

**MONTECITO
COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
FINANCIAL REPORT
FOR THE FISCAL YEAR ENDED
SEPTEMBER 30, 2013**

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Supervisors
Montecito Community Development District
Satellite Beach, Florida

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities and each major fund of Montecito Community Development District, Satellite Beach, Florida ("District") as of and for the fiscal year ended September 30, 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. Except as discussed in the following 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

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

The District was unable to provide sufficient competent evidential matter for certain expenditures paid for by the Trustee from the Capital Projects Fund. The financial information of the Capital Projects Fund is part of the governmental activities and is considered a major fund.

Opinions

In our opinion, because of the omission of the Special Revenue Funds, 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 Funds and the governmental activities of the District, as of September 30, 2013, or the changes in financial position thereof for the fiscal year then ended.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the District been able to provide sufficient competent evidential matter for certain selected expenditures paid for by the Trustee from the Capital Projects Fund, the financial statements referred to above present fairly, in all material respects, the respective financial position of the general fund, debt service fund and capital projects fund of the District, as of September 30, 2013, 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.

Emphasis of Matters

As described in Note 2 to the financial statements, in fiscal year 2013, the District implemented new accounting guidance, Governmental Accounting Standards Board ("GASB") Statements No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* and No. 65, *Items Previously Reported as Assets and Liabilities*.

As discussed in Note 9 and other referenced notes to the financial statements, the District's financial conditions continue to deteriorate. The Developer and certain major landowners failed to pay a significant portion of the assessments in fiscal years 2009 - 2014. As a result, reserve funds were used to partially pay certain required debt service payments during the prior fiscal years. In addition, certain required debt service payments were not made during the prior, current, and subsequent fiscal years, resulting in events of default. Further, the general fund and debt service fund reported deficit fund balances at the end of the fiscal year. The District has initiated foreclosure proceedings for the delinquent assessments. The District is economically dependent on the Developer and major landowners. In addition, there are significant uncontested delinquent payables exceeding 90 days. Our opinion is not modified with respect to this matter.

During the current fiscal year, the District entered into a tri-party agreement with the Trustee and the SPE relating to delinquent assessments. Under the agreement, the SPE will acquire certain property subject to delinquent assessments and manage the property for resale – see Note 10 for additional information. Our opinion is modified with respect to this matter.

Other Matters

Required Supplementary Information

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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 24, 2014, 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, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

June 24, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Montecito Community Development District, Satellite Beach, Florida ("District") provides a narrative overview of the District's financial activities for the fiscal year ended September 30, 2013. 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 most recent fiscal year resulting in a net position balance of \$1,468,376.
- The change in the District's total net position in comparison with the prior year was (\$875,753), a decrease. The key components of the District's net position and change in net position are reflected in the table in the government-wide financial analysis section.
- At September, 30, 2013, the District's governmental funds reported combined ending deficit fund balances of (\$8,457,747), a decrease of (\$13,401,180) in comparison with the prior fiscal year. A portion of fund balance is restricted for capital projects, default expenditures and non-spendable for prepaid items and deposits, (\$14,252,766) is unassigned, deficit fund balance reported in the debt service fund, and (\$113,167) is unassigned, deficit fund balance reported in the general fund.
- During fiscal year 2013, the District implemented Governmental Accounting Standards Board ("GASB") Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 Financial Accounting Standards Board ("FASB") and American Institute of Certified Public Accountants ("AICPA") Pronouncements*, GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Please see New Accounting Standards Adopted in Note 2 of the financial statements for additional information.

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis is 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 position presents information on all the District's assets, deferred outflows of resources, liabilities, and deferred inflows of resources with the residual amount being reported as net position. Over time, increases or decreases in net position 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 position changed during the most recent fiscal year. All changes in net position 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), maintenance and recreation functions.

OVERVIEW OF FINANCIAL STATEMENTS (Continued)

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.

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 project 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 position 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.

A portion of the District's net position 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; 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.

GOVERNMENT-WIDE FINANCIAL ANALYSIS (Continued)

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

	NET POSITION	
	SEPTEMBER 30,	
	Governmental Activities	
	2013	2012
Current and other assets	\$ 7,133,025	\$ 7,444,001
Capital assets, net	15,475,276	16,049,305
Total assets	22,608,301	23,493,306
Liabilities, excluding long-term liabilities	15,984,925	2,459,561
Long-term liabilities	5,155,000	18,245,000
Total liabilities	21,139,925	20,704,561
Net position		
Net investment in capital assets	2,159,624	2,882,031
Restricted for capital projects	1,709,935	1,695,688
Restricted for default expenditures	15,779	43,260
Unrestricted	(2,416,962)	(1,832,234)
Total net position	\$ 1,468,376	\$ 2,788,745

The District's net position decreased during the most recent fiscal year. The majority of the decrease represents the extent to which the cost of operations and depreciation expense exceeded ongoing program revenues as a result of delinquent assessments.

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

	CHANGES IN NET POSITION	
	FOR THE FISCAL YEAR ENDED SEPTEMBER 30,	
	Governmental Activities	
	2013	2012
Revenues:		
Program revenues	\$ 1,073,727	\$ 897,543
General revenues	2,096	1,843
Total revenues	1,075,823	899,386
Expenses:		
General government	200,898	141,041
Physical environment	665,557	738,588
Culture and recreation	129,359	130,585
Interest on long-term debt	955,762	993,916
Total expenses	1,951,576	2,004,130
Change in net position	(875,753)	(1,104,744)
Net position - beginning, previously stated	2,788,745	3,893,489
Effect of adoption of GASB No. 65 (Note 2)	(444,616)	-
Net position - beginning, as restated	2,344,129	3,893,489
Net position - ending	\$ 1,468,376	\$ 2,788,745

Program revenues of the District are comprised primarily of assessments and a substantial portion of program revenues were comprised of prepaid assessments for both the current and prior fiscal years. As lots in the District are sold to homeowners, prepaid assessments and related debt paid from those assessments are expected to decrease over time. The increase in program revenues is mainly due to more prepayment revenues in the current fiscal 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 general fund expenditures did not exceed appropriations for the fiscal year ended September 30, 2013.

