent landowners (including the Developer). In addition, an agreement was entered into between the District and SPE 1, whereby, debt service assessments on the Bond would be forborne but continue to constitute a lien on the property. The operation and maintenance assessments for the lots will be billed to SPE 1. For the fiscal year ended September 30, 2010, the SPE was billed \$23,057 of which \$3,804 is reported as a receivable at year end. The agreement states that in the event funds are no longer available in the trust accounts and another funding source has not been secured or changes affecting the delinquent lands results in increased risk to SPE 1 or related parties, SPE 1 may convey the lands to the District for ownership and maintenance.

Expenditures (legal fees and trustee fees) paid for costs related to the default were approximately \$51,000. The costs were paid from the Series 2006 Revenue Trust Account. In addition, the Trustee transferred \$20,553 of District funds to SPE 1 for its operating costs.

Further, the Bondholder provided \$396,666 to fund expenditures of SPE 1. The amounts were transferred to the SPE. The revenues and expenditures of SPE 1 have not been included in the District's financial statements.

Assessment revenues collected for the Series 2006A Bonds during the current year were approximately \$90,000. The revenues were not used to pay debt service due on the Bonds.

Further, on September 14, 2010, the District declared an event of default on the Series 2003 Bonds as a result of non-collection of assessments to make the lump sum principal payment on the Series 2003B on November 1, 2010. Expenditures related to the event of default were approximately \$11,000 and was paid from the Series 2003A and 2003B Reserve Trust Accounts.

NOTE 8 – EMPHASIS OF A MATTER

The District's financial condition is deteriorating. During the current fiscal year, \$161,264 of funds held on deposit in the Series 2006A&B Bonds were used to partially make the necessary debt service interest payments. In addition, as mentioned in Notes 6 and 7, the District did not make the scheduled principal payment on the Series 2006A Bonds and did not collect sufficient assessments on the Series 2006B Bonds to make the scheduled interest payments during the year and balloon payment on May 1, 2011.

In addition, the District did not collect sufficient assessments for the Series 2003B Bonds to make the scheduled balloon payment due on November 1, 2010.

NOTE 9 – DEVELOPER TRANSACTIONS

During the current fiscal year, DEVCO, LLC ("former Developer") deeded its interest in the land bearing debt for the Series 2006B Bonds within the District to SPE 1. The Developer still owns a portion of the land within the District related to the Series 2006A Bonds; therefore, assessment revenues in the general and debt service funds include assessments levied on those lots owned by the Developer.

NOTE 11 – 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 12 – 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. The District has not filed any claims under this commercial coverage during the last three years.

NOTE 13 – SUBSEQUENT EVENTS

Series 2003 Bonds

As of September 30, 2010, the Series 2003A&B Prepayment Trust Accounts had a balance of \$18,530 and \$177,966 respectively. The amounts were not used to prepay the debt subsequent to year end, as the Trustee is awaiting direction from a majority of the Bondholders. Currently there are differing opinions among the Bondholders regarding the distribution of funds. As of the report date, the amounts have not been paid.

Subsequent to year end, the District prepaid \$15,000 of the Series 2003A Bonds. The prepayments were considered extraordinary mandatory redemptions as outlined in the Bond Indenture.

Foreclosure

Subsequent to year end, the District filed foreclosure lawsuits against three landowners for failure to pay assessments due on the Series 2003B Bonds. SPE 2 has been created and one of the landowners conveyed their land to the SPE by delivering an executed deed in lieu of foreclosure. The foreclosure lawsuits are still pending against the other two delinquent landowners. In addition, the District is considering filing foreclosure lawsuits against other delinquent landowners.

