

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Basic Financial Statements

September 30, 2006

(With Independent Auditors' Report Thereon)

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

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INDEPENDENT AUDITORS' REPORT

Board of Supervisors
Village Community Development District No. 3
The Villages, Florida

We have audited the accompanying basic financial statements of the governmental activities and each major fund of Village Community Development District No. 3 (the District), as of and for the year ended September 30, 2006, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic 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 basic financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the basic 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 basic 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, 2006, and the respective changes in financial position thereof and the budgetary comparison of the general fund for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 26, 2007, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 read in conjunction with this report in considering the results of our audit.

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Board of Supervisors
Villages Community Development District No. 3
The Villages, Florida

INDEPENDENT AUDITORS' REPORT
(Concluded)

The management's discussion and analysis, as listed in the accompanying contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

January 26, 2007
Ocala, Florida

Surick, Gray and Company, LLP

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Management's Discussion and Analysis

(UNAUDITED)

September 30, 2006

The Village Community Development District No. 3 (the District) management's discussion and analysis is designed to (a) assist the reader in focusing on significant financial issues, (b) provide an overview of the District's financial activities and (c) identify changes in the District's financial position and its ability to address the next and subsequent year challenges.

Financial Highlights

- The assets of the District exceeded its liabilities at September 30, 2006 by \$22 million (net assets). Of this amount, \$1,064,893 of unrestricted net assets may be used to meet the District's ongoing obligations to citizens and creditors.
- The District's total debt decreased by \$1.6 million during the current fiscal year. The decrease represents principal payments made on revenue bonds.
- Special assessments are now being shown as assessments receivable. At the fund level there is an off-setting line item for deferred revenue. In the Statement of Activities the net assets restricted for debt service has been restated to reflect this change. Assessments receivable decreased by \$1,423,400 during the year and has a September 30, 2006 balance of \$14,384,549.

Using this Annual Report

The financial statement's focus is on both the District as a whole (government-wide) and on the major individual funds. Both perspectives (government-wide and major fund) allow the user to address relevant questions, broaden a basis for comparison (year to year or government to government) and enhance the District's accountability.

The Statement of Net Assets (page 7) and **the Statement of Activities** (page 8) provide information about the activities of the District as a whole and present a longer-term view of the District's finances. The statements are measured and reported using the economic resources measurement focus and full accrual basis of accounting and are designed to be corporate-like in structure.

The Fund Financial Statements, which report by individual fund, begin on page 9. Traditional users of governmental financial statements will find the fund financial statements presentation more familiar. The governmental funds measure and report activities using the current financial resources measurement focus and the modified accrual basis of accounting. Therefore you will find the reconciliation on page 10 that converts this data to an economic resources measurement focus and the accrual basis of accounting for use in the government-wide financial statements. The fund financial statements present information in more detail than the government-wide financial statements. Governmental Accounting Standards Board (GASB) Statement No. 34 provides the authoritative guidance on the governmental financial reporting model.

The Government-Wide Financial Statements

The Statement of Net Assets and the Statement of Activities

Government-wide financial statements are designed to be corporate-like in structure. They are intended to allow the reader to assess the government's operational accountability. Operational accountability is defined as the extent to which the government has met its operating objectives efficiently and effectively, using all resources available for that purpose, and whether it can continue to meet its objectives for the foreseeable future.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Management's Discussion and Analysis

(UNAUDITED)

September 30, 2006

The statement of net assets presents information on all the District's assets and liabilities, with the difference being reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or not.

The statement of activities presents information showing how the District's net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Fund Financial Statements

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

Governmental funds account for all of the District's assessment supported activities. These include the General fund and the Debt Service fund. These funds focus on how money flows into and out of the funds, and the balances left at year-end. The accounting method used is called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash (usually 60 day focus). The two criteria used are that the revenue is measurable and available. Examples of the difference between this and the economic resources measurement focus are that debt financing is considered current revenue, and purchases of capital assets are considered current expenditures, whereas depreciation is not since there is no outlay of cash. In a highly regulatory environment, fund accounting serves a very important purpose, in that funds received for specific purposes are identified as such.

Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found beginning on page 14.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Management's Discussion and Analysis
(UNAUDITED)
September 30, 2006

The District as a Whole

The District's net assets as of September 30, 2006 and 2005 were \$21.9 million and \$22.4 million, respectively, representing a decrease of approximately \$490,500. The District's revenues for the years ending September 30, 2006 and 2005, including assessments and investment earnings were \$1.95 million and \$1.97 million, respectively, representing a decrease of approximately \$20,000. Total expenses for each of the years ending September 30, 2006 and 2005 were \$2.4 million and \$2.5 million respectively. Table 1 reflects the summary statement of net assets for the current year and prior year.

