

FALCON HIGHLANDS METROPOLITAN DISTRICT

Financial Statements

And

Supplemental Schedules

For the Year Ended December 31, 2008

And

Independent Auditors' Report

FALCON HIGHLANDS METROPOLITAN DISTRICT

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Falcon Highlands Metropolitan District

We have audited the accompanying financial statements of the governmental activities, the business-type activities, and each major fund of Falcon Highlands Metropolitan District (the District) as of and for the year ended December 31, 2008, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the governmental activities, the business-type activities, and each major fund of the District at December 31, 2008, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The District has not presented a management's discussion and analysis that accounting principles generally accepted in the United States has determined is necessary to supplement, although not required to be a part of, the basic financial statements.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The accompanying supplementary information listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements. These schedules are the responsibility of the District's management. These schedules have been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

Stockman Kast Ryan & Co., LLP
July 29, 2009

FALCON HIGHLANDS METROPOLITAN DISTRICT

STATEMENT OF NET ASSETS FOR THE YEAR ENDED DECEMBER 31, 2008

	Primary Government		
	Governmental Activities	Business-Type Activities	Total
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents:			
Non-restricted		\$ 208,950	\$ 208,950
Restricted	\$ 986,212		986,212
Property taxes receivable	491,834		491,834
Total current assets	<u>1,478,046</u>	<u>208,950</u>	<u>1,686,996</u>
NON-CURRENT ASSETS			
Capital assets, net	<u>7,946,644</u>	<u>7,495,574</u>	<u>15,442,218</u>
OTHER NONCURRENT ASSETS			
Water rights		402,786	402,786
Bond issuance costs, net	<u>593,180</u>		<u>593,180</u>
Total other noncurrent assets	<u>593,180</u>	<u>402,786</u>	<u>995,966</u>
TOTAL	<u>\$ 10,017,870</u>	<u>\$ 8,107,310</u>	<u>\$ 18,125,180</u>
LIABILITIES AND EQUITY			
CURRENT LIABILITIES			
Accounts payable and accrued expenses		\$ 2,877	\$ 2,877
Accrued interest	\$ 210,500		210,500
Advances payable to related parties	4,601,507		4,601,507
Deferred property tax revenue	491,834		491,834
Current portion of bonds payable, net	320,000		320,000
Current portion of lease payable		<u>5,084</u>	<u>5,084</u>
Total	5,623,841	7,961	5,631,802
NON-CURRENT LIABILITIES			
Bonds payable, net	14,913,291		14,913,291
Lease payable		<u>9,094</u>	<u>9,094</u>
Total liabilities	<u>20,537,132</u>	<u>17,055</u>	<u>20,554,187</u>
NET ASSETS (DEFICIT)			
Restricted for debt service	973,066		973,066
Restricted for capital projects	3,105		3,105
Restricted for interest	10,000		10,000
Invested in capital projects, net of related debt			—
Restricted for emergency reserve	46,784	17,330	64,114
Unrestricted deficit	<u>(11,552,217)</u>	<u>8,072,925</u>	<u>(3,479,292)</u>
Total net assets (deficit)	<u>(10,519,262)</u>	<u>8,090,255</u>	<u>(2,429,007)</u>
TOTAL	<u>\$ 10,017,870</u>	<u>\$ 8,107,310</u>	<u>\$ 18,125,180</u>