**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, 2010**

	Budgeted Amounts <u>Original & Final</u>	Actual Amounts	Variance with Final Budget - Positive (Negative)
REVENUES			
Assessments	\$ 1,109,754	\$ 1,170,890	\$ 61,136
Interest and miscellaneous revenue	-	12,777	12,777
Total revenues	<u>1,109,754</u>	<u>1,183,667</u>	<u>73,913</u>
EXPENDITURES			
Current:			
General government	142,149	150,261	(8,112)
Public safety	43,435	42,195	1,240
Roads and streets	35,150	107,827	(72,677)
Physical environment	620,210	358,084	262,126
Parks and recreation	268,810	267,925	885
Total expenditures	<u>1,109,754</u>	<u>926,292</u>	<u>183,462</u>
Excess (deficiency) of revenues over (under) expenditures	-	257,375	257,375
OTHER FINANCING SOURCES			
Transfers in	-	210	210
Total other financing sources	<u>-</u>	<u>210</u>	<u>210</u>
Net change in fund balances	<u>\$ -</u>	<u>257,585</u>	<u>\$ 257,585</u>
Fund balance - beginning		<u>266,945</u>	
Fund balance - ending		<u>\$ 524,530</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 budget, is in the aggregate. Any budget amendments that increase the aggregate budgeted appropriations must be approved by the Board of Supervisors. Actual expenditures in the general fund did not exceed appropriations during the fiscal year ended September 30, 2010.

The variance between budgeted and actual general fund revenues for the 2010 fiscal year is partially the result less discounts being taken by landowners therefore; net assessment collections were higher than anticipated. The actual general fund expenditures for the 2010 fiscal year were lower than budgeted amounts due primarily to anticipated costs which were not incurred in the current fiscal year.



**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, 2010, which collectively comprise the District's basic financial statements and have issued our report thereon dated December 19, 2011, which includes an explanatory paragraph regarding the adverse opinion for the omission of the Special Revenue Fund and an emphasis of a matter paragraph. Except as discussed in the explanatory paragraph, 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 District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We identified a deficiency in internal control over financial reporting that we consider to be a material weakness, as defined above. See accompanying report to management dated December 19, 2011, finding 2010-01 for details of the material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, and agreements, 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*.

We noted certain matters that we reported to management of the District in a separate letter dated December 19, 2011.

The District's responses to the findings identified in our audit are described in the accompanying Management Letter. We did not audit the District's responses and, accordingly, we express no opinion on them.

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.


December 19, 2011



**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, 2010, and have issued our report thereon dated December 19, 2011, which includes an explanatory paragraph regarding the adverse opinion for the omission of the Special Revenue Fund and an emphasis of a matter paragraph.

Except as discussed in the explanatory paragraph, 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 December 19, 2011. 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.

December 19, 2011

REPORT TO MANAGEMENT

I. CURRENT YEAR FINDINGS AND RECOMMENDATIONS

Material Weakness

2010-01 Omission of a Major Fund

Observation: The District did not include SPE 1 as a major fund as required by generally accepted accounting principles. As a result, the total governmental activities of the District are not reflected in the financial statements.

Recommendation: The District should include SPE 1 as a major fund of the District's governmental activities.

Management Response: Management does not agree that the Special Purpose Entity (SPE 1) should be included as a component unit, and, thus, a Special Revenue Fund of the District. In summary, management feels that it would be misleading to the users of the financial statements to include SPE 1 as a component unit for the following reasons. The District has no ownership and/or control over SPE 1 and in no way can impose its will on SPE 1. In addition, the District will not benefit from the activities of SPE 1. When the land held by SPE 1 is sold, the net proceeds will be paid directly to the Bondholders to satisfy the Bond debt. The District will not be responsible for any deficiency between the net proceeds of the sale and the associated Bond debt.

Other Findings

2010-02 Bond Reserve Requirement

Observation: As a result of unscheduled draws on the Series 2003A, Series 2003B, Series 2006A, and Series 2006B to either make debt service payments or pay for costs related to foreclosure process, the reserve requirement was not met at September 30, 2010.

Recommendation: The District should take the necessary steps to replenish the reserve account.