Table 1
Net Assets

	Governmental Activities	
	September 30, 2006	September 30, 2005
		(as restated)
Assets:		
Current and other assets	\$ 3,076,905	3,145,293
Assessments receivable	14,384,549	15,807,949
Capital assets - net	19,515,212	20,065,432
Total assets	36,976,666	39,018,674
Liabilities :		
Current and other liabilities	391,582	411,091
Long-term liabilities	14,670,000	16,220,000
Total liabilities	15,061,582	16,631,091
Net assets:		
Invested in capital assets, net of related debt	5,439,641	4,480,751
Restricted for debt service	15,392,550	16,925,569
Unrestricted	1,064,893	981,263
Total net assets	\$ 21,897,084	22,387,583

The majority of the District's net assets represent investments in capital assets, less the indebtedness outstanding, used to acquire those capital assets. The resources required to repay this debt must be provided annually from assessments, since it is unlikely that the capital assets themselves will be liquidated to pay the liabilities.

The District's net assets also include amounts restricted for debt service and renewal and replacement, and are subject to external restrictions under the District's Bond Resolutions.

Table 2 reflects the summary statement of activities for the current year and prior year.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Management's Discussion and Analysis
(UNAUDITED)
September 30, 2006

Table 2
Changes in Net Assets

	<u>Governmental Activities</u>	
	<u>September 30,</u> <u>2006</u>	<u>September 30,</u> <u>2005</u> (as restated)
Revenues:		
Special assessments	\$ 1,850,323	1,908,753
Other revenues	14,500	19,827
Investment earnings	84,926	41,088
Total revenues	<u>1,949,749</u>	<u>1,969,668</u>
Expenses:		
General government	1,581,838	1,531,186
Interest on long-term debt	858,410	942,923
Total expenses	<u>2,440,248</u>	<u>2,474,109</u>
 Increase in net assets	 \$ <u>(490,499)</u>	 <u>(504,441)</u>

Revenues

Revenues include assessments on District landowners for maintenance and debt service. Other revenues include reimbursements from Sumter County for maintaining county right-of-ways.

Expenses

General government expenses of the District are mainly for landscaping, irrigation and utilities costs.

Capital Assets

The District's capital assets as of September 30, 2006 and 2005 amounts to \$19,515,212 and \$20,065,432, respectively. This investment is net of accumulated depreciation and includes land and improvements. Additional information regarding the District's capital assets can be found in Note 3 to the financial statements.

Long-term Debt

At September 30, 2006 and 2005, the District had long-term debt outstanding of \$14,670,000 and \$16,220,000, respectively. All of the debt is special assessment debt and is secured solely by revenue sources. Additional information regarding the District's long-term debt can be found in Note 4 to the financial statements.

Request for Information

The District's financial statements are designed to present users (citizens, taxpayers, customers, investors and creditors) with a general overview of the District's finances and to demonstrate the District's accountability. If you have any questions about the report or need additional financial information, contact the Village Center Community Development District's Chief Financial Officer at 3231 Wedgewood Lane, The Villages, FL 32162, telephone (352) 753-0421.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Statement of Net Assets

September 30, 2006

	Assets	Governmental Activities
Cash and investments		\$ 2,482,476
Assessments receivable		14,384,549
Unamortized bond issuance costs		594,429
Capital assets, net of accumulated depreciation		<u>19,515,212</u>
Total assets		<u>36,976,666</u>
	Liabilities	
Accounts payable		40,764
Accrued interest		348,818
Payable to Developer		20,000
Long-term debt:		
Due within one year		535,000
Due in more than one year		<u>14,135,000</u>
Total liabilities		<u>15,079,582</u>
	Net Assets	
Invested in capital assets, net of related debt		5,439,641
Restricted for debt service		15,392,550
Unrestricted		<u>1,064,893</u>
Total net assets		\$ <u><u>21,897,084</u></u>

See accompanying notes to basic financial statements.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Statement of Activities

Year ended September 30, 2006

Functions/Programs	Expenses	Program revenues			Net (expense) revenue and changes in net assets	
		Charges for services	Operating contributions	Capital grants and contributions	Governmental activities	Total
Governmental activities:						
General government	\$ 1,581,838	\$ 1,850,323	\$ -	\$ -	\$ 268,485	\$ 268,485
Interest on long-term debt	858,410	-	-	-	(858,410)	(858,410)
Total governmental activities	<u>\$ 2,440,248</u>	<u>\$ 1,850,323</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$(589,925)</u>	<u>\$(589,925)</u>
General revenue:						
Other revenues					14,500	14,500
Investment earnings					84,926	84,926
Total general revenues					<u>99,426</u>	<u>99,426</u>
Change in net assets					(490,499)	(490,499)
Net assets – beginning (as restated)					22,387,583	22,387,583
Net assets – ending					<u>21,897,084</u>	<u>21,897,084</u>

See accompanying notes to basic financial statements.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Balance Sheet – Governmental Funds

