

CORNERSTONE METROPOLITAN DISTRICT NO. 2
FINANCIAL STATEMENTS AND REPORT OF
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

December 31, 2017

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Office of the State Auditor

July 30, 2018

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**INDEPENDENT AUDITOR'S REPORT**

June 1, 2018

To the Board of Directors
Cornerstone Metropolitan District No. 2

We have audited the accompanying financial statements of the governmental activities and the major fund of Cornerstone Metropolitan District No. 2 (the District) as of and for the year ended December 31, 2017, 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. 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 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.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of Cornerstone Metropolitan District No. 2, as of December 31, 2017, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3-6 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



Board of Directors
Cornerstone Metropolitan District No. 2
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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 Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Cornerstone Metropolitan District No. 2's basic financial statements. The debt service fund budget to actual schedule is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The debt service fund budget to actual schedule is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the debt service fund budget to actual schedule is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Chadwick, Steinkirchner, Davis & Co., P.C.

Grand Junction, Colorado

Cornerstone Metropolitan District No. 2 Management's Discussion and Analysis December 31, 2017

As management of Cornerstone Metropolitan District No. 2 (the "District"), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended December 31, 2017.

Overview of the Financial Statements

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

Government-wide financial statements

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

The Statement of Net Position presents information on all the District's assets, deferred outflows, liabilities, and deferred inflows with the difference reported as net position.

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 governmental activities of the District relate to satisfying an intergovernmental agreement with Cornerstone Metropolitan District No. 1 and to service the District's long-term debt requirements. The government-wide financial statements can be found on pages 7 and 8 of this report.

Fund financial statements

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

Governmental funds

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. The governmental funds provide a reconciliation to facilitate this comparison between governmental funds and governmental activities. The governmental funds financial statements are located on pages 9 through 11 of this report.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The Notes to the Financial Statements can be found starting on page 12 of this report.

Government-wide Financial Analysis

The following table shows a condensed statement of net position as of December 31, 2017, derived from the government-wide financial statements.

Cornerstone Metropolitan District No. 2 Net Position

	Governmental Activities 2017	Governmental Activities 2016
Assets:		
Current assets	\$ 387,951	\$ 814,918
Other assets	-	-
Total Assets	<u>387,951</u>	<u>814,918</u>
Liabilities & Deferred Inflows:		
Current liabilities & deferred inflows	399,267	760,594
Long-term and other liabilities	<u>36,536,356</u>	<u>34,679,103</u>
Total Liabilities & Deferred Inflows	<u>36,935,623</u>	<u>35,439,697</u>
Net Position:		
Restricted	8,684	59,324
Unrestricted	<u>(36,556,356)</u>	<u>(34,684,103)</u>
Total Net Position	<u>\$ (36,547,672)</u>	<u>\$ (34,624,779)</u>

The District is the “taxing district” in a dual district structure whereby the District has and will continue to finance the construction and operation of the infrastructure for Cornerstone subdivision. The District has entered into a District Facilities Construction and Service Agreement with Cornerstone Metropolitan District No. 1. Under the agreement, District No. 1 (the “operating district”) is responsible for managing the construction of all facilities and improvements and for the operation and maintenance of all improvements not conveyed to another public entity. The District is responsible for providing the funding for all infrastructure improvements and the revenue needed to support the ongoing operation and maintenance of the improvements and public facilities. The District reports a liability for the “capital obligation” for construction costs as well as the “service obligation” for the excess costs of operating and maintaining the facilities. Even though it is doubtful that the District will ever be able to fund such obligations based on the current revenue levels, the liabilities are required to be reported in the Statement of Net Position.

At the end of the current fiscal year, the District has a negative unrestricted net position which is primarily a result of the issuance of the Series 2010 A and B Bonds and reporting of the capital and service obligation owed to District No. 1, combined with the infrastructure assets being owned and recorded on the books of District No. 1 and other governmental entities.