The variance between budgeted and actual general fund revenues for the 2013 fiscal year is the result of the non-payment of a significant portion of the 2013 fiscal year assessments by a major landowner, although Developer contributions were received which had not been budgeted for to help cover the cost of the District's operations thereby reducing the difference between budgeted and actual general fund revenues. The actual general fund expenditures for the current fiscal year were lower than budgeted amounts due primarily to anticipated costs which were not incurred in the current fiscal year.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At September 30, 2013, the District had \$18,535,509 invested in land, infrastructure in progress, various infrastructure capital assets, recreational facilities and furniture, fixtures and equipment. In the government-wide financial statements depreciation of \$3,060,233 has been taken, which resulted in a net book value of \$15,475,276. More detailed information about the District's capital assets is presented in the notes to the financial statements.

Capital Debt

At September 30, 2013, the District had \$5,155,000 in Bonds outstanding for its governmental activities. In addition, \$12,960,000 of past due principal is included in Due to Bondholder. More detailed information about the District's capital debt is presented in the notes to the financial statements.

ECONOMIC FACTORS AND NEXT YEARS BUDGETS

The District does not anticipate any major changes to its infrastructure maintenance program for fiscal year 2013. In addition, it is anticipated that the general operations of the District will remain fairly constant.

As discussed in the notes to the financial statements, there are significant delinquent fiscal year 2009 - 2014 assessments that have not been collected from the Developer and certain major landowners. Consequently, certain debt service payments were not made or were made in part by draws from the reserve accounts. The District has initiated foreclosure proceedings for the delinquent assessments. The District is economically dependent on the Developer and major landowners.

During the current fiscal year, the District entered into a tri-party agreement with the Trustee and the SPE relating to delinquent assessments. Under the agreement, the SPE will acquire certain property subject to delinquent assessments and manage the property for resale. The SPE is expected to be funded from available funds held in the Series 2006 Trust Estate.

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 Montecito Community Development District's Finance Department at 3434 Colwell Avenue, Suite 200, Tampa, Florida 33614.

FINANCIAL STATEMENTS

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
STATEMENT OF NET POSITION
SEPTEMBER 30, 2013**

	Governmental Activities
ASSETS	
Cash	\$ 12,165
Investments	187
Prepaid items and deposits	21,804
Restricted assets:	
Investments	7,098,869
Capital assets	
Non-depreciable assets	6,877,652
Depreciable assets, net	8,597,624
Total assets	22,608,301
LIABILITIES	
Accounts payable and accrued expenses	130,342
Accrued interest payable	394,153
Due to Bondholders:	
Principal	12,960,000
Interest	2,488,886
Due to Developer	11,544
Non-current liabilities:	
Due within one year*	105,000
Due in more than one year	5,050,000
Total liabilities	21,139,925
NET POSITION	
Net investment in capital assets	2,159,624
Restricted for capital projects	1,709,935
Restricted for default expenditures	15,779
Unrestricted	(2,416,962)
Total net position	\$ 1,468,376

* The missed debt service payments due for the Series 2006 Bonds are reflected in the due to Bondholders account balance.

See notes to the financial statements

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2013**

<u>Functions/Programs</u>	Program Revenues			Net (Expense) Revenue and Changes in Net Position	
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities
Primary government:					
Governmental activities:					
General government	\$ 200,898	\$ 131,661	\$ 109,605	\$ -	\$ 40,368
Physical environment	665,557	-	-	624	(664,933)
Culture and recreation	129,359	-	-	-	(129,359)
Interest on long-term debt	955,762	826,725	5,112	-	(123,925)
Total governmental activities	1,951,576	958,386	114,717	624	(877,849)
General revenues:					
Unrestricted investment earnings					12
Other Revenue					2,084
Total general revenues					2,096
Change in net position					(875,753)
Net position - beginning, previously stated					2,788,745
Effect of adoption of GASB No. 65 (Note 2)					(444,616)
Net position - beginning, as restated					2,344,129
Net position - ending					\$ 1,468,376

See notes to the financial statements

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
BALANCE SHEET
GOVERNMENTAL FUNDS – SEPTEMBER 30, 2013**

	Major Funds			Total Governmental Funds
	General	Debt Service	Capital Project	
ASSETS				
Cash	\$ 12,165	\$ -	\$ -	\$ 12,165
Investments	187	1,196,120	5,902,749	7,099,056
Prepaid items and deposits	21,804	-	-	21,804
Total assets	<u>\$ 34,156</u>	<u>\$ 1,196,120</u>	<u>\$ 5,902,749</u>	<u>\$ 7,133,025</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable and accrued expenses	\$ 113,975	\$ -	\$ 16,367	\$ 130,342
Due to Bondholders	-	15,448,886	-	15,448,886
Due to Developer	11,544	-	-	11,544
Total liabilities	<u>125,519</u>	<u>15,448,886</u>	<u>16,367</u>	<u>15,590,772</u>
Fund balances:				
Nonspendable:				
Prepaid items and deposits	21,804	-	-	21,804
Restricted for:				
Default expenditures	-	-	15,779	15,779
Capital projects	-	-	5,870,603	5,870,603
Unassigned	(113,167)	(14,252,766)	-	(14,365,933)
Total fund balances (deficit)	<u>(91,363)</u>	<u>(14,252,766)</u>	<u>5,886,382</u>	<u>(8,457,747)</u>
Total liabilities and fund balances	<u>\$ 34,156</u>	<u>\$ 1,196,120</u>	<u>\$ 5,902,749</u>	<u>\$ 7,133,025</u>