September 30, 2006

	<u>General</u>	<u>Debt Service</u>	<u>Total</u>
Assets:			
Cash and investments	\$ 1,125,657	1,356,819	2,482,476
Assessments Receivable	-	14,384,549	14,384,549
Total assets	<u>\$ 1,125,657</u>	<u>15,741,368</u>	<u>16,867,025</u>
Liabilities:			
Accounts payable	\$ 40,764	-	40,764
Deferred assessment revenue	-	14,384,549	14,384,549
Total liabilities	<u>40,764</u>	<u>14,384,549</u>	<u>14,425,313</u>
Fund balances:			
Reserved:			
Debt service	-	1,356,819	1,356,819
Unreserved, designated for:			
Renewal and replacement	678,522	-	678,522
Operating reserves	110,000	-	110,000
Unreserved, undesignated	296,371	-	296,371
Total fund balances	<u>1,084,893</u>	<u>1,356,819</u>	<u>2,441,712</u>
Total liabilities and fund balances	<u>\$ 1,125,657</u>	<u>15,741,368</u>	<u>16,867,025</u>

See accompanying notes to basic financial statements.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Reconciliation of the Balance Sheet – Governmental Funds to the Statement of Net Assets

September 30, 2006

Total fund balances, governmental funds		\$	2,441,712
Total net assets reported for governmental activities in the statement of net assets is different because:			
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds:			
Capital assets	\$	22,198,755	
Less accumulated depreciation		<u>(2,683,543)</u>	19,515,212
Long-term liabilities are not due and payable in the current period and therefore are not reported in the funds:			
Special assessment revenue bonds		(14,670,000)	
Accrued interest		(348,818)	
Payable to Developer		<u>(20,000)</u>	(15,038,818)
Deferred revenue reported in the funds is added to the balance of net assets restricted for debt service to reflect the revenue as recorded when the total assessment is levied.			14,384,549
Certain long-term assets are not available to pay for current period expenditures and therefore are not included in the funds:			
Unamortized bond issuance costs			<u>594,429</u>
Net assets of governmental activities	\$		<u><u>21,897,084</u></u>

See accompanying notes to basic financial statements.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

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

Year ended September 30, 2006

	<u>General</u>	<u>Debt Service</u>	<u>Total</u>
Revenues:			
Special assessments	\$ 966,070	2,307,653	3,273,723
Other revenues	14,500	-	14,500
Interest income	48,400	36,525	84,925
Total revenues	<u>1,028,970</u>	<u>2,344,178</u>	<u>3,373,148</u>
Expenditures:			
Current – general government	990,728	-	990,728
Debt service:			
Principal	-	1,550,000	1,550,000
Interest	-	893,674	893,674
Total expenditures	<u>990,728</u>	<u>2,443,674</u>	<u>3,434,402</u>
Excess (deficiency) of revenues over expenditures	<u>38,242</u>	<u>(99,496)</u>	<u>(61,254)</u>
Other financing sources (uses):			
Transfer in (out)	45,387	(45,387)	-
Total other financing sources (uses)	<u>45,387</u>	<u>(45,387)</u>	<u>-</u>
Net change in fund balances	83,629	(144,883)	(61,254)
Fund balances, at beginning of year	<u>1,001,263</u>	<u>1,501,702</u>	<u>2,502,965</u>
Fund balances, at end of year	\$ <u>1,084,892</u>	<u>1,356,819</u>	<u>2,441,711</u>

See accompanying notes to basic financial statements.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Reconciliation of the Statement of Revenues, Expenditures, and Changes in
Fund Balances – Governmental Funds to the Statement of Activities
Year ended September 30, 2005

Net change in fund balances – total governmental funds	\$	(61,254)
Amounts reported for governmental activities in the statement of activities are different because:		
Governmental funds report capital outlays as expenditures.		
However, in the statement of activities the cost of those assets is capitalized and allocated over their estimated useful lives as depreciation expense. This is the amount of depreciation expense in the current period.		(550,219)
Governmental funds report the costs of bond issuance as expenditures. However, in the statement of activities, bond issuance costs are capitalized and allocated over the term of the related bonds as amortization expense. This is the amount of bond issuance cost amortization expense in the current period.		
		(40,890)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds:		
Accrued interest		35,264
Governmental funds report special assessment debt service revenue when collected, however in the statement of activities the revenue is recorded when the total assessment is levied.		
Deferred assessment revenue at September 30, 2006	14,384,549	
Deferred assessment revenue at September 30, 2005	<u>(15,807,949)</u>	(1,423,400)
Repayment of long-term debt is an expenditure in governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.		
		<u>1,550,000</u>
Change in net assets of governmental activities	\$	<u><u>(490,499)</u></u>

See accompanying notes to basic financial statements.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Statement of Revenues, Expenditures and Changes in
Fund Balance – Budget and Actual