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

**Cornerstone Metropolitan District No. 2
Change in Net Position**

	Governmental Activities 2017	Governmental Activities 2016
Revenues:		
Charges for services	\$ -	\$ -
Property taxes	436,998	534,363
Interest and other income	12,581	42,267
Operating grants and contributions	-	-
Capital grants and contributions	-	-
Total Revenues	<u>449,579</u>	<u>576,630</u>
Expenses:		
General government	10,824	16,757
Intergovernmental agreement	824,248	1,368,535
Interest expense	1,537,400	1,469,736
Total Expenses	<u>2,372,472</u>	<u>2,855,028</u>
Change in Net Position	(1,922,893)	(2,278,398)
Net Position- Beginning	<u>(34,624,779)</u>	<u>(32,346,381)</u>
Net Position- Ending	<u>\$ (36,547,672)</u>	<u>\$ (34,624,779)</u>

The primary reasons for the decrease in net position during both 2016 and 2017 are 1) the reduction in property tax revenue due to reduced assessed valuations; 2) the excess in debt service expenses on the 2010 A and 2010 B Bonds over revenues available for such debt service; and 3) additions to obligations owed to District No. 1 for unfunded accrued interest on developer notes.

Financial Analysis of the District's Funds

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

Governmental funds

The focus of the District's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the District's financing requirements.

Debt Service Fund revenues were \$449,579 in 2017 and consisted primarily of property and specific ownership taxes.

Debt Service Fund expenditures totaled \$500,219 in 2017 and were primarily related to partial interest payments on the 2010A Bonds and funding provided to District No. 1 used towards community operations.

As of the end of 2017, the District's governmental fund reported an ending fund balance of \$8,684. This balance is restricted for future debt service.

Budget variances

The District amended its 2017 budget because of additional property tax collections, part of which were then transferred to District No. 1 for operations. The Debt Service Fund budget to actual report can be found in the Supplementary Information section of this report, on page 24.

Long-term debt

As of December 31, 2017 the Series 2010 A and B Bonds principal balances totaled \$21,483,001. The District did not have sufficient revenue to allow payment of all of its debt service on the 2010A Bonds. The 2010A Bonds are secured by a Reserve Fund but that fund was drawn down to zero and used to fund the partial payment of annual debt service. It is not anticipated the shortfall will be made up but rather that additional shortfalls will continue into future years based on the District's current financial condition. Additionally, since the District does not have sufficient revenues to allow payment of interest on the 2010B Bonds, such amounts have been accrued to future years. Details regarding the District's long-term debt are located in Note E starting on page 18 of this report.

Economic Conditions and Outlook:

Beginning in 2012, the District saw a large-scale reduction in the District's assessed value reflecting an overall decrease of approximately 80% since 2010, which can be attributed to the overall downturn in the real estate market, the pull out of the original developer from the Cornerstone community, and litigation with the subsequent purchasers which was settled during 2015. The significant decrease in assessed valuation is causing funding shortfalls for both the 2010A and 2010B Bonds as well as to District No. 1 for operations. Beginning in 2014 the District increased the debt service mill levy rate from 32 to the maximum of 40 mills to partially offset the reduction in assessed values. However, even with the increased mill levy, the District does not generate sufficient property tax revenues to cover debt expenses and has been using accumulated reserves to cover the shortfall. The Reserve fund balance decreased to a December 31, 2017 balance of \$0. The District will not have sufficient funds available from the reserve fund or property tax revenue to meet its debt service obligations of the 2010A or 2010B Bonds. Such shortfalls shall accrue to future years but since the District is levying the maximum mill levy, the Bonds are not in a default status. Shortfalls of revenue available for debt service are expected to continue. See Note E beginning on page 18 for additional information.

Request for Information

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

Cornerstone Metropolitan District No. 2

STATEMENT OF NET POSITION

December 31, 2017

	<u>Governmental Activities</u>
ASSETS	
Cash and investments - restricted	\$ 19,395
Due from treasurer	3,910
Property taxes receivable	364,646
Total assets	<u>387,951</u>
LIABILITIES	
Intergovernmental payable	14,621
Accrued interest payable	3,507,217
Non-current capital and service obligations due to Cornerstone Metro District No. 1	11,566,138
Bonds payable, current portion	20,000
Bonds payable, non-current portion	21,463,001
Total liabilities	<u>36,570,977</u>
DEFERRED INFLOWS OF RESOURCES	
Deferred property tax revenue	364,646
Total deferred inflows of resources	<u>364,646</u>
NET POSITION	
Restricted for debt service	8,684
Unrestricted	(36,556,356)
Total net position	<u><u>\$ (36,547,672)</u></u>

The accompanying notes are an integral part of this statement.