See notes to the financial statements

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
RECONCILIATION OF THE BALANCE SHEET-
GOVERNMENTAL FUNDS TO THE STATEMENT OF NET POSITION
SEPTEMBER 30, 2013**

Fund balance - governmental funds		\$ (8,457,747)
<p>Amounts reported for governmental activities in the statement of net position are different because:</p>		
<p>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 position includes those capital assets in the net position of the government as a whole.</p>		
Cost of capital assets	18,535,509	
Accumulated depreciation	<u>(3,060,233)</u>	15,475,276
<p>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.</p>		
Accrued interest payable	(394,153)	
Bonds payable	<u>(5,155,000)</u>	<u>(5,549,153)</u>
Net position of governmental activities		<u>\$ 1,468,376</u>

See notes to the financial statements

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2013**

	Major Funds			Total Governmental Funds
	General	Debt Service	Capital Project	
REVENUES				
Assessments	\$ 131,661	\$ 286,971	\$ -	\$ 418,632
Assessments - prepayments	-	539,754	-	539,754
Developer contributions	109,605	-	-	109,605
Interest income	12	5,112	624	5,748
Miscellaneous	2,084	-	-	2,084
Total revenues	<u>243,362</u>	<u>831,837</u>	<u>624</u>	<u>1,075,823</u>
EXPENDITURES				
Current:				
General government	98,281	-	102,617	200,898
Physical environment	157,270	-	19,783	177,053
Culture and recreation	23,957	-	-	23,957
Debt service:				
Principal	-	13,090,000	-	13,090,000
Interest	-	965,218	-	965,218
Capital outlay	-	-	19,877	19,877
Total expenditures	<u>279,508</u>	<u>14,055,218</u>	<u>142,277</u>	<u>14,477,003</u>
Excess (deficiency) of revenues over (under) expenditures	(36,146)	(13,223,381)	(141,653)	(13,401,180)
OTHER FINANCING SOURCES (USES)				
Transfers in	3,150	-	-	3,150
Transfers out	-	-	(3,150)	(3,150)
Total other financing sources (uses)	<u>3,150</u>	<u>-</u>	<u>(3,150)</u>	<u>-</u>
Net change in fund balances	(32,996)	(13,223,381)	(144,803)	(13,401,180)
Fund balances (deficit) - beginning	(58,367)	(1,029,385)	6,031,185	4,943,433
Fund balances (deficit) - ending	<u>\$ (91,363)</u>	<u>\$ (14,252,766)</u>	<u>\$ 5,886,382</u>	<u>\$ (8,457,747)</u>

See notes to the financial statements

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, 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, 2013**

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

Net change in fund balances - total governmental funds	\$ (13,401,180)
Depreciation of capital assets is not recognized in the governmental fund statements but is reported as an expense in the statement of activities.	(593,906)
Governmental funds report capital outlays as expenditures; however, the cost of capital assets is eliminated in the statement of activities and capitalized in the statement of net assets.	19,877
Repayments of long-term liabilities are reported as expenditures in the governmental fund statement but such repayments reduce liabilities in the statement of net position and are eliminated in the statement of activities.	13,090,000
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.	9,456
Change in net position of governmental activities	<u><u>\$ (875,753)</u></u>

See notes to the financial statements

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
NOTES TO THE FINANCIAL STATEMENTS**

NOTE 1 – NATURE OF ORGANIZATION AND REPORTING ENTITY

Montecito Community Development District ("District") was established on July 20, 2005 by Ordinance No. 904 of the City of Satellite Beach, Florida, pursuant to the Uniform Community Development District Act of 1980, otherwise known as Chapter 190, Florida Statutes. 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. Three of the Supervisors are elected on an at large basis by land owners of the District. Two of the Supervisors are elected on an at large basis by qualified electors that reside within the District. The Board of Supervisors of the District exercises all powers granted to the District pursuant to Chapter 190, Florida Statutes. At September 30, 2013, one Board member is affiliated with Mercedes Homes, a builder within the District. Phoenix Community Developers, Inc. ("Developer") owns land within the District; therefore, the District is economically dependent on the Developer.

The Board has the responsibility for:

1. Allocating 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") Statements. Under the provisions of those standards, the financial reporting entity consists of the primary government, organizations for which the District 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 position 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 benefitted by the District's activities. Operation and maintenance 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 benefitted lands in the District. Debt service assessments are imposed upon certain lots and lands as described in each resolution imposing the special assessments for each Series of Bonds issued by the District. Certain debt service assessments are collected upon the closing of those lots subject to short term debt and are used to prepay a portion of the Bonds outstanding.

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.

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 Project Fund

The capital project fund is used to account for 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 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)

New Accounting Standards Implemented

During fiscal year 2013, the District implemented three new accounting standards as follows:

GASB Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements

This Statement incorporates into the GASB's authoritative literature certain guidance that previously could only be found in certain FASB and AICPA pronouncements issued on or before November 30, 1989 and eliminates the selection to apply post-November 30, 1989 FASB pronouncements that do not conflict with or contradict GASB pronouncements.