General Fund

Year ended September 30, 2006

	Budgeted Amounts		Actual Amounts	Variance with final budget
	Original	Final		
Revenues:				
Special assessments	\$ 963,314	966,070	966,070	—
Interest and other income	23,945	61,545	62,900	1,355
Total revenues	<u>987,259</u>	<u>1,027,615</u>	<u>1,028,970</u>	<u>1,355</u>
Expenditures:				
General government:				
Professional services	209,622	203,322	201,637	1,685
Accounting and auditing	16,300	16,300	16,300	—
Other contractual services	51,000	51,000	51,000	—
Communication and freight	1,850	1,700	1,636	64
Utility services	171,000	162,000	160,615	1,385
Rentals and leases	2,000	2,000	—	2,000
Insurance	9,000	9,580	9,580	—
Repair and maintenance/landscape	554,500	540,500	545,664	(5,164)
Printing and binding	1,200	750	721	29
Other current charges	2,850	1,050	933	117
Office supplies	800	800	779	21
Operating supplies	2,500	2,500	1,863	637
Total expenditures	<u>1,022,622</u>	<u>991,502</u>	<u>990,728</u>	<u>774</u>
Excess (deficiency) of revenues over expenditures	<u>(35,363)</u>	<u>36,113</u>	<u>38,242</u>	<u>2,129</u>
Other financing sources:				
Transfers in	—	45,706	45,387	(319)
Total other financing sources	<u>—</u>	<u>45,706</u>	<u>45,387</u>	<u>(319)</u>
Net change in fund balances	<u>(35,363)</u>	<u>81,819</u>	<u>83,629</u>	<u>1,810</u>
Fund balances, at beginning of year	<u>179,389</u>	<u>179,389</u>	<u>179,389</u>	<u>—</u>
Fund balances, at end of year	<u>\$ 144,026</u>	<u>261,208</u>	<u>263,018</u>	<u>1,810</u>

See accompanying notes to basic financial statements.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Notes to Basic Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

Village Community Development District No. 3 (the District) was established in 1998 for the purpose of planning, financing, constructing, operating, and maintaining certain community-wide infrastructure for a community development district located entirely within Sumter County, Florida. The District was created by Sumter County Commission Ordinance No. 98-10 pursuant to the provisions of Chapter 190.005 of the Florida Statutes and operates within the criteria established by Chapter 190. The District is governed by a five member Board of Supervisors. As of September 30, 2006, each of the five members of the Board of Supervisors is an elected resident of the District.

The District boundary consists of approximately 894 acres in the northeast corner of the county. Planned development includes construction of 3,765 residential units. The land within the District is part of the active adult retirement community known as "The Villages". The Villages consists of approximately 20,256 acres spanning the borders of Lake, Sumter and Marion Counties and the Town of Lady Lake, Florida, and when fully developed is expected to include 55,960 residences and approximately 100,000 residents. The Villages of Lake-Sumter, Inc. (the Developer) is the developer and initial owner of the property within the District. The Villages is being developed by the Developer, a family-owned business established for the single purpose of developing The Villages.

The financial statements of the District have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for establishing governmental accounting and financial reporting principles. The District's more significant accounting policies are described below.

There are no component units that are legally separate from the District. There are however twelve Community Development Districts (CDD) in the total makeup of The Villages.

The Developer has formed the following community development districts:

- Village Center CDD – This CDD provides water and sewer utility services, recreation and security services, and fire protection and paramedic services to the residents. The cost of operations is funded by amenity and utility fees that residents pay monthly. This CDD also provides for the maintenance of common areas and roadways for the commercial areas within the CDD boundaries. The cost of maintenance is funded through commercial maintenance assessments.
- Sumter Landing CDD – This CDD provides recreation and security services to the residents. The cost of operations is funded by amenity fees that residents pay monthly. This CDD also provides for the maintenance of common areas and roadways for the commercial areas within the CDD boundaries. The cost of maintenance is funded through maintenance assessments.
- Village CDD No. 1 (Sumter County) – This CDD's boundary consists of approximately 998 acres in the northeast corner of the county. The development includes construction of 3,427 residential units.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Notes to Basic Financial Statements

September 30, 2006

(1) Summary of Significant Accounting Policies (continued)

(a) Reporting Entity (continued)

- Village CDD No. 2 (Sumter County) – This CDD’s boundary consists of approximately 990 acres in the northeast corner of the county. The development includes construction of 3,672 residential units.
- Village CDD No. 3 (Sumter County) – This CDD’s boundary consists of approximately 894 acres in the northeast corner of the county. The development includes construction of 3,765 residential units.
- Village CDD No. 4 (Marion County) – This CDD’s boundary consists of approximately 1,187 acres in the northeast corner of the county. The development includes construction of 5,141 residential units.
- Village CDD No. 5 (Sumter County) – This CDD’s boundary consists of approximately 1,407 acres in the northeast corner of the county. The development includes construction of 6,399 residential units.
- Village CDD No. 6 (Sumter County) – This CDD’s boundary consists of approximately 1,008 acres in the northeast corner of the county. Planned development includes construction of 4,621 residential units.
- Village CDD No. 7 (Sumter County) – This CDD’s boundary consists of approximately 976 acres in the northeast corner of the county. Planned development includes construction of 4,745 residential units.
- Village CDD No. 8 (Sumter County) – This CDD has been formed, but is not being developed as of September 30, 2006.
- Village CDD No. 9 (Sumter County) – This CDD has been formed, but is not being developed as of September 30, 2006.
- Village CDD No. 10 (Sumter County) – This CDD has been formed, but is not being developed as of September 30, 2006.