Cornerstone Metropolitan District No. 2

STATEMENT OF ACTIVITIES

Year ended December 31, 2017

Function/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Position
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Primary government:					
Governmental activities:					
General government	\$ 10,824	\$ -	\$ -	\$ -	\$ (10,824)
Intergovernmental agreement	824,248	-	-	-	(824,248)
Interest and related costs on long term debt	1,537,400	-	-	-	(1,537,400)
Total primary government	<u>\$ 2,372,472</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>(2,372,472)</u>
General revenues (expenses):					
Property taxes					389,398
Specific ownership taxes					47,600
Interest income					12,581
Total general revenues and transfers					<u>449,579</u>
Change in net position					(1,922,893)
Net position - beginning					<u>(34,624,779)</u>
Net position - ending					<u>\$ (36,547,672)</u>

The accompanying notes are an integral part of this statement.

Cornerstone Metropolitan District No. 2

BALANCE SHEET - GOVERNMENTAL FUNDS

December 31, 2017

	<u>Debt Service</u>
ASSETS	
Cash and investments - restricted	19,395
Due from treasurer	3,910
Property taxes receivable	364,646
Total assets	<u>\$ 387,951</u>
LIABILITIES	
Intergovernmental payable	\$ 14,621
Total liabilities	<u>14,621</u>
DEFERRED INFLOWS OF RESOURCES	
Deferred property tax revenue	364,646
Total deferred inflows of resources	<u>364,646</u>
FUND BALANCES	
Restricted for debt service	8,684
Total fund balances	<u>8,684</u>
Total liabilities, deferred inflows, and fund balance	<u>\$ 387,951</u>
Total governmental fund balance per above	\$ 8,684

Amounts reported for governmental activities in the statement of net position are excluded from the governmental fund balance because:

Long term assets or liabilities not receivable or payable in the current year are excluded in the governmental funds. Interest on long-term debt is recognized as an expenditure in governmental funds when due. These items consist of:

Capital and service obligations due to Cornerstone Metro Dist. No. 1	(11,566,138)
Bonds payable	(21,483,001)
Accrued interest payable	<u>(3,507,217)</u>
Net position of governmental activities	<u>\$ (36,547,672)</u>

The accompanying notes are an integral part of this statement.

Cornerstone Metropolitan District No. 2

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES - GOVERNMENTAL FUNDS

Year ended December 31, 2017

	<u>Debt Service</u>
Revenues	
Property taxes	\$ 389,398
Specific ownership taxes	47,600
Investment income	12,581
Total general revenues	<u>449,579</u>
Expenditures	
General government	
Operations transfer to Cornerstone Metro District No. 1	277,664
Treasurer's fees	6,888
Debt service	
Treasurer's fees	3,936
Bond principal	-
Bond interest	211,731
Total expenditures	<u>500,219</u>
Excess of revenues over (under) expenditures	(50,640)
Fund balances:	
Beginning of the year	59,324
End of the year	<u><u>\$ 8,684</u></u>

The accompanying notes are an integral part of this statement.

Cornerstone Metropolitan District No. 2

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCES OF GOVERNMENT FUNDS TO THE
STATEMENT OF ACTIVITIES

Year ended December 31, 2017

Amounts reported as governmental activities in the

Statement of Activities are different because:

Net change in fund balance - total governmental funds	\$ (50,640)
Interest expense is recognized as it comes due and is able to be paid in the funds but is recognized as it accrues in the government wide statements.	(1,325,669)
Capital and service obligations reported in the Statement of Activities do not provide or consume current financial resources and, therefore, are not reported as revenues or expenditures in governmental funds.	(546,584)
Change in net position of governmental activities	<u>\$ (1,922,893)</u>

The accompanying notes are an integral part of this statement.

