

Tern Bay Community Development District

Financial Statements

September 30, 2012

Tern Bay Community Development District
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INDEPENDENT AUDITOR'S REPORT

To the Board of Supervisors
Tern Bay Community Development District
Charlotte County, Florida

We have audited the accompanying financial statements of the governmental activities and each major fund of Tern Bay Community Development District (hereinafter referred to as "District"), as of and for the year ended September 30, 2012, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the District as of September 30, 2012, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 5 and 10 to the financial statements, the Developer of Tern Bay has abandoned the development and this District. For the fiscal year ended September 30, 2012 and through the date of this report, the District did not receive any assessment amounts from the Developer or any other significant landowner. No debt service payments have been made by the District since November 2008. This continued lack of activity has had a material adverse effect on the District's operations.

In accordance with *Government Auditing Standards*, we have also issued a report dated February 26, 2013 on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 7 and on page 23 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.

Cam, Riggs & Ingram, L.L.C.

Miramar Beach, Florida
February 26, 2013

Management's Discussion And Analysis

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Tern Bay Community Development District's financial performance provides an overview of the District's financial activities for the fiscal year ended September 30, 2012. Please read it in conjunction with the District's financial statements, which begin on page 8.

FINANCIAL HIGHLIGHTS

The District defaulted on its Series 2005 Capital Improvement Revenue Bonds and has not made any principal or interest payments since the end of the capitalized interest period on November 1, 2008 and continues to remain in default. The Developer has abandoned the project and the current property owners have not paid any assessments levied on the property. Since 2008, the District has levied approximately \$19 million to pay for operations and maintenance assessments and debt service assessments, all of which remain outstanding and have been deemed uncollectible and written off by the District.

In fiscal year 2010, the bondholder's agreed to permit the District to utilize construction funds and assessments due for debt service received from property owners' who have paid the debt service assessments to fund the District's operations during the year. In accordance with the bondholder's request, the total amount of funds utilized from the Capital Project Fund totaled approximately \$2.1 million of which approximately \$400,000 were used in the current year. It is unlikely that the District will be able to re-pay those funds any time in the foreseeable future.

USING THE ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities on pages 8 – 9 provide information about the activities of the District as a whole and present a longer-term view of the District's finances. Fund financial statements start on page 10. For governmental activities, these statements tell how these services were financed in the short-term as well as what remains for future spending. Fund financial statements also report the District's operations in more detail than the government-wide statements by providing information about the District's most significant funds.

Reporting the District as a Whole

Our analysis of the District as a whole begins on page 4. One of the most important questions asked about the District's finances is, "Is the District as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the District as a whole and about its activities in a way that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the District's net assets and changes in them. You can think of the District's net assets – the difference between assets and liabilities – as one way to measure the District's financial health, or financial position. Over time, increases or decreases in the District's net assets are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the District's assessment base and the condition of the District's infrastructure, to assess the overall health of the District.

Reporting the District's Most Significant Funds

Our analysis of the District's major funds begins on page 5. The fund financial statements begin on page 10 and provide detailed information about the most significant funds – not the District as a whole. Some funds are required to be established by State law and by bond covenants. All of the District's funds are governmental fund-types.

- **Governmental funds** – All of the District's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the District's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the District's programs. We describe the relationship (or differences) between governmental activities and governmental funds in a reconciliation with the fund financial statements.

THE DISTRICT AS A WHOLE

The following table reflects the condensed Statement of Net Assets and is compared to the prior year.

September 30,	2012	2011	Change
Assets			
Current and other assets	\$ 3,601,209	\$ 3,948,898	\$ (347,689)
Capital assets, not being depreciated	45,419,499	45,419,499	-
Total assets	\$ 49,020,708	\$ 49,368,397	\$ (347,689)
Liabilities			
Current liabilities	\$ 14,698,216	\$ 11,169,347	\$ 3,528,869
Other liabilities	53,755,000	54,355,000	(600,000)
Total liabilities	68,453,216	65,524,347	2,928,869
Net assets			
Invested in capital assets, net of related debt	(10,181,665)	(10,144,407)	(37,258)
Restricted for:			
Capital projects	4,296,126	4,292,386	3,740
Unrestricted	(13,546,969)	(10,303,929)	(3,243,040)
Total net assets (deficit)	(19,432,508)	(16,155,950)	(3,276,558)
Total liabilities and net assets	\$ 49,020,708	\$ 49,368,397	\$ (347,689)

For more detailed information, see the accompanying Statement of Net Assets.