Certain of these community development districts have issued special assessment revenue bonds to finance various infrastructure improvements in their respective boundaries that are secured by special assessments levied on benefited lands in each district. It is anticipated that additional infrastructure improvements within The Villages will be undertaken by these community development districts and/or community development districts that will be created in the future, for which special assessments may be imposed on residences in The Villages and lands owned by the Developer.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Notes to Basic Financial Statements

September 30, 2006

(1) Summary of Significant Accounting Policies (continued)

(b) Basic Financial Statements

Government-wide and Fund Financial Statements

The basic financial statements include both government-wide (based on the District as a whole) and fund financial statements. The government-wide financial statements (i.e. the statement of net assets and statement of activities) report information on all of the nonfiduciary activities of the District. For the most part, the effect of internal activity has been removed from these statements.

The financial reporting model focus is on either the District as a whole, or major individual funds. The government-wide statement of net assets reports the governmental activities of the District (a) on a government-wide basis and (b) on a full accrual basis, using the economic resources measurement focus, which incorporates long-term assets and receivables as well as long-term debt and obligations. The statement of activities reflects the expenses of the District, which are offset by program revenues. Program revenues are defined as charges for services, operating grants and contributions, and capital grants and contributions directly associated with a given function.

The District's major funds are presented in separate columns on the fund financial statements. The definition of a major fund is one that meets certain criteria set forth in GASB 34.

Program revenues in the Statement of Activities consist primarily of special assessment revenues.

Net assets are categorized as invested in capital assets, net of related debt, restricted and unrestricted.

Invested in capital assets, net of related debt is intended to reflect the portion of net assets which are associated with capital assets net of accumulated depreciation less outstanding capital asset related debt. Related debt is the debt less any associated unamortized bond issuance costs.

Restricted net assets are assets that have third party (statutory, bond covenant or granting agency) or enabling legislation limits on their use. The District would typically use restricted assets first, as appropriate opportunities arise, but reserves the right to selectively defer the use thereof to a future project or replacement equipment acquisition.

Unrestricted net assets represent net assets not included in *Invested in capital assets, net of related debt* or *Restricted net assets*.

(c) Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Assessments are recognized as revenues in the year for which they are levied.

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

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Notes to Basic Financial Statements
September 30, 2006

(1) Summary of Significant Accounting Policies (continued)

(c) *Measurement Focus, Basis of Accounting and Financial Statement Presentation (continued)*

incurred, as under accrual accounting. However, debt service expenditures are only recorded when payment is due.

The following are the District's major governmental funds:

General Fund

The general fund is the operating fund of the District and is used to account for all financial resources of the general government except those required to be accounted for in another fund.

Debt Service Fund

The debt service fund is used to account for the accumulation of resources for, and payment of, general long-term debt principal, interest and related costs.

(d) *Budgetary Data*

Legal authority and control are established in accordance with Section 190.008, *Florida Statutes*. Annual budgets, as well as subsequent amendments, are adopted and approved for the general fund by the Board of Supervisors. Budgets are adopted on a basis consistent with GAAP.

All budget amounts presented in the statements reflect the original budget and the amended budget if so amended.

(e) *Cash equivalents and Investments*

The District considers the following highly liquid investments (including restricted assets) to be cash equivalents:

- Money Market Mutual funds
- Repurchase agreements
- Florida State Board of Administration's Local Government Investment Pool (SBA LGIP).

The money market mutual funds and repurchase agreements are stated at cost which approximates fair value.

(f) *Capital Assets*

Capital assets are reported in the government-wide financial statements. As defined by the District, capital assets are assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. The District values and records donated capital assets at the estimated fair value of the item at the date of its donation.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Notes to Basic Financial Statements

September 30, 2006

(1) **Summary of Significant Accounting Policies (continued)**

(f) *Capital Assets (continued)*

The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Depreciation of capital assets is computed using the straight-line method and is recorded in general government expenses in the District's statement of activities. Estimated useful lives of the assets are as follows:

Improvements other than buildings	40 years
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(g) *Bond Issuance Costs*

In the government-wide financial statements, bond issuance costs are deferred and amortized over the term of the bonds using the straight-line method, which approximates the effective interest method. In the fund financial statements, bond issuance costs are recorded as expenditures when incurred.

(h) *Assessments*

Bond Assessments

The bond debt is repaid from the proceeds of an assessment levied by the District's Board of Supervisors. The levy is in the form of non-ad-valorem special assessment that will have a lien against properties within the boundary of the District that receive special benefits from the infrastructure improvements financed by the bonds. These assessments may be prepaid in total or annually as non-ad-valorem special assessments. The bond assessment revenue and the debt service activity is accounted for in the Debt Service fund.

Maintenance Assessments

In addition to the assessment for the repayment of bond obligations, the District has levied an assessment for the maintenance of the infrastructure and the operations of the District. This assessment is derived from the general fund's annual budget. The maintenance assessment revenue is classified as general revenue.

