H2O COMMUNITY
DEVELOPMENT AUTHORITY

AUDITED FINANCIAL STATEMENTS
JUNE 30, 2018 and 2017

CUSIP Number:
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H2O COMMUNITY
DEVELOPMENT AUTHORITY

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DEVELOPMENT AUTHORITY

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
H2O Community Development Authority
Hampton, Virginia

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the H2O Community Development Authority, Hampton, Virginia (Authority), as of and for the years ended June 30, 2018 and 2017, and the related notes to the financial statements, which collectively comprise the Authority'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Specifications for Audits of Authorities, Boards, and Commissions*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia. 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 business-type activities of the Authority as of June 30, 2018 and 2017, and the respective changes in financial position and cash flows thereof for the years 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 4-7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The introductory section is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2018, on our consideration of the Authority's internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

The Nichols Group

The Nichols Group, PA
Certified Public Accountants
Fleming Island, Florida
November 30, 2018

H2O Community Development Authority
Management's Discussion and Analysis
For the Years Ended June 30, 2018 and 2017
(Unaudited)

The Management's Discussion and Analysis of the financial performance of the H2O Community Development Authority (the "Authority") provides an overall review of the Authority's financial activities for the years ended June 30, 2018 and 2017. The intent of this discussion and analysis is to look at the Authority's financial performance as a whole. Readers should also review the basic financial statements and notes to the financial statements to enhance their understanding of the Authority's financial performance.

Financial Highlights

1. The Authority incurred long term debt of $9,440,000 in Special Assessment Bonds on May 16, 2007, bearing interest at 5.20% per annum. The Authority's debt will be paid through the collection of special assessments imposed on the chargeable properties benefiting from the capital improvements.

2. Net Position at June 30, 2018 and 2017 totaled $3,220,847 and $2,845,092, respectively.

3. Construction costs at June 30, 2018 and 2017 were $5,734,482, which represents approximately 80% of the estimated project budget.

4. Special assessments of $503,931 and $507,389 were imposed in fiscal years 2018 and 2017, respectively. As of June 30, 2018, there are no delinquent assessments.

5. On March 8, 2012, the property was foreclosed on by Cygnus VA, LLC ("Cygnus"), the holder of the development notes. Cygnus had subsequently become delinquent on its assessment payments. On September 16, 2013, Cygnus, Sandler at Coliseum Central (the "Previous Landowner"), and the Authority entered into an Assignment and Assumption Agreement wherein Cygnus agreed to complete certain improvements and pay all administrative expenses, as long as Cygnus is delinquent in payment of special assessments on property owned by Cygnus, and the Authority agreed to release certain project funds conditioned upon specified construction milestones.

6. On December 14, 2015, the trustee redeemed an additional $1,270,000 in Bonds outstanding, per the instructions of the bondholder, pursuant to Section 4.3(b) of the Indenture. However, the Authority had made no certification as to the completion of the project. The Authority and its legal counsel are working on resolving this matter.

7. As of December 31, 2015, all outstanding assessments, plus interest and penalties, were paid by the property owner. These funds were transferred to the Authority.

8. At a board meeting held May 16, 2018, the board accepted a resolution to approve a Settlement Agreement and a Second Supplemental Indenture of Trust. The details of these agreements can be found in the notes to the financial statements. The second Supplemental Indenture of Trust was executed on October 17, 2018. The Settlement Agreement has not yet been executed.

9. On September 7, 2018, an additional $416,000 of Bonds were redeemed with prepaid assessments.

Overview of the Financial Statements

This annual report consists of two parts – Management's Discussion and Analysis and the basic financial statements consisting of a *Statement of Net Position; Statement of Revenues, Expenses, and Changes in Net Position; Statement of Cash Flows;* and related footnotes. The Statement of Net Position represents the financial position of the Authority and provides information about the activities of the Authority, including all short-term and long-term financial resources and obligations. Enterprise accounting uses a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities are included in the Statement of Net Position. The Statement of Revenues, Expenses, and Changes in Net Position presents increases (e.g., revenues) and decreases (e.g., expenses) in financial resources. The Statement of Cash Flows reflects how the Authority finances and meets its cash flow needs. Finally, the notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided on the basic financial statements.