During the fiscal year ended September 30, 2012, total assets decreased approximately \$348,000 while total liabilities increased by approximately \$2.9 million. The decrease in assets is primarily due to the continued lack of assessment collections which forced the District to utilize construction fund monies to fund the operations of the District. The increase in liabilities is due to the accrual of debt service interest payments that had not been paid as of September 30, 2012.

The following schedule compares the Statement of Activities for the current and previous fiscal year.

<i>Year ended September 30,</i>	2012	2011	Change
Revenues:			
Program revenues:			
Charges for services	\$ 124,816	\$ 112,218	\$ 12,598
Interest and other revenues	-	338	(338)
Total revenues	124,816	112,556	12,260
Expenses:			
General government	236,664	162,332	74,332
Maintenance and operations	181,627	239,325	(57,698)
Interest	2,983,083	2,983,083	-
Total expenses	3,401,374	3,384,740	16,634
Increase (decrease) in net assets	(3,276,558)	(3,272,184)	(4,374)
Net assets (deficit), beginning	(16,155,950)	(12,883,766)	(3,272,184)
Net assets (deficit), ending	\$ (19,432,508)	\$ (16,155,950)	\$ (3,276,558)

For more detailed information, see the accompanying Statement of Activities.

For the fifth consecutive year, substantially all of the District's assessments were deemed uncollectible. It is the continued lack of assessments that has had a material adverse impact on the District. Revenues and expenses did not change significantly from the prior year. The overall result was a \$3.3 million decrease in net assets for fiscal year 2012. Over the previous five years the District has operated at a net loss of approximately \$16.5 million.

THE DISTRICT'S FUNDS

As the District completed the year, its governmental funds (as presented in the balance sheet on page 10) reported a combined fund balance deficit of approximately \$10.2 million, which is a decrease from last year's deficit balance that totaled approximately \$6.3 million. Significant transactions are discussed below.

- The District accrued interest and principal due on the bonds totaling approximately \$2.9 million and \$600,000, respectively, for unpaid 2012 debt service interest and principal payments.
- The District did not recognize assessments that were deemed uncollectible of approximately \$3.9 million on the governmental fund financial statements.

The overall decrease in fund balance for the year ended September 30, 2012 totaled approximately \$3.8 million.

GOVERNMENTAL FUNDS BUDGETARY HIGHLIGHTS

An Operating budget was established by the governing Board for the District pursuant to the requirements of the Florida Statutes. The budget to actual comparison for the General Fund, including the original budget and final adopted budget, is shown at page 23.

The District experienced an unfavorable variance in revenues as compared to the budget in the amount of \$567,228. Conversely, the District has a favorable variance in expenses over the budget in the amount of \$185,889. These differences occurred primarily due to unpaid assessments and anticipated budgeted operating expenditures that were not incurred during the year.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At September 30, 2012, the District had approximately \$45.4 million invested in capital assets, which remained unchanged from the prior year.

A listing of capital assets by major category for the current and prior year follows:

<i>September 30,</i>	2012	2011	Change
Land	\$ 7,428,992	\$ 7,428,992	\$ -
Infrastructure under construction	37,990,507	37,990,507	-
Net capital assets	\$ 45,419,499	\$ 45,419,499	\$ -

More information about the District's capital assets is presented in Note 4 to the financial statements.

Debt

At September 30, 2012, the District had approximately \$56.5 million in bonds outstanding, which remained unchanged from the prior year.

A listing of debt amounts outstanding for the current and prior year is as follows:

<i>September 30,</i>	2012	2011	Change
Series 2005 A bonds	\$ 32,820,000	\$ 32,820,000	\$ -
Series 2005 B bonds	23,635,000	23,635,000	-
	\$ 56,455,000	\$ 56,455,000	\$ -

More information about the District's long-term debt is presented in Note 5 to the financial statements.

FUTURE FINANCIAL FACTORS

Tern Bay Community Development District is an independent special district that is established pursuant to and governed by the provisions of Chapter 190, Florida Statutes. The District is governed by an elected Board of Supervisors which establishes policy and sets assessment rates. Assessment rates for fiscal year 2013 were established to provide for the operations of the District. Approximately 97% of the assessments levied by the District each year remain uncollected with no other revenue sources available to the District.

As disclosed in Note 10 to the financial statements, from 2008 onward, the District did not receive a majority of assessments attached to the land formerly owned by the Developer. As a result, the District has been unable to make any debt service payments since November 2008. The District has initiated foreclosure proceedings. As of the date of this report, the foreclosure process has not been completed.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the District's finances. If you have questions about this report or need additional financial information, contact the Tern Bay Community Development District's management company, JPWard and Associates, LLC, at 513 Northeast 13th Avenue, Fort Lauderdale, Florida 33301, (954)658-4900, ward9490@comcast.net.