GASB Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position

This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources and identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements by incorporating deferred outflows of resources and deferred inflows of resources (previously reported as assets and liabilities) into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

GASB Statement No. 65, Items Previously Reported as Assets and Liabilities

This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

The implementation of GASB 65 resulted in the write off of Bond issuance costs and the effect of adoption of GASB 65 is the reduction of beginning net position by \$444,616 of the governmental activities. The effect on fiscal year 2012 had the implementation of GASB 65 occurred earlier would have resulted in a decrease in expenses of the governmental activities by \$19,412.

Assets, Liabilities and Net Position 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 allowed as specified in the Bond Indenture.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Position or Equity (Continued)

Deposits and Investments (Continued)

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 governmental 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.

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	20
Water & sewer facilities	25
Stormwater management	25
Recreational facilities	15-30
Landscape & streetscape	15
Furniture, fixtures and equipment	5

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.

Unearned Revenue

Governmental funds report unearned revenue in connection with resources that have been received, but not yet earned.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Position or Equity (Continued)

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 position. Bond premiums and discounts are deferred and amortized over the life of the Bonds. Bonds payable are reported net of applicable premiums or discounts. Bond issuance costs are expensed when incurred.

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 debt service expenditures.

Deferred Outflows/Inflows of Resources

The statement of net position reports, as applicable, a separate section for deferred outflows of resources. Deferred outflows of resources represent a consumption of net position that applies to future reporting period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until that time. For example, the District would record deferred outflows of resources related to debit amounts resulting from current and advance refundings resulting in the defeasance of debt (i.e. when there are differences between the reacquisition price and the net carrying amount of the old debt).

The statement of net position reports, as applicable, a separate section for deferred inflows of resources. Deferred inflows of resources represent an acquisition of net position that applies to future reporting period(s) and so will not be recognized as an inflow of resources (revenue) until that time. For example, when an asset is recorded in the governmental fund financial statements, but the revenue is not available, the District reports a deferred inflow of resources until such times as the revenue becomes available.

Fund Equity/Net Position

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

The District can establish limitations on the use of fund balance as follows:

Committed fund balance – Amounts that can be used only for the specific purposes determined by a formal action (resolution) of the Board of Supervisors. Commitments may be changed or lifted only by the Board of Supervisors taking the same formal action (resolution) that imposed the constraint originally. Resources accumulated pursuant to stabilization arrangements sometimes are reported in this category.

Assigned fund balance – Includes spendable fund balance amounts established by the Board of Supervisors that are intended to be used for specific purposes that are neither considered restricted nor committed. The Board may also assign fund balance as it does when appropriating fund balance to cover differences in estimated revenue and appropriations in the subsequent year's appropriated budget. Assignments are generally temporary and normally the same formal action need not be taken to remove the assignment.

The District first uses committed fund balance, followed by assigned fund balance and then unassigned fund balance when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Position or Equity (Continued)

Fund Equity/Net Position (Continued)

Net position is the difference between assets and deferred outflows of resources less liabilities and deferred inflows of resources. Net position in the government-wide financial statements are categorized as net investment in capital assets, restricted or unrestricted. Net investment in capital assets represents net position related to infrastructure and property, plant and equipment. Restricted net position represents the assets restricted by the District's Bond covenants or other contractual restrictions. Unrestricted net position consists of the net position not meeting the definition of either of the other two components.

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 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.

NOTE 4 – DEPOSITS AND INVESTMENTS (Continued)

Investments

The District's investments were held as follows at September 30, 2013:

	Fair Value	Credit Risk	Weighted Average Maturity
Wells Fargo Advantage Treasury Plus Money Market Service #454	\$ 7,040,580	S&P AAAM	51 days
Investment in Local Government Surplus Funds Trust Fund (Florida PRIME)	148	S&P AAAM	44 days
Local Government Surplus Funds Investment Pool - Fund B	58,328	Not rated	4.04 years
Total Investments	<u>\$ 7,099,056</u>		

The State Board of Administration's Local Government Surplus Funds Trust Fund Investment Pool ("Pool") was restructured on December 4, 2007 into two separate pools. Pool A consisted of all money market appropriate assets, which was approximately 86% of Pool assets. Pool B consisted of assets that have either defaulted on a payment, paid more slowly than expected, and/or had any significant credit and liquidity risk, which was approximately 14% of Pool assets. At the time of the restructuring, all current pool participants had their existing balances proportionately allocated into Pool A and Pool B and certain restrictions were implemented. On December 21, 2007, Standard and Poor's Ratings Services assigned its "AAAM" principal stability fund rating to Pool Fund A. Pool Fund B is not rated by any nationally recognized statistical rating agency. Pool A has been subsequently renamed as Florida PRIME and Pool B has subsequently been renamed as Fund B Surplus Funds Trust Fund ("Fund B").