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE A – DEFINITION OF REPORTING ENTITY

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

The reporting entity consists of (a) the primary government; i.e., the District, and (b) organizations for which the District is financially accountable. The District is considered financially accountable for legally separate organizations if it is able to appoint a voting majority of an organization's governing body and is either able to impose its will on that organization or there is a potential for the organization to provide specific financial benefits, to, or to impose specific financial burdens on, the District. Consideration is also given to other organizations which are fiscally dependent; i.e., unable to adopt a budget, levy taxes, or issue debt without approval by the District. Organizations for which the nature and significance of their relationship with the District are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete are also included in the reporting entity.

Based on the criteria discussed above, the District is not financially accountable for any other entity, nor is the District a component unit of any other government.

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

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

1. Government- wide and Fund Financial Statements

The District's basic financial statements include both government-wide (reporting the District as a whole) and fund financial statements (reporting the District's major funds). Both the government-wide and fund financial statements categorize primary activities as either governmental or business-type. The District currently has only government-type activities.

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

1. Government- wide and Fund Financial Statements- Continued

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

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

2. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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

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

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

2. Measurement Focus, Basis of Accounting, and Financial Statement Presentation- Continued

The District reports the following major governmental funds:

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

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

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

3. Budgets

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

4. Fund Equity

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

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES- CONTINUED

4. Fund Equity- Continued

The following classifications describe the relative strength of the spending constraints:

- *Nonspendable fund balance* – The portion of fund balance that cannot be spent because it is either not in spendable form (such as prepaid amounts or inventory) or legally or contractually required to be maintained intact.
- *Restricted fund balance* – The portion of fund balance that is constrained to be used for a specific purpose by external parties (such as bondholders and Cornerstone Metropolitan District No. 1), constitutional provisions, or enabling legislation.
- *Committed fund balance* – The portion of fund balance that can only be used for specific purposes pursuant to constraints imposed by formal action of the government’s highest level of decision – making authority, the Board of Directors. The constraint may be removed or changed only through formal action of the Board of Directors.
- *Assigned fund balance* – The portion of fund balance that is constrained by the government’s intent to be used for specific purposes, but is neither restricted nor committed. Intent is expressed by the Board of Directors to be used for a specific purpose. Constraints imposed on the use of assigned amounts are more easily removed or modified than those imposed on amounts that are classified as committed.
- *Unassigned fund balance* – The residual portion of fund balance that does not meet any of the criteria described above. If more than one classification of fund balance is available for use when an expenditure is incurred, it is the District’s policy to use the most restrictive classification first.

5. Fund Balance Classifications

The total fund balance of the governmental funds was \$8,684 as of December 31, 2017. The entire balance was restricted for the payment of future debt service principal, interest and related costs, as well as operational funding to District No. 1.

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE C – CASH AND INVESTMENTS

The Colorado Public Deposit Protection Act (PDPA) requires that all units of local government deposit cash in eligible public depositories. Eligibility is determined by state regulators. Amounts on deposit in excess of federal insurance levels must be collateralized. The eligible collateral is determined by the PDPA. PDPA allows the institution to create a single collateral pool for all public funds. The pool for all the uninsured public deposits as a group is to be maintained by another institution or held in trust. The market value of the collateral must be at least equal to 102% of the aggregate uninsured deposits. The State Commissioners for banks and financial services are required by statute to monitor the naming of eligible depositories and reporting of the uninsured deposits and assets maintained in the collateral pools.

As of December 31, 2017, the District's cash deposits had a bank balance of \$0 and a carrying balance of \$0.

1. Investments

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

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

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

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

- Obligations of the United States, certain U.S. government agency securities and the World Bank
- General obligation and revenue bonds of U.S. local government entities
- Bankers acceptances of certain banks
- Commercial paper
- Written repurchase agreements and certain reverse repurchase agreements collateralized by certain authorized securities
- Guaranteed investment contracts
- * Local government investment pools

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE C – CASH AND INVESTMENTS – CONTINUED

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

As of December 31, 2017, the District had the following investments:

Investment	Maturity	<u>Fair Value</u>
Colostrust	Weighted average Under 60 days	<u>\$ 19,260</u>