Basic Financial Statements

Tern Bay Community Development District

Statement of Net Assets

<i>September 30,</i>	2012
	Governmental Activities
Assets	
Cash and short-term investments	\$ 2,736,899
Prepaid expenses	10,474
Deferred charges, net	853,836
Capital assets:	
Not being depreciated	45,419,499
Total assets	49,020,708
Liabilities	
Accounts payable	11,790
Accounts payable - capital projects	448,609
Accrued interest payable	11,537,817
Non-current liabilities:	
Due within one year	2,700,000
Due in more than one year	53,755,000
Total liabilities	68,453,216
Net assets	
Invested in capital assets, net of related debt	(10,181,665)
Restricted for:	
Capital projects	4,296,126
Unrestricted	(13,546,969)
Total net assets (deficit)	\$ (19,432,508)

See accompanying notes to financial statements.

Tern Bay Community Development District

Statement of Activities

Year ended September 30,

2012

Functions/Programs	Expenses	Program Revenues			Governmental Activities	Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions		
Primary government:						
Governmental activities:						
General government	\$ (236,664)	\$ 20,907	\$ -	\$ -	\$ (215,757)	
Maintenance and operations	(181,627)	16,045	-	-	(165,582)	
Interest	(2,983,083)	87,864	-	-	(2,895,219)	
Total governmental activities	\$(3,401,374)	\$ 124,816	\$ -	\$ -	(3,276,558)	
Change in net assets					(3,276,558)	
Net assets (deficit) - beginning of year					(16,155,950)	
Net assets (deficit) - end of year					\$(19,432,508)	

See accompanying notes to financial statements.

Tern Bay Community Development District

Balance Sheet - Governmental Funds

September 30,

2012

	General	Debt Service	Capital Projects	Total Governmental Funds
Assets				
Cash and short-term investments	\$ 33,357	\$ 62,975	\$ 2,640,567	\$ 2,736,899
Prepaid expenditures	10,474	-	-	10,474
Due from other funds	-	22,838	-	22,838
Interfund advances	-	-	2,127,006	2,127,006
Total assets	\$ 43,831	\$ 85,813	\$ 4,767,573	\$ 4,897,217
Liabilities and Fund Balances				
Liabilities				
Accounts payable	\$ 11,790	\$ -	\$ 448,609	\$ 460,399
Accrued interest payable	-	10,310,389	-	10,310,389
Debt service liability	-	2,135,000	-	2,135,000
Due to other funds	-	-	22,838	22,838
Interfund advances	2,127,006	-	-	2,127,006
Total liabilities	2,138,796	12,445,389	471,447	15,055,632
Fund balances				
Nonspendable	10,474	-	2,127,006	2,137,480
Restricted for:				
Capital projects	-	-	2,169,120	2,169,120
Unassigned	(2,105,439)	(12,359,576)	-	(14,465,015)
Total fund balances (deficit)	(2,094,965)	(12,359,576)	4,296,126	(10,158,415)
Total liabilities and fund balances	\$ 43,831	\$ 85,813	\$ 4,767,573	\$ 4,897,217

See accompanying notes to financial statements.

Tern Bay Community Development District

Reconciliation of the Balance Sheet to the Statement of Net Assets

<i>September 30,</i>	2012
Total fund balances (deficit), governmental funds	\$ (10,158,415)
Capital assets used in governmental activities are not financial resources and therefore are not reported in the fund financial statements.	45,419,499
Bond issue costs are not financial resources and therefore are not reported as assets in governmental funds. The Statement of Net Assets includes these costs, net of amortization.	853,836
Liabilities not due and payable from current resources, including accrued interest, are not reported in the fund financial statements.	(55,547,428)
Total net assets (deficit) - governmental activities	\$ (19,432,508)

See accompanying notes to financial statements.