There are two options for accounting and reporting for money market investment pools either "2a-7 like" or fluctuating net asset value ("NAV"). "2a-7 like" pool is an external investment pool that is not registered with the Securities and Exchange Commission ("SEC") as an investment company, but nevertheless has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a-7 of the Investment Company Act of 1940, which comprises the rules governing money market funds. Thus, the pool operates essentially as a money market fund. Rule 2a-7 is the rule that allows money market funds to use amortized cost to maintain a constant NAV of \$1.00 per share, provided that such funds meet certain conditions. The Local Government Surplus Funds Trust Fund Investment Pool (Florida PRIME) is considered a 2a7-like fund and the District has reported its investment in Florida PRIME at the same value as the pooled shares allocated to the District. The estimated weighted average maturity of the Florida PRIME portfolio is 44 days. Fund B is accounted for as a fluctuating NAV pool and the fair value factor for September 30, 2013 was 1.13262284. The District has multiplied its account balance by the factor to determine the investment balance to be reported. The NAV balance in Fund B was \$58,328 for a net unrealized gain of approximately \$7,736. Due to the nature of the securities in Fund B, the weighted average maturity is not available. The weighted average life of the fund is estimated at 4.04 years. Additional information regarding the Local Government Surplus Funds Trust Fund may be obtained from the State Board of Administration.

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 for unspent bond proceeds.

NOTE 5 – CAPITAL ASSETS

The infrastructure intended to serve the District has been estimated at a total cost of approximately \$23,542,000. The infrastructure will include roadways, stormwater management, security and recreational facilities, and landscape/streetscape. The project costs will be funded with the proceeds from the issuance of the Series 2006 Bonds. Upon completion, certain infrastructure improvements will be conveyed to other entities. Phases 1A, 1B, 2A, and 2B were completed in a prior year. Phases 2C and 2D are on hold. The estimated cost to complete the project is unknown.

Capital asset activity for the fiscal year ended September 30, 2013 was as follows:

	Beginning Balance	Additions	Disposals	Ending Balance
<u>Governmental activities</u>				
Capital assets, not being depreciated				
Land	\$ 6,788,410	\$ -	\$ -	\$ 6,788,410
Infrastructure under construction	89,242	-	-	89,242
Total capital assets, not being depreciated	<u>6,877,652</u>	<u>-</u>	<u>-</u>	<u>6,877,652</u>
Capital assets, being depreciated				
Roadways	1,719,432	-	-	1,719,432
Water & sewer facilities	1,936,187	-	-	1,936,187
Stormwater management	1,660,044	-	-	1,660,044
Recreational facilities	2,699,000	5,307	-	2,704,307
Landscape & streetscape	3,461,254	14,570	-	3,475,824
Furniture, fixtures and equipment	162,063	-	-	162,063
Total capital assets, being depreciated	<u>11,637,980</u>	<u>19,877</u>	<u>-</u>	<u>11,657,857</u>
Less accumulated depreciation for:				
Roadways	(343,512)	(85,972)	-	(429,484)
Water & sewer facilities	(309,788)	(77,447)	-	(387,235)
Stormwater management	(262,104)	(66,402)	-	(328,506)
Recreational facilities	(501,554)	(105,402)	-	(606,956)
Landscape & streetscape	(914,996)	(230,993)	-	(1,145,989)
Furniture, fixtures and equipment	(134,373)	(27,690)	-	(162,063)
Total accumulated depreciation	<u>(2,466,327)</u>	<u>(593,906)</u>	<u>-</u>	<u>(3,060,233)</u>
Total capital assets being depreciated, net	<u>9,171,653</u>	<u>(574,029)</u>	<u>-</u>	<u>8,597,624</u>
Governmental activities capital assets, net	<u>\$ 16,049,305</u>	<u>\$ (574,029)</u>	<u>\$ -</u>	<u>\$ 15,475,276</u>

Depreciation expense was charged to the following functions:

Governmental activities:	
Physical environment	\$ 488,504
Culture and recreation	105,402
Total depreciation expense - governmental activities	<u>\$ 593,906</u>

NOTE 6 – LONG-TERM LIABILITIES

On February 1, 2006, the District issued \$27,565,000 of Special Assessment Bonds, Series 2006 consisting of \$5,690,000 of Term Bonds Series 2006A due on May 1, 2037 with a fixed interest rate of 5.50% and \$21,875,000 of Term Bonds, Series 2006B due on May 1, 2013 with a fixed interest rate of 5.10%. 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 Bonds is to be paid serially commencing May 1, 2008 through May 1, 2037.

The Series 2006A Bonds are subject to redemption at the option of the issuer prior to their maturity. The Series 2006 A and B 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. For the Series 2006B Bonds, this occurred during the current fiscal year as the District collected prepaid assessments and redeemed \$400,000 of the Series 2006B Bonds. See Note 13 – Subsequent Events for subsequent extraordinary redemption.

NOTE 6 – LONG-TERM LIABILITIES (Continued)

The Bond Indenture established a debt service reserve requirement as well as other 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 1) levy special assessments in annual amounts adequate to provide payment of debt service and 2) to meet the reserve requirements. The District was not in compliance with the reserve requirements of the Bond Indenture at September 30, 2013. See Note 9 – Financial Condition below.

Changes in long-term liability activity for the fiscal year ended September 30, 2013 were as follows:

	Beginning Balance	Additions	Reductions*	Ending Balance	Due Within One Year
<u>Governmental activities</u>					
Bonds payable:					
Series 2006	\$ 18,245,000	\$ -	\$ 13,090,000	\$ 5,155,000	\$ 105,000
Total	\$ 18,245,000	\$ -	\$ 13,090,000	\$ 5,155,000	\$ 105,000

* Includes \$100,000 for the Series 2006A Bonds and \$12,590,000 for the Series 2006B Bonds due on May 1, 2013 that has not been paid.