Assessment Methodology

The assessment methodology consists of five steps. First, the District engineer determines the costs for all District improvements needed. Second, the assessable acres that benefit from the District's infrastructure improvements are determined. Third, the District Financial Advisor and Underwriter estimate total funding needed to acquire and/or construct the infrastructure improvements. Fourth, this amount is divided equally among the benefited properties on a net assessable acreage basis. Finally, as land is platted, the debt on each assessable acre is allocated to each residential unit. This methodology is applied to both the bond and the maintenance assessments.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Notes to Basic Financial Statements

September 30, 2006

(1) Summary of Significant Accounting Policies (continued)

(h) Assessments (continued)

Billing / Collection of Assessments

The District has entered into an agreement with the Tax Collector of the respective county. The assessments are placed on the county property tax bill as a non-ad-valorem assessment. It is collected by the county under the uniform tax collection process and then remitted to the District.

(j) Use of Estimates

The preparation of financial statements requires management of the District to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

(k) Income Taxes

The District is created as a special purpose government under Florida Statutes Chapter 190 and therefore is exempt from federal and state income tax.

(2) Investments

<u>Investment Type</u>	<u>Fair Value at September 30, 2006</u>	<u>Weighted Average Maturity (days)</u>	<u>Credit Rating</u>
Repurchase Agreements	102,370	overnight	n/a
Money Market Mutual Funds	1,356,819	23	AAAm
SBA LGIP	1,023,187	32	n/a

The District's investments consist of funds placed with the State Board of Administration for participation in the Local Government Surplus Funds Trust Fund investment pool created by Section 218.415, Florida Statutes. This investment pool operates under investment guidelines established by Section 215.47, Florida Statutes. The District's investments in the Local Government Surplus Funds Trust Fund, a Securities and Exchange Commission Rule 2a7-like external investment pool, are reported at fair value which is amortized cost.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3

Notes to Basic Financial Statements

September 30, 2006

(2) Investments (continued)

Custodial Credit Risk

All cash and investments, other than demand deposit accounts, are held in the name of a custodian or a Trustee for the District. The repurchase agreement is an obligation of Citizen's First Bank. The securities pledged as collateral are held by a safekeeping agent. In the event of insolvency of the bank the District may become an unsecured creditor to the extent the market value of the federal agency security falls below the amount invested during the tenure of the repurchase agreement.

Interest Rate Risk

The short term liquidity of the cash equivalents and investments minimizes the impact that interest rate risk may have on the District.

Concentration of Credit Risk

<u>Type of Investment:</u>	<u>Issuer:</u>	<u>% of Total Investments</u>
Repurchase Agreement	Citizen's First Bank	4.12%

Investment Policy

The District is authorized to invest in those financial instruments as established by the Investment Policy of the District. This policy allows investments allowed under *Florida Statutes 218.415* amended to include Repurchase Agreements and prohibiting derivative type investments. The authorized investments consist of:

- The Local Government Surplus Funds Trust Fund or any intergovernmental investment pool authorized pursuant to the Florida Inter-local Cooperation Act as provided in s. 163.01.
- Securities and Exchange Commission registered money market mutual funds with the highest credit quality rating from a nationally recognized rating agency.
- Interest-bearing time deposits or savings accounts in qualified public depositories as defined in s. 280.02.
- Direct obligations of the United States Treasury.
- Federal agencies and instrumentalities.
- Repurchase agreements with financial institutions approved as public depositories, provided that the underlying collateral consist of obligations of the United States Government, it's agencies and instrumentalities. The repurchase agreement shall be collateralized at 102 percent of the value of the District's investment.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Notes to Basic Financial Statements
September 30, 2006

(3) Capital Assets

Capital asset activity for the year ended September 30, 2006 was as follows:

	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>
Governmental activities:				
Assets not being depreciated:				
Land	\$ 190,000	—	—	190,000
Assets being depreciated:				
Improvements other than buildings	22,008,755	—	—	22,008,755
Less accumulated depreciation for:				
Improvements other than buildings	(2,133,323)	(550,219)	—	(2,683,542)
Total assets being depreciated, net	<u>19,875,432</u>	<u>(550,219)</u>	<u>—</u>	<u>19,325,213</u>
Governmental activities, capital assets	<u>\$ 20,065,432</u>	<u>(550,219)</u>	<u>—</u>	<u>19,515,213</u>

Total depreciation expense for fiscal year 2006 is \$550,219 and is all classified as General Government expense in the Statement of Activities.

(4) Payable to Developer

In November 2002, the District entered into an agreement with the Developer whereby amounts needed to fund construction of District infrastructure were loaned to the District in anticipation of the issuance of the Special Assessment Revenue Bonds. The District agreed to reimburse the Developer for amounts borrowed with, among other sources as noted in the agreement, any available bond proceeds and amounts held by the District in excess of Bond Reserve Amount Requirements, as described in the related bond indentures. As of September 30, 2006, the District owed the Developer \$20,000 under this agreement, which is recorded as a payable to Developer on the District's statement of net assets.