Summary Statement of Net Position

	2018	2017
Assets:		
Other assets	$ 2,277,905	$ 2,022,525
Capital assets	7,701,134	7,701,134
Total assets	9,979,039	9,723,659
Liabilities:		
Current liabilities	277,665	286,708
Long-term debt, net of discount	6,480,527	6,591,859
Total Liabilities	6,758,192	6,878,567
Net Position:		
Net investment in capital assets	1,104,607	1,006,275
Restricted	2,022,303	1,775,043
Unrestricted	93,937	63,774
Total Net Position	$ 3,220,847	$ 2,845,092

Special assessments and bond proceeds were used to finance the District's infrastructure improvements and other administrative costs of the Authority. Funds from the Project Fund were used to redeem Bonds of $1,270,000 in fiscal year 2016.

Summary Statement of Revenues, Expenses, and Changes in Net Position

	2018	2017
Operating Revenues	$ 783,585	$ 1,179,521
Operating Expenses	68,991	92,628
Operating Income	714,594	1,086,893
Non-operating Revenues	14,394	1,225
Non-operating Expenses	(353,233)	(376,520)
Change in Net Position	$ 375,755	$ 711,598

The change in net position from 2018 to 2017 is due to a decrease in collection of prepaid assessments partially offset by decreased legal expenses due to the resolution of the completion of the public improvements, and decreased bond interest expense as the result of decreasing bonds principal outstanding.

Capital Assets

The Authority's capital assets consisted of construction in progress of public improvements financed with the Series 2007 bonds and construction financing costs. Construction costs through June 30, 2018 were $5,734,482, which represents approximately 80% of the estimated project completion cost of $7,105,690. The board has approved a Settlement Agreement, which, among other items, deems the improvements complete and transfers the improvements to the Master Association (as defined in the Settlement Agreement). This agreement has not yet been executed.

Long-Term Debt

The Authority issued $9,440,000 of Special Assessment Bonds, Series 2007, dated May 16, 2007, paying interest at 5.20% per annum, and due in annual installments beginning September 1, 2010 with a final maturity of September 1, 2037. This bond issuance represents 100% of the Authority's long-term debt balance.

The proceeds from the bonds were used to finance construction of certain public infrastructure improvements within the H2O Community Development Authority District including road and alley improvements, parking, storm water management improvements, sanitary sewer lines and pump stations, lighting, fencing, sidewalks, and streetscapes.

The debt service will be paid annually by the revenue received from the special assessments levied on the property owners within the District.

It is anticipated that, with the forthcoming execution of the Second Supplemental Indenture of Trust, approximately $700,000 of previously-paid delinquent assessments will be made available to redeem Bonds.

Special Assessments

Special assessments totaling $503,931 and $507,389 were imposed on the property owners within the District in fiscal years 2018 and 2017, respectively. As of June 30, 2018, there are no delinquencies in the annual assessments.

Economic Factors and Future Outlook

As of June 30, 2015, the property owner had failed to make assessment payments on parcels in Phase 2B of the development, due from 2012 to 2015. These delinquencies led to a deficiency in the required Debt Service Reserve Fund balance and the postponement of payment of the September 1, 2014 mandatory sinking fund redemption payment of $83,000 to bondholders. As of December 31, 2015, all assessments, penalties and interest were paid and transferred to the Authority. The Debt Service Reserve Fund has since been replenished.

On September 16, 2013, Cygnus, the Previous Landowner, and the Authority entered into an Assignment and Assumption Agreement which allowed for Cygnus to use project funds to pay for a limited amount of improvements to the District given certain requirements are met. As one condition of the Agreement, Cygnus is responsible for payment of all administrative expenses of the Authority so long as assessments are delinquent on property owned by Cygnus. These payments are reported in the financial statements as "Contribution by property owner". Cygnus ceased making payments in July 2015, indicating their belief that they had satisfied the conditions of the Agreement. In September 2015, an affiliate of Cygnus purchased all Bonds outstanding.

Presently, the Authority is not aware of any additional changes in conditions that would have a significant effect on the administrative expenses or payment of debt service in the near future.