At September 30, 2013, the scheduled debt service requirements on the long-term debt were as follows:

Year ending September 30:	Governmental Activities		
	Principal	Interest	Total
2014	\$ 105,000	\$ 945,965	\$ 1,050,965
2015	110,000	277,750	387,750
2016	120,000	271,700	391,700
2017	125,000	265,100	390,100
2018	135,000	258,225	393,225
2019-2023	785,000	1,172,325	1,957,325
2024-2028	1,035,000	930,600	1,965,600
2029-2033	1,360,000	612,150	1,972,150
2034-2037	1,380,000	193,875	1,573,875
Total	\$ 5,155,000	\$ 4,927,690	\$ 10,082,690

NOTE 7 – DEFICIT FUND BALANCES

The general fund and debt service fund reported deficit fund balances of (\$91,363) and (\$14,252,766), respectively, at September 30, 2013. It is unclear how the deficits will be covered as the District has not collected its delinquent assessments to-date. The District has filed a foreclosure lawsuit on the land with delinquent assessments. However, it is unclear how events will unfold pertaining to the lawsuit.

NOTE 8 – RELATED PARTY TRANSACTIONS

The District has a Developer, Phoenix Community Developers, Inc. (“Developer”), and three major landowners (Satellite Beach Partners, LLC, Towns of Montecito Community Developers, LLC. and Mercedes Homes, Inc.) within the District. The Towns of Montecito Community Developers and Mercedes Homes, Inc. are related to the Developer. Revenues for the fiscal year ended September 30, 2013 include applicable amounts from the Developer and landowners.

NOTE 8 – RELATED PARTY TRANSACTIONS (Continued)

In addition, the Developer and two of the major landowners (Satellite Beach Partners, LLC, and Towns of Montecito Community Developers, LLC,) failed to pay their share of assessments for the current and prior fiscal years, resulting in delinquent assessments receivable of approximately \$1,223,450 for the general fund and \$2,688,660 for the debt service fund. The District initiated foreclosure proceedings for the delinquent assessments. As a result, certain debt service assessments on land owned by Satellite Beach Partners, LLC, and Towns of Montecito Community Developers, LLC were not billed in the prior or current fiscal year.

The Developer agreed to fund the general operations of the District which could not be funded as a result of the delinquent assessments. In connection with that agreement, Developer contributions to the general fund were \$109,605 for the current fiscal year.

During the fiscal year ended September 30, 2009, a lawsuit was filed against the District by Satellite Beach Partners, LLC (landowner). An un-platted parcel owned by the landowner is the subject of a pending foreclosure suit brought by the District. The lawsuit brought by Satellite Beach Partners, LLC asserts fraud, breach of fiduciary duties and numerous other grounds related to the District's foreclosure suit. National City Bank has filed a counterclaim against the District in relation to the suit alleging that the District's interest is subordinate to that of the bank and the bank is seeking to foreclose on its mortgage with Satellite Beach Partners. As of the report date, the lawsuits are ongoing. The ultimate outcome and impact on the District is not currently known. However, in the event of an unfavorable outcome, the range of exposure would be the loss of the non-ad valorem special assessments imposed on the properties owned by Satellite Beach Partners.

On January 26, 2009, Mercedes Homes filed for Chapter 11 bankruptcy. The District has filed a proof of claim with the bankruptcy court; however, the ultimate outcome and impact on the District is currently unknown. There were no delinquent assessments owed by Mercedes Homes at the end of the fiscal year.

The District's activity is dependent on the continued involvement of the Developer and major landowners. As such, the nonpayment of assessments by the Developer and certain major landowners has resulted in the deterioration of the District's financial condition.

NOTE 9 – FINANCIAL CONDITION

The District's financial conditions continue to deteriorate. As noted above in Note 8, the Developer and certain major landowners failed to pay a substantial portion of their assessments in the current and prior fiscal years. As a result, the Trustee utilized reserve funds to pay a portion of the interest payments due in the prior fiscal years. As a result, there was a deficit in the Series 2006A and Series 2006B reserve accounts of approximately \$195,000 and \$302,000, respectively. In addition, certain scheduled debt service payments were not made, partially made or made late, resulting in events of default. See Note 13 – Subsequent Events for additional information subsequent to fiscal year end.

NOTE 9 – FINANCIAL CONDITION (Continued)

As a result of non-payment of operation and maintenance assessments, the District amended the Master Indenture and First Supplemental Indenture for the Series 2006 Bonds dated August 15, 2009. The amendment allows for \$300,000 of the amounts held on deposit in the Acquisition and Construction trust account to be transferred to a Default Expenditure account to pay for default expenditures. Pursuant to the agreement, a Default Expenditure account was established in the capital projects fund and the \$300,000 was deposited during the fiscal year ended September 30, 2009. As of the end of the 2011 fiscal year, all of the allowable funds were expended from the account. During the current fiscal year, the District transferred \$93,500 from the acquisition and construction account to the default expenditures account. The transfer was approved by the majority bondholder to fund default expenditures for FY 2013. In addition, \$22,560 was reimbursed to the acquisition and construction account from the default expenditures account for expenditures paid in fiscal year 2012. During the current fiscal year, approximately \$103,000 in additional default expenditures were incurred and were paid from the construction and default expenditures account in the capital projects fund. See Note 13 – Subsequent Events for additional information subsequent to fiscal year end. Furthermore, the District has a significant amount of uncontested delinquent payables that are over 90 days old.