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

STATEMENT OF ACTIVITIES FOR THE YEAR ENDED DECEMBER 31, 2008

FUNCTIONS/PROGRAMS	Expenses	Program Revenues	Net (Expense) Revenue and Change in Net Assets		
			Charges for Services	Governmental Activities	Primary Government-Business-Type Activities
PRIMARY GOVERNMENT					
Government activities:					
General government	\$ 479,150		\$ (479,150)		\$ (479,150)
Interest on long-term debt	<u>1,080,316</u>		<u>(1,080,316)</u>		<u>(1,080,316)</u>
Total general government	1,559,466	\$ —	(1,559,466)	\$ —	(1,559,466)
Business-type activities:					
Water	<u>577,666</u>	<u>780,265</u>		<u>202,599</u>	<u>202,599</u>
Total primary government	<u>\$ 2,137,132</u>	<u>\$ 780,265</u>	<u>(1,559,466)</u>	<u>202,599</u>	<u>(1,356,867)</u>
GENERAL REVENUES					
Property taxes, levied for debt service			380,783		380,783
Interest revenue			24,583		24,583
Transfers			<u>(186,213)</u>	<u>186,213</u>	
Total general revenue and transfers			<u>219,153</u>	<u>186,213</u>	<u>405,366</u>
CHANGE IN NET ASSETS			(1,340,313)	388,812	(951,501)
NET ASSETS, Beginning of year			<u>(9,178,949)</u>	<u>7,701,443</u>	<u>(1,477,506)</u>
NET ASSETS, End of year			<u>\$ (10,519,262)</u>	<u>\$ 8,090,255</u>	<u>\$ (2,429,007)</u>

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

BALANCE SHEET — GOVERNMENTAL FUNDS DECEMBER 31, 2008

	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS			
Cash deposits and investments		\$ 986,212	\$ 986,212
Property taxes receivable		491,834	491,834
Total assets	\$ —	\$ 1,478,046	\$ 1,478,046
LIABILITIES AND FUND BALANCES			
LIABILITIES			
Advances payable to related parties		\$ 4,601,507	\$ 4,601,507
Deferred property tax revenue		491,834	491,834
Total liabilities	\$ —	5,093,341	5,093,341
FUND BALANCES			
Reserved for debt service		973,066	973,066
Reserved for capital projects		3,105	3,105
Reserved for interest		10,000	10,000
Reserved for emergency		46,784	46,784
Unreserved fund balance (deficit)		(4,648,250)	(4,648,250)
Total fund balances (deficit)	—	(3,615,295)	(3,615,295)
Total liabilities and fund balances	\$ —	\$ 1,478,046	\$ 1,478,046
RECONCILIATION OF TOTAL GOVERNMENT FUND BALANCES TO NET ASSETS OF GOVERNMENTAL ACTIVITIES			
Total government fund balances			\$ (3,615,295)
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 in the funds			7,946,644
Accrued interest on long-term bonds is not accounted for under modified accrual and therefore is not reported in the funds			(210,500)
Bond issuance costs are not accrued on the governmental fund financial statements			593,180
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds			(15,233,291)
Net assets (deficit) of governmental activities			\$(10,519,262)
See notes to financial statements.			

FALCON HIGHLANDS METROPOLITAN DISTRICT

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES — GOVERNMENTAL FUNDS FOR THE YEAR ENDED DECEMBER 31, 2008

	General Fund	Debt Service Fund	Total Governmental Funds
REVENUE			
Property taxes		\$ 380,783	\$ 380,783
Interest		24,583	24,583
Total revenue	\$ —	405,366	405,366
EXPENDITURES			
Capital outlay		406,623	406,623
Bond interest		1,020,316	1,020,316
Bond principal		505,000	505,000
Total expenditures	—	1,931,939	1,931,939
OTHER FINANCINGS SOURCES (USES)			
Transfers out		(186,213)	(186,213)
NET CHANGE IN FUND BALANCES		(1,712,786)	(1,712,786)
FUND BALANCES, Beginning of year		(1,902,509)	(1,902,509)
FUND BALANCES, End of year	\$ —	\$ (3,615,295)	\$ (3,615,295)

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

RECONCILIATION STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED DECEMBER 31, 2008

NET CHANGE IN GOVERNMENTAL FUND BALANCES	\$ (1,712,786)
Amounts reported for the governmental activities in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures; however, in the statement of activities, the cost of those assets is allocated over to the projects as construction in process.	(39,673)
Amortization of the bond issuance costs is recorded on the statements of activities whereas they were expenses when incurred on the governmental fund financial statements.	(32,854)
Payment of long-term debt proceeds is not reflected in the statement of activities; whereas, in governmental funds, they are reported as an expense.	505,000
In the statement of activities, interest and charges are accrued on outstanding bonds; whereas, in governmental funds, they are reported when due.	<u>(60,000)</u>
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES	<u>\$ (1,340,313)</u>