Contacting Authority's Financial Management

This financial report is designed to provide citizens, taxpayers, investors, and creditors with a general overview of the Authority's finances and to reflect the Authority's accountability for the monies it receives. Questions concerning any of the information in this report or requests for additional information should be directed to the Authority's administrator, MuniCap, Inc., at 8965 Guilford Road, Suite 210, Columbia, Maryland 21046.

H2O COMMUNITY DEVELOPMENT AUTHORITY
STATEMENTS OF NET POSITION
As of June 30, 2018 and 2017

	2018	2017
Assets		
Current Assets		
Accrued interest receivable	$ 2,056	$ 410
Due from primary government	253,546	247,072
Total Current Assets	255,602	247,482
Noncurrent Assets		
Restricted cash and cash equivalents	2,022,303	1,775,043
Capital assets	7,701,134	7,701,134
Total Noncurrent Assets	9,723,437	9,476,177
Total Assets	9,979,039	9,723,659
Liabilities		
Current Liabilities		
Accounts payable	45,774	66,032
Accrued interest payable	115,891	117,676
Current portion of long-term debt	116,000	103,000
Total Current Liabilities	277,665	286,708
Noncurrent Liabilities		
Bonds payable	6,570,000	6,686,000
Less discount on long-term debt	(89,473)	(94,141)
Total Noncurrent Liabilities	6,480,527	6,591,859
Total Liabilities	6,758,192	6,878,567
Net Position:		
Net investment in capital assets	1,104,607	1,006,275
Restricted	2,022,303	1,775,043
Unrestricted	93,937	63,774
Total Net Position	$ 3,220,847	$ 2,845,092

H2O COMMUNITY DEVELOPMENT AUTHORITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For the Years Ended June 30, 2018 and 2017

	2018	2017
Operating Revenues	$ 783,585	$ 1,179,521
Operating Expenses		
Administrative fees	41,018	44,523
Audit fees	3,400	6,800
Insurance	550	550
Legal fees	24,023	40,755
Total Operating Expenses	68,991	92,628
Operating Income	714,594	1,086,893
Non-Operating Revenues (Expenses)		
Interest income	14,280	1,225
Penalties and interest on delinquent assessments	114	-
Bond interest expense	(353,233)	(376,520)
Total Non-Operating Revenues (Expenses)	(338,839)	(375,295)
Change in Net Position	375,755	711,598
Net Position at Beginning of Year	2,845,092	2,133,494
Net Position at End of Year	$ 3,220,847	$ 2,845,092

The accompanying notes to financial statements are an integral part of this statement.

H2O COMMUNITY DEVELOPMENT AUTHORITY
STATEMENTS OF CASH FLOWS
For the Years Ended June 30, 2018 and 2017

	2018	2017
Cash Flows from Operating Activities		
Cash receipts from property owners	$ 777,225	$ 1,225,455
Cash payments for administrative fees	(47,240)	(37,497)
Cash payments for audit fees	(10,200)	-
Cash payments for insurance	(1,100)	-
Cash payments for legal fees	(30,709)	(24,810)
Net Cash Provided by Operating Activities	687,976	1,163,148
Cash Flows from Capital and Related Financing Activities		
Interest paid	(350,350)	(382,512)
Principal paid	(103,000)	(615,000)
Net Cash Used in Capital and Related Financing Activities	(453,350)	(997,512)
Cash Flows from Investing Activities		
Interest and dividends received on investments	12,634	889
Net Cash Provided by Investing Activities	12,634	889
Change in Cash and Cash Equivalents	247,260	166,525
Cash and Cash Equivalents, Beginning of Year	1,775,043	1,608,518
Cash and Cash Equivalents, End of Year	$ 2,022,303	$ 1,775,043
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Operating income	$ 714,594	$ 1,086,893
Adjustments		
(Increase) decrease in due from primary government	(6,360)	48,434
(Decrease) increase in accounts payable	(20,258)	27,821
Net Cash Provided by Operating Activities	$ 687,976	$ 1,163,148

NOTE 1—REPORTING ENTITY

The H2O Community Development Authority (the "Authority") was established pursuant to the Virginia Water and Waste Authorities Act, Chapter 51, Section 15.2-5152 *et seq*., of the Code of Virginia, 1950 (the "Act") as amended. The Act provides for the creation of an authority and a related Special Assessment District (the "District") for the sole purpose of financing, constructing, and maintaining, if necessary, certain public improvements within, contiguous to or serving the District. In accordance with the Act, the Authority was created as a Virginia public body by the adoption of Ordinance No. 05-0589 by the City of Hampton City Council on September 28, 2005.