NOTE 10 – TRI-PARTY AGREEMENT AND SPECIAL PURPOSE ENTITY

As discussed in Note 9, as a result of non-collection of assessments from the Developer and major landowners, the District did not make certain debt service payments when due, which constitutes an event of default under the applicable trust indenture. During the current fiscal year, the District entered into an agreement with the Trustee and Montecito CDD Holding, LLC., (SPE). The Trustee, on behalf of the Bondholder, created or caused to be created a SPE to own, manage, and dispose of the Property subject to delinquent Series 2006 assessments. The SPE shall acquire the rights to the delinquent property enforced through tax certificate and tax deed procedures. Under the terms of the agreement, the District will bill the SPE for operations and maintenance (O&M) assessments. However, the debt service assessments will be held in abeyance and continue to constitute a lien on the property. The operations of the SPE will be funded from amounts on deposit in the funds and accounts comprising the Series 2006 Trust Estate and proceeds from the sale of the delinquent property.

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 insurance coverage during the last three years.

NOTE 13 – SUBSEQUENT EVENTS

Bond payment

Subsequent to year end, the District paid \$140,000 of the Series 2006B Bonds from prepayments which were considered extraordinary mandatory redemptions as outlined in the Bond Indenture.

NOTE 13 – SUBSEQUENT EVENTS (Continued)

Non-payment of Debt

Subsequent to fiscal year end, the District did not collect sufficient assessments in the revenue account to make the November 2013 Series 2006A interest payment (after paying the delinquent May 2013 interest). At the direction of a majority of the holders of the Series 2006A Bonds, the payment was not made by a draw on the reserve. The District made a regular interest payment on the Series 2006A Bonds in May 2014, however, the May 2014 principal payment due on the Series 2006A Bonds were not made. For the Series 2006B Bonds, the scheduled interest due for November 2013 and May 2014 has not been made. While there were sufficient funds between the revenue and reserve accounts to make one of the interest payments due on the Series 2006B Bonds, at the direction of a majority of the bondholders, no scheduled payment was made except for accrued interest on the 2006B Bonds prepaid above. In May 2014, the District made a partial redemption of \$366,002 in principal plus \$83,998 in interest for the Series 2006B Bonds.

Default expenditures

Subsequent to fiscal year end, the District transferred \$200,000 from the acquisition and construction account to the default expenditures account. The transfer was approved by the majority bondholder to fund default expenditures for FY 2014. As of May 22, 2014, approximately \$149,000 in additional default related expenditures, including expenditures relating to the operation of the SPE, has been incurred by the District from the default expenditures, construction, and reserve accounts. Furthermore \$12,955 has been transferred from the trust accounts to fund general fund operating expenditures.

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, FLORIDA
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES IN
FUND BALANCE - BUDGET AND ACTUAL – GENERAL FUND
FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2013**

	Original and Final Budget	Actual Amounts	Variance with Budget - Positive (Negative)
REVENUES			
Assessments	\$ 367,530	\$ 131,661	\$ (235,869)
Developer contributions	-	109,605	109,605
Interest and other revenues	-	2,096	2,096
Total revenues	<u>367,530</u>	<u>243,362</u>	<u>(124,168)</u>
EXPENDITURES			
Current:			
General government	119,980	98,281	21,699
Physical environment	192,700	157,270	35,430
Culture and recreation	54,850	23,957	30,893
Total expenditures	<u>367,530</u>	<u>279,508</u>	<u>88,022</u>
Excess (deficiency) of revenues over (under) expenditures	-	(36,146)	(36,146)
OTHER FINANCING SOURCES			
Transfers in	-	3,150	3,150
Total other financing sources	<u>-</u>	<u>3,150</u>	<u>3,150</u>
Net change in fund balances	<u>\$ -</u>	<u>(32,996)</u>	<u>\$ (32,996)</u>
Fund balance (deficit) - beginning		<u>(58,367)</u>	
Fund balance (deficit) - ending		<u>\$ (91,363)</u>	

See notes to required supplementary information

**MONTECITO COMMUNITY DEVELOPMENT DISTRICT
SATELLITE BEACH, 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 general fund expenditures did not exceed appropriations for the fiscal year ended September 30, 2013.

The variance between budgeted and actual general fund revenues for the 2013 fiscal year is the result of the non-payment of a significant portion of the 2013 fiscal year assessments by a major landowner, although Developer contributions were received which had not been budgeted for to help cover the cost of the District's operations thereby reducing the difference between budgeted and actual general fund revenues. The actual general fund expenditures for the current fiscal year were lower than budgeted amounts due primarily to anticipated costs which were not incurred in the current fiscal year.



INDEPENDENT AUDITOR'S 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
Montecito Community Development District
Satellite Beach, Florida

Except as discussed in the explanatory paragraphs, we have audited, in accordance with the 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, the financial statements of the governmental activities and each major fund of Montecito Community Development District, Satellite Beach, Florida ("District") as of and for the fiscal year ended September 30, 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our opinion thereon dated June 24, 2014, which includes emphasis of matter paragraphs. The report on the SPE Special Revenue Fund and the governmental activities had an adverse opinion due to the departure from generally accepted accounting principles due to the omission of the blended component unit. The report on the Capital Projects Fund had a qualified opinion due to the lack of sufficient competent evidential matter for certain selected expenditures paid for by the Trustee.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, as discussed in the accompanying report to management dated June 24, 2014, we consider deficiency 2013-01 to be a material weakness in internal control over financial reporting and 2013-02 to be a significant deficiency in internal control over financial reporting. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, 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 involving the internal control over financial reporting and compliance that we have reported to management of the District in a separate letter dated June 24, 2014.