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

STATEMENT OF NET ASSETS — PROPRIETARY FUNDS FOR THE YEAR ENDED DECEMBER 31, 2008

	Enterprise Fund
ASSETS	
CURRENT ASSETS	
Cash	\$ 208,950
NON-CURRENT ASSETS	
Capital assets, net	7,495,574
Water rights	<u>402,786</u>
TOTAL ASSETS	<u>\$ 8,107,310</u>
 LIABILITIES AND FUND BALANCE	
CURRENT LIABILITIES	
Accounts payable	\$ 2,877
Current portion of capital lease	<u>5,084</u>
Total current liabilities	7,961
LEASE PAYABLE	<u>9,094</u>
Total liabilities	<u>17,055</u>
FUND BALANCE	
Reserved for emergency service	17,330
Unreserved fund balance	<u>8,072,925</u>
Total net assets	<u>8,090,255</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 8,107,310</u>

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND BALANCES — PROPRIETARY FUNDS FOR THE YEAR ENDED DECEMBER 31, 2008

	Enterprise Fund
OPERATING REVENUES	
Water treatment and usage fees	\$ 281,975
Other income	<u>24,305</u>
Total operating revenues	<u>306,280</u>
OPERATING EXPENSES	
Depreciation	253,830
Contract labor	165,105
Utilities	58,788
Professional fees	22,844
Miscellaneous	<u>77,099</u>
Total operating expenses	<u>577,666</u>
LOSS FROM OPERATIONS	(271,386)
NON-OPERATING REVENUE	
Water tap and infrastructure fees, net	<u>473,985</u>
EXCESS OF REVENUE OVER EXPENDITURES	<u>\$ 202,599</u>

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

STATEMENT OF CASH FLOWS — PROPRIETARY FUNDS FOR THE YEAR ENDED DECEMBER 31, 2008

	Enterprise Fund
CASH FLOWS FROM OPERATING ACTIVITIES	
Cash receipts from customers	\$ 306,280
Cash payments for goods and services	<u>(387,192)</u>
Net cash used in operating activities	<u>(80,912)</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and construction of capital assets	(413,340)
Water tap fees, net and infrastructure	473,985
Lease payable payments	(6,162)
Transfer from governmental activities	<u>186,213</u>
Net cash provided by capital and related financing activities	<u>240,696</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	159,784
CASH AND CASH EQUIVALENTS, Beginning of year	<u>49,166</u>
CASH AND CASH EQUIVALENTS, End of year	<u>\$ 208,950</u>
RECONCILIATION OF LOSS FROM OPERATIONS TO NET CASH USED IN OPERATING ACTIVITIES	
Loss from operations	\$ (271,386)
Adjustments to reconcile operating income to net cash used in operating activities:	
Depreciation expense	253,830
Other	(64,600)
Changes in operating assets and liabilities:	
Other liabilities	<u>1,244</u>
Net cash used in operating activities	<u>\$ (80,912)</u>

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

GENERAL FUND STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE — BUDGET AND ACTUAL FOR THE YEAR ENDED DECEMBER 31, 2008

	Budget Amounts		Actual	Variance
	Original	Final		
REVENUE				
Charges for services	\$ —	\$ —	\$ —	\$ —
EXPENDITURES				
Professional fees				
Insurance				
Miscellaneous				
Total expenditures	—	—	—	—
Deficit of revenues over expenditures	—	—	—	—
OTHER FINANCING SOURCES				
Developer advances				
Transfers in				
Total other financing sources	—	—	—	—
Net change in fund balances	\$ —	\$ —	\$ —	\$ —

See notes to financial statements.

FALCON HIGHLANDS METROPOLITAN DISTRICT

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of Falcon Highlands Metropolitan District of El Paso County, Colorado (the District) conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies consistently applied in the preparation of the District's financial statements.

The District was organized to provide water and waste water services to the property within its boundaries and to construct and maintain roads and bridges on the property.

Reporting Entity — The District was organized on November 12, 2002 and is governed by an elected Board of Directors. As required by generally accepted accounting principles, these financial statements present the activities of the District, which is legally separate and financially independent of other state and local governments. The District supplies water and waste water services to its geographical service area. The District has no component units as defined by the Governmental Accounting Standards Board (GASB).