The H2O Community Development Authority, Special Assessment Bonds, Series 2007 (the "Bonds"), were issued pursuant to an Indenture of Trust (the "Indenture") by and between the Authority and Manufacturers and Traders Trust Company (now Wilmington Trust, the "Trustee"), dated as of May 1, 2007, and a limited offering memorandum for the bonds dated April 26, 2007. The Bonds are limited obligations payable from special assessments imposed and collected by the City Council of the City of Hampton, Virginia (the "City"), against the taxable real property in the District. Unless prepaid, such special assessments are payable in installments at the same time general real estate taxes are paid. The City will apply its customary tax payment enforcement procedures to the collection of any delinquent payments of the special assessment annual installment.

The District consists of approximately 25 acres of land within the City adjacent to Freeman Drive and approximately one quarter mile from the Hampton Coliseum and the Hampton Roads Convention Center. The District is located approximately seven miles from downtown Newport News and approximately twenty-five miles east of the City of Williamsburg's historic district. At the time the Series 2007 Bonds were issued, the District was expected to contain approximately 481 residential units of various types with the option to include an additional 102 residential units. On September 2, 2010, the Hampton Redevelopment and Housing Authority terminated the developer's option to purchase additional land, which would have included an additional 102 residential units, under the Land Agreement.

The Authority is governed by a board of five directors which are appointed by the City Council, one of which is designated by the City Manager. The City Council also appoints successor directors of the Authority for a term of four years. In 2017, the Authority and the City Council approved changes to stagger the directors' terms over a four-year period and to remove the requirement that the directors be recommended by the former developer.

The Authority's management believes these financial statements present all activities for which the Authority is financially accountable.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies followed in the preparation of these financial statements are summarized below. The policies conform to accounting principles generally accepted in the United States of America (GAAP) for local governmental units as prescribed in the statements issued by the Governmental Accounting Standards Board (GASB) and other recognized authoritative sources.

A. Basis of Presentation

The Authority's basic financial statements consist of a Statement of Net Position; a Statement of

Revenues, Expenses, and Changes in Net Position; and a Statement of Cash Flows. The Authority uses enterprise fund accounting to maintain its financial records during the fiscal year. Enterprise fund accounting focuses on the determination of operating income, changes in net position, financial position, and cash flows.

B. Measurement Focus and Basis of Accounting

The Authority's financial activity is accounted for using a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the Authority are included on the Statement of Net Position. The Statement of Revenues, Expenses and Changes in Net Position presents increases (e.g., revenues) and decreases (e.g., expenses) in total net position. The Statement of Cash Flows reflects how the Authority finances and meets its cash flow needs.

Net Position is segregated into Net Investment in Capital Assets, Restricted, and Unrestricted components, if applicable.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements, and measurement focus relates to the timing of the measurements made. The Authority uses the accrual basis of accounting and the flow of economic resources measurement focus for reporting purposes. Revenues are recognized when they are earned, and expenses are recognized when they are incurred.

C. Cash and Investments

Cash received by the Authority is deposited with a financial institution or invested. Deposits and investments having an original maturity of three months or less at the time they are purchased are presented in the financial statements as Cash and Cash Equivalents. Investments with an initial maturity of more than three months are reported as Investments.

D. Capital Assets

All capital assets are capitalized at cost and updated for additions and reductions during the year. Donated capital assets will be recorded at their fair market value on the date that they will be donated. The Authority does not maintain a capitalization threshold as all infrastructure assets are capitalized. Interest expense during the period of construction is capitalized, net of investment earnings. The Authority does not depreciate the infrastructure improvements that will be donated to the City upon completion/acquisition. Any improvements deemed to be owned by the Authority, once completed, will be depreciated over their useful lives.