2. COLOTRUST

On December 31, 2017 the District had \$19,260 of deposits in the Colorado Government Liquid Asset Trust (COLOTRUST), an investment vehicle established for local government entities in Colorado to pool surplus funds. COLOTRUST operates similarly to a money market fund and each share is equal in value to \$1.00. Investments of COLOTRUST consist of U.S. Treasury bills, notes and note strips and repurchase agreements collateralized by U.S. Treasury securities. A designated custodial bank provides safekeeping and depository services to COLOTRUST in connection with the direct investment and withdrawal functions of COLOTRUST. Substantially all securities owned by COLOTRUST are held by the Federal Reserve Bank in the account maintained for the custodial bank. The custodian's internal records identify the investments owned by COLOTRUST. These pools are not required to and are not registered with the SEC. COLOTRUST's two funds are rated AAAM by Standard and Poor's, Fitch's and Moody's rating services. COLOTRUST operates like a 2a-7 external investment pool and investments in the pool are valued at \$1 net asset value (NAV) per share. The underlying investments held by COLOTRUST are valued at fair value.

NOTE D – NON-CURRENT CAPITAL AND SERVICE OBLIGATION

The District is obligated under the Master IGA (see Note I) between the Districts to provide funding for all public infrastructure improvements (capital obligation) and to provide the revenue needed to support the ongoing operation and maintenance of the improvements and public facilities (service obligation). In 2010 the District issued Bonds (see Note E) to repay a portion of the balances owed to District No. 1. The non-current capital and service obligations due to Cornerstone Metropolitan District No. 1 reported in the Statement of Net Position are the remaining amounts not yet reimbursed to District No. 1 as of December 31, 2017. The District does not have the financial ability to issue additional debt due to declining assessed property values in the District and the cap of 40 mills to be levied for repayment of debt, which is required to be used for

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE D – NON-CURRENT CAPITAL AND SERVICE OBLIGATION – CONTINUED

repayment of the Bonds of the District before being used to pay the obligations owed to District No. 1. Even though it is not anticipated that the District will be able to repay this balance, accounting rules require that the liability should still be reported in the Statement of Net Position.

NOTE E – LONG-TERM LIABILITIES

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

The following is an analysis of changes in the District’s long- term debt for the year ended December 31, 2017:

	Balance December 31, 2016	Additions	Payments	Balance December 31, 2017	Due Within One Year
Series 2010A Bonds	\$ 5,185,000	\$ –	\$ –	\$ 5,185,000	\$ 20,000
Series 2010B Bonds	16,298,001	–	–	16,298,001	–
	<u>\$ 21,483,001</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ 21,483,001</u>	<u>\$ 20,000</u>

The detail of the District’s long- term debt outstanding at December 31, 2017 is as follows:

1. Series 2010A

The Series 2010A Bonds bear interest at a fixed rate of 8.0% with interest payments due semi - annually on June 1 and December 1 of each year. Principal payments are due on December 1 of each year beginning in 2015, continuing through final maturity in 2040. The Bonds are subject to redemption prior to maturity at the option of the District on or after December 1, 2021, without premium. The bonds are payable from the net pledged revenues, including ad valorem property taxes, specific ownership taxes, development fees and other legally available revenues. The property tax mill levy used to pay the bonds is required to be no less than 25 mills and not greater than 40 mills unless there is a change in method of calculating assessed value or any constitutionally mandated tax credit, cut or abatement occurs in which case the mills may be adjusted to maintain revenue levels that are neither enhanced or diminished by these changes. During 2013 the assessed value of property in Montrose and Ouray Counties was reassessed and decreased. The District adjusted the mill levy to the maximum of 40 mills, however this levy is not adequate to fund current debt service. The Bonds were originally secured by a reserve fund in the amount of \$520,000, which was drawn upon to cover multiple shortfalls. As of December 31, 2017

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE E – LONG-TERM LIABILITIES – CONTINUED

the balance in the reserve fund was \$0, the debt service shortfall was \$5,000 in principal and \$241,831 in interest. Debt service shortfalls are expected to continue.