Basis of Accounting — The government-wide financial statements of the District are accounted for on a flow of economic resources measurement focus. Under this method, revenue is recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met. Depreciation is computed and recorded as an operating expense. Expenditures for property and equipment are shown as increases in assets and redemption of bonds and notes are recorded as a reduction in liabilities.

The District has elected to follow Governmental Accounting Standards Board pronouncements in government-wide financial statements. Therefore, statements issued by the Financial Accounting Standards Board after November 30, 1989 are not applied.

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 measureable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. The major sources of revenue susceptible to accrual are property taxes and developments fees. Expenditures, other than interest on long-term obligations are recorded when the liability is incurred or the long-term obligation paid. All other revenue items are considered to be measureable and available only when cash is received by the District.

The District reports the following major governmental funds:

General Fund — The General Fund is used to account for all financial resources of the District except those required to be accounted for in another fund. The General Fund balance is available to the District for any purpose provided it is expended or transferred according to the general laws of Colorado and the bylaws of the District.

Special Revenue Fund — A Special Revenue Fund is used to collect and disburse monies earmarked for specific purposes due to either legal or contractual arrangements. The Special Revenue Fund is used to account for service revenues and property tax revenues. The District has chosen to use this type of fund because the revenue from these service fees are paid to other entities for services rendered and because the service fees are not established to cover the cost of the assets.

Capital Projects Fund — The Capital Projects Fund accounts for the construction costs of public improvements undertaken and financed by the District.

Debt Service Fund — The Debt Service Fund accounts for the servicing of general long-term debt and revenues generated and received by the District that are required to be used in payment of long-term debt.

Enterprise Fund — The Enterprise Fund has elected to implement the provisions of GASB Statement No. 20 with regard to the application of Financial Accounting Standards Board (FASB) Pronouncements to its proprietary funds. In accordance with the provisions of GASB Statement No. 20, the District has elected not to apply those FASB Statements and Interpretations issued after November 30, 1989. The Enterprise Fund is used to account for operations that are financed and operated in a manner similar to a private business enterprise; (a) where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenue earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes. Operating revenue and expenses are those that result from providing services and producing and delivering goods and/or services. It also includes all revenue and expenses not related to capital and related financing, non-capital financing, or investing activities. All revenue and expenses not meeting this definition are reported as non-operating revenue and expenses.

Net Assets — The Districts net assets are classified in the following three components:

- Invested in capital assets, net of related debt — This component consists of capital assets, net of accumulated depreciation, and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds. At December 31, 2008 and 2007 debt related to investment in capital assets was in excess of the capital assets.
- Restricted — This component consists of net assets which have constraints placed on the use of the assets through external constraints imposed by creditors (such as through debt covenants), contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net assets — This component consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Budgets — In the fall, the District manager is required to submit to the Board of Directors a budget for the fiscal year commencing the following January 1. The operating budget includes proposed expenditures and the means of financing them. Public hearings are conducted at the District to obtain taxpayer comments. Prior to December 31, the budget is legally enacted by the Board. The manager is authorized to transfer budgeted amounts between line items of the District; however, any revisions that alter the total expenditures of the District must be approved by the Board of Directors. During 2008, actual operating expenses exceeded budgeted operating expenses.

Capital Assets — All development costs in excess of \$500 which have a useful life of greater than one year and all expenditures for repairs, maintenance, renewals, and betterments that materially prolong the lives of assets are capitalized. Capital assets are recorded at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets, which range from five to fifty years.

Cash and Cash Equivalents — Cash, consisting of demand deposits, money market accounts and cash on hand are deemed to be cash equivalents for the purpose of the statement of cash flows.

Property Taxes Receivable — Management has determined that property taxes receivable are collectible and no allowance for doubtful accounts is deemed necessary.

Water Rights — During 2005, a developer within the District, who also serves on the District's Board of Directors, donated certain water rights to the District. These rights were recorded by the District at their estimated fair market value. A limited market exists for the sale of water rights. As a result, the recorded value of the water rights could differ materially from their actual value.

Fair Value of Financial Instruments — The District's financial instruments include cash and cash equivalents, accounts payable, and advances payable. The District estimates that the fair value of all financial instruments at December 31, 2008 does not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying balance sheet. The carrying amount of these financial instruments approximates fair value because of the short maturity of these instruments.