E. Net Position

Net position represents the difference between assets and liabilities. Net position is reported as restricted when there are limitations imposed on the use of resources either through enabling legislation adopted by the Authority or through external restrictions imposed by creditors, grantors, or laws or regulations of other governments. The Authority first applies restricted resources when an expense is incurred for which both restricted and unrestricted assets are available.

F. Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the Authority. For the Authority, these revenues are special assessments. Operating expenses are the necessary costs incurred to provide the service that is the primary activity of the Authority. All revenues and expenses not meeting this definition are reported as non-operating.

G. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from those estimates.

H. Income Taxes

The Authority is a governmental entity, and therefore, is exempt from all federal and state income taxes.

I. New Accounting Standards

The Authority has adopted all current Statements of the GASB that are applicable.

J. Future Accounting Standards

GASB has issued new standards that will become effective in future fiscal years. The Authority will evaluate the impact each of these pronouncements may have on its financial statements and will implement them as applicable and when material.

NOTE 3—DEPOSITS AND INVESTMENTS

Cash received by the Authority is deposited with a financial institution or invested. Deposits and investments having an original maturity of three months or less at the time they are purchased are presented in the financial statements as Cash and Cash Equivalents. Investments with an initial maturity of more than three months are reported as Investments.

Cash and cash equivalents consisted entirely of deposits in money market accounts at June 30, 2018 and 2017. Cash and cash equivalents are carried at cost, which approximates fair market value.

A. Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of a bank failure, the Authority's deposits may not be returned. There is no custodial credit risk to these accounts as the entire bank balance was covered by federal depository insurance or collateralized in accordance with the provisions of the Indenture.

B. Interest Rate Risk

Interest rate risk is the risk that an interest rate change could adversely affect an investment's fair value. As a means of limiting exposure to fair value losses arising from rising interest rates, the Indenture requires the investment of moneys in the Debt Service Reserve Fund must mature or be payable at the option of the Trustee not more than five years after the date of their purchase. The Authority's investments in money market funds are withdraw-able on demand.

C. Credit Risk

Credit risk is the risk that an issuer or counterparty to an investment will be unable to fulfill its obligations. The Indenture specifies the minimum rating of different types of cash equivalents and investments in order to address this risk. Investments in the money market funds at June 30, 2018 and 2017 have met the specified ratings criteria.

Although state statute does not impose credit standards on repurchase agreement counterparties, bankers' acceptances, or money market mutual funds, the Indenture establishes stringent credit standards for these investments to minimize portfolio risk. All money held in the funds created by the Indenture which are on deposit with any bank will be continuously secured in the manner required by the Indenture and applicable state statutes.

D. Concentration of Credit Risk

Concentration of credit risk can also arise by failing to adequately diversify investments. The Indenture establishes limitations on portfolio composition by issuer in order to control concentration of credit risk. Not more than 35% of the Authority's total funds available for investment may be invested in commercial paper, and not more than 5% of the Authority's total funds available for investment may be invested in the commercial paper of any single issuer.

E. Permitted Investments

Investments permitted are governed by certain provisions of the Indenture and include bonds, notes and other evidence of indebtedness of the U.S. Government, the Commonwealth of Virginia, or certain of its agencies, commercial paper and/or corporate notes which meet certain criteria as permitted under the Indenture, and deposits and guaranteed contracts with banks and financial institutions which meet standards as stipulated in agreements with the Authority.

F. Fair Value Measurements

The Authority categorizes its fair value measurements within the fair value hierarchy established by GAAP. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs, and Level 3 inputs are significant unobservable inputs. The Authority's investments in the Wilmington U.S. Government Money Market Fund totaling $2,022,303 as of June 30, 2018 are valued using quoted market prices (Level 1 inputs).

NOTE 4—RECEIVABLES

Receivables at June 30, 2018 and 2017 consist of interest and dividends on investments and assessments due to the Authority from the City of Hampton, all of which are considered collectible in full within one year.