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Notes to Basic Financial Statements
September 30, 2006

(5) Long-term Debt

Long-term debt consisted of the following at September 30, 2006:

\$12,625,000 Special Assessment Revenue Bonds, Series 1998 principal installments ranging from \$425,000 to \$755,000 through May 2019 in accordance with the redemption schedule. Interest is due semi-annually on May 1 and November 1 of each year until redemption or maturity. Interest rates range from 4.45% to 5.0%.	\$ 7,455,000
\$8,725,000 Special Assessment Revenue Bonds, Series 2002 principal installments ranging from \$110,000 to \$555,000 through May 2032 in accordance with the redemption schedule. Interest is due semi-annually on May 1 and November 1 of each year until redemption or maturity. Interest rate is 6.5%.	\$ <u>7,215,000</u>
Total long -term debt	14,670,000
Less current installments of bonds payable	<u>(535,000)</u>
Long-term debt less current installments	<u><u>14,135,000</u></u>

The Special Assessment Revenue Bonds are secured by a lien and pledge of revenues under the indentures, which are derived by the District through levy and collection on land within the District specifically benefited. These bonds are additionally secured by amounts on deposit in the funds and accounts created pursuant to the indentures.

The annual requirements to amortize the principal and interest of all revenue bonds payable as of September 30, 2006 are as follows:

	Principal	Interest	Total
Fiscal year ending September 30:			
2007	535,000	837,163	1,372,163
2008	560,000	811,100	1,371,100
2009	590,000	783,600	1,373,600
2010	620,000	752,225	1,372,225
2011	650,000	719,200	1,369,200
2012 - 2016	3,830,000	3,036,275	6,866,275
2017 - 2021	3,365,000	1,933,875	5,298,875
2022 - 2026	1,660,000	1,267,175	2,927,175
2027 - 2032	2,860,000	684,775	3,544,775
Total	\$ 14,670,000	10,825,388	25,495,388

VILLAGE COMMUNITY DEVELOPMENT DISTRICT NO. 3
Notes to Basic Financial Statements
September 30, 2006

(5) Long-term Debt (continued)

Changes in Long-Term Debt

The following is a summary of changes in long-term debt for the year ended September 30, 2006:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Governmental activities:					
Bonds payable	\$ 16,220,000	—	1,550,000	14,670,000	535,000
Governmental activities long-term debt	<u>\$ 16,220,000</u>	<u>—</u>	<u>1,550,000</u>	<u>14,670,000</u>	<u>535,000</u>

(6) Transfers

During the year ended September 30, 2006 the District made a transfer of \$46,070 from the debt service fund to the general fund to recognize the release from bond related restrictions of these amounts.

(7) Related Parties

The District has no employees. For certain management, finance, and administrative services, the District entered into an inter-local agreement with Village Center Community Development District (Center District), a community development district created under Florida Statute 190. Under the agreement, fees paid to Center by the District for such services totaled \$186,567 for the year ended September 30, 2006.

The Developer provides to Center District at no cost information system support, including software, hardware, computer programming and internal mail room operations. The Center District then passes on this benefit to the District.

Engineering services were provided to the District by the Developer, some of which were for no charge.

Substantially all capital costs for infrastructure were acquired from the Developer or paid on contracts that were assigned to the District by the Developer using bond proceeds in either the current or previous years.

(8) Risk Management

The District is exposed to various risks of loss related to torts, theft, damage and destruction of assets; errors and omissions and natural disasters. The District generally carries insurance for these risks, however the District retains risk for certain property coverage and for losses in excess of coverage limits. There have been no claims in excess of coverage limits for the past two years.

(9) Restatement of Beginning Net Assets

The beginning net assets at the government wide level was restated to reflect Special Assessments not previously reported. This change to net assets resulted in an increase of \$14,384,549.

**INDEPENDENT AUDITORS' 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***

Board of Supervisors
Village Community Development District No. 3
The Villages, Florida

We have audited the financial statements of the governmental activities and each major fund of Village Community Development District No. 3 (the District), as of and for the year ended September 30, 2006, which collectively comprise the District's basic financial statements, and have issued our report thereon dated January 26, 2007. 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

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have communicated to the Board of Supervisors in a separate letter dated January 26, 2007.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's basic 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 no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Supervisors, management and the Auditor General of the State of Florida. It is not intended to be used, and should not be used by anyone other than these specified parties.

January 26, 2007
Ocala, Florida

Purvis, Gray and Company, LLP
Certified Public Accountants

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MANAGEMENT LETTER

Board of Supervisors
Village Community Development District No. 3
The Villages, Florida

We have audited the accompanying basic financial statements of the governmental activities and each major fund of Village Community Development District No. 3 (the District), as of and for the fiscal year ended September 30, 2006, and have issued our report thereon dated January 26, 2007.

We have issued our independent auditors' report on compliance and on internal control over financial reporting dated January 26, 2007. Disclosures in this report, if any, should be considered in conjunction with this management letter.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Additionally, our audit was conducted in accordance with the provisions of Chapter 10.550, *Rules of the Auditor General*, which govern the conduct of local governmental entity audits performed in the State of Florida and require that certain items be addressed in this letter.

The *Rules of the Auditor General* [Section 10.554(1)(h)1.] require that we comment as to whether or not corrective action has been taken to address significant findings and recommendations made in the preceding annual financial audit report (see attached management letter comments).