Fund Equity — In the fund financial statements, Governmental Funds report reservations of fund balance for amounts that are legally segregated or are not subject to future appropriations. Designations of unreserved fund balances indicate management's intention for future utilization of such funds and are subject to change by management.

The District considers all unreserved fund balances to be "reserves" for future operations or capital replacement as defined within Article X, Section 20 of the Constitution of the State of Colorado.

Reserved Fund Balance — Emergency Reserves have been provided for as required by Article X, Section 20 of the Constitution of the State of Colorado (see Note 9). \$64,114 of the fund balance has been reserved in compliance with this requirement.

Use of Estimates — Preparation of the District's financial statements in conformity with accounting principles generally accepted in the United States of America 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 income and expenses during the reporting period. Actual results could differ from those estimates.

2. **CAPITAL ASSETS**

Capital asset activity for the year ended December 31, 2008 is as follows:

	Balance at January 1, 2008	Increases	Decreases	Balance at December 31, 2008
Land	\$ 1,345,302			\$ 1,345,302
Equipment and systems	6,580,938	\$ 294,784		6,875,722
Roads and drainage	8,841,309	287,935		9,129,244
Vehicles	<u>71,236</u>	<u> </u>	<u> </u>	<u>71,236</u>
Total capital assets	16,838,785	582,719		17,421,504
Total accumulated depreciation	<u>1,279,160</u>	<u>700,126</u>	<u> </u>	<u>1,979,286</u>
Capital assets, net	<u>\$ 15,559,625</u>	<u>\$ (117,407)</u>	<u>\$ —</u>	<u>\$ 15,442,218</u>

3. **CAPITAL LEASE OBLIGATION**

The District is obligated under a lease for a vehicle that is accounted for as a capital lease. The vehicle under capital lease at December 31, 2008 is recorded at a cost of \$30,812 and accumulated depreciation of \$15,406.

A summary of activity for the year ended December 31 is as follows:

	Balance at January 1, 2008	Increases	Decreases	Balance at December 31, 2008
Capital lease obligation	<u>\$ 20,340</u>	<u>\$ —</u>	<u>\$ 6,162</u>	<u>\$ 14,178</u>

The following is a schedule of future minimum lease payments under the capital lease as of December 31, 2008:

2009	\$ 6,162
2010	6,162
2011	<u>3,724</u>
Total minimum lease payments	16,048
Less amount representing interest	<u>1,870</u>
Total capital lease obligation	14,178
Less current portion	<u>5,084</u>
Long-term portion	<u>\$ 9,094</u>

4. **BONDS PAYABLE**

A summary of bonds payable for the year ended December 31, 2008 is as follows:

	Balance at January 1, 2008	Increase	Decrease	Balance at December 31, 2008	Amounts Due Within One Year
General Obligation Limited Tax Bonds Series 2004 A — \$9,465,000 originally issued with 7.625% interest	\$ 8,380,000		\$ 505,000	\$ 7,875,000	\$ 320,000
Series 2004 B-1 Notes to related parties	1,000,000			1,000,000	
Series 2004 B-2 Notes to related parties	1,500,000			1,500,000	
General Obligation Limited Tax Subordinate Bonds Series 2007 — \$4,935,000 originally issued with 8.5% interest	4,935,000			4,935,000	
Unamortized portion of original issue discount	<u>(81,163)</u>	\$ 4,454		<u>(76,709)</u>	
Total	<u>\$15,733,837</u>	<u>\$ 4,454</u>	<u>\$ 505,000</u>	<u>\$15,233,291</u>	<u>\$ 320,000</u>

Payment of the principal and interest on the bonds is anticipated to come from water tap fees, infrastructure fees and facility fees as the District develops. After the majority of properties in the District have been sold, homes, commercial facilities and other improvements have been constructed and the District's tax base has had time to develop, the source of payment of debt service on the Bonds will be primarily paid from the limited mill levy to be levied on the taxable property within the District.