NOTE 5—CAPITAL ASSETS

The Authority's capital asset activity for the years ended June 30, 2018 and 2017 was as follows:

2018	Beginning Balance	Additions	Reductions	Ending Balance
Construction in progress	$ 5,734,482	$ -	$ -	$ 5,734,482
Capitalized bond interest	2,432,839	-	-	2,432,839
Capitalized investment income	(466,187)	-	-	(466,187)
Total Capital Assets	$ 7,701,134	$ -	$ -	$ 7,701,134

2017	Beginning Balance	Additions	Reductions	Ending Balance
Construction in progress	$ 5,734,482	$ -	$ -	$ 5,734,482
Capitalized bond interest	2,432,839	-	-	2,432,839
Capitalized investment income	(466,187)	-	-	(466,187)
Total Capital Assets	$ 7,701,134	$ -	$ -	$ 7,701,134

Construction in progress consists of public infrastructure improvements, including road and alley improvements, parking, storm water management improvements, sanitary sewer lines and pump stations, lighting, fencing, sidewalks, and streetscapes. Pursuant to the Memorandum of Understanding, the infrastructure improvements will be transferred to the Authority or to the appropriate public entity for their operation and maintenance upon final inspection and acceptance.

According to the terms of the Assignment and Assumption Agreement executed on September 19, 2013, the Authority agreed to release $1,000,000 in project funds for reimbursement of additional public improvements costs according to specified construction milestones so long as the majority property owner ("Cygnus") is in compliance with its obligations. Cygnus had drawn $620,201 of that $1,000,000 as of June 30, 2016 and has stated its belief that the improvements are complete.

On May 16, 2018, the board approved a resolution authorizing the acceptance of a Settlement Agreement, which would effectively deem all public improvements complete and transfer all improvements to the Master Association (as defined in the Settlement Agreement). As of June 30, 2018, this agreement has not been executed.

NOTE 6—LONG-TERM OBLIGATIONS

The Authority's long-term obligations activity for the years ended June 30, 2018 and 2017 was as follows:

2018	Opening Balance	Increase	Decrease	Ending Balance	Due within one year
Series 2007 Bonds	$ 6,789,000	$ -	$ (103,000)	$ 6,686,000	$ 116,000
Less: Unamortized discount	(94,141)	-	4,668	(89,473)	
Total Bonds Payable	$ 6,694,859	$ -	$ (98,332)	$ 6,596,527	$ 116,000

2017	Opening Balance	Increase	Decrease	Ending Balance	Due within one year
Series 2007 Bonds	$ 7,404,000	$ -	$ (615,000)	$ 6,789,000	$ 103,000
Less: Unamortized discount	(98,809)	-	4,668	(94,141)	
Total Bonds Payable	$ 7,305,191	$ -	$ (610,332)	$ 6,694,859	$ 103,000

A. Special Assessment Bonds, Series 2007

On May 16, 2007, the Authority issued $9,440,000 in Special Assessment Bonds Series 2007 to finance the construction of public infrastructure improvements located within the District, to fund a reserve fund, to fund construction period interest and administrative expenses, and to pay costs relating to the issuance of the Bonds. The City, on behalf of the Authority, will impose and collect the special assessment annual installments and has agreed to apply its customary tax payment enforcement procedures to the collection of any delinquent payments of the special assessment annual installments.

The Bonds are limited obligations of the Authority, payable solely from and secured by revenues collected from special assessments after payment of administrative expenses.

Interest on the Bonds is payable semiannually on March 1 and September 1 of each year beginning on September 1, 2007. Principal payments on the Bonds are due each September 1 according to the mandatory sinking fund redemption schedule. Interest is calculated on the basis of a 360-day year comprised of twelve 30-day months.

The Bonds are subject to optional redemption, mandatory sinking fund redemption, and special mandatory redemption.

Interest payments totaled $350,350 and $382,512 for the years ended June 30, 2018 and 2017, respectively. Principal payments of $103,000 and $615,000, including prepayment redemptions, were made during fiscal years 2018 and 2017, respectively. All interest during the construction period was capitalized. Due to an extended stoppage in construction of the public improvements in fiscal years 2013 and 2012, bond interest payments were expensed. The construction period resumed during the period from September 2013 through June 2015 with the execution of the Assignment and Assumption Agreement and Cygnus' subsequent resumption of construction of the public improvements.