Tern Bay Community Development District

Statement of Revenues, Expenditures and Changes in Fund Balances-
Governmental Funds

<i>Year ended September 30,</i>	2012			
	General	Debt Service	Capital Projects	Total Governmental Funds
Revenues				
Assessments	\$ 36,952	\$ 87,864	\$ -	\$ 124,816
Total revenues	36,952	87,864	-	124,816
Expenditures				
Current:				
General government	236,664	-	-	236,664
Maintenance and operations	181,627	-	-	181,627
Debt service:				
Principal	-	600,000	-	600,000
Interest	-	2,945,825	-	2,945,825
Total expenditures	418,291	3,545,825	-	3,964,116
Excess (deficit) of revenues over expenditures	(381,339)	(3,457,961)	-	(3,839,300)
Other Financing Sources (Uses)				
Transfer in	-	-	3,740	3,740
Transfer out	-	(3,740)	-	(3,740)
Total other financing sources (uses)	-	(3,740)	3,740	-
Net change in fund balances	(381,339)	(3,461,701)	3,740	(3,839,300)
Fund balances (deficit), beginning of year	(1,713,626)	(8,897,875)	4,292,386	(6,319,115)
Fund balances (deficit), end of year	\$ (2,094,965)	\$ (12,359,576)	\$ 4,296,126	\$ (10,158,415)

See accompanying notes to financial statements.

Tern Bay Community Development District

Reconciliation of the Statement of Revenues, Expenditures and Changes
in Fund Balances of Governmental Funds to the Statement of Activities

<i>Year ended September 30,</i>	2012
Net change in fund balances - governmental funds	\$ (3,839,300)
Governmental funds report scheduled principal payments on bonds when debt is due even though the amounts have not been paid, whereas these amounts do not affect the Statement of Activities.	600,000
Amortization of bond issuance costs is not recognized in the governmental fund statements but is reported as an expense in the Statement of Activities.	<u>(37,258)</u>
<u>Change in net assets of governmental activities</u>	<u>\$ (3,276,558)</u>

See accompanying notes to financial statements.

NOTE 1 – NATURE OF ORGANIZATION

The Tern Bay Community Development District (the “District”) was established on September 15, 2004 pursuant to the Uniform Community Development District Act of 1980, otherwise known as Chapter 190, Florida Statutes (the “Act”), by The Florida Land and Water Adjudicatory Commission Chapter 42VV-1.001-1.003. The Act provides among other things, the power to manage basic services for community development, the 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 a Board of Supervisors (“Board”), which is comprised of five members. The Supervisors are elected on an at large basis by the owners of the property within the District. The Board of Supervisors of the District exercises all powers granted to the District pursuant to Chapter 190, Florida Statutes.

The Board has the final responsibility for:

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

In evaluating how to define the government, for financial reporting purposes, management has considered all potential component units. The decision to include or exclude a potential component unit in the reporting entity was made by applying the criteria set forth by Generally Accepted Accounting Principles (GAAP). The primary criteria for including organizations within the District's reporting entity, as defined by the Governmental Accounting Standards Board (GASB) No. 14 is financial accountability. The District is financially accountable if it appoints a voting majority of the organization's governing body and (a) it is able to impose its will on that organization or (b) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the District. The District may be financially accountable if an organization is fiscally dependent on the District regardless of whether the organization has (a) a separately elected governing board, (b) a governing board appointed by a higher level of government, or a jointly appointed board. Based on the foregoing criteria, no potential component units were found.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the District conform to GAAP as applicable to governments in accordance with those promulgated by GASB. The following is a summary of the more significant policies:

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Government-wide and Fund Financial Statements

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

The government-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all the non-fiduciary activities of the primary government. Governmental activities, which normally are supported by assessments, are reported separately from business-type activities, which rely to a significant extent on fees and charges for support. The business-type activities are reported separately in government-wide financial statements; however, at September 30, 2012, the District did not have any significant business-type activities. Therefore, no business-type activities are reported. Assessments and other items not properly included as program revenues (i.e., charges to customers or applicants who purchase, use, or directly benefit from goods or services) are reported as general revenues.

The preparation of government-wide financial statements includes the application of both GASB pronouncements and those of the Financial Accounting Standards Board (FASB) issued before November 30, 1989.

Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting and Basis of 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 the related cash flows. Assessments are recognized as revenues in the year for which they are levied. Grants and other 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 District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Assessments, including debt service assessments and operation and maintenance assessments, are non-ad valorem assessments imposed on all lands located within the District and benefited by the District's activities. Assessments are levied and/or certified for collection 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 certain lots and lands located in the District. Debt service special assessments are imposed upon certain lots and lands as described in each resolution imposing the special assessment for each series of bonds issued by the District.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Assessments and interest associated with the current fiscal period are generally considered to be susceptible to accrual and have been recognized as revenues of the current fiscal period. However, as discussed in Note 10 to the financial statements, at September 30, 2012, certain assessment amounts were not recognized as revenue because the District considers these amounts uncollectible. All other revenue items are considered to be measurable and available only when cash is received by the District.

The District reports the following major governmental funds:

General Fund – The General Fund is the primary operating fund of the District. It is used to account for all financial resources except those required to be accounted for in other funds

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 for the Series 2005 Bonds.