In addition to the Bonds, the District simultaneously issued Subordinated General Obligation Limited Tax Notes, designated "Series 2004 B-1 Notes", in the amount of \$1,000,000 to the developer and the primary property owner in partial exchange for sums expended, or to be expended, on behalf of the District for organizational costs and infrastructure improvements. The Series 2004 B-1 Notes mature December 15, 2035. In February 2006, the District issued additional Subordinated General Obligation Limited Tax Notes, designated "Series 2004 B-2 Notes", in the amount of \$1,500,000 to the developer and primary property owner for the same purpose. The Series 2004 B-2 Notes mature December 15, 2037. The Series 2004 B-1 Notes and the Series 2004 B-2 Notes are held by two companies that are each owned in part by one or more members of the Board of Directors of the District.

Payment of debt service on the Series 2004 B-1 and B-2 Notes is subordinate to payment of debt service on the Bonds. Interest on the Notes is payable on December 15 of each year first from revenues of the District pledged to the payment of debt service on the Bonds and secondly from moneys not pledged to the payment of debt service on the bonds. Unpaid interest will accrue in years when available funds of the District are not sufficient to pay interest on the Notes, and will be paid only after all debt service on the Bonds due and to become due through maturity of the Bonds has been paid.

During 2007 the District issued \$4,935,000 General Obligation Limited Tax Subordinate Bonds. These Series 2007 Bonds are subordinate to the Series 2004A Bonds. Payments on the Series 2007 Bonds of principal and interest will only be made from revenues that are in excess of the debt service requirements of the 2004A Bonds or from sources not pledged to the payment of the Series 2004A Bonds. All unpaid principal and interest will accrue on the Series 2007 Bonds until the Series 2004A Bonds are paid in full.

The following is a summary of mandatory sinking fund payments and interest requirements on the Bonds and notes:

Year Ending December 31,	Series 2004 Bonds	Series 2004 B-1 Notes	Series 2004 B-2 Notes	Series 2007 Bonds	Total
2009	\$ 920,469	\$ 30,000	\$ 45,000	\$ 419,475	\$ 1,414,944
2010	721,069	40,000	45,000	419,475	1,225,544
2011	570,013	40,000	60,000	419,475	1,089,488
2012	594,631	40,000	60,000	419,475	1,114,106
2013	682,344	45,000	60,000	419,475	1,206,819
2014-2018	3,418,838	240,000	352,500	2,097,375	6,108,713
2019-2023	3,424,906	285,000	412,500	2,097,375	6,219,781
2024-2028	3,416,144	325,000	472,500	2,097,375	6,311,019
2029-2033	3,416,213	365,000	540,000	2,097,375	6,418,588
2034-2037	<u>1,630,517</u>	<u>1,130,800</u>	<u>1,838,900</u>	<u>5,989,425</u>	<u>10,589,642</u>
Total	18,795,144	2,540,800	3,886,400	16,476,300	<u>\$ 41,698,644</u>
Less interest	<u>10,920,144</u>	<u>1,540,800</u>	<u>2,386,400</u>	<u>11,541,300</u>	
Outstanding principal	<u>\$ 7,875,000</u>	<u>\$ 1,000,000</u>	<u>\$ 1,500,000</u>	<u>\$ 4,935,000</u>	

5. INTERGOVERNMENTAL AGREEMENT

In April 2003, the District entered into an Intergovernmental Agreement with the Woodmen Hills Metropolitan District (Woodmen Hills), for the purpose of the District acquiring waste water services from Woodmen Hills. Under the terms of the agreement, the District is responsible for the design, construction, installation, maintenance, and financing of a complete municipal waste water collection system. Woodmen Hills will provide all waste water services to the properties within the District's boundaries, up to 754 single family equivalent users. Woodmen Hills will retain all sewer tap fees and monthly sewer service charges. The District is responsible for the replacement, upgrade, and improvements to the infrastructure.

6. ADVANCES PAYABLE TO RELATED PARTIES

Certain members of the Board of Directors of the District, and entities controlled by the Board members, have advanced funds to the District. The advances as of December 31, 2008 are short-term, unsecured, and bear interest at 8 percent.