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.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

June 24, 2014



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

To the Board of Supervisors
Montecito Community Development District
Satellite Beach, Florida

We have audited the accompanying basic financial statements of Montecito Community Development District, Satellite Beach, Florida (the "District") as of and for the fiscal year ended September 30, 2013, and have issued our report thereon dated June 24, 2014, which includes explanatory paragraphs regarding the qualified opinion on the Capital Projects Fund due to the lack of sufficient competent evidential matter and the adverse opinion on the SPE and the governmental activities due to omission of the SPE, and emphasis of a matter paragraphs.

Except as discussed in the explanatory paragraphs, we conducted our audit in accordance with auditing standards generally accepted in the United States of America; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Chapter 10.550, Rules of the Florida Auditor General. 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 Independent Auditor's Report on Internal Control over Financial Reporting and Compliance and Other Matters based on an audit of the financial statements performed in accordance with *Government Auditing Standards* and Chapter 10.550, Rules of the Florida Auditor General dated June 24, 2014. 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 of 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.**

Our management letter is intended solely for the information and use of the Legislative Auditing Committee, members of the Florida Senate and the Florida House of Representatives, the Florida Auditor General, Federal and other granting agencies, as applicable, management, and the Board of Supervisors of the District and is not intended to be and should not be used by anyone other than these specified parties.

We wish to thank the District 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.

June 24, 2014

REPORT TO MANAGEMENT

I. CURRENT YEAR FINDINGS AND RECOMMENDATIONS

Material Weakness

2013-01: Omission of a Major Fund

Observation: The District did not include the SPE 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 the SPE as a major fund of the District's governmental activities.

Management Response: Management does not agree that the Special Purpose Entity should be included as a blended component unit on the government-wide financial statements. In summary, management feels that it would be misleading to the users of the financial statements to include the SPE as a component unit for the following reasons. The District has no ownership and/or control over this SPE and in no way can it impose its will on this SPE. In addition, the District will not benefit from the activities of this SPE. When the land held by the SPE is sold, the proceeds will be paid 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.

Significant Deficiency

2013-02 No Supporting Documentation Provided for Certain Expenditures

Observation: Invoices could not be provided for certain expenditures paid for out of the Trust Accounts. Accordingly, the auditor was unable to determine whether these expenditures had been recorded correctly.

Recommendation: When the activity of the Trust Accounts is being reconciled and recorded in the general ledger on a monthly basis, the invoices that are being paid for directly out of the Trust Accounts should be requested from the Trustee. If the District is unable to obtain the documentation from the Trustee, the District could also contact the vendor directly to see if a duplicate copy of the invoice that was paid could be provided.

Management Response: The District has attempted, on numerous occasions, to obtain supporting documentation from the Trustee for all expenditures paid by the Trustee out of the trust accounts. The Trustee stated that they are not required to provide copies of supporting documents relating to the expenditures and have refused to do so. In addition, District Management has attempted to obtain supporting documentation directly from the vendor and was informed that the vendor would not provide the requested documentation to the District.

Other Findings

2013-03 Reserve Requirement

Observation: The Debt Service Reserve Requirements were not met at September 30, 2013.

Recommendation: The District should make the necessary arrangements to replenish the reserve accounts.

REPORT TO MANAGEMENT (Continued)

Management Response: The District is pursuing assessments to replenish the debt service reserve fund. If the SPE is successful in selling the delinquent property, the District is uncertain if the funds collected will be used to replenish the debt service account.

2013-04 Financial Condition Assessment:

Observation: The District's financial conditions continue to deteriorate. The Developer and certain major landowners failed to pay a significant portion of the assessments in fiscal years 2009 - 2014. As a result, reserve funds were used to partially pay certain required debt service payments during the prior and current fiscal years. In addition, certain required debt service payments were not made during the prior, current, and subsequent fiscal years, resulting in events of default. Further, the general fund and debt service fund reported deficit fund balances at the end of the fiscal year.

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

Management Response: The District and Bondholders are working to alleviate this issue through efforts to collect delinquent assessments. The District, Trustee and SPE entered into a Tri-Party agreement. The Trustee, on behalf of the Bondholder, created or caused to be created a SPE to own, manage and dispose of the property subject to the delinquent Series 2006 assessments. Under the terms of the agreement the District will bill the SPE for operations and maintenance assessments. However the debt service assessments will be held in abeyance and continue to constitute a lien on the property. The operations of the SPE will be funded from amounts on deposit in the funds and accounts comprising the Series 2006 Trust Estate and proceeds from the sale of the delinquent property. If the SPE is successful in selling the land the amount of debt service assessments to be collected by the district is uncertain at this time.

II. PRIOR YEAR FINDINGS AND RECOMMENDATIONS

2012-01 No Supporting Documentation Provided for Certain Expenditures

Current Status: See finding 2013-02 above.

2009-01, 2010-01, 2011-01, 2012-02 Reserve Requirement

Current Status: See finding 2013-03 above.

2009-02, 2010-02, 2011-02, 2012-03 Financial Condition Assessment

Current Status: See finding 2013-04 above.

2012-04 Bondholder Consent

Current Status: Recommendation has been implemented.

REPORT TO MANAGEMENT (Continued)

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, 2012, 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, 2013, except as noted above.

4. Noncompliance with 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 which warrants the attention of those charged with governance

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, 2013, except as noted above.

5. The name or official title and legal authority of the District are disclosed in the notes to the financial statements.

6. 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, 2013 financial audit report.

7. 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. The District failed to make certain scheduled debt service payments when due during the current and prior fiscal years, as a result of a lack of funds, due to the Developer and certain major landowners' failure to pay a significant portion of assessments. We applied financial condition assessment procedures pursuant to Rule 10.556(7) and determined that deteriorating financial conditions were 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.