Capital Projects Fund – The Capital Projects Fund accounts for the financial resources to be used in the acquisition or construction of major infrastructure within the District financed with the Series 2005 Bonds.

For the year ended September 30, 2012, the District does not report any proprietary funds.

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

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

Cash, Deposits and Investments

The District maintains deposits with "Qualified Public Depositories" as defined in Chapter 280, Florida Statutes. All Qualified Public Depositories must place with the Treasurer of the State of Florida securities in accordance with collateral requirements determined by the State's Chief Financial Officer. In the event of default by a Qualified Public Depository, the State Treasurer will pay public depositors all losses. Losses in excess of insurance and collateral will be paid through assessments between all Qualified Public Depositories.

Under this method, all the District's deposits are fully insured or collateralized at the highest level of security as defined by GASB, Statement Number 40, *Deposits and Investment Disclosures (An Amendment of GASB, Statement Number 3)*.

The District is authorized to invest in financial instruments as established by Section 218.415, Florida Statutes. The authorized investments include among others negotiable direct or indirect obligations of the United States Government; the Local Government Surplus Trust Funds as created by Section 218.405, Florida Statutes; SEC registered money market funds with the highest credit quality rating from a nationally recognized rating agency; and interest-bearing time deposits or savings accounts in authorized financial institutions.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Capital Assets

Capital assets, which include primarily infrastructure assets (e.g., roads, sidewalks, water management systems and similar items), are reported in the governmental activities column in the government-wide financial statements. Capital assets are defined by the District as assets with an initial/individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost and estimated historical cost if purchased or constructed. Donated assets are recorded at estimated fair market value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Major outlays for capital assets and improvements are capitalized as projects are constructed.

Upon being placed in service, property, plant and equipment of the primary government will be depreciated using the straight-line method over the following estimated useful lives:

Infrastructure	Years
Roadways, parks, courts & fields	20
Stormwater management system	25
Water/sewer system	25
Landscaping/entry features	15

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.

Long-Term Obligations

In the government-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line or effective-interest method. Bonds payable are reported net of premiums or discounts. Bond issuance costs are shown as deferred charges and are presented net of \$263,911 of accumulated amortization.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of the 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.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fund Equity

Governmental fund equity is classified as fund balance. Fund balance is further classified as nonspendable, restricted, committed, assigned, or unassigned. Nonspendable fund balance cannot be spent because of its form. Restricted fund balance has limitations imposed by creditors, grantors, or contributors or by enabling legislation or constitutional provisions. Committed fund balance is a limitation imposed by the District board through approval of resolutions. Assigned fund balances is a limitation imposed by a designee of the District board. Unassigned fund balance in the General Fund is the net resources in excess of what can be properly classified in one of the above four categories. Negative unassigned fund balance in other governmental funds represents excess expenditures incurred over the amounts restricted, committed, or assigned to those purposes.

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

Budgets

The District is required to establish a budgetary system and an approved annual budget. Annual budgets are legally adopted on a basis consistent with GAAP for the General Fund. Any revision to the budget must be approved by the District Board. The budgets are compared to actual expenditures. In instances where budget appropriations and estimated revenues have been revised during the year, budget data presented in the financial statements represent final authorization amounts.

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. Certain budget changes must be approved by the District Board.
- E. Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America.

NOTE 3 – INVESTMENTS

All investments held at September 30, 2012 are reported at fair value based on quoted market prices, which approximates amortized cost.

Tern Bay Community Development District

Notes to Financial Statements

NOTE 3 – INVESTMENTS

The following is a summary of the District’s investments:

<i>September 30,</i>	2012	Credit Risk	Weighted Average Maturities
Short-term Money Market Funds	\$ 2,703,542	S&P AAAM	54 days
Total investments	\$ 2,703,542		

Concentration risk – The District’s investment policy requires diversification, but does not specify limits on types of investments.

Custodial credit risk – For an investment, custodial credit risk is the risk that the District will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party. The District has no formal policy for custodial risk. At September 30, 2012, the District’s investments are not exposed to custodial credit risk because their existence is not evidenced by securities that exist in physical or book entry form.

Interest rate risk – The District does not have a formal policy for addressing interest rate risk; however, investments are made with discretion, to seek reasonable returns, preserve capital, and in general, avoid speculative investments. The District manages its exposure to declines in fair values from interest rate changes by reviewing the portfolio on an ongoing basis for changes in effective yield amounts.