Future principal and interest payments on the Series 2010A bonds are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018 (Including accrued interest)	\$ 20,000	\$ 617,869	\$ 637,869
2019	20,000	413,200	433,200
2020	30,000	411,600	441,600
2021	35,000	409,200	444,200
2022	45,000	406,400	451,400
2023- 2027	430,000	1,955,200	2,385,200
2028- 2032	845,000	1,722,000	2,567,000
2033- 2037	1,455,000	1,294,000	2,749,000
2038- 2040	<u>2,305,000</u>	<u>456,800</u>	<u>2,761,800</u>
Total	<u>\$ 5,185,000</u>	<u>\$ 7,686,269</u>	<u>\$ 12,871,269</u>

2. Series 2010B

The Series 2010B Bonds bear interest at a rate of 6%. Principal payments are due on December 1 of each year beginning in 2023 and continuing through the final maturity date in 2046. The Bonds are subject to redemption prior to maturity at the option of the District at any time, without premium. The Bonds are subordinate to the Series 2010A Bonds and are payable from the remaining net pledged revenues, including ad valorem property taxes, specific ownership taxes and development fees. In the event that a mill levy of 25 mills (the minimum levy required by the 2010A Bonds), along with other available revenues, after making the required annual payments on the 2010A Bonds, is insufficient to pay the debt service on the Series 2010B Bonds, the total mill levy will be increased up to a maximum of 30 mills unless there is a change in method of calculating assessed value or any constitutionally mandated tax credit, cut or abatement occurs in which case the mills may be adjusted to maintain revenue levels that are neither enhanced or diminished by these changes. During 2013 the assessed value of property in Montrose and Ouray Counties was re-assessed and decreased causing the entire mill levy to be pledged to the 2010A Bonds. The Series 2010B Bonds were originally secured by an irrevocable direct pay letter of credit issued by the Bank of America, N.A. During 2014 the District was advised that the letter of credit would not be renewed and consequently terminated. Pursuant to the terms of the indenture, non-renewal of the letter of credit resulted in conversion of the 2010B Bonds into Developer Bonds on November 24, 2014. The Developer Bonds bear a fixed interest rate of 6%. At the time the bonds were converted there were funds available to pay \$701,999 of principal, leaving an outstanding principal balance as of December 31, 2017 of \$16,298,001. As no funds have been available since the conversion, there is a balance of accrued but unpaid interest as of December 31, 2017 of \$3,265,386.

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE E – LONG- TERM LIABILITIES – CONTINUED

The Subordinate Series 2010B Bonds are also subject to mandatory sinking fund redemption, in part, by lot, on December 1, 2023 and on each December 1 thereafter prior to the maturity date. Future estimated principal and interest payments are as follows, however as the District currently has no funding available to make the required payments, it is anticipated that the unpaid amounts will carry forward to future years and ultimately may never be fully repaid.

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018 (Including accrued interest)	\$ –	\$ 4,162,892	\$ 4,162,892
2019	–	977,880	977,880
2020	–	977,880	977,880
2021	–	977,880	977,880
2022	–	977,880	977,880
2023- 2027	1,225,000	4,751,400	5,976,400
2028- 2032	1,660,000	4,333,800	5,993,800
2033- 2037	2,170,000	3,776,700	5,946,700
2038- 2042	4,520,000	3,003,900	7,523,900
2043- 2046	<u>6,723,001</u>	<u>988,020</u>	<u>7,711,021</u>
Total	<u>\$ 16,298,001</u>	<u>\$ 24,928,232</u>	<u>\$ 41,226,233</u>

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE E- LONG – TERM LIABILITIES – CONTINUED

3. Debt Authorization

On November 2, 2004, the District electors authorized the issuance of indebtedness totaling \$787,500,000 at an interest rate not to exceed 12%. However, pursuant to the Service Plan, the District will not issue more than \$30,000,000 in indebtedness. The following schedule shows the amounts authorized and unissued as of December 31, 2017:

	Authorized November 2, 2004	Authorization Used, Series 2010	Remaining at December 31, 2017
Streets	\$ 60,000,000	\$ —	\$ 60,000,000
Traffic & safety	60,000,000	—	60,000,000
Water	60,000,000	—	60,000,000
Sanitary sewer and storm drainage	60,000,000	—	60,000,000
Parks and recreation	60,000,000	—	60,000,000
Transportation	60,000,000	—	60,000,000
Television relay	60,000,000	—	60,000,000
Mosquito control	60,000,000	—	60,000,000
Fire and ambulance	60,000,000	—	60,000,000
Operations and maintenance	60,000,000	—	60,000,000
Intergovernmental contracts	60,000,000	—	60,000,000
Reimbursement agreements	60,000,000	—	60,000,000
Management services	7,500,000	—	7,500,000
Refunding of debt	<u>60,000,000</u>	<u>22,200,000</u>	<u>37,800,000</u>
Total	<u>\$ 787,500,000</u>	<u>\$ 22,200,000</u>	<u>\$ 765,300,000</u>