B. Optional Redemption

The Bonds may be redeemed at the option of the Authority prior to their respective maturities in whole or in part at any time on or after September 1, 2017, plus accrued interest to the redemption date at 100% of the redemption principal amount.

C. Special Mandatory Redemption

The Bonds are subject to special mandatory redemption at a redemption price equal to 100% of the principal amount plus accrued interest on any March 1 or September 1 from prepaid assessments or moneys remaining in the Project Fund after completion of the improvements. Prepayments of $276,368 and $634,443 were received in fiscal years 2018 and 2017, respectively. Special mandatory redemptions of $519,000 were made in fiscal year 2017 due to prepaid assessments. No special mandatory redemptions were made in fiscal year 2018.

On December 14, 2015, the trustee redeemed an additional $1,270,000 of bonds outstanding pursuant to Section 4.3(b) of the Indenture, which states that project funds remaining after completion of the project may be used for bond redemption. However, the Authority had not certified the project as complete, as required by Section 6.3 of the Indenture.

D. Mandatory Sinking Fund Redemption

The Bonds are required to be redeemed prior to maturity by the Authority on September 1 in the years and in the amounts set forth below, as revised for all mandatory sinking fund and prepayment redemptions as of June 30, 2018:

For the Year Ending June 30:	Principal	Interest
2019	$ 116,000	$ 344,656
2020	133,000	338,182
2021	149,000	330,850
2022	164,000	322,712
2023	185,000	313,638
2024-2028	1,237,000	1,395,082
2029-2033	1,910,000	990,340
2034-2038	2,792,000	383,968
Total	$ 6,686,000	$4,419,428

E. Purchase of Bonds

On September 24, 2015, Cygnus Opportunity Fund LLC (an affiliate of Cygnus) purchased all of the bonds outstanding.

NOTE 7—SPECIAL ASSESSMENTS

Annual special assessments are to be collected from each parcel of taxable property within the District (excepting those for which the assessment lien has been prepaid) each year in an amount equal to the

"Annual Revenue Requirement." The Annual Revenue Requirement, generally, is equal to: (i) annual debt service and administrative expenses, less (ii) other amounts available for the payment of such debt service and expense. Special assessments, unless prepaid, will be payable in installments at the same time general real estate taxes are paid to the City. The City has agreed to apply its customary tax payment enforcement proceedings to the collection of any delinquent payment of special assessments.

Assessments totaling $503,931 and $507,389 have been imposed on property owners for the fiscal years ending June 30, 2018 and 2017, respectively. According to the Memorandum of Understanding among the City, the Authority and the developer, these assessments are due in two equal installments on December 5 and June 5 of each year and shall be paid over to the Authority within 30 calendar days of receipt by the City.

As of June 30, 2018, there were no delinquent assessments.

NOTE 8—ARBITRAGE REQUIREMENTS

When applicable, arbitrage calculations are performed on the Authority's funds to determine any arbitrage rebate or yield restriction liability. No liabilities for arbitrage rebate or yield restrictions were identified in fiscal years June 30, 2018 and 2017.

NOTE 9—CONTINGENT LIABILITIES

There are no claims or lawsuits pending against the Authority.

NOTE 10—SUBSEQUENT EVENTS

As stated in Note 5, the board has approved a Settlement Agreement and Second Supplement to the Indenture. The Second Supplement to the Indenture was executed on October 17, 2018. The Settlement Agreement has not yet been executed.

On September 7, 2018, a special mandatory redemption of $416,000 in Bonds was made from prepaid special assessments.

NOTE 11—EVALUATION OF SUBSEQUENT EVENTS

The Authority has evaluated subsequent events through November 30, 2018, the date which the financial statements are available to be issued.

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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
H2O Community Development Authority
Hampton, Virginia

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and the *Specifications for Audits of Authorities, Boards, and Commissions*, issued by the Auditor of Public Accounts of the Commonwealth of Virginia, the financial statements of business-type activities of the H2O Community Development Authority of Hampton, Virginia (Authority), as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated November 30, 2018.

Internal Control over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free from 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

The Nichols Group

The Nichols Group, PA
Certified Public Accountants
Fleming Island, Florida

November 30, 2018