NOTE 4 – CAPITAL ASSETS

The following is a summary of changes in the capital assets for the year ended September 30, 2012:

	Beginning Balance	Additions	Deletions	Ending Balance
Governmental Activities:				
<i>Capital assets not being depreciated:</i>				
Land	\$ 7,428,992	\$ -	\$ -	\$ 7,428,992
Infrastructure under construction	37,990,507	-	-	37,990,507
Total capital assets, not being depreciated	45,419,499	-	-	45,419,499
Governmental activities capital assets, net	\$ 45,419,499	\$ -	\$ -	\$ 45,419,499

In 2005, the total projected cost of the infrastructure improvements was previously estimated at \$69.9 million, of which approximately \$47.5 million was to be funded with proceeds from Series 2005 bonds. The District does not currently have an estimated cost to complete the project. Any estimate would be subject to change based on the timing of when the project is to be completed as well as the cost associated with the ongoing deterioration of the existing infrastructure. Additionally, any new developer may make changes to the project as it was originally planned. The District will convey certain infrastructure improvements to other governmental entities upon completion of the project.

NOTE 4 – CAPITAL ASSETS (CONTINUED)

The District believes any erosion or loss of value related to the infrastructure under construction is temporary in nature until the development stoppage is ended; thus, no permanent impairment charge has been recorded. Additional funding is needed to complete the project, and the District is uncertain how it will obtain the necessary funding.

The payments for certain prior year additions are being disputed by the District. The outcome of this dispute is uncertain at this time.

NOTE 5 – BONDS PAYABLE

In September 2005, the District issued \$57,940,000 of Capital Improvement Revenue Bonds, Series 2005 consisting of \$33,280,000 Series 2005 A Bonds and \$24,660,000 of Series 2005 B Bonds with fixed interest rates of 5.375% and 5%, respectively. The Bonds were issued to finance the acquisition and construction of certain improvements for the benefit of the District. Interest is due semiannually on each May 1 and November 1. Principal on the Series 2005 A Bonds is due serially commencing on May 1, 2008 through May 1, 2037. Principal on the Series 2005 B Bonds is due in full on May 1, 2015.

The Bond Indenture has certain restrictions and requirement relating principally to the use of proceeds to pay for the infrastructure improvements and the procedures to be followed by the District on assessments to property owners. The District agreed to levy special assessments in annual amounts adequate to provide payment of debt service and to meet the reserve requirements. As described below, the District was not in compliance with the requirements of the Bond Indenture as of September 30, 2012.

The Bond Indenture requires that the District maintain adequate funds in a reserve account to meet the debt service reserve requirement as defined in the Indenture. The debt service reserve requirement has not been met for the fiscal year ended September 30, 2012.

The reserve account funds were substantially exhausted to fund the November 2008 bond payment and have not been replenished as of the date of this report. The use of reserve funds was a result of unpaid debt service assessments to the District which is indicative of the ongoing financial challenges of the District (see Note 10). After exhausting its reserve funds to pay the November 2008 bond interest payment, the District has failed to make any subsequent debt service payments. As a result, a debt service liability and accrued interest totaling approximately \$2.1 million and \$10.3 million, respectively, has been recorded in the accompanying Balance Sheet – Governmental Funds. Subsequent to the year ended September 30, 2012, the District failed to make the November 2012 debt service payment. The District was not in compliance with the requirements of the Bond Indenture as of the date of this report.

Tern Bay Community Development District

Notes to Financial Statements

NOTE 5 – BONDS PAYABLE (CONTINUED)

Long-term liability activity for the year ended September 30, 2012, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
<i>Governmental Activities</i>				
Bonds Payable:				
Series 2005 A	\$ 32,820,000	\$ -	\$ -	\$ 32,820,000
Series 2005 B	23,635,000	-	-	23,635,000
	\$ 56,455,000	\$ -	\$ -	\$ 56,455,000

At September 30, 2012, the scheduled debt service requirements on long-term debt were as follows:

Year Ending September 30,	Principal	Interest	Total Debt Service
2013	\$ 2,700,000	\$ 13,256,213	\$ 15,956,213
2014	630,000	2,800,700	3,430,700
2015	24,300,000	2,766,838	27,066,838
2016	705,000	1,549,344	2,254,344
2017	745,000	1,511,450	2,256,450
2018-2022	4,370,000	6,912,250	11,282,250
2023-2027	5,720,000	5,600,750	11,320,750
2028-2032	7,490,000	3,883,706	11,373,706
2033-2037	9,795,000	1,635,881	11,430,881
	\$ 56,455,000	\$ 39,917,132	\$ 96,372,132

NOTE 6 – 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 maintains commercial insurance coverage to mitigate the risk of loss. Coverage may not extend to all situations. Management believes such coverage is sufficient to preclude any significant uninsured losses to the District. The District has not filed any insurance claims under this commercial coverage in the previous three years.