Management Response: The District and the Bondholders have been working to alleviate this issue. As discussed in the Notes to the Financial Statements, during the current fiscal year, the Trustee formed a Special Purpose Entity (SPE 1) to own and maintain the property subject to delinquent 2006 assessments. In addition, subsequent to year end, the District filed foreclosure against three landowners for failure to pay assessments due on the Series 2003B Bonds. The Trustee formed SPE 2 to own and maintain the property subject to delinquent 2003B Bond assessments upon transfer of ownership to the SPE. The District is taking all necessary and available actions in order to collect both O&M assessments and Debt assessments. Once the assessments have been collected, the Trustee, on behalf of the Bondholders, and the District will need to discuss the status of the debt service reserve funds and determine if the debt service reserve funds will be replenished to an appropriate level based on the Bond Indentures.

2010-03 Financial Condition Assessment

Observation: The District's financial conditions are deteriorating. The Developer and other landowners failed to pay their share of assessments during the 2010 fiscal year. As a result, the Series 2006A principal payment was not made and only a portion of the interest payment for both Series was made, partially from funds held in the Reserve accounts. As a result of the District's failure to make scheduled debt service payments when they are due events of default have been declared for both the Series 2003 and Series 2006 Bonds.

Recommendation: The District should take the necessary steps to alleviate the deteriorating financial conditions.

REPORT TO MANAGEMENT (Continued)

2010-03 Financial Condition Assessment (Continued)

Management Response: As discussed above and in the Notes to the Financial Statements, during the current fiscal year, the Trustee formed a Special Purpose Entity (SPE 1) to own and maintain the property subject to delinquent 2006 assessments. In addition, subsequent to year end, the District filed foreclosure against three landowners for failure to pay assessments due on the Series 2003B Bonds. The Trustee formed SPE 2 to own and maintain the property subject to delinquent 2003B Bond assessments upon transfer of ownership to the SPE. The District is taking all necessary and available actions in order to collect both O&M assessments and Debt assessments. If successful, the collection of the outstanding assessments will allow the District to properly fund the operations of the District going forward.

II. PRIOR YEAR FINDINGS AND RECOMMENDATIONS

Reserve Account Requirement

Current Status: Matter not resolved, see finding above.

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

Unless otherwise required to be reported in the auditor's report on compliance and internal controls, the management letter shall include, but not be limited to the following:

1. A statement as to whether or not corrective actions have been taken to address 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, 2009, except as noted above.

2. A statement as to whether or not the local governmental entity complied with Section 218.415, Florida Statutes, regarding the investment of public funds.

The District complied with Section 218.415, Florida Statutes, regarding the investment of public funds.

3. Any recommendations to improve the local governmental entity's financial management.

There were no such matters discovered by, or that came to the attention of, the auditor, to be reported for the fiscal year ended September 30, 2010, except as noted above.

4. Violations of provisions of contracts or grant agreements, or abuse, that have occurred, or are likely to have occurred, that have an effect on the financial statements that is less than material but more than inconsequential.

There were no such matters discovered by, or that came to the attention of, the auditor, to be reported, for the fiscal year ended September 30, 2010, except as noted above.

5. For matters that have an inconsequential effect on the financial statements, considering both quantitative and qualitative factors, the following may be reported based on professional judgment:

- a. Violations of provisions of contracts or grant agreements, fraud, illegal acts, or abuse.
- b. Deficiencies in internal control that are not significant deficiencies.

There were no such matters discovered by, or that came to the attention of, the auditor, that, in our judgment, are required to be reported, for the fiscal year ended September 30, 2010, except as noted above.

REPORT TO MANAGEMENT (Continued)

6. The name or official title and legal authority of the District are disclosed in the notes to the financial statements.
7. 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, 2010 financial audit report.
8. In connection with our audit, we determined that the District has met one or more of the financial emergency conditions described in Section 218.503 (1), Florida Statutes. On May 1, 2010, the District failed to make the Series 2006A debt service payment when due; used reserve funds to make partial interest payments on the Series 2006A&B Bonds, and a portion of the interest for both Bonds was not paid. This failure to pay is as a result of a lack of funds due to a significant portion of the assessments for the fiscal year ended September 30, 2010 being delinquent. We applied financial condition assessment procedures pursuant to Rule 10.556(7) and determined that a deteriorating financial condition was noted. See Findings section above for additional information. 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.