The *Rules of the Auditor General* [Section 10.554(1)(h)2.] require that we determine whether the District complied with Section 218.415, Florida Statutes, regarding investment of public funds. Our audit disclosed no matters requiring comment as outlined in Section 218.415, Florida Statutes.

The *Rules of the Auditor General* [Sections 10.554(1)(h)3.] require us to provide any recommendations to improve the District's financial management, accounting procedures and internal controls (see attached management letter comments).

The *Rules of the Auditor General* [Sections 10.554(1)(h)4.] require disclosure in the management letter of the following matters if not clearly inconsequential, and if not already addressed in the auditors' report on compliance and internal control: violations of laws, rules, regulations and contractual provisions or abuse that have occurred, or were likely to have occurred, and were discovered within the scope of the audit; improper or illegal expenditures discovered within the scope of the audit that may not materially affect the financial statements; deficiencies in internal control, including but not limited to: improper or inadequate accounting procedures (e.g., the omission of required disclosures from the annual financial statements); failures to properly record financial transactions; and other inaccuracies, shortages, and defalcations and instances of fraud discovered by, or that come to the attention of, the auditor. Our audit disclosed no matters required to be disclosed by *Rules of the Auditor General* [Sections 10.554(1)(h)4.].

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Board of Supervisors
Village Community Development District No. 3
The Villages, Florida

MANAGEMENT LETTER
(Concluded)

The *Rules of the Auditor General* [Section 10.554(1)(h)5.] also require that the name or official title and legal authority for the government be disclosed in the management letter, unless disclosed in the notes to the financial statements. See note 1 of the September 30, 2006, Village Community Development District No. 3 basic financial statements for this information.

As required by the *Rules of the Auditor General* [Section 10.554(1)(h)6.(a)], the scope of our audit included a review of the provisions of Section 218.503(1)(a), Florida Statutes, "Determination of Financial Emergency." In connection with our audit, we determined that the District did not meet one or more of the financial emergency criteria described in Section 218.503(1), Florida Statutes.

As required by the *Rules of the Auditor General* [Section 10.554(1)(h)6.(b)], we determined that the financial report for the District for the fiscal year ended September 30, 2006, filed with the 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, 2006.

As required by the *Rules of the Auditor General* [Section 10.554(1)(h)6.(c)], we applied financial condition assessment procedures pursuant to Rule 10.556(8). There were no findings of deteriorating financial condition, which were required to be reported.

This management letter is intended solely for the information and use of the Board of Supervisors, management and the Auditor General of the State of Florida, and is not intended to be and should not be used by anyone other than these specified parties.

We wish to take this opportunity to thank you and your staff for the cooperation and courtesies extended to us during the course of our audit. Please let us know if you have any questions or comments concerning this letter, our accompanying reports, or other matters.

January 26, 2007
Ocala, Florida

Hurdie, Gray and Company, LLP

MANAGEMENT LETTER COMMENTS

Board of Supervisors
Village Community Development District No. 3
The Villages, Florida

During the course of our audit, the following items came to our attention involving primarily operational matters, which if improved, will result in more efficient and effective operations:

Status of Prior Year Comments and Recommendations

All prior year comments and recommendations have been addressed.

Current Year Recommendations

Capital Asset Renewal and Replacement

The Village Community Development District No. 3 (the District) has a very large investment in infrastructure that is all debt financed and likely to require significant ongoing renewal and replacements over time as these assets age. Accordingly, we recommend that the District continue its existing efforts to develop a comprehensive capital improvement plan that would identify the timetable and funding source for all significant items likely to require renewal or replacement.

The District should also review policies and procedures in effect to ensure that all significant items of tangible personal property are inventoried annually and that capital asset retirements are communicated and recorded in the accounting records.

Restatement of Government-wide Net Assets – Special Assessments

The beginning net assets of the number districts have been restated to include the recognition of special assessment revenues that should have been recognized on the accrual basis at the government-wide level in prior years. The calculation of the special assessment receivable balances for the restatements were based upon the amount of bonds outstanding net of unapplied bond prepayments, which is believed to give an accurate receivable balance. We recommend that the District verify the balance of special assessments recorded in the financial statements based upon subsidiary receivable records to corroborate the balance calculated based upon the bond balance outstanding method.

This management letter comments is intended solely for the information and use of the Board of Supervisors, management, the State of Florida and other governmental agencies and is not intended to be and should not be used by anyone other than these specified parties.

We would like to take this opportunity to express our appreciation for the courtesies that have been extended to our staff. If you have any questions or comments about the contents of this letter, please do not hesitate to contact us.

January 26, 2007
Ocala, Florida

Purvis, Gray and Company, LLP

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Board of Supervisors
Village Community Development District No. 3
The Villages, Florida

Response to Management Letter Comments

- **Capital Asset Renewal and Replacement**
Management agrees and will begin implementation of procedures to comply with the recommendations.
- **Restatement of Government Wide Net Assets**
Management agrees and will implement for the current fiscal year.