NOTE 7 – MANAGEMENT COMPANY

The District has contracted with a management company to perform management advisory services, which include financial and accounting advisory services. Under the agreement, the District compensates the management company for management, accounting, financial reporting, and other administrative costs. On October 6, 2011, a member of the Board of Supervisors resigned to assume the position of Development Manager.

NOTE 8 – INTERFUND BALANCES

At September 30, 2012, the General Fund owed the Capital Projects Fund \$2,127,006, and the Capital Projects Fund owed the Debt Service Fund \$22,838. The outstanding balance between the funds resulted primarily from the utilization of Debt Service Fund and Capital Project Fund monies to pay for a portion of the outstanding expenditures in the General Fund, as approved by the bondholders.

NOTE 9 – INTERFUND TRANSFERS

The District transferred debt service assessments from the Debt Service Fund to the Capital Projects Fund to facilitate payment of operating expenses on a regular basis. During the year ended September 30, 2012, these transfers totaled \$3,740.

NOTE 10 – CONCENTRATION

The Developer of Tern Bay abandoned the development and this District during 2008. A majority of the property is now owned by various entities. The lack of involvement by the Developer and current landowners of the property formerly owned by the Developer has had an adverse effect on the District's operations. As a result, the construction project has not been completed and developmental activities on the project have ceased.

During the year ended September 30, 2012, the District directly assessed the current landowners of the property formerly owned by the Developer \$587,437 and \$3,341,981 for operation and maintenance and debt service assessments, respectively, all of which were unpaid at September 30, 2012. Management considers the operation and maintenance and debt service assessments totaling approximately \$3.9 million to be uncollectible. Accordingly, management has reported assessments receivable and assessments revenue net of this estimated uncollectible amount on the accompanying government-wide and fund-level financial statements.

As mentioned above, the various landowners failed to fund the debt service of the District for the year ended September 30, 2012. At the request of the majority of the bondholders, the District has not made any principal and interest payments since November 2008 through the date of this report. Supplemental Trust Indentures were established which allow construction funds to be used to pay for certain operating and maintenance expenditures, subject to the approval of bondholders.

The District has initiated foreclosure proceedings against this property. As of the date of this report, the foreclosure process has not been completed.

NOTE 11 - CONTINGENCIES

During fiscal year 2008, a claim was made by a vendor to recover monetary damages based on a construction contract. The District is aggressively defending against liability and the ultimate outcome is currently unknown.

Required Supplemental Information
(Other Than MD&A)

Tern Bay Community Development District

Budget to Actual Comparison Schedule - General Fund

<i>Year ended September 30,</i>	2012		
	Original and Final Budget	Actual Amounts	Variance with Final Budget
Revenues			
Assessments	\$ 604,180	\$ 36,952	\$ (567,228)
Total revenues	604,180	36,952	(567,228)
Expenditures			
General government	302,090	236,664	65,426
Maintenance and operations	302,090	181,627	120,463
Total expenditures	604,180	418,291	185,889
Excess (deficit) of revenues over expenditures	\$ -	\$ (381,339)	\$ (381,339)

**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
Tern Bay Community Development District
Charlotte County, Florida

We have audited the financial statements of the governmental activities and each major fund of Tern Bay Community Development District (hereinafter referred to as the "District"), as of and for the year ended September 30, 2012, which collectively comprise the District's basic financial statements and have issued our report thereon dated February 26, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant 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 an instance of noncompliance that is required to be reported under *Government Auditing Standards* and which is described below.

- IC2009-01: The District is not in compliance with certain provisions of its Bond Indenture including those relating to 1) collecting assessments to provide payment of debt service, 2) maintaining adequate funds in debt service reserve accounts, and 3) making its semi-annual debt service principal and interest payments.

The District's response to the finding identified in our audit is described below. We did not audit the District's response and, accordingly, we express no opinion on it.

- The District has been involved in the foreclosure process for several years in an effort to collect assessments. If successful, the collection of the assessments will allow the District to replenish the debt service reserve fund, make debt service payments when due, and fund the operations of the District.

This report is intended for the information of management, the Board of Supervisors, others within the District, and the Auditor General of the State of Florida, and is not intended to be and should not be used by anyone other than those specified parties.

Carly Riggs & Ingram, L.L.C.