7. DEPOSITS

The Colorado Public Deposit Protection Act, (PDPA) requires that all units of local government deposit cash into eligible public depositories as determined by state regulators. Amounts on deposit in excess of federal insurance levels must be collateralized. The eligible collateral is determined by the PDPA which allows the institution to create a single collateral pool for all public funds. The pool is to be maintained by another institution, or held in trust for all the uninsured public deposits as a group. The market value of the collateral must be at least equal to 102% of the aggregate uninsured deposits. At December 31, 2008 the carrying amount of the District's cash was \$1,195,162 and the bank balances were \$217,181. All of the bank balances were covered by federal depository insurance and \$977,981 is required by Colorado Statutes to be collateralized with securities held by the pledging financing institution's trust department in the District's name.

8. RISK MANAGEMENT

The District is exposed to various risks of losses related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District carries commercial insurance for these risks of loss. There were no claims resulting from these risks that exceeded commercial insurance coverage during 2008.

9. TAX SPENDING AND DEBT LIMITATIONS

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

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

TABOR requires local governments to establish Emergency Reserves. These reserves must be at least 3% of Fiscal Year Spending (excluding bonded debt service). Local governments are not allowed to use the emergency reserves to compensate for economic conditions, revenue shortfalls, or salary or benefit increases.

The District elected to be exempt from the TABOR provisions.

FALCON HIGHLANDS METROPOLITAN DISTRICT

SUPPLEMENTAL SCHEDULES

FALCON HIGHLANDS METROPOLITAN DISTRICT

DEBT SERVICE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE — BUDGET AND ACTUAL FOR THE YEAR ENDED DECEMBER 31, 2008

	Original and Final Budget ⁽¹⁾	Actual	Variance
REVENUE			
Property taxes	\$ 268,536	\$ 380,783	\$ 112,247
Interest	<u>5,000</u>	<u>24,583</u>	<u>19,583</u>
Total revenue	<u>273,536</u>	<u>405,366</u>	<u>131,830</u>
EXPENDITURES			
Bond interest	638,975	1,020,316	(381,341)
Bond principal		505,000	(505,000)
Capital outlay	<u> </u>	<u>406,623</u>	<u>(406,623)</u>
Total expenditures	<u>638,975</u>	<u>1,931,939</u>	<u>(1,292,964)</u>
OTHER FINANCINGS SOURCES (USES)			
Transfers in (out)	<u> </u>	<u>(186,213)</u>	<u>(186,213)</u>
NET CHANGE IN FUND BALANCE	<u>\$ (365,439)</u>	<u>\$ (1,712,786)</u>	<u>\$ (1,347,347)</u>

⁽¹⁾ Original budget and final budget are the same; there were no amendments to the 2008 budget.

FALCON HIGHLANDS METROPOLITAN DISTRICT

STATEMENT OF ACTIVITIES COMPARED TO BUDGET – ENTERPRISE FUND FOR THE YEAR ENDED DECEMBER 31, 2008

	Original and Final Budget ⁽¹⁾	Actual	Variance
OPERATING REVENUES			
Water treatment and usage fees	\$ 1,065,648	\$ 281,975	\$ (783,673)
Other income	<u>53,850</u>	<u>24,305</u>	<u>(29,545)</u>
Total operating revenues	<u>1,119,498</u>	<u>306,280</u>	<u>(813,218)</u>
OPERATING EXPENSES			
Contract labor, repairs and insurance	579,751	165,105	414,646
Utilities	41,227	58,788	(17,561)
Professional fees	18,000	22,844	(4,844)
Miscellaneous	<u>232,211</u>	<u>77,099</u>	<u>155,112</u>
Total operating expenses	<u>871,189</u>	<u>323,836</u>	<u>547,353</u>
INCOME (LOSS) FROM OPERATIONS	248,309	(17,556)	(265,865)
NONOPERATING REVENUE (EXPENSE)			
Water tap and infrastructure fees, net	<u>655,000</u>	<u>473,985</u>	<u>(181,015)</u>
EXCESS (DEFICIT OF) REVENUE OVER EXPENDITURES	<u>\$ 903,309</u>	456,429	<u>\$ (446,880)</u>
GAAP ADJUSTMENTS			
Depreciation and amortization		<u>253,830</u>	
CHANGE IN NET ASSETS		<u>\$ 202,599</u>	

⁽¹⁾ Original budget and final budget are the same; there were no amendments to the 2008 budget.