NOTE F – NET POSITION

Restricted net position is that portion of the Districts total net position restricted externally by grantors, contributors, or laws and regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

The District’s unrestricted net position as of December 31, 2017 totaled \$(36,556,356) because the District reports the liabilities for both Bonds and the Capital and Service Obligation yet the infrastructure paid for by the debt of the District is owned and reported by District No. 1 and other governmental entities.

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE G – RELATED PARTIES

All members of the Board of Directors for the District are also the members of the Board of Directors for District No. 1. Some of the members on the Board of Directors for the District are also on the Board of Directors for the Cornerstone Owners Association (COA). The COA owns the majority of the property that was owned by the previous developer.

NOTE H – RISK MANAGEMENT

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

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

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

NOTE I – INTERGOVERNMENTAL AGREEMENTS

1. District Facilities Construction and Service Agreement

On December 16, 2004, the Districts entered into a Districts Facilities Construction and Service Agreement (the Master IGA). The Master IGA provides that the District is to finance the construction, maintenance and operations of the facilities constructed and operated by Cornerstone Metropolitan District No. 1 as provided by the Consolidated Service Plan. The District is to finance such activities from their annual certification of a mill levy, specific ownership taxes and development fees. The mill levy of District No. 2 is limited by the Service Plan as amended in 2013, wherein the maximum operations mill levy was removed, and the maximum debt mill levy is not to exceed 40 mills.

Per the Service Plan if there is a change in method of calculating assessed value or if any constitutionally mandated tax credit, cut or abatement occurs, the mills may be adjusted to maintain revenue levels that are neither enhanced nor diminished by these changes.

Cornerstone Metropolitan District No. 2

Notes to the Financial Statements

December 31, 2017

NOTE I – INTERGOVERNMENTAL AGREEMENTS - CONTINUED

During 2013 the assessed value of property in Montrose and Ouray Counties was re-assessed resulting in a decrease of property value. The District adjusted the mill levy for operations to 70 mills and the mill levy for debt service to 40 mills in order to partially offset revenue levels diminished by the re-assessment.

NOTE J – TAX, SPENDING AND DEBT LIMITATIONS

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

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

TABOR requires local governments to establish Emergency Reserves. These reserves must be at least 3% of Fiscal Year Spending (excluding bonded debt service). At December 31, 2017, the District was not required to have an emergency reserve as all operations are performed by District No. 1.

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

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

Cornerstone Metropolitan District No. 2

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCE - BUDGET AND ACTUAL - DEBT SERVICE FUND

Year ended December 31, 2017

	Original Budget	Final Budget	Actual	Variance Favorable (Unfavorable)
Revenues				
Property taxes	\$ 390,565	\$ 390,565	\$ 389,398	\$ (1,167)
Specific ownership taxes	34,328	46,831	47,600	769
Interest income	20,000	30,000	12,581	(17,419)
Total revenues	<u>444,893</u>	<u>467,396</u>	<u>449,579</u>	<u>(17,817)</u>
Expenditures				
General government				
Operations transfer to				
Cornerstone Metro District No. 1	263,642	271,599	277,664	(6,065)
Treasurer's fees	6,744	6,744	6,888	(144)
Contingency	10,000	15,000	-	15,000
Debt service				
Treasurer's fees	3,854	3,854	3,936	(82)
Bond interest	216,570	218,905	211,731	7,174
Bond principal	-	-	-	-
Contingency	-	10,000	-	10,000
Total expenditures	<u>500,810</u>	<u>526,102</u>	<u>500,219</u>	<u>25,883</u>
Excess of revenues over (under) expenditures	(55,917)	(58,706)	(50,640)	8,066
Fund balance - beginning of year	<u>56,535</u>	<u>59,324</u>	<u>59,324</u>	<u>-</u>
Fund balance - end of year	<u>\$ 618</u>	<u>\$ 618</u>	<u>\$ 8,684</u>	<u>\$ 8,066</u>