Miramar Beach, Florida
February 26, 2013

MANAGEMENT LETTER

To the Board of Supervisors
Tern Bay Community Development District
Charlotte County, Florida

We have audited the financial statements of Tern Bay Community Development District ("District") as of and for the fiscal year ended September 30, 2012, and have issued our report thereon dated February 26, 2013.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Chapter 10.550, Rules of the Florida Auditor General. We have issued our Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Financial Statements Performed in Accordance with *Government Auditing Standards*. Disclosures in this report which is dated February 26, 2013, should be considered in conjunction with this management letter.

Additionally, our audit was conducted in accordance with Chapter 10.550, Rules of the Auditor General, which governs the conduct of local governmental entity audits performed in the State of Florida. This letter includes the following information, which is not included in the aforementioned auditor's report:

Section 10.554(1)(i)1., Rules of the Auditor General, requires that we determine whether or not corrective actions have been taken to address findings and recommendations made in the preceding annual financial audit report. Corrective actions have not been taken to address findings and recommendations made in the preceding annual financial audit report. The comment regarding the District's noncompliance with certain provisions of its bond indenture, identified on page 25 of this report, was also included in the second preceding fiscal year audit report.

Section 10.554(1)(i)2., Rules of the Auditor General, requires our audit to include a review of the provisions of Section 218.415, Florida Statutes, regarding the investment of public funds. In connection with our audit, we determined that the District complied with Section 218.415, Florida Statutes.

Section 10.554(1)(i)3., Rules of the Auditor General, requires that we address in the management letter any recommendations to improve financial management. In connection with our audit, we did not have any such recommendations.

Section 10.554(1)(i)4., Rules of the Auditor General, requires that we address violations of provisions of contracts or grant agreements, or abuse that have occurred, or are likely to have occurred, that have an effect on the financial statements that is less than material but more than inconsequential. In connection with our audit, we did not have any such findings.

Section 10.554(1)(i)5., Rules of the Auditor General, provides that the auditor may, based on professional judgment, report the following matters that have an inconsequential effect on financial statements, considering both quantitative and qualitative factors: (1) violations of provisions of contracts or grant agreements, fraud, illegal acts, or abuse, and (2) deficiencies in internal control that are not significant deficiencies. In connection with our audit, we did not have any such findings.

Section 10.554(1)(i)6., Rules of the Auditor General, requires that the name or official title and legal authority for the primary government and each component unit of the reporting entity be disclosed in this management letter, unless disclosed in the notes to the financial statements. The information required is disclosed in the notes to the financial statements.

Section 10.554(1)(i)7.a., Rules of the Auditor General, requires a statement be included as to whether or not the local governmental entity has met one or more of the conditions described in Section 218.503(1), Florida Statutes, and identification of the specific condition(s) met. In connection with our audit, we determined that the District met the conditions described in Sections 218.503(1)(a) and 218.503(1)(e), Florida Statutes. The District has not made any principal and interest payments since November 2008 through the date of this report as a result of a lack of funds. In addition, at September 30, 2012, the District reported a total deficit unassigned fund balance of \$14.5 million. We applied financial condition assessment procedures pursuant to Rule 10.566(7) and deteriorating financial conditions were noted. See the District's response to the findings on page 25.

Section 10.554(1)(i)7.b., Rules of the Auditor General, requires that we determine whether the annual financial report for the District for the fiscal year ended September 30, 2012, filed with the Florida Department of Financial Services pursuant to Section 218.32(1)(a), Florida Statutes, is in agreement with the annual financial audit report for the fiscal year ended September 30, 2012. In connection with our audit, we determined that these two reports were in agreement.

Pursuant to Sections 10.554(1)(i)7.c. and 10.556(7), Rules of the Auditor General, we applied financial condition assessment procedures, and as a result, it was determined that a deteriorating financial condition exists with respect to the District. As discussed in Note 10 to the financial statements, the Developer of Tern Bay has abandoned the development and the District. For the year ended September 30, 2012 and through the date of this report, the District did not receive any assessment amounts from the Developer or any other significant landowner and has not made any principal and interest payments since November 2008 through the date of this report. The District has initiated foreclosure proceedings on the property formerly owned by the Developer. As of the date of this report, the foreclosure process has not been completed. It is management's responsibility to monitor the District's 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.

Pursuant to Chapter 119, Florida Statutes, this management letter is a public record and its distribution is not limited. Auditing standards generally accepted in the United States of America require us to indicate that this letter is intended solely for the information and use of management and the Florida Auditor General, and is not intended to be and should not be used by anyone other than these specified parties.

Carr, Riggs & Ingram, L.L.C.

Miramar Beach, Florida
February 26, 2013