SUN COMMUNITIES INC
Form 10-K
February 25, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012.
Commission file number 1-12616

SUN COMMUNITIES, INC.
(Exact Name of Registrant as Specified in its Charter)

Maryland	38-2730780
(State of Incorporation)	(I.R.S. Employer Identification No.)
27777 Franklin Rd.	
Suite 200	
Southfield, Michigan	48034
(Address of Principal Executive Offices)	(Zip Code)
(248) 208-2500	
(Registrant's telephone number, including area code)	
Common Stock, Par Value $0.01 per Share	New York Stock Exchange
Securities Registered Pursuant to Section 12(b) of the Act	Name of each exchange on which registered
7.125% Series A Cumulative Redeemable Preferred Stock, Par Value $0.01 per Share	New York Stock Exchange
Securities Registered Pursuant to Section 12(b) of the Act	Name of each exchange on which registered

Securities Registered Pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [X] No [ ]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. Yes [ ] No [X]

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. (Check one):
Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes[ ] No [X]

As of June 30, 2012, the aggregate market value of the Registrant’s stock held by non-affiliates was approximately $1,100,729,025 (computed by reference to the closing sales price of the Registrant’s common stock as of June 30, 2012). For this computation, the Registrant has excluded the market value of all shares of common stock reported as beneficially owned by executive officers and directors of the Registrant; such exclusion shall not be deemed to constitute an admission that any such person is an affiliate of the Registrant.

Number of shares of Common Stock, $0.01 par value per share, outstanding as of February 15, 2013: 31,642,521

SUN COMMUNITIES, INC.

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SUN COMMUNITIES, INC.

PART I

ITEM 1. BUSINESS

GENERAL

Sun Communities, Inc., a Maryland corporation, together with the Sun Communities Operating Limited Partnership, a Michigan limited partnership (the “Operating Partnership”) and other consolidated subsidiaries are referred to herein as the “Company”, “us”, “we”, and “our”. We are a self-administered and self-managed real estate investment trust (“REIT”).

We are a fully integrated real estate company which, together with our affiliates and predecessors, has been in the business of acquiring, operating, developing and expanding manufactured housing and recreational vehicle ("RV") communities since 1975. We lease individual parcels of land (“sites”) with utility access for placement of manufactured homes and RVs to our customers. We are also engaged through a taxable subsidiary, Sun Home Services, Inc., a Michigan corporation (“SHS”), in the marketing, selling, and leasing of new and pre-owned homes to current and future residents in our communities. The operations of SHS support and enhance our occupancy levels, property performance, and cash flows.

We own, operate, and develop manufactured housing and RV communities concentrated in the midwestern, southern, and southeastern United States. As of December 31, 2012, we owned and operated a portfolio of 173 properties located in 19 states (the “Properties”, or “Property”), including 149 manufactured housing communities, 13 RV communities, and 11 Properties containing both manufactured housing and RV sites. As of December 31, 2012, the Properties contained an aggregate of 63,697 developed sites comprised of 52,833 developed manufactured home sites, 4,904 permanent RV sites, 5,960 transient RV sites, and approximately 6,900 additional manufactured home sites suitable for development.

Our executive and principal property management office is located at 27777 Franklin Road, Suite 200, Southfield, Michigan 48034 and our telephone number is (248) 208-2500. We have regional property management offices located in Austin, Texas; Dayton, Ohio; Grand Rapids, Michigan; Elkhart, Indiana; and Orlando, Florida; and we employed an aggregate of 915 full and part time employees as of December 31, 2012.

Our website address is www.suncommunities.com and we make available, free of charge, on or through our website all of our periodic reports, including our annual report on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, as soon as reasonably practicable after we file such reports with the Securities and Exchange Commission.

STRUCTURE OF THE COMPANY

The Operating Partnership is structured as an umbrella partnership REIT, or UPREIT. In 1993, we contributed our net assets to the Operating Partnership in exchange for the sole general partner interest in the Operating Partnership and the majority of all the Operating Partnership’s initial capital. We substantially conduct our operations through the Operating Partnership. The Operating Partnership owns, either directly or indirectly through subsidiaries, all of our assets. This UPREIT structure enables us to comply with certain complex requirements under the federal tax rules and regulations applicable to REITs, and to acquire manufactured housing and RV communities in transactions that defer some or all of the sellers’ tax consequences. The financial results of the Operating Partnership and our other subsidiaries are consolidated in our consolidated financial statements. The financial results include certain activities that do not necessarily qualify as REIT activities under the Internal Revenue Code of 1986, as amended (the “Code”). We have formed taxable REIT subsidiaries, as defined in the Code, to engage in such activities. We use taxable REIT subsidiaries to offer certain services to our residents and engage in activities that would not otherwise be permitted under the REIT rules if provided directly by us or by the Operating Partnership. The taxable REIT subsidiaries include our home sales business, SHS, which provides manufactured home sales, leasing and other services to current and prospective tenants of the Properties.

We do not own all of the OP Units. As of December 31, 2012, the Operating Partnership had issued and outstanding 31,824,586 common OP Units, 3,400,000 7.125% Series A Cumulative Redeemable Preferred OP Units (the "7.125% Series A OP Units"), 1,325,275 preferred OP Units ("Aspen preferred OP Units"), 455,476 Series A-1 preferred OP Units, and 112,400 Series B-3 preferred OP Units. As of December 31, 2012, we held 29,755,264 common OP Units, or approximately 93.5% of the issued and outstanding common OP Units, all of the issued and outstanding 7.125% Series A OP Units, and no Aspen preferred OP Units, Series A-1 preferred OP Units or Series B-3 preferred OP Units. In addition, on February 8, 2013, the Operating Partnership created a new class of OP Units designated as Series A-3 Preferred Units (the "Series A-3 preferred OP Units") and issued all of the authorized 40,267.50 Series A-3 preferred OP Units to a third party.

SUN COMMUNITIES, INC.

Subject to certain limitations, the holder of each common OP Unit at its option may convert such common OP Unit at any time into one share of our common stock. The holders of common OP Units receive distributions on the same dates and in amounts equal to the dividends paid to holders of our common stock.

Subject to certain limitations, at any time prior to January 1, 2024, the holder of each Aspen preferred OP Unit at its option may convert such Aspen preferred OP Unit into: (a) if the market price of our common stock is $68.00 per share or less, 0.397 common OP Units, or (b) if the market price of our common stock is greater than $68.00 per share, that number of common OP Units determined by dividing (i) the sum of (A) $27.00 plus (B) 25% of the amount by which the market price of our common stock exceeds $68.00 per share, by (ii) the per-share market price of our common stock. The holders of Aspen preferred OP Units generally receive distributions on the same dates as distributions are paid to holders of common OP Units. Each Aspen preferred OP Unit is entitled to receive distributions in an amount equal to the product of (x) $27.00, multiplied by (y) an annual rate equal to the 10-year United States Treasury bond yield plus 239 basis points; provided, however, that the aggregate distribution rate shall not be less than 6.5% nor more than 9%. On January 2, 2024, we are required to redeem all Aspen preferred OP Units that have not been converted to common OP Units. In addition, we are required to redeem the Aspen preferred OP Units of any holder thereof within five days after receipt of a written demand during the existence of certain uncured Aspen preferred OP Unit defaults, including our failure to pay distributions on the Aspen preferred OP Units when due and our failure to provide certain security for the payment of distributions on the Aspen preferred OP Units. We may also redeem Aspen preferred OP Units from time to time if we and the holder thereof agree to do so.

Subject to certain limitations, the holder of each Series A-1 preferred OP Unit at its option may exchange such Series A-1 preferred OP Unit at any time on or after December 31, 2013, into 2.439 shares of our common stock (which exchange rate is subject to adjustment upon stock splits, recapitalizations and similar events). The holders of Series A-1 preferred OP Units generally receive distributions on the same dates as distributions are paid to holders of common OP Units. Each Series A-1 preferred OP Unit is entitled to receive distributions in an amount equal to the product of $100.00 multiplied by an annual rate equal to 5.1% until June 23, 2013, and an annual rate equal to 6.0% thereafter.

Series B-3 preferred OP Units are not convertible. The holders of Series B-3 preferred OP Units generally receive distributions on the same dates as distributions are paid to holders of common OP Units. Each Series B-3 preferred OP Unit is entitled to receive distributions in an amount equal to the product of $100.00 multiplied by an annual rate equal to 8.0%. As of November 5, 2012, there were outstanding 36,700 Series B-3 preferred OP Units which were issued on December 1, 2002, 33,450 Series B-3 preferred OP Units which were issued on January 1, 2003, and 42,250 Series B-3 preferred OP Units which were issued on January 5, 2004. Subject to certain limitations, (x) during the 90-day period beginning on each of the tenth through fifteenth anniversaries of the issue date of the applicable Series B-3 preferred OP Units, (y) at any time after the fifteenth anniversary of the issue date of the applicable Series B-3 preferred OP Units, or (z) after our receipt of notice of the death of the electing holder of a Series B-3 preferred OP Unit, each holder of Series B-3 preferred OP Units may require us to redeem such holder's Series B-3 preferred OP Units at the redemption price of $100.00 per unit. In addition, at any time after the fifteenth anniversary of the issue date of the applicable Series B-3 preferred OP Units we may redeem, at our option, all of the Series B-3 preferred OP Units of any holder thereof at the redemption price of $100.00 per unit.
In connection with the issuance of the 7.125% Series A Cumulative Redeemable Preferred Stock ("Series A Preferred Stock"), the Operating Partnership created the 7.125% Series A OP Units as a new class of OP Units. All of the outstanding 7.125% Series A OP Units are held by us and they have rights, preferences and other terms substantially similar to the Series A Preferred Stock, including rights to receive distributions at the same time and in the same amounts as dividends paid on Series A Preferred Stock. The Operating Partnership issued the 7.125% Series A OP Units to us in consideration of our contributing to the Operating Partnership the net proceeds of our November 2012 offering of shares of Series A Preferred Stock. The 7.125% Series A OP Units rank senior in all respects to the Aspen preferred OP Units, the Series A-1 preferred OP Units, the Series A-3 preferred OP Units, the Series B-3 preferred OP

Units and the common OP Units. So long as any Aspen preferred OP Units remain issued and outstanding, the Operating Partnership may not issue any OP Units that are not junior to the Aspen preferred OP Units, without the written consent of holders of a majority of the Aspen preferred OP Units. Holders of a majority of the Aspen preferred OP Units have consented to the issuance of up to $150.0 million in OP Units senior to the Aspen preferred OP Units, including the 7.125% Series A OP Units issued to us. Holders of a majority of the Aspen preferred OP Units have previously consented to the issuance of up to approximately an additional $54.5 million of OP Units that are pari passu with the Aspen preferred OP Units.

SUN COMMUNITIES, INC.

Subject to certain limitations, including certain contractual restrictions contained in the related acquisition agreemnts, the holder of each Series A-3 preferred OP Unit at its option may exchange such Series A-3 preferred OP Unit at any time into 1.8605 shares of our common stock (which exchange rate is subject to adjustment upon stock splits, recapitalizations and similar events). The holders of Series A-3 preferred OP Units generally receive distributions on the same dates as distributions are paid to holders of common OP Units. Each Series A-3 preferred OP Unit is entitled to receive distributions in an amount equal to the product of $100.00 multiplied by an annual rate equal to 4.5%.

THE MANUFACTURED HOUSING COMMUNITY

A manufactured housing community is a residential subdivision designed and improved with sites for the placement of manufactured homes and related improvements and amenities. Manufactured homes are detached, single family homes which are produced off site by manufacturers and installed on sites within the community. Manufactured homes are available in a wide array of designs, providing owners with a level of customization generally unavailable in other forms of multi-family housing developments.

Modern manufactured housing communities, such as the Properties, contain improvements similar to other garden style residential developments, including centralized entrances, paved streets, curbs and gutters, and parkways. In addition, these communities also often provide a number of amenities, such as a clubhouse, a swimming pool, shuffleboard courts, tennis courts, and laundry facilities.

The owner of each home on our Properties leases the site on which the home is located. We own the underlying land, utility connections, streets, lighting, driveways, common area amenities and other capital improvements and are responsible for enforcement of community guidelines and maintenance. Some of the Properties provide water and sewer service through public or private utilities, while others provide these services to residents from on site facilities. Each owner of a home within our Properties is responsible for the maintenance of the home and leased site. As a result, capital expenditure needs tend to be less significant relative to multi family rental apartment complexes.

PROPERTY MANAGEMENT

Our property management strategy emphasizes intensive, hands on management by dedicated, on site district and community managers. We believe that this on site focus enables us to continually monitor and address resident concerns, the performance of competitive properties and local market conditions. As of December 31, 2012, we employed 915 full and part time employees, of which 748 were located on site as property managers, support staff, or maintenance personnel.

Our community managers are overseen by John B. McLaren, our Chief Operating Officer, who has been in the manufactured housing industry since 1995, four Senior Vice Presidents of Operations and Sales, two Division Vice Presidents and 18 Regional Vice Presidents. The Regional Vice Presidents are responsible for semi-annual market surveys of competitive communities, interaction with local manufactured home dealers and regular property inspections.

Each district or community manager performs regular inspections in order to continually monitor the Property's physical condition and to effectively address tenant concerns. In addition to a district or community manager, each district or property has on-site maintenance personnel and management support staff. We hold mandatory training sessions for all new property management personnel to ensure that management policies and procedures are executed effectively and professionally. All of our property management personnel participate in on-going training to ensure that changes to management policies and procedures are implemented consistently. We offer nearly 300 courses for our team members through our Sun University, which has led to increased knowledge and accountability for daily operations and policies and procedures.

HOME SALES AND LEASING

SHS is engaged in the marketing, selling and leasing of new and pre-owned homes to current and future residents in our communities. Since tenants often purchase a home already on-site within a community, such services enhance occupancy and property performance. Additionally, because many of the homes on the Properties are sold through SHS, better control of home quality in our communities can be maintained than if sales services were conducted solely through third-party brokers. SHS also leases homes to prospective tenants. At December 31, 2012, SHS had 8,110 occupied leased homes in its portfolio. Homes for this rental program (the "Rental Program") are purchased at discounted rates from finance companies that hold repossessed homes within our communities. New homes are purchased as necessary to supplement these repossessed home purchases. Leases associated with the Rental Program generally have a term of one year. This program requires intensive management of costs associated with repair and refurbishment of these homes as the tenants vacate and the homes are re-leased, similar to apartment rentals. We have added repair and service supervisors in areas with high concentrations of rental homes to aggressively pursue cost containment programs. The program is a strategic response to capture the value inherent in the purchase of substantially discounted repossessed homes in our communities. We receive approximately 27,000 applications each year to live in our Properties, providing a significant "resident boarding" system allowing us to market purchasing a home to the best applicants and to rent to the remainder of approved applicants. Through the Rental Program we are able to demonstrate our product and lifestyle to the renters, while monitoring their payment history and converting qualified renters to owners.

REGULATIONS AND INSURANCE

General

Manufactured housing and RV community properties are subject to various laws, ordinances and regulations, including regulations relating to recreational facilities such as swimming pools, clubhouses and other common areas. We believe that each Property has the necessary operating permits and approvals.

Insurance

Our management believes that the Properties are covered by adequate fire, flood (where appropriate), property and business interruption insurance provided by reputable companies with commercially reasonable deductibles and limits. We maintain a blanket policy that covers all of our Properties. We have obtained title insurance insuring fee title to the Properties in an aggregate amount which we believe to be adequate. Claims made to our insurance carriers that are determined to be recoverable are classified in other receivables as incurred.

SITE LEASES OR USAGE RIGHTS

The typical lease we enter into with a tenant for the rental of a manufactured home site is month to month or year to year, renewable upon the consent of both parties, or, in some instances, as provided by statute. A small number of our leases, mainly Florida properties, are tied to consumer price index or other indices as it relates to rent increase. Generally, market rate adjustments are made on an annual basis. These leases are cancelable for non payment of rent, violation of community rules and regulations or other specified defaults. During the five calendar years ended December 31, 2012, on average 2.5 percent of the homes in our communities have been removed by their owners and 5.1 percent of the homes have been sold by their owners to a new owner who then assumes rental obligations as a community resident. The cost to move a home is approximately $4,000 to $10,000. The average resident remains in our communities for approximately 20 years, while the average home, which gives rise to the rental stream, remains in our communities for approximately 40 years.

At Properties zoned for RV use, our customers have short-term (“transient”) usage rights or long-term (“permanent”) usage rights. The transient RV customers typically prepay for their stay or leave deposits to reserve a site for the following year, whereas the permanent RV customers prepay or pay on a monthly basis. Many of these RV customers do not live full time on the Property.

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains various “forward-looking statements” within the meaning of the United States Securities Act of 1933, as amended, and the United States Securities Exchange Act of 1934, as amended, and we intend that such forward-looking statements will be subject to the safe harbors created thereby. For this purpose, any statements contained in this filing that relate to expectations, beliefs, projections, future plans and strategies, trends or prospective events or developments and similar expressions concerning matters that are not historical facts are deemed to be forward-looking statements. Words such as “forecasts,” “intends,” “intend,” “intended,” “goal,” “estimate,”

“estimates,” “expects,” “expect,” “expected,” “project,” “projected,” “projections,” “plans,” “predicts,” “potential,” “seeks,” “a
“anticipated,” “should,” “could,” “may,” “will,” “designed to,” “foreseeable future,” “believe,” “believes,” “scheduled” and sir
expressions are intended to identify forward-looking statements, although not all forward looking statements contain these words. These forward-looking statements reflect our current views with respect to future events and financial performance, but involve known and unknown risks and uncertainties, both general and specific to the matters discussed in this filing. These risks and uncertainties may cause our actual results to be materially different from any future results expressed or implied by such forward-looking statements. In addition to the risks disclosed under “Risk Factors” contained in this Annual Report on Form 10-K and our other filings with the Securities and Exchange Commission, such risks and uncertainties include:

- changes in general economic conditions, the real estate industry and the markets in which we operate;

- difficulties in our ability to evaluate, finance, complete and integrate acquisitions, developments and expansions successfully;

- our liquidity and refinancing demands;
- our ability to obtain or refinance maturing debt;
- our ability to maintain compliance with covenants contained in our debt facilities;
- availability of capital;
- difficulties in completing acquisitions;
- our failure to maintain effective internal control over financial reporting and disclosure controls and procedures;
- increases in interest rates and operating costs, including insurance premiums and real property taxes;
- risks related to natural disasters;
- general volatility of the capital markets and the market price of shares of our capital stock;
- our failure to maintain our status as a REIT;
- changes in real estate and zoning laws and regulations;
- legislative or regulatory changes, including changes to laws governing the taxation of REITs;
- litigation, judgments or settlements;
- our ability to maintain rental rates and occupancy levels;
- competitive market forces; and
- the ability of manufactured home buyers to obtain financing and the level of repossessions by manufactured home lenders

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made. We undertake no obligation to publicly update or revise any forward-looking statements included or incorporated by reference into this filing, whether as a result of new information, future events, changes in our expectations or otherwise.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. All written and oral forward-looking statements attributable to us or persons acting on our behalf are qualified in their entirety by these cautionary statements.

SUN COMMUNITIES, INC.

ITEM 1A. RISK FACTORS

Our prospects are subject to certain uncertainties and risks. Our future results could differ materially from current results, and our actual results could differ materially from those projected in forward looking statements as a result of certain risk factors. These risk factors include, but are not limited to, those set forth below, other one time events, and important factors disclosed previously and from time to time in our other filings with the Securities and Exchange Commission.

REAL ESTATE RISKS

General economic conditions and the concentration of our properties in Michigan, Florida, Indiana, and Texas may affect our ability to generate sufficient revenue.

The market and economic conditions in our current markets generally, and specifically in metropolitan areas of our current markets, may significantly affect manufactured home occupancy or rental rates. Occupancy and rental rates, in turn, may significantly affect our revenues, and if our communities do not generate revenues sufficient to meet our operating expenses, including debt service and capital expenditures, our cash flow and ability to pay or refinance our debt obligations could be adversely affected. We derive significant amounts of our rental income from properties located in Michigan, Florida, Indiana, and Texas. As of December 31, 2012, 73 of our 173 Properties, representing approximately 38% of developed sites, are located in Michigan; 27 Properties, representing approximately 20% of developed sites, are located in Florida; 18 Properties, representing approximately 10% of developed sites, are located in Indiana; and 18 Properties, representing approximately 9% of developed sites, are located in Texas. As a result of the geographic concentration of our Properties in Michigan, Florida, Indiana, and Texas, we are exposed to the risks of downturns in the local economy or other local real estate market conditions which could adversely affect occupancy rates, rental rates, and property values of properties in these markets.

Our income would also be adversely affected if tenants were unable to pay rent or if sites were unable to be rented on favorable terms. If we were unable to promptly relet or renew the leases for a significant number of the sites, or if the rental rates upon such renewal or reletting were significantly lower than expected rates, then our business and results of operations could be adversely affected. In addition, certain expenditures associated with each Property (such as real estate taxes and maintenance costs) generally are not reduced when circumstances cause a reduction in income from the Property. Furthermore, real estate investments are relatively illiquid and, therefore, will tend to limit our ability to vary our portfolio promptly in response to changes in economic or other conditions.

The following factors, among others, may adversely affect the revenues generated by our communities:

- the national and local economic climate which may be adversely impacted by, among other factors, plant closings, and industry slowdowns;
- local real estate market conditions such as the oversupply of manufactured housing sites or a reduction in demand for manufactured housing sites in an area;
- the number of repossessed homes in a particular market;
- the lack of an established dealer network;
- the rental market which may limit the extent to which rents may be increased to meet increased expenses without decreasing occupancy rates;
- the perceptions by prospective tenants of the safety, convenience and attractiveness of our Properties and the neighborhoods where they are located;

- zoning or other regulatory restrictions;
- competition from other available manufactured housing communities and alternative forms of housing (such as apartment buildings and site built single family homes);
- our ability to provide adequate management, maintenance and insurance;

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SUN COMMUNITIES, INC.

REAL ESTATE RISKS, CONTINUED

- increased operating costs, including insurance premiums, real estate taxes, and utilities; and

- the enactment of rent control laws or laws taxing the owners of manufactured homes.

Competition affects occupancy levels and rents which could adversely affect our revenues.

All of our Properties are located in developed areas that include other manufactured housing community properties. The number of competitive manufactured housing community properties in a particular area could have a material adverse effect on our ability to lease sites and increase rents charged at our Properties or at any newly acquired properties. We may be competing with others with greater resources and whose officers and directors have more experience than our officers and directors. In addition, other forms of multi family residential properties, such as private and federally funded or assisted multi family housing projects and single family housing, provide housing alternatives to potential tenants of manufactured housing communities.

Our ability to sell or lease manufactured homes may be affected by various factors, which may in turn adversely affect our profitability.

SHS operates in the manufactured home market offering manufactured home sales and leasing services to tenants and prospective tenants of our communities. The market for the sale and lease of manufactured homes may be adversely affected by the following factors:

- downturns in economic conditions which adversely impact the housing market;

- an oversupply of, or a reduced demand for, manufactured homes;

- the difficulty facing potential purchasers in obtaining affordable financing as a result of heightened lending criteria; and

- an increase or decrease in the rate of manufactured home repossessions which provide aggressively priced competition to new manufactured home sales.

Any of the above listed factors could adversely impact our rate of manufactured home sales and leases, which would result in a decrease in profitability.

Increases in taxes and regulatory compliance costs may reduce our revenue.

Costs resulting from changes in real estate laws, income taxes, service or other taxes, generally are not passed through to tenants under leases and may adversely affect our funds from operations and our ability to pay or refinance our debt. Similarly, changes in laws increasing the potential liability for environmental conditions existing on properties or increasing the restrictions on discharges or other conditions may result in significant unanticipated expenditures, which would adversely affect our business and results of operations.

We may not be able to integrate or finance our expansion and development activities.

From time to time, we engage in the construction and development of new communities or expansion of existing communities, and may continue to engage in the development and construction business in the future. Our development and construction business may be exposed to the following risks which are in addition to those risks associated with the ownership and operation of established manufactured housing communities:

- we may not be able to obtain financing with favorable terms for community development which may make us unable to proceed with the development;

- we may be unable to obtain, or face delays in obtaining, necessary zoning, building and other governmental permits and authorizations, which could result in increased costs and delays, and even require us to abandon development of the community entirely if we are unable to obtain such permits or authorizations;

- we may abandon development opportunities that we have already begun to explore and as a result we may not recover expenses already incurred in connection with exploring such development opportunities;

SUN COMMUNITIES, INC.

REAL ESTATE RISKS, CONTINUED

- we may be unable to complete construction and lease up of a community on schedule resulting in increased debt service expense and construction costs;

- we may incur construction and development costs for a community which exceed our original estimates due to increased materials, labor or other costs, which could make completion of the community uneconomical and we may not be able to increase rents to compensate for the increase in development costs which may impact our profitability;

- we may be unable to secure long term financing on completion of development resulting in increased debt service and lower profitability; and

- occupancy rates and rents at a newly developed community may fluctuate depending on several factors, including market and economic conditions, which may result in the community not being profitable.

If any of the above occurred, our business and results of operations could be adversely affected.

We may not be able to integrate or finance our acquisitions and our acquisitions may not perform as expected.

We have acquired and intend to continue to acquire manufactured housing and RV communities on a select basis. Our acquisition activities and their success are subject to the following risks:

- we may be unable to acquire a desired property because of competition from other well capitalized real estate investors, including both publicly traded real estate investment trusts and institutional investment funds;

- even if we enter into an acquisition agreement for a property, it is usually subject to customary conditions to closing, including completion of due diligence investigations to our satisfaction, which may not be satisfied;

- even if we are able to acquire a desired property, competition from other real estate investors may significantly increase the purchase price;

- we may be unable to finance acquisitions on favorable terms;

- acquired properties may fail to perform as expected;

- acquired properties may be located in new markets where we face risks associated with a lack of market knowledge or understanding of the local economy, lack of business relationships in the area and unfamiliarity with local governmental and permitting procedures; and

-
10,377
-
20,754
Water tap fees recognized
-
3,573
49,948
7,147
Other
31,597

21,238
58,019
52,961
Total revenues
844,661
237,078
1,854,793
436,177

Expenses:

Water service operations
(136,804)
(77,701)
(488,619)
(157,566)
Wastewater service operations
(8,684)
(7,393)
(14,671)
(14,969)
Depletion and depreciation
(44,196)
(67,575)
(100,142)
(109,380)
Other
(24,127)
(16,011)
(40,579)
(32,272)
Total cost of revenues
(213,811)
(168,680)
(644,011)
(314,187)
Gross profit
630,850
68,398
1,210,782
121,990

General and administrative expenses
(519,626)
(449,545)
(1,180,608)
(892,787)
Depreciation
(125,537)
(74,267)
(244,577)
(148,255)
Operating loss
(14,313)
(455,414)
(214,403)
(919,052)

Other income (expense):

Oil and gas lease income, net
13,933
6,000
23,222
11,265
Oil and gas royalty income, net
49,778
71,275
91,540
139,403
Interest income
52,512
66,098
106,974
139,665
Other
(2,588)
(2,600)
(5,203)
(5,215)
Net income (loss) from continuing operations
99,322
(314,641)
2,130

(633,934)
Income (loss) from discontinued operations, net of taxes
840
(2,649)
1,421
(21,329)
Net income (loss)
$100,162
$(317,290)
$3,551
$(655,263)
Unrealized holding gains (losses)
11,096
(12,682)
30,718
(34,892)
Total comprehensive income (loss)
$111,258
$(329,972)
$34,269
$(690,155)

Basic and diluted net income (loss) per common share

Income (loss) from continuing operations
*
$(0.01)
*
$(0.03)
Income (loss) from discontinued operations
*
*
*
*
Net income (loss)
*
$(0.01)
*
$(0.03)

Weighted average common shares outstanding–basic	23,760,765	23,754,098	23,757,431	23,754,098
Weighted average common shares outstanding–diluted	23,915,194	23,814,351	23,893,272	23,813,529

* Amount is less than $.01 per share

See accompanying Notes to Consolidated Financial Statements

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PURE CYCLE CORPORATION
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
Three months ended February 28, 2018
(unaudited)

	Preferred Stock		Common Stock		Additional Paid-in	Other Comprehensive	Accumulated	
	Shares	Amount	Shares	Amount	Capital	(Loss) Income	Deficit	Total
August 31, 2017 balance:	432,513	$433	23,754,098	$79,185	$171,431,486	$(11,105)	$(103,993,900)	$67,506,099
Stock option exercises			10,000	$33	$74,967			75,000
Share-based compensation	–	–	–	–	157,578	–	–	157,578
Adoption of accounting standards	–	–	–	–	–	–	1,055,049	1,055,049
Net income	–	–	–	–	–	–	3,551	3,551
Unrealized holding gain on investments	–	–	–	–	–	30,718	–	30,718
February 28, 2018 balance:	432,513	$433	23,764,098	$79,218	$171,664,031	$19,613	$(102,935,300)	$68,827,995

See accompanying Notes to Consolidated Financial Statements

3

PURE CYCLE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six Months Ended February 28,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$3,551	$(655,263)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and depletion	344,716	257,639
Equity loss in Well Enhancement Recovery Systems, LLC	5,204	4,267
Share-based compensation expense	157,578	104,495
Interest income and other non-cash items	30,508	(34,997)
Interest added to receivable from related parties	(15,057)	(12,476)
Changes in operating assets and liabilities:		
Trade accounts receivable	(245,765)	102,670
Prepaid expenses	(1,091,882)	(134,927)
Notes receivable - related parties	(60,244)	(53,608)
Accounts payable and accrued liabilities	(328,982)	(185,377)
Deferred revenues	-	(27,902)
Deferred oil and gas lease payment	143,978	(12,000)
Net cash used in operating activities from continuing operations	(1,056,395)	(647,479)
Net cash provided by operating activities from discontinued operations	16,650	111,180
Net cash used in operating activities	(1,039,745)	(536,299)
Cash flows from investing activities:		
Sale (purchase) of short-term investments, net	2,928,145	7,218,350
Purchase of long-term investments	(1,244,889)	-
Investments in water, water systems, and land	(1,769,695)	(4,596,397)
Purchase of property and equipment	(160,699)	(29,542)
Net cash (used in) provided by investing activities	(247,138)	2,592,411
Cash flows from financing activities:		
Issuance of note receivable - related parties	(1,490,000)	-
Proceeds from note receivable - related parties	215,504	-
Proceeds from the issuance of stock	75,000	-
Payments to contingent liability holders	(1,621)	(1,909)
Net cash used in financing activities	(1,201,117)	(1,909)
Net change in cash and cash equivalents	(2,488,000)	2,054,203
Cash and cash equivalents – beginning of period	5,575,823	4,697,288

Cash and cash equivalents – end of period	$3,087,823	$6,751,491
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES		
Investments in water assets through accounts payable	$-	$1,141,373

See accompanying Notes to Consolidated Financial Statements

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PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2018

NOTE 1 – PRESENTATION OF INTERIM INFORMATION

The February 28, 2018 consolidated balance sheet, the consolidated statements of operations and comprehensive income (loss) for the three and six months ended February 28, 2018 and 2017, the consolidated statement of shareholders' equity for the six months ended February 28, 2018, and the consolidated statements of cash flows for the six months ended February 28, 2018 and 2017 have been prepared by Pure Cycle Corporation (the "Company") and have not been audited. The unaudited consolidated financial statements include all adjustments that are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows at February 28, 2018, and for all periods presented. As described in Revenue Recognition and Recently Issued Accounting Pronouncements below, the Company early adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), using the modified retrospective method.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended August 31, 2017 (the "2017 Annual Report") filed with the Securities and Exchange Commission (the "SEC") on November 15, 2017. The results of operations for interim periods presented are not necessarily indicative of the operating results for the full fiscal year. The August 31, 2017 balance sheet was derived from the Company's audited consolidated financial statements.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid debt instruments with original maturities of three months or less. The Company's cash equivalents are comprised entirely of money market funds maintained at a reputable financial institution. At various times during the three months ended February 28, 2018, the Company's main operating account exceeded federally insured limits. The Company has never suffered a loss due to such excess balance.

Investments

Management determines the appropriate classification of its investments in certificates of deposit and debt and equity securities at the time of purchase and re-evaluates such determinations each reporting period.

Certificates of deposit and debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. The Company has $1,428,000 of investments classified as held-to-maturity at February 28, 2018, which represent certificates of deposit and a U.S. Treasury note with maturity dates after February 28, 2019. Securities that the Company does not have the positive intent or ability to hold to maturity, including certificates of deposit, debt securities and any investments in equity securities, are classified as available-for-sale. Securities classified as available-for-sale are marked-to-market at each reporting period. Changes in value of such securities are recorded as a component of Accumulated other comprehensive income (loss). The cost of securities sold is based on the specific identification method. The Company's certificates of deposit and treasury securities mature at various dates through March 2019.

Concentration of Credit Risk and Fair Value

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and investments. From time to time, the Company places its cash in money market instruments, certificates of deposit and U.S. government treasury obligations. To date, the Company has not experienced significant losses on any of these investments.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value.

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Cash and Cash Equivalents – The Company’s cash and cash equivalents are reported using the values as reported by the financial institution where the funds are held. These securities primarily include balances in the Company’s operating and savings accounts. The carrying amounts of cash and cash equivalents approximate fair value.

Trade Accounts Receivable – The Company records accounts receivable net of allowances for uncollectible accounts.

Investments – The carrying amounts of investments approximate fair value. Investments are described further in Note 2 – Fair Value Measurements.

Accounts Payable – The carrying amounts of accounts payable approximate fair value due to the relatively short period to maturity for these instruments.

Long-Term Financial Liabilities – The Comprehensive Amendment Agreement No. 1 (the “CAA”) is comprised of a recorded balance sheet and an off-balance sheet or “contingent” obligation associated with the Company’s acquisition of its “Rangeview Water Supply” (defined in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report). The amount payable is a fixed amount but is repayable only upon the sale of “Export Water” (defined in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report). Because of the uncertainty of the sale of Export Water, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. The CAA is described further in Note 4 – Long-Term Obligations and Operating Lease – Participating Interests in Export Water Supply.

Notes Receivable – Related Parties – The market value of the notes receivable – related parties from Rangeview Metropolitan District (the “Rangeview District”), Sky Ranch Metropolitan District No. 5 and the Sky Ranch Community Authority Board, an entity formed by Sky Ranch Metropolitan District Nos. 1 and 5 (the "CAB") as described fruther in Note 6 - Related Party Transactions, are not practical to estimate due to the related party nature of the underlying transactions.

Off-Balance Sheet Instruments – The Company’s off-balance sheet instruments consist entirely of the contingent portion of the CAA. Because repayment of this portion of the CAA is contingent on the sale of Export Water, which is not reasonably estimable, the Company has determined that the contingent portion of the CAA does not have a determinable fair value. See further discussion in Note 4 – Long-Term Obligations and Operating Lease – Participating Interests in Export Water Supply.

Revenue Recognition

The Company disaggregates revenue by major product line as reported on the consolidated statements of operations and comprehensive income (loss).

Comparative results for the three and six months ended February 28, 2018 and 2017 differ due to the adoption by the Company of ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), as of September 1, 2017. Prior to the adoption of ASU 2014-09, proceeds from tap fees and construction fees were deferred upon receipt and recognized in income either upon completion of construction of infrastructure or ratably over time, depending on whether the Company owned the infrastructure constructed with the proceeds or a customer owned the infrastructure constructed with the proceeds. Tap and construction fees derived from agreements in which the Company would not own the assets constructed with the fees were recognized as revenue using the percentage-of-completion method. Tap and construction fees derived from agreements for which the Company would own the infrastructure were recognized as revenues ratably over the estimated accounting service life of the facilities constructed, starting at completion of construction, which could be in excess of 30 years.

As described in Recently Issued Accounting Pronouncements below, the Company has completed its review of the adoption of ASU 2014-09 and the related impact on each of the Company's revenue streams (water and wastewater usage fees, consulting fees, tap fees, special facility or construction fees, and oil and gas revenues). Upon completion of the Company's evaluation of the standard, the Company determined to early adopt the new revenue recognition standard beginning September 1, 2017, in accordance with the transition provisions in ASU 2014-09, utilizing the modified retrospective method. The Company's analysis concluded that the adoption did have a material impact on the 2018 financial statements.

The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The most significant impact of the standard relates to the Company' accounting for tap fees and special facility or construction fees, which revenues are expected to be recognized in earlier periods under the new revenue standard. Revenue recognition related to the Company's water and wastewater usage fees, consulting fees and oil and gas royalty or lease payments will remain substantially unchanged.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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Wholesale Water and Wastewater Fees – Monthly wholesale water usage charges are assessed to the Company's customers based on actual metered usage each month plus a base monthly service fee. The Company recognizes wholesale water usage revenues upon delivering water to its customers or its governmental customer's end-use customers, as applicable. Sales of Export Water are invoiced directly by the Company, and revenues recognized by the Company are shown gross of royalties to the State of Colorado Board of Land Commissioners (the "Land Board"). Sales of water on the "Lowry Range" (described in Note 4 – Water and Land Assets under "Rangeview Water Supply and Water System" of the 2017 Annual Report) are invoiced directly by the Rangeview District, and the Rangeview District pays a percentage of such collections to the Company. Water revenues recognized from sales on the Lowry Range are shown net of royalties paid to the Land Board and amounts retained by the Rangeview District. The Company recognized $804,800 and $190,700 of metered water usage revenues during the three months ended February 28, 2018 and 2017, respectively. The Company recognized $1,726,400 and $331,800 of metered water usage revenues during the six months ended February 28, 2018 and 2017, respectively.

The Company recognizes wastewater treatment fees monthly based on usage. The monthly wastewater treatment fees are shown net of amounts retained by Rangeview. The Company recognized $9,300 and $11,200 of wastewater treatment fees during the three months ended February 28, 2018 and 2017, respectively. The Company recognized $20,500 and $23,500 of wastewater treatment fees during the six months ended February 28, 2018 and 2017, respectively. Costs of delivering water and providing wastewater services to customers are recognized as incurred.

Tap Fees – The Company has various water and wastewater service agreements, components of which may include tap fees. A tap fee constitutes a right to connect to the Company's wholesale water and wastewater systems through a service line to a residential or commercial building or property, and once granted, the customer may make a physical tap into the wholesale line(s) to connect its property for water and/or wastewater service. Once connected to the water and/or wastewater systems, the customer has live service to receive metered water deliveries and send wastewater. Thus, the customer has full control of the connection right as it has the ability to obtain all of the benefits from this right. As such, management has determined that tap fees are separate and distinct performance obligations.

The Company recognizes water tap fees as revenue at the time the Company grants a right for the customer to tap into the water service line to obtain water service. The Company recognized $0 and $3,600 of water tap fee revenues during the three months ended February 28, 2018 and 2017, respectively. The Company recognized $49,900 and $7,100 of water tap fee revenues during the six months ended February 28, 2018 and 2017, respectively. The water tap fees recognized during these periods are net of the royalty payments to the Land Board and amounts paid to third parties pursuant to the CAA as further described in Note 4 – Long-Term Obligations and Operating Lease below.

The Company recognizes construction fees, including fees received to construct "Special Facilities" (defined in Part I, Item 1 of the 2017 Annual Report), on a percentage-of-completion basis as the construction is completed. Special Facilities are facilities that enable water to be delivered to a single customer. Management has determined that Special Facilities are separate and distinct performance obligations. The Company recognized $10,400 and $20,800 of Special Facilities funding as revenue during the three and six months ended February 28, 2017, respectively. No Special Facilities revenue has been recognized during the three or six months ended February 28, 2018. The 2017 amounts are the ratable portion of the Special Facilities funding, or construction fees, received from water agreements as more fully described in Note 2 – Summary of Significant Accounting Policies in Part II, Item 8 of the 2017 Annual Report.

As of February 28, 2018, and August 31, 2017, the Company has deferred recognition of approximately $0 and $1,055,500, respectively, of water tap and construction fee revenue.

Consulting Fees – Consulting fees are fees the Company receives, typically on a monthly basis, from municipalities and area water providers along the I-70 corridor, for contract operations services. Consulting fees are recognized monthly based on a flat monthly fee plus charges for additional work performed. The Company recognized $31,600 and $21,200 of consulting fees during the three months ended February 28, 2018 and 2017, respectively. The Company recognized $58,000 and $53,000 of consulting fees during the six months ended February 28, 2018 and 2017, respectively.

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Lot Sales – The Company owns 931 acres of land zoned as a Master Planned Community along the I-70 corridor east of Denver, Colorado, known as Sky Ranch. We have entered into purchase and sale agreements with three separate home builders pursuant to which the Company agreed to sell, and each builder agreed to purchase, residential lots at the property. The Company began construction of lots on March 1, 2018 and will segment its reporting of the activity relating to the costs and revenues from the construction and sale of lots at Sky Ranch. The Company did not recognize any lot sales during the six months ended February 28, 2018.

The Company sells lots at Sky Ranch pursuant to distinct agreements with each builder. These agreements follow one of two formats. One format is the sale of a finished lot, whereby the purchaser pays for a finished lot which is ready to build and the payment is a lump-sum payment upon completion of the finished lot. The Company will recognize revenues from the sale of finished lots at the time of sale as the transaction cycle will be complete with the delivery of a finished lot and the Company will have no further obligations.

The Company's second format for the sale of lots is pursuant to a development agreement with builders, whereby the Company will recognize revenues in stages that include (i) payment upon the delivery of platted lots (which requires the Company to deliver deeded title to individual lots), (ii) a second payment at the completion of certain infrastructure milestones, and (iii) final payment at the delivery of the finished lot. Under the development agreement format, the Company will defer the receipt of revenues from the first two milestones and recognize the full revenue from the sale of the lot once the Company completes all contractual commitments concurrent with the final delivery of the finished lot.

Royalty and Other Obligations

Revenues from the sale of Export Water are shown gross of royalties payable to the Land Board. Revenues from the sale of water on the “Lowry Range” (described in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report) are shown net of the royalties to the Land Board and the amounts retained by the Rangeview District.

Oil and Gas Lease Payments

As further described in Note 2 – Summary of Significant Accounting Policies in Part II, Item 8 of the 2017 Annual Report, in March 2011, the Company entered into a Paid-Up Oil and Gas Lease and a Surface Use and Damage Agreement that were subsequently purchased by a wholly owned subsidiary of ConocoPhillips Company. Two wells were drilled within the Company’s mineral interest and in March 2015 were placed into service and began producing oil and gas and accruing royalties to the Company. During the three months ended February 28, 2018 and 2017, the Company received $49,800 and $71,300 net of taxes, respectively, in royalties attributable to these two wells. During the six months ended February 28, 2018 and 2017, the Company received $91,500 and $139,400 net of taxes, respectively, in royalties attributable to these two wells. The Company classifies income from oil and gas lease and royalty payments as Other Income in the statement of operations and comprehensive income (loss) as the Company does not consider these arrangements to be an operating business activity.

On October 5, 2017, the Company entered into a Paid-Up Oil and Gas Lease with Bison Oil and Gas, LLP, for the purpose of exploring for, developing, producing, and marketing oil and gas on the 40 acres of mineral estate the Company owns adjacent to the Lowry Range (the “Bison Lease”). Pursuant to the Bison Lease, the Company received an up-front payment of $167,200, which will be recognized as income on a straight-line basis over three years (the term of the Bison Lease). The Company recognized $13,900 and $23,200 during the three and six months ended

February 28, 2018, respectively, of lease income related to the up-front payment received pursuant to the Bison Lease. As of February 28, 2018, the Company has deferred recognition of $144,000 of income related to the Bison Lease which will be recognized into income ratably through September 2020.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the eventual use of the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Capitalized Costs of Water and Wastewater Systems and Depletion and Depreciation of Water Assets

Costs to construct water and wastewater systems that meet the Company's capitalization criteria are capitalized as incurred, including interest, and depreciated on a straight-line basis over their estimated useful lives of up to 30 years. The Company capitalizes design and construction costs related to construction activities, and it capitalizes certain legal, engineering and permitting costs relating to the adjudication and improvement of its water assets. The Company depletes its groundwater assets that are being utilized on the basis of units produced (i.e., thousands of gallons sold) divided by the total volume of water adjudicated in the water decrees.

Capitalized Lot Development Costs and Public Improvement Loans at Sky Ranch

Capitalized lot development costs at Sky Ranch are costs incurred to construct lots at Sky Ranch that meet the Company's capitalization criteria for improvements to a lot and are capitalized as incurred, including interest. The Company capitalizes certain legal, engineering, design, permitting, land acquisition, and construction costs related to the development of lots at Sky Ranch. We use the specific identification method for purposes of accumulating land development costs and allocate costs to each lot to determine the cost basis for each lot sale. We will record all land cost of sales when a lot is closed on a lot-by-lot basis.

Additionally, the Company will fund certain costs related to the development of public improvements, such as drainage improvements, storm water improvements, roadways, curb and gutter improvements, parks and open spaces, etc. These costs are incurred by the CAB and funds for these improvements are advanced by the Company to the CAB under a Project Funding and Reimbursement Agreement which acts as a loan of funds from the Company to the CAB and earns interest at the rate of 6%. As homes are sold, the Sky Ranch Metropolitan Districts will develop assessed value in the community and levy mills against the assessed value to generate property tax revenues to the Sky Ranch Metropolitan Districts that can be used to fund the CAB to repay the Company's loan advances. These loan advances are recorded as a note receivable and accrue interest from the time of the loan.

Share-Based Compensation

The Company maintains a stock option plan for the benefit of its employees and non-employee directors. The Company records share-based compensation costs as expense over the applicable vesting period of the stock award using the straight-line method. The compensation costs to be expensed are measured at the grant date based on the fair value of the award. The Company has adopted the alternative transition method for calculating the tax effects of share-based compensation, which allows for a simplified method of calculating the tax effects of employee share-based compensation. Because the Company has a full valuation allowance on its deferred tax assets, the granting and exercise of stock options has no impact on the income tax provisions. The Company recognized $77,400 and $64,500 of share-based compensation expense during the three months ended February 28, 2018 and 2017, respectively, and $157,600 and $104,500 of share-based compensation expense during the six months ended February 28, 2018 and 2017, respectively.

Income Taxes

The Company uses a "more-likely-than-not" threshold for the recognition and de-recognition of tax positions, including any potential interest and penalties relating to tax positions taken by the Company. The Company did not have any significant unrecognized tax benefits as of February 28, 2018.

Due to the complexities involved in accounting for the recently enacted Tax Cuts and Jobs Act (the "Tax Act"), the SEC’s Staff Accounting Bulletin No. 118 (“SAB 118”) requires that the Company include in its financial statements the reasonable estimate of the impact of the Tax Act on earnings to the extent such estimate has been determined. Pursuant to SAB 118, the Company is allowed a measurement period of up to one year after the enactment date of the Tax Act to finalize the recording of the related tax impacts. The final impact on the Company from the Tax Act may differ from the aforementioned estimates due to the complexity of calculating and supporting with primary evidence, changes in interpretations of the Tax Act, future legislative action to address questions that arise because of the Tax Act, changes in accounting standards for income taxes or related interpretations in response to the Tax Act, or any updates or changes to estimates the Company has utilized to calculate the reasonable estimate. The Company’s deferred tax asset and full valuation allowance was decreased by approximately $1 million as a result of the decreased corporate tax rate. The Company will continue to evaluate the impact of the Tax Act and will record any resulting tax adjustments during 2018.

PURE CYCLE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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The Company files income tax returns with the Internal Revenue Service and the State of Colorado. The tax years that remain subject to examination are fiscal year 2014 through fiscal year 2017. The Company does not believe there will be any material changes in its unrecognized tax positions over the next 12 months.

The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. At February 28, 2018, the Company did not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any interest expense recognized during the three months ended February 28, 2018 or 2017.

Discontinued Operations

In August 2015, the Company sold substantially all of its Arkansas River water and land properties. Pursuant to the terms of the purchase and sale agreement, the Company continued to manage and receive the lease income associated with such properties until December 31, 2015. The operating results and the assets and liabilities of the discontinued operations, which formerly comprised the agricultural segment, are presented separately in the Company's consolidated financial statements. Summarized financial information for the discontinued agricultural business is shown below. Prior period balances have been reclassified to present the operations of the agricultural business as a discontinued operation.

Discontinued Operations Income Statement

	Three Months Ended February 28,		Six Months Ended February 28,	
	2018	2017	2018	2017
Farm revenues	$840	$6,034	$1,421	$6,034
Farm expenses	-	-	-	-
Gross profit	840	6,034	1,421	6,034
General and administrative expenses	-	17,104	-	36,730
Operating profit (loss)	840	(11,070)	1,421	(30,696)
Finance charges	-	8,421	-	9,367
Income (loss) from discontinued operations	$840	$(2,649)	$1,421	$(21,329)

The Company anticipates continued expenses through calendar 2018 related to the discontinued operations. The Company will continue to incur expenses (including property taxes) related to the remaining agricultural land the Company continues to own and for the purpose of collecting outstanding receivables.

The individual assets and liabilities of the discontinued agricultural business are combined in the captions “Assets of discontinued operations held for sale” and “Liabilities of discontinued operations” in the consolidated balance sheet. The carrying amounts of the major classes of assets and liabilities included as part of the discontinued business are presented in the following table:

Discontinued Operations Balance Sheet

	February 28, 2018	August 31, 2017
Assets:		
Trade accounts receivable	$91,100	$110,700
Land held for sale (*)	450,600	450,600
Total assets	$541,700	$561,300
Liabilities:		
Accrued liabilities	$8,600	$11,200
Total liabilities	$8,600	$11,200

(*) Land Held for Sale. During the fiscal quarter ended November 30, 2015, the Company purchased three farms totaling 700 acres for approximately $450,600. The farms were acquired in order to correct dry-up covenant issues related to water only farms in order to obtain the release of the escrow funds related to the Company’s farm sale to Arkansas River Farms, LLC. The Company intends to sell the farms in due course and has classified the farms as long-term assets.

Income (Loss) per Common Share

Income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares outstanding during each period. Common stock options and warrants aggregating 535,500 and 480,500 common share equivalents were outstanding as of February 28, 2018 and 2017, respectively, and have been included in the calculation of net income per common share but excluded from the calculation of loss per common share as their effect is anti-dilutive.

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Recently Issued Accounting Pronouncements

The Company continually assesses any new accounting pronouncements to determine their applicability. When it is determined that a new accounting pronouncement affects the Company's financial reporting, the Company undertakes a study to determine the consequence of the change to its consolidated financial statements and ensure that there are proper controls in place to ascertain that the Company's consolidated financial statements properly reflect the change. New pronouncements assessed by the Company recently are discussed below:

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842). ASU 2016-02 provides guidance on the recognition, measurement, presentation, and disclosure of leases. The new standard supersedes the present GAAP standard on leases and requires substantially all leases to be reported on the balance sheet as right-of-use assets and lease obligations. This standard is effective for fiscal years beginning after December 15, 2018. The Company is currently assessing the impact of ASU 2016-02.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825). ASU No. 2016-01 revises the classification and measurement of investments in certain equity investments and the presentation of certain fair value changes for certain financial liabilities measured at fair value. ASU No. 2016-01 requires the change in fair value of many equity investments to be recognized in net income. This standard is effective for interim and annual periods beginning after December 15, 2017, with early adoption permitted. Adopting ASU No. 2016-01 will result in an adjustment for any unrealized gains and losses on available-for-sale securities that are equity instruments as of the beginning of the year of adoption.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. ASU 2014-15 describes how an entity's management should assess, considering both quantitative and qualitative factors, whether there are conditions and events that raise substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued, which represents a change from the existing literature that requires consideration about an entity's ability to continue as a going concern within one year after the balance sheet date. The standard was effective for the Company on September 1, 2017. The adoption of ASU 2014-15 did not have a material impact on the Company's financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), that requires recognition of revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which a company expects to be entitled in exchange for those goods or services. The FASB has also issued several updates to ASU 2014-09. The standard supersedes ASU No. 2009-13, Revenue Recognition (Topic 605) ("ASC 605") and requires the use of more estimates and judgments than do the present standards. It also requires additional disclosures. The Company has completed its review of the adoption of ASU 2014-09 and the related impact on each of the Company's revenue streams (water and wastewater usage fees, consulting fees, tap fees, special facility or construction fees, and oil and gas revenues). Upon completion of the Company's evaluation of the standard, the Company determined to early adopt the new revenue recognition standard beginning September 1, 2017, in accordance with the transition provisions in ASU 2014-09, utilizing the modified retrospective method. The Company concluded that the adoption did have a material impact on the Company's financial statements.

The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The cumulative effect of the changes made to the Company's consolidated September 1, 2017 balance sheet for the adoption of ASU 2014-09 were as follows:

	Balance at August 31, 2017	Adjustments Due to ASU 2014-09	Balance at September 1, 2017
Balance Sheet			
Assets			
Deferred tax assets (Deferred revenue)	$316,400	$(316,400)	$-
Deferred tax assets - valuation allowance (Deferred revenue)	(316,400)	316,400	-
Liabilities			
Deferred revenues	$55,800	$(55,800)	$-
Deferred revenues, less current portion	999,249	(999,249)	-
Equity			
Accumulated deficit	$(103,993,900)	$1,055,049	$(102,938,851)

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In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on the Company's consolidated statements of operations and comprehensive income (loss) and balance sheet was as follows:

For the Six Months Ended February 28, 2018

	As Reported	Amounts that would have been reported under ASC 605	Effect of Change Higher/(Lower)
Income statement			
Revenues			
Special facility fees	$-	$20,754	$(20,754)
Water tap fees	49,948	57,095	(7,147)
Net income	$3,551	$31,452	$(27,901)

As of February 28, 2018

	As Reported	Amounts that would have been reported under ASC 605 (1)	Effect of Change Higher/(Lower)
Balance Sheet			
Liabilities			
Deferred revenues	$-	$55,800	$(55,800)
Deferred revenues, less current portion	-	999,249	(999,249)
Deferred oil and gas lease payment (1)	55,733	55,733	-
Deferred oil and gas lease payment, less current portion	88,244	88,244	-

Equity			
Accumulated deficit	$(102,935,300)	$(103,962,448)	$1,027,148

(1)
Inclusive of the Bison Lease deferred oil and gas lease payment and water tap and construction fee deferred revenues as described in the 2017 Annual Report.

Revenue recognition related to the Company’s water and wastewater usage, consulting revenues and oil and gas revenues will remain substantially unchanged. The most significant impact of the standard relates to the Company’s accounting for water and wastewater tap fees and special facility/construction fees, which revenues will be recognized in earlier periods when performance obligations are complete under the new revenue standard.

NOTE 2 – FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or most advantageous market. The Company uses a fair value hierarchy that has three levels of inputs, both observable and unobservable, with use of the lowest possible level of input to determine where within the fair value hierarchy the measurment falls.

Level 1 — Valuations for assets and liabilities traded in active exchange markets, such as the NASDAQ Stock Market. The Company had no Level 1 assets or liabilities as of February 28, 2018 or August 31, 2017.

Level 2 — Valuations for assets and liabilities obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The Company had 17 and 56 Level 2 assets as of February 28, 2018 and August 31, 2017, respectively, which consist of certificates of deposit, U.S. Treasury bills and U.S. Treasury notes.

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Level 3 — Valuations for assets and liabilities that are derived from other valuation methodologies, including discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker-traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities. The Company had one Level 3 liability, the contingent portion of the CAA, as of February 28, 2018 and August 31, 2017. The Company has determined that the contingent portion of the CAA does not have a determinable fair value (see Note 4 – Long-Term Obligations and Operating Lease).

The Company maintains policies and procedures to value instruments using what management believes to be the best and most relevant data available.

Level 2 Asset – Available for Sale Securities. The Company's available for sale securities are the Company's only financial asset measured at fair value on a recurring basis. The fair value of the available for sale securities is based on the values reported by the financial institutions where the funds are held. These securities include only federally insured certificates of deposit and U.S. Treasury bills and notes.

The Company's non-financial assets measured at fair value on a non-recurring basis consist entirely of its investments in water and water systems, land held for sale, and other long-lived assets. See Note 3 – Water and Land Assets below.

The following table provides information on the assets and liabilities measured at fair value on a recurring basis as of February 28, 2018:

			Fair Value Measurement Using:			
		Cost / Other	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs	Accumulated Unrealized Gains and
	Fair Value	Value	(Level 1)	(Level 2)	(Level 3)	(Losses)
Certificates of deposit	$1,246,500	$1,250,000	$-	$1,246,500	$-	$(3,500)
U.S. treasuries	15,885,900	15,862,300	-	15,885,900	-	23,600
Subtotal	$17,132,400	$17,112,300	$-	$17,132,400	$-	$20,100
Long-term investments	1,427,700	1,428,200	-	1,427,700	-	(500)
Total	$18,560,100	$18,540,500	$-	$18,560,100	$-	$19,600

The following table provides information on the assets and liabilities measured at fair value on a recurring basis as of August 31, 2017:

			Fair Value Measurement Using:			
	Fair Value	Cost / Other Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Accumulated Unrealized Gains and (Losses)
Certificates of deposit	$12,673,700	$12,694,500	$-	$12,673,700	$-	$(20,800)
U.S. treasuries	7,381,700	7,372,000	-	7,381,700	-	9,700
Subtotal	$20,055,400	$20,066,500	$-	$20,055,400	$-	$(11,100)
Long-term investments	188,000	188,000	-	188,000	-	-
Total	$20,243,400	$20,254,500	$-	$20,243,400	$-	$(11,100)

NOTE 3 – WATER AND LAND ASSETS

The Company’s water rights and current water and wastewater service agreements are more fully described in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report. There have been no significant changes to the Company’s water rights or water and wastewater service agreements during the six months ended February 28, 2018.

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Investment in Water and Water Systems

The Company's Investments in Water and Water Systems consist of the following costs and accumulated depreciation and depletion at February 28, 2018 and August 31, 2017:

	February 28, 2018		August 31, 2017	
	Costs	Accumulated Depreciation and Depletion	Costs	Accumulated Depreciation and Depletion
Rangeview water supply	$14,794,700	$(11,700)	$14,529,600	$(10,600)
Sky Ranch water rights and other costs	6,772,300	(488,400)	6,725,000	(436,300)
Fairgrounds water and water system	2,899,900	(1,018,900)	2,899,900	(974,800)
Rangeview water system	1,639,000	(234,100)	1,639,000	(207,000)
WISE partnership	3,114,100	-	3,114,100	-
Water supply – other	1,049,200	(455,300)	944,800	(401,300)
Wild Pointe service rights	1,631,800	(227,000)	1,631,700	(213,000)
Sky Ranch pipeline	4,697,800	(117,500)	4,700,000	(39,200)
Construction in progress	861,300	-	673,800	-
Totals	37,460,100	(2,552,900)	36,857,900	(2,282,200)
Net investments in water and water systems	$34,907,200		$34,575,700	

Capitalized terms in this section not defined herein are defined in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report.

Depletion and Depreciation

The Company recorded depletion charges of $900 and $200 during the three months ended February 28, 2018 and 2017, respectively. The Company recorded depletion charges of $1,000 and $500 during the six months ended February 28, 2018 and 2017, respectively. During the three and six months ended February 28, 2018, the depletion was related entirely to the "Lowry Water Supply." The Lowry Water Supply is defined as the "Rangeview Water Supply" and described in detail in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report.

The Company recorded $169,700 and $141,800 of depreciation expense during the three months ended February 28, 2018 and 2017, respectively. The Company recorded $344,700 and $257,600 of depreciation expense during the six months ended February 28, 2018 and 2017, respectively. These figures include depreciation for other equipment not included in the table above.

NOTE 4 – LONG-TERM OBLIGATIONS AND OPERATING LEASE

The Participating Interests in Export Water Supply is an obligation of the Company that has no scheduled maturity date. Therefore, maturity of this liability is not disclosed in tabular format, but is described below.

Participating Interests in Export Water Supply

The Company acquired its Lowry Water Supply through various amended agreements entered into in the early 1990s. The acquisition was consummated with the signing of the CAA in 1996. Upon entering into the CAA, the Company recorded an initial liability of $11.1 million, which represented the cash the Company received from the participating interest holders that was used to purchase the Company’s Export Water (described in greater detail in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report). The Company agreed to remit a total of $31.8 million of proceeds received from the sale of Export Water to the participating interest holders in return for their initial $11.1 million investment. The obligation for the $11.1 million was recorded as debt, and the remaining $20.7 million contingent liability was not reflected on the Company’s balance sheet because the obligation to pay this is contingent on the sale of Export Water, the amounts and timing of which are not reasonably determinable.

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The CAA obligation is non-interest bearing, and if the Export Water is not sold, the parties to the CAA have no recourse against the Company. If the Company does not sell the Export Water, the holders of the Series B Preferred Stock are also not entitled to payment of any dividend and have no contractual recourse against the Company.

As the proceeds from the sale of Export Water are received and the amounts are remitted to the external CAA holders, the Company allocates a ratable percentage of this payment to the principal portion (the Participating Interests in Export Water Supply liability account), with the balance of the payment being charged to the contingent obligation portion. Because the original recorded liability, which was $11.1 million, was 35% of the original total liability of $31.8 million, approximately 35% of each payment remitted to the CAA holders is allocated to the recorded liability account. The remaining portion of each payment, or approximately 65%, is allocated to the contingent obligation, which is recorded on a net revenue basis.

From time to time, the Company reacquired various portions of the CAA obligations, which retained their original priority, including the Land Board's CAA interest which was assigned and relinquished to the Company in 2014. The Company did not make any CAA acquisitions during the three months ended February 28, 2018 and 2017.

As a result of the acquisitions, the Company is currently allocated approximately 88% of the total proceeds from the sale of Export Water after payment of the Land Board royalty. The acquisitions and cumulative sales of Export Water are detailed in the table below. The remaining potential third-party obligation at February 28, 2018, is approximately $1 million.

	Export Water Proceeds Received	Initial Export Water Proceeds to Pure Cycle	Total Potential Third-Party Obligation	Paticipating Interests Liability	Contingency
Original balances	$–	$218,500	$31,807,700	$11,090,600	$20,717,100
Activity from inception until August 31, 2017:					
Acquisitions	–	28,042,500	(28,042,500)	(9,790,000)	(18,252,500)
Relinquishment	–	2,386,400	(2,386,400)	(832,100)	(1,554,300)
Option payments - Sky Ranch and The Hills at Sky Ranch	110,400	(42,300)	(68,100)	(23,800)	(44,300)
Arapahoe County tap fees (1)	533,000	(373,100)	(159,900)	(55,800)	(104,100)
Export Water sale payments	676,500	(540,300)	(136,200)	(47,300)	(88,900)
Balance at August 31, 2017	1,319,900	29,691,700	1,014,600	341,600	673,000
Fiscal 2018 activity:					
Export Water sale payments	39,100	(34,400)	(4,700)	(1,600)	(3,100)
	$1,359,000	$29,657,300	$1,009,900	$340,000	$669,900

Balance at February
28, 2018

(1) The Arapahoe County tap fees are net of $34,522 in royalties paid to the Land Board.

The CAA includes contractually established priorities which call for payments to CAA holders in order of their priority. This means the first payees receive their full payment before the next priority level receives any payment and so on until full repayment. Of the next approximately $6.6 million of Export Water payouts, which at current levels would occur over several years, the Company will receive approximately $5.9 million of revenue. Thereafter, the Company will be entitled to all but approximately $220,000 of the proceeds from the sale of Export Water after deduction of the Land Board royalty.

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WISE Partnership

During December 2014, the Company, through Rangeview, consented to the waiver of all contingencies set forth in the Amended and Restated WISE Partnership – Water Delivery Agreement, dated December 31, 2013 (the "WISE Partnership Agreement"), among the City and County of Denver acting through its Board of Water Commissioners ("Denver Water"), the City of Aurora acting by and through its Utility Enterprise ("Aurora Water"), and the South Metro WISE Authority ("SMWA"). The SMWA was formed by Rangeview and nine other governmental or quasi-governmental water providers pursuant to the South Metro WISE Authority Formation and Organizational Intergovernmental Agreement, dated December 31, 2013 (the "SM IGA"), to enable the members of SMWA to participate in the regional water supply project known as the Water Infrastructure Supply Efficiency partnership ("WISE") created by the WISE Partnership Agreement. The SM IGA specifies each member's pro rata share of WISE and the members' rights and obligations with respect to WISE. The WISE Partnership Agreement provides for the purchase of certain infrastructure (i.e., pipelines, water storage facilities, water treatment facilities, and other appurtenant facilities) to deliver water to and among the 10 members of the SMWA, Denver Water and Aurora Water. Certain infrastructure has been constructed, and other infrastructure will be constructed over the next several years.

By consenting to the waiver of the contingencies set forth in the WISE Partnership Agreement, pursuant to the terms of the Rangeview/Pure Cycle WISE Project Financing Agreement (the "WISE Financing Agreement") between the Company and Rangeview, the Company has an agreement to fund Rangeview's participation in WISE effective as of December 22, 2014. The Company's cost of funding Rangeview's purchase of its share of existing infrastructure and future infrastructure for WISE and funding operations and water deliveries related to WISE is projected to be approximately $5.2 million over the next five years. See further discussion in Note 6 – Related Party Transactions.

Operating Lease

Effective February 2018, the Company entered into an operating lease for office space totaling approximately 11,393 square feet of office and warehouse space. The lease has a three-year term with payments of $6,600 per month and an option to extend the primary lease term for a two-year period at a rate equal to a 12.5% increase over the primary base payments. The change in the lease costs is not material to the Company's operations.

NOTE 5 – SHAREHOLDERS' EQUITY

The Company maintains the 2014 Equity Incentive Plan (the "2014 Equity Plan"), which was approved by shareholders in January 2014 and became effective April 12, 2014. Executives, eligible employees, consultants and non-employee directors are eligible to receive options and stock grants pursuant to the 2014 Equity Plan. Pursuant to the 2014 Equity Plan, options to purchase shares of stock and restricted stock awards can be granted with exercise prices, vesting conditions and other performance criteria determined by the Compensation Committee of the board of directors. The Company has reserved 1.6 million shares of common stock for issuance under the 2014 Equity Plan. The Company began awarding options under the 2014 Equity Plan during January 2015. Prior to the effective date of the 2014 Equity Plan, the Company granted stock awards to eligible participants under its 2004 Incentive Plan (the "2004 Incentive Plan"), which expired April 11, 2014. No additional awards may be granted pursuant to the 2004 Incentive Plan; however, awards outstanding as of April 11, 2014, will continue to vest and expire and may be exercised in accordance with the terms of the 2004 Incentive Plan.

The following table summarizes the combined stock option activity for the 2004 Incentive Plan and 2014 Equity Plan for the six months ended February 28, 2018:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Approximate Aggregate Instrinsic Value
Oustanding at August 31, 2017	465,500	$4.88	6.30	$1,007,740
Granted (1)	82,500	8.05		
Exercised	(10,000)	7.50		
Forfeited or expired	(2,500)	7.50		
Outstanding at February 28, 2018	535,500	$5.31	6.54	$1,439,840
Options exercisable at February 28, 2018	379,668	$4.66	5.46	$1,248,740

(1) Includes 50,000 shares granted to Mr. Harding on September 27, 2017 and 32,500 total shares granted to the board of directors on January 17, 2018.

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The following table summarizes the combined activity and value of non-vested options under the 2004 Equity Plan and 2014 Incentive Plan as of and for the six months ended February 28, 2018:

	Number of Options	Weighted-Average Grant Date Fair Value
Non-vested options oustanding at August 31, 2017	147,500	$3.64
Granted	82,500	4.41
Vested	(74,168)	2.84
Forfeited	-	-
Non-vested options outstanding at February 28, 2018	155,832	$3.76

All non-vested options are expected to vest.

Stock-based compensation expense was $77,400 and $64,500 for the three months ended February 28, 2018 and 2017, respectively. Stock-based compensation expense was $157,600 and $104,500 for the six months ended February 28, 2018 and 2017, respectively.

At February 28, 2018, the Company had unrecognized expenses relating to non-vested options that are expected to vest totaling $294,800. The weighted-average period over which these options are expected to vest is approximately two years.

NOTE 6 – RELATED PARTY TRANSACTIONS

The Rangeview District is a quasi-municipal corporation and political subdivision of Colorado formed in 1986 for the purpose of providing water and wastewater service to the Lowry Range and other approved areas. The Rangeview District is governed by an elected board of directors. Eligible voters and persons eligible to serve as a director of the Rangeview District must own an interest in property within the boundaries of the Rangeview District. The Company owns certain rights and real property interests which encompass the current boundaries of the Rangeview District. Sky Ranch Metropolitan District Nos. 1, 3, 4 and 5 are quasi-municipal corporations and political subdivisions of Colorado formed for the purpose of providing service to the Company's Sky Ranch property (the "Sky Ranch Districts"). The current members of the board of directors of the Rangeview District and Sky Ranch Districts consist of three employees of the Company and two independent board members.

On December 16, 2009, the Company entered into a Participation Agreement with the Rangeview District, whereby the Company agreed to provide funding to the Rangeview District in connection with the Rangeview District joining the South Metro Water Supply Authority ("SMWSA"). The Company provides funding pursuant to the Participation Agreement annually with an estimated 2018 funding amount of $22,200 and actual funding amount of $198,200 provided during the fiscal year 2017.

Through the WISE Financing Agreement, the Company agreed to fund the Rangeview District's cost of participating in the regional water supply project known as the WISE partnership. The Company anticipates spending approximately $5.2 million over the next five fiscal years to fund the Rangeview District's purchase of its share of the water transmission line and additional facilities, water and related assets for WISE and to fund operations and water deliveries related to WISE. To date, the Company has capitalized the funding provided pursuant to the WISE Financing Agreement because the funding has been provided to purchase capacity in the WISE infrastructure. Total investment in the WISE assets as of February 28, 2018 is approximately $3.1 million.

In 1995, the Company extended a loan to the Rangeview District. The loan provided for borrowings of up to $250,000, is unsecured, and bears interest based on the prevailing prime rate plus 2% (6.50% at February 28, 2018). The maturity date of the loan is December 31, 2020. In January 2014, the Rangeview District and the Company entered into a funding agreement that allows the Company to continue to provide funding to the Rangeview District for day-to-day operations and accrue the funding into a note that bears interest at a rate of 8% per annum and remains in full force and effect for so long as the 2014 Amended and Restated Lease Agreement remains in effect. The $851,700 balance of the notes receivable at February 28, 2018, includes borrowings of $463,600 and accrued interest of $388,100.

The Company has been providing funding to the Sky Ranch Districts. In each year, since 2012, the Company has entered into an Operation Funding Agreement with one of the Sky Ranch Districts obligating the Company to advance funding to the Sky Ranch District for operations and maintenance expenses for the then current calendar year. All payments are subject to annual appropriations by the Sky Ranch District in its absolute discretion. The advances by the Company accrue interest at a rate of 8% per annum from the date of the advance.

In November 2014, but effective as of January 1, 2014, the Company entered into a Facilities Funding and Acquisition Agreement with a Sky Ranch District obligating the Company to either finance district improvements or to construct improvements on behalf of the Sky Ranch District subject to reimbursement. Improvements subject to this agreement are determined pursuant to a mutually agreed upon budget. Each year in September, the parties are to mutually determine the improvements required for the following year and finalize a budget by the end of October. Each advance or reimbursable expense accrues interest at a rate of 8% per annum. Upon the Sky Ranch District's ratification of the advances and related expenditures, the amount is reclassified to long-term and is recorded as part of Notes receivable – related parties.

During the six months ended February 28, 2018, the Sky Ranch Districts repaid all advances plus accrued interest totaling $215,504, and as of the period then ended, there was no outstanding balance on the receivable.

In November 2017, but effective as of January 1, 2018, the Company entered into a Project Funding and Reimbursement Agreement with the CAB for the property within the boundaries and/or service area of the Sky Ranch Districts (the "Property"). Pursuant to that certain Community Authority Board Establishment Agreement (the "CABEA"), as the same may be amended from time to time, Sky Ranch Metropolitan District No. 1 and Sky Ranch Metropolitan District No. 5 formed the CAB to, among other things, design, construct, finance, operate and maintain certain public improvements for the benefit of the Property. In order for the public improvements to be constructed and/or acquired, it is necessary for each Sky Ranch District to be able to fund the improvements and pay its ongoing operations and maintenance expenses related to the provision of services that benefit the Property. Improvements subject to the Project Funding and Reimbursement Agreement are determined pursuant to a mutually agreed upon budget. Each advance or reimbursable expense accrues interest at a rate of 6% per annum. Upon the CAB's ratification of the advances and related expenditures, the amount is recorded as part of Notes receivable – related parties and reclassified from a short-term to a long-term asset.

During the three months ended February 28, 2018, the Company advanced the CAB $1.5 million to begin construction of improvements on the Property.

NOTE 7 – SIGNIFICANT CUSTOMERS

Pursuant to the Rangeview Water Agreements (defined in Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report) and an Export Service Agreement entered into with the Rangeview District dated June 16, 2017, the Company provides water and wastewater services on the Rangeview District's behalf to the Rangeview District's customers. Sales to the Rangeview District accounted for 4% and 27% of the Company's total water and wastewater revenues for the three months ended February 28, 2018 and 2017, respectively. Sales to the Rangeview District accounted for 5% and 28% of the Company's total water and wastewater revenues for the six months ended February 28, 2018 and 2017, respectively. The Rangeview District has one significant customer, the Ridgeview Youth Services Center. Rangeview's significant customer accounted for 4% and 16% of the Company's total water and wastewater revenues for the three months ended February 28, 2018 and 2017, respectively. Rangeview's significant customer accounted for 4% and 23% of the Company's total water and wastewater revenues for the six months ended February 28, 2018 and 2017, respectively.

Revenues related to the provision of water for the oil and gas industry to two customers accounted for 95% of the Company's water and wastewater revenues for the three months ended February 28, 2018. Revenues related to the provision of water for the oil and gas industry to three customers accounted for 93% of the Company's water and wastewater revenues for the six months ended February 28, 2018. Revenues related to the provision of water for the oil and gas industry to one customer accounted for 60% and 61% of the Company's water and wastewater revenues for the three and six months ended February 28, 2017, respectively.

The Company had accounts receivable from the Rangeview District which accounted for 24% and 50% of the Company's trade receivables balances at February 28, 2018 and August 31, 2017, respectively. The Company had accounts receivable from one other customer of 54% at February 28, 2018 and 46% at August 31, 2017. Accounts receivable from the Rangeview District's largest customer accounted for 15% and 19% of the Company's water and wastewater trade receivables as of February 28, 2018 and August 31, 2017, respectively.

NOTE 8 – ACCRUED LIABILITIES

At February 28, 2018, the Company had accrued liabilities of $85,100, of which $5,000 was for estimated property taxes, $39,900 was for professional fees, and $40,200 was for operating payables.

At August 31, 2017, the Company had accrued liabilities of $380,860, of which $265,000 was for accrued compensation, $5,000 was for estimated property taxes, $48,500 was for professional fees, and the remaining $62,400 was related to operating payables.

NOTE 9 – LITIGATION LOSS CONTINGENCIES

The Company has historically been involved in various claims, litigation and other legal proceedings that arise in the ordinary course of its business. The Company records an accrual for a loss contingency when its occurrence is probable and damages can be reasonably estimated based on the anticipated most likely outcome or the minimum amount within a range of possible outcomes. The Company makes such estimates based on information known about the claims and experience in contesting, litigating and settling similar claims. Disclosures are also provided for reasonably possible losses that could have a material effect on the Company's financial position, results of operations or cash flows. The Company is currently not aware of any probable or reasonably possible claims requiring disclosure or an accrual.

NOTE 10 – SEGMENT INFORMATION

Prior to the sale of the Company's agricultural assets and the residual operations through December 31, 2015, the Company operated primarily in two lines of business: (i) the wholesale water and wastewater business and (ii) the agricultural farming business. The Company has discontinued its agricultural farming operations. Currently the Company operates its wholesale water and wastewater services segment as its only line of business but anticipates it will report its land development activities at Sky Ranch as a separate segment in future filings. The wholesale water and wastewater services business includes selling water service to customers, which is then provided by the Company using water rights owned or controlled by the Company and developing infrastructure to divert, treat and distribute that water and collect, treat and reuse wastewater.

As part of the Company's Sky Ranch development, the Company entered into contracts for the sale of lots (see Note 1 –Presentation of Interim Information). The Company anticipates that the real estate sales will be a separate segment in fiscal 2018. As of February 28, 2018, there were no real estate revenues or profits, and the carrying cost of the real estate is less than 10% of the Company's total assets. Oil and gas royalties and licenses are a passive activity and not an operating business activity, and therefore, are not classified as a segment.

Item 2.
Management's Discussion and Analysis of Financial Condition and Results of Operations

OVERVIEW

The discussion and analysis below includes certain forward-looking statements that are subject to risks, uncertainties and other factors, as described in "Risk Factors" in our Annual Report on Form 10-K, that could cause our actual growth, results of operations, performance, financial position and business prospects and opportunities for this fiscal year and periods that follow to differ materially from those expressed in or implied by those forward-looking statements. Readers are cautioned that forward-looking statements contained in this Quarterly Report on Form 10-Q should be read in conjunction with our disclosure under the heading "Disclosure Regarding Forward-Looking Statements" below.

The following Management's Discussion and Analysis ("MD&A") is intended to help the reader understand our results of operations and financial condition and should be read in conjunction with the accompanying consolidated financial statements and the notes thereto and the financial statements and the notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended August 31, 2017 (the "2017 Annual Report"). This section focuses on the key indicators reviewed by management in evaluating our financial condition and operating performance, including the following:

Revenue generated from providing water and wastewater services;

Expenses associated with developing our water and land assets; and

Cash available to continue development of our land, water rights and service agreements.

Our MD&A section includes the following items:

Our Business – a general description of our business, our services and our business strategy.

Results of Operations – an analysis of our results of operations for the periods presented in our consolidated financial statements. We present our discussion in the MD&A in conjunction with the accompanying financial statements.

Liquidity, Capital Resources and Financial Position – an analysis of our cash position and cash flows, as well as a discussion of our financial obligations.

Critical Accounting Policies and Use of Estimates – a discussion of our critical accounting policies that require critical judgments, assumptions and estimates.

Our Business

Pure Cycle Corporation ("we," "us," or "our") is a Colorado corporation that (i) provides wholesale water and wastewater services to end-use customers of governmental entities and to commercial and industrial customers and (ii) is developing 931 acres of land zoned as a Master Planned Community along the I-70 corridor known as Sky Ranch.

Wholesale Water and Wastewater

Our utility services include water production, storage, treatment, bulk transmission to retail distribution systems, wastewater collection and treatment, irrigation water treatment and transmission, industrial water sales, construction management, billing and collection and emergency response.

We are a vertically integrated wholesale water and wastewater provider, which means we own or control substantially all assets necessary to provide wholesale water and wastewater services to our customers. This includes owning (i) water rights which we use to provide domestic, irrigation, and industrial water to our wholesale customers (we own surface water, groundwater, reclaimed water rights and storage rights); (ii) infrastructure (such as wells, diversion structures, pipelines, reservoirs and treatment facilities) required to withdraw, treat, store and deliver water; (iii) infrastructure required to collect, treat, store and reuse wastewater; and (iv) infrastructure required to treat and deliver reclaimed water for irrigation and industrial use.

We own or control directly or through our participation in regional water partnerships approximately 28,634 acre feet of tributary, non-tributary and not non-tributary groundwater rights and approximately 26,000 acre feet of adjudicated reservoir sites. This water is located in the southeast Denver metropolitan area. Most of our water is located at the Lowry Range, a 27,000-acre parcel of land owned by the State of Colorado Board of Land Commissioners (the “Land Board”). Our “Lowry Water Supply” consists of approximately 26,985 acre feet of water, 11,650 acre feet of which we own and can export from the Lowry Range (“Export Water”). Our Export Water consists of 10,000 acre feet of groundwater and 1,650 acre feet of average yield surface water, pending completion by the Land Board of documentation related to the exercise of our right to substitute 1,650 acre feet of our groundwater for a comparable amount of surface water. Additionally, assuming the completion of the substitution of groundwater for surface water, we hold the exclusive right to develop and deliver through the year 2081 the remaining 12,035 acre feet of groundwater and approximately 1,650 acre feet of average yield surface water to customers either on or off of the Lowry Range.

We currently provide wholesale water and wastewater service predominantly to two local governmental entity customers. Our largest wholesale domestic customer is the Rangeview Metropolitan District (the “Rangeview District”). We provide service to the Rangeview District and its end-use customers pursuant to the Rangeview Water Agreements (defined in Part I, Item 1 – Business – Our Water and Land Assets in the 2017 Annual Report). Through the Rangeview District, we serve 391 Single Family Equivalent (“SFE”) water connections and 157 SFE wastewater connections located in southeastern metropolitan Denver.

We also provide untreated water to industrial customers in the oil and gas industry located in our service areas and adjacent to our service areas for the purpose of hydraulic fracturing. Oil and gas operators have leased more than 135,000 acres within and adjacent to our service areas for the purpose of exploring oil and gas interests in the Niobrara and other formations, and this activity has led to varying water demands.

We plan to utilize our significant water assets along with our adjudicated reservoir sites to provide wholesale water and wastewater services to local governmental entities, which in turn will provide residential/commercial water and wastewater services to communities along the eastern slope of Colorado in the area generally referred to as the Front Range. Principally, we target the I-70 corridor, which is located east of downtown Denver and south of Denver International Airport. This area is predominantly undeveloped and is expected to experience substantial growth over the next 30 years. We also plan to continue to provide water service to commercial and industrial customers.

Sky Ranch

We also own 931 acres of land, zoned as a Master Planned Community along the I-70 corridor east of Denver, Colorado. In anticipation of developing this land, we have installed approximately ten miles of water transmission lines to connect our Lowry Range water system to Sky Ranch and have extended service lines to our initial phase of development at Sky Ranch.

In June 2017, we entered into purchase and sale agreements (collectively, the “Purchase and Sale Contracts”) with three separate home builders pursuant to which we agreed to sell, and each builder agreed to purchase, a certain number (totaling 506) of single-family, detached residential lots at the Sky Ranch property. Each builder is also required to purchase from the Rangeview District water and sewer taps for the lots. Each builder had a 60-day due diligence period which was extended, during which it had the right to terminate the Purchase and Sale Contract and receive a full refund of its earnest money deposit. On November 10, 2017, each builder completed its due diligence period and agreed to continue with its respective Purchase and Sale Contract.

We are obligated, pursuant to the Purchase and Sale Contracts, or separate Lot Development Agreements (the “Lot Development Agreements” and, together with the Purchase and Sale Contracts, the “Builder Contracts”), to construct infrastructure and other improvements, such as roads, curbs and gutters, park amenities, sidewalks, street and traffic signs, water and sanitary sewer mains and stubs, storm water management facilities, and lot grading improvements for delivery of finished lots to each builder. Pursuant to the Builder Contracts, we must cause the Rangeview District to install and construct off-site infrastructure improvements (i.e., a wastewater reclamation facility and wholesale water facilities) for the provision of water and wastewater service to the property. In conjunction with approvals with Arapahoe County for the Sky Ranch project, we and/or the Rangeview District and the Sky Ranch Metropolitan Districts, quasi-municipal corporations and political subdivisions of Colorado formed to provide service to the Sky Ranch property (the "Sky Ranch Districts"), are obligated to deposit into an account the anticipated costs to install and construct substantially all the off-site infrastructure improvements (which include drainage and storm water retention ponds and an entry roadway). The Rangeview and Sky Ranch off-site infrastructure improvements are estimated to cost approximately $10.2 million. We finance the obligations of the Rangeview District and the Sky Ranch Districts as described in Note 6 – Related Party Transactions to the accompanying consolidated financial statements.

We estimate that the development of the finished lots for the first phase (506 lots) of Sky Ranch will require total capital of approximately $27.8 million and that lot sales to home builders will generate gross proceeds of approximately $35 million, providing a projected margin on lots of approximately $7.2 million. The costs of developing lots and revenues from the sales of finished lots are expected to be incurred over several quarters and the timing of cash flows will include certain milestone deliveries, including, but not limited to, completion of governmental approvals, installation of improvements, and completion of lot deliveries. Utility revenues are derived from tap fees (which vary depending on lot size, house size, and amount of irrigated turf) and usage fees (which are monthly water and wastewater fees). The current Sky Ranch water tap fees are $26,650 (per SFE), and wastewater taps fees are $4,659 (per SFE).

Discontinued Agricultural Operations and Leasing

In 2015, we sold approximately 14,600 acres of real property located in southeastern Colorado and related water rights in the Fort Lyon Canal Company to Arkansas River Farms, LLC, and pursuant to the purchase and sale agreement, we retained our farm leasing operations through December 31, 2015, after which we discontinued our farm operations.

We continue to own approximately 700 acres of real property in this area and approximately 13,900 acres of mineral interests. We expect to liquidate the remaining 700 acres of property in due course and are holding the property as a long term-asset. We intend to hold the mineral interests for future development.

These land interests are described in the Land and Mineral Interests section of Note 4 – Water and Land Assets in Part II, Item 8 of the 2017 Annual Report.

Results of Operations

Executive Summary

The results of our operations for the three and six months ended February 28, 2018 and 2017 are as follows:

Table 1a - Summary of Results of Operations

	Three months ended February 28,			
	2018	2017	Change	% Change
Millions of gallons of water delivered	62.7	17.7	45.0	254%
Metered water usage revenues	$803,800	$190,700	$613,100	321%
Operating costs to deliver water	$136,800	$77,700	$59,100	76%
(excluding depreciation and depletion)				
Water delivery gross margin %	83%	59%		
Wastewater treatment revenues	$9,300	$11,200	$(1,900)	-17%
Operating costs to treat wastewater	$8,700	$7,400	$1,300	18%
Wastewater treatment gross margin %	6%	34%		
Other income	$31,600	$21,200	$10,400	49%
Other income costs incurred	$24,100	$16,000	$8,100	51%
Other income gross margin %	24%	25%		
Tap and specialty facility revenues	$-	$13,900	$(13,900)	-100%
General and administrative expenses	$519,600	$449,500	$70,100	16%
Net income (loss) from continuing operatons	$99,300	$(314,600)	$413,900	-132%
Net income (loss) from discontinued operations	$840	$(2,600)	$3,440	132%
Net income (loss)	$100,200	$(317,200)	$417,400	132%

Table 1b - Summary of Results of Operations

	Six months ended February 28,			
	2018	2017	Change	% Change

Millions of gallons of water delivered	140.2	35.6	104.6	294%
Metered water usage revenues	$1,726,300	$331,800	$1,394,500	420%
Operating costs to deliver water	$488,600	$157,600	$331,000	210%
(excluding depreciation and depletion)				
Water delivery gross margin %	72%	53%		
Wastewater treatment revenues	$20,500	$23,500	$(3,000)	-13%
Operating costs to treat wastewater	$14,700	$15,000	$(300)	-2%
Wastewater treatment gross margin %	28%	36%		
Other income	$58,000	$53,000	$5,000	9%
Other income costs incurred	$40,600	$32,300	$8,300	26%
Other income gross margin %	30%	39%		
Tap and specialty facility revenues	$49,900	$27,900	$22,000	79%
General and administrative expenses	$1,180,600	$892,800	$287,800	32%
Net income (loss) from continuing operatons	$2,100	$(633,900)	$636,000	-100%
Net income (loss) from discontinued operations	$1,400	$(21,300)	$22,700	107%
Net income (loss)	$3,500	$(655,200)	$658,700	101%

Changes in Revenues

Metered Water Usage Revenues – Our water service charges, which are used to defray the costs to operate and maintain the systems, include a fixed monthly fee and a fee based on actual amounts of metered water delivered, which is based on a tiered pricing structure that provides for higher prices as customers use greater amounts of water. We typically negotiate the terms of our rates and charges with our wholesale customers as a component of our service agreements prior to commencement of service. Our rates and charges for service on the Lowry Range are based on the average rates and charges of three surrounding water providers.

Water deliveries increased 254% and water revenues increased 321% during the three months ended February 28, 2018, as compared to the three months ended February 28, 2017. The increases in water deliveries and revenues are the result of an increase in demand for water for oil and gas operations, which is used primarily to frack wells drilled in the Niobrara formation. Water deliveries increased 294% and water revenues increased 420% during the six months ended February 28, 2018, compared to the six months ended February 28, 2017. This increase was due primarily to a higher demand for water by the oil and gas industry during the current six month period compared to the prior corresponding period. As a result of the difference in metered rates for fracking water compared to rates for tap customers, revenues received for fracking water have a greater margin. Increases and decreases in water deliveries charged at different rates will result in disproportionate increases and decreases in revenues. The following tables detail the sources of our sales, the number of kgal (1,000 gallons) sold, and the average price per kgal for the three and six months ended February 28, 2018 and 2017, respectively.

Table 2a - Water Revenue Summary

	Three months ended February 28,					
	2018			2017		
Customer Type	Sales	kgal	Average price per kgal	Sales	kgal	Average price per kgal
On Site	$25,900	1,967.9	$13.16	$44,000	1,434.4	$30.67
Export - Commercial	24,900	1,804.7	13.80	5,200	315.1	16.50
Fracking	753,000	58,968.5	12.77	141,500	13,350.1	10.60
	$803,800	62,741.1	$12.81	$190,700	15,099.6	$12.63

Table 2b - Water Revenue Summary

	Six months ended February 28,					
	2018			2017		
Customer Type	Sales	kgal	Average price per kgal	Sales	kgal	Average price per kgal
On Site	$66,500	8,951.4	$7.43	$85,700	10,430.6	$8.22
Export - Commercial	60,500	4,772.2	12.68	24,400	1,564.3	15.60
Fracking	1,599,300	126,519.9	12.64	221,700	20,988.8	10.56
	$1,726,300	140,243.5	$12.31	$331,800	32,983.7	$10.06

The gross margin on delivering water increased to 83% and 72% during the three and six months ended February 28, 2018, compared to 59% and 53% during the three and six months ended February 28, 2017, respectively. The change in our gross margin was due to an increased demand for water and our ability to apply the revenue from those deliveries to offset the fixed costs of the ECCV system (defined under Liquidity, Capital Resources and Financial Position below). Our current cost associated with the use of the system without any production is a flat fee of $8,000 per month. In addition, the ECCV system costs us approximately $6,870 per month to maintain. We had significant production through the ECCV system related to the oil and gas water deliveries for the three and six months ended February 28, 2018, which has positively impacted our gross margin.

Wastewater Treatment Revenues – Our wastewater customer is charged based on the estimated amount of wastewater treated. Wastewater fees decreased 17% and 13% during the three and six months ended February 28, 2018, respectively, as compared to the three months ended February 28, 2017, respectively. The decrease was primarily the result of decreased demand from our only wastewater customer. Wastewater operating costs and gross margin fluctuate based on timing of expenses and regulatory requirements, but generally fluctuate consistent with demand.

Tap and Special Facility/Construction Revenues – We have various water and wastewater service agreements, a component of which may include tap fee and special facility or construction fee revenues. We determined to early adopt Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), beginning September 1, 2017, in accordance with the transition provisions in ASU 2014-09, utilizing the modified retrospective method. ASU 2014-09 governs recognition of revenue from each of our revenue streams (water and wastewater usage fees, consulting fees, tap fees, special facility or construction fees, and oil and gas revenues).

The most significant impact of the standard relates to our accounting for tap fees and special facility or construction fees. Prior to the adoption of ASU 2014-09, proceeds from tap fees and construction fees were deferred upon receipt and recognized in income either upon completion of construction of infrastructure or ratably over time, depending on whether the Company or a customer owned the infrastructure constructed with the proceeds. Tap and construction fees derived from agreements in which the Company would not own the assets constructed with the fees were recognized as revenue using the percentage-of-completion method. Tap and construction fees derived from agreements for which the Company would own the infrastructure were recognized as revenues ratably over the estimated accounting service life of the facilities constructed, starting at completion of construction, which could be in excess of 30 years.

Following adoption of ASU 2014-09, tap fees are expected to be recognized once the tap fee has been paid and the customer has the right to receive water or wastewater service, and, once received, special facility fees or construction revenues are expected to be recorded as deferred revenue and recognized on a percentage-of-completion basis as the construction of the infrastructure is completed, regardless of whether the Company owns the assets. Once the infrastructure is completed, 100% of the deferred revenue will be recognized. We recognized the cumulative effect of applying the new revenue standard as an adjustment to the opening balance of accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. Comparative results for the three and six months ended February 28, 2018 and 2017 differ due to the adoption of ASU 2014-09.

We sold two tap fees during the six months ended February 28, 2018, recognizing revenues of $49,900. We did not sell any water or wastewater taps during the six months ended February 28, 2017; however, we recognized revenues of $3,600 and $7,200 for the three and six months ended February 28, 2017, respectively under the previous revenue recognition standard, ASU No. 2009-13, Revenue Recognition (Topic 605). The water tap fees to be recognized over these periods are net of the royalty payments to the Land Board and amounts paid to third parties pursuant to the "CAA," which is described in Note 4 – Long-Term Obligations and Operating Lease to the accompanying consolidated financial statements.

We did not recognize special facility fees for the three or six months ended February 28, 2018. Prior to the adoption of ASU 2014-09, we recognized approximately $10,300 and $20,700 of "Special Facilities" (defined in the 2017 Annual Report) funding as revenue during the three and six months ended February 28, 2017. This is the ratable portion of the Special Facilities funding proceeds received from Arapahoe County pursuant to a water service agreement as more fully described in Note 2 – Summary of Significant Accounting Policies to Part II, Item 8 of the 2017 Annual Report.

At February 28, 2018 and 2017, we had deferred recognition of approximately $0 and $1.0 million, respectively, of water tap and special facility/construction fee revenues.

Revenue recognition related to our water and wastewater usage fees, consulting fees, and oil and gas revenue will remain substantially unchanged.

Other Income – Other income of $31,600 and $21,200 for the three months ended February 28, 2018 and 2017, respectively, consisted principally of consulting fees. Other income consisted principally of consulting fees of $58,000 and $53,000 for the six months ended February 28, 2018 and 2017, respectively. Consulting fees fluctuate from one period to the other based on our customer’s needs.

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General and Administrative Expenses

Significant balances classified as general and administrative ("G&A") expenses for the three and six months ended February 28, 2018 and 2017, respectively, were:

Table 3a - Significant Balances in G&A

	Three months ended February 28,			
	2018	2017	$ Change	% Change
Salary and salary-related expenses:				
Including share-based compensation	$281,600	$274,500	$7,100	3%
Excluding share-based compensation	$204,200	$212,800	$(8,600)	-4%
Professional fees	$57,800	$56,164	$1,636	3%
Fees paid to directors (including insurance)	$41,300	$29,426	$11,874	40%
Public entity related expenses	$42,500	$21,400	$21,100	99%

Table 3b - Significant Balances in G&A

	Six months ended February 28,			
	2018	2017	$ Change	% Change
Salary and salary-related expenses:				
Including share-based compensation	$608,100	$507,000	$101,100	20%
Excluding share-based compensation	$450,500	$402,500	$48,000	12%
Professional fees	$158,800	$118,500	$40,300	34%
Fees paid to directors (including insurance)	$81,700	$63,700	$18,000	28%
Public entity related expenses	$73,100	$49,700	$23,400	47%

Salary and salary-related expenses – Salary and salary-related expenses including share-based compensation expense increased 3% and 20% for the three and six months ended February 28, 2018, respectively, as compared to the three and six months ended February 28, 2017, respectively. The increase was primarily the result of additional employees and increased share-based compensation expense. The salary and salary-related expenses noted above include $77,400 and $61,700 of share-based compensation expenses during the three months ended February 28, 2018 and 2017, respectively. The salary and salary related expenses noted above include $157,600 and $104,500 of share-based compensation expenses during the six months ended February 28, 2018 and 2017, respectively.

Professional fees (predominately accounting and legal) – Legal and accounting fees increased 3% and 34% during the three and six months ended February 28, 2018, as compared to the three and six months ended February 28, 2017, respectively. The increase in the six months ended February 28, 2018, as compared to the six months ended February 28, 2017, was primarily due to increased accounting fees related to the 2017 10-K audit of approximately $35,000.

Fees paid to directors (including insurance) – Directors' fees, including D&O insurance, increased 40% and 28% for the three and six months ended February 28, 2018, respectively, as compared to the three and six months ended February 28, 2017. These fees vary due to the number of meetings and timing of payments, however, they are generally expected to remain consistent year over year.

Public entity expenses – Costs associated with corporate governance and costs associated with being a publicly traded entity increased 99% and 47% for the three and six months ended February 28, 2018, respectively, as compared to the three and six months ended February 28, 2017, respectively. The fluctuations are due to the timing and number of filings and compliance costs for filing with the Securities and Exchange Commission (the "SEC").

Other Income and Expense Items

Table 4a - Other Items

	Three Months Ended February 28,			
	2018	2017	$ Change	% Change
Other income items:				
Oil and gas lease income, net	$13,900	$6,000	$7,900	132%
Oil and gas royalty income, net	$49,800	$71,300	$(21,500)	-30%
Interest income	$52,500	$66,100	$(13,600)	-21%

Table 4b - Other Items

	Six Months Ended February 28,			
	2018	2017	$ Change	% Change
Other income items:				
Oil and gas lease income, net	$23,200	$11,200	$12,000	107%
Oil and gas royalty income, net	$91,500	$139,400	$(47,900)	-34%
Interest income	$107,000	$139,700	$(32,700)	-23%

Oil and gas lease income – The oil and gas lease income amounts in 2017 represent a portion of the up-front payment of $72,000 we received in fiscal 2014 for exploring for, developing, producing, and marketing oil and gas on 40 acres of mineral estate we own adjacent to the Lowry Range (the "Rangeview Lease"). The income received for the Rangeview Lease was recognized ratably through June 2017, and the Rangeview Lease has expired.

On October 5, 2017, we entered into a Paid-Up Oil and Gas Lease with Bison Oil and Gas, LLP, for the purpose of exploring for, developing, producing, and marketing oil and gas on the 40 acres of mineral estate we own adjacent to the Lowry Range (the “Bison Lease”). Pursuant to the Bison Lease, we received an up-front payment of $167,200, which will be recognized as income on a straight-line basis over three years (the term of the Bison Lease). We recognized $13,900 and $23,200 during the three and six months ended February 28, 2018, respectively, of lease income related to the up-front payment received pursuant to the Bison Lease. As of February 28, 2018, we had deferred recognition of $144,000 of income related to the Bison Lease, which will be recognized into income ratably through September 2020.

Oil and gas royalty income – In 2011, we entered into a Paid-Up Oil and Gas Lease, which was subsequently purchased by a wholly-owned subsidiary of ConocoPhillips Company, for the purpose of exploring for, developing, producing and marketing oil and gas on 634 acres of mineral estate we own at our Sky Ranch property (the "Sky Ranch O&G Lease"). The Sky Ranch O&G Lease is held by production through two wells drilled in our mineral estate. The oil and gas royalty income represents amounts received pursuant to the Sky Ranch O&G Lease as royalties from oil and gas production from wells in our mineral estate at Sky Ranch. The royalties for the three months ended February 28, 2018, were $49,800, as compared to $71,300 for the same period in 2017. The royalties for the six months ended February 28, 2018 were $91,500, as compared to $139,400 for the same period in 2017. The decrease in oil and gas royalties is a result of lower production of oil and gas from wells in our mineral estate at Sky Ranch.

Interest Income – Interest income represents interest earned on the temporary investment of capital in cash and cash equivalents, available-for-sale securities, finance charges, and interest accrued on the notes receivable from the Rangeview District and the Sky Ranch Districts. The decrease was primarily attributable to the use of cash to invest in the development of Sky Ranch.

Discontinued Operations

For additional information about our discontinued operations, see Note 1 – Presentation of Interim Information to the accompanying consolidated financial statements.

The following table provides the components of discontinued operations:

Table 5 - Discontinued Operations Income Statement

	Three Months Ended February 28,		Six Months Ended February 28,	
	2018	2017	2018	2017
Farm revenues	$840	$6,034	$1,421	$6,034
Farm expenses	-	-	-	-
Gross profit	840	6,034	1,421	6,034
General and administrative expenses	-	17,104	-	36,730
Operating (loss) profit	840	(11,070)	1,421	(30,696)
Finance charges	-	8,421	-	9,367
Income (loss) from discontinued operations	$840	$(2,649)	$1,421	$(21,329)

We anticipate continued expenses through the end of fiscal 2018 related to the discontinued operations including expenses related to the remaining agricultural land we own and for the purpose of collecting outstanding receivables.

Liquidity, Capital Resources and Financial Position

At February 28, 2018, our working capital, defined as current assets less current liabilities, was $22.2 million, which included $20.2 million in cash and cash equivalents and short-term investments, and an additional $1.4 million held in long-term investments. We believe that as of February 28, 2018, and as of the date of the filing of this Quarterly Report on Form 10-Q, we have sufficient working capital to fund our operations for the next 12 months.

Sky Ranch Development – During fiscal year 2018, we anticipate beginning construction of off-site improvements at Sky Ranch, including drainage improvements, access roads, water and sewer facilities and other improvements which are estimated to cost approximately $10.2 million. We expect to phase construction of lots to deliver approximately 250 initial lots to builders over the next 12-18 months, which have an estimated construction cost of approximately $8 million. Pursuant to our Builder Contracts, we will collect certain funds from two of the three builders as we reach specified infrastructure milestones. We estimate that the development of the finished lots for the first phase (506 lots) of Sky Ranch will require total capital of approximately $28 million and estimate lot sales to home builders will generate approximately $35 million, providing a projected margin on lots of approximately $7 million. We believe that our plan for phased construction and delivery of lots together with the progress payments from builders will enable us to have adequate cash to fund the development of lots.

ECCV Capacity Operating System – Pursuant to a 1982 contractual right, Rangeview may purchase water produced from East Cherry Creek Valley Water and Sanitation District's ("ECCV") Land Board system. ECCV's Land Board system is comprised of eight wells and more than 10 miles of buried water pipeline located on the Lowry Range. In May 2012, in order to increase the delivery capacity and reliability of these wells, in our capacity as Rangeview's service provider and the Export Water Contractor (as defined in the 2014 Amended and Restated Lease Agreement among us, Rangeview and the Land Board), we entered into an agreement to operate and maintain the ECCV facilities, allowing us to utilize the system to provide water to commercial and industrial customers, including customers providing water for drilling and hydraulic fracturing of oil and gas wells. Our costs associated with the use of the ECCV system are a flat fee of $8,000 per month from January 1, 2013 through December 31, 2020, and will decrease to $3,000 per month from January 1, 2021 through April 2032. Additionally, we pay a fee per 1,000 gallons of water produced from the ECCV's system, which is included in the water usage fees charged to customers. In addition, in 2018 the ECCV system has cost us and is anticipated to continue to cost us approximately $6,870 per month to maintain.

South Metropolitan Water Supply Authority ("SMWSA") and the Water Infrastructure Supply Efficiency Partnership ("WISE") – SMWSA is a municipal water authority in the State of Colorado organized to pursue the acquisition and development of new water supplies on behalf of its members, including Rangeview. Pursuant to the SMWSA Participation Agreement with Rangeview, we agreed to provide funding to Rangeview in connection with its membership in the SMWSA. In July 2013, Rangeview, together with nine other SMWSA members, formed an entity to enable its members to participle in a cooperative water project known as WISE and entered into an agreement that specifies each member's pro rata share of WISE and the members' rights and obligations with respect to WISE. On December 31, 2013, the South Metro WISE Authority ("SMWA"), the City and County of Denver acting through its Board of Water Commissioners ("Denver Water") and the City of Aurora acting by and through its Utility Enterprise ("Aurora Water") entered into the Amended and Restated WISE Partnership – Water Delivery Agreement (the "WISE Partnership Agreement"), which provides for the purchase of certain infrastructure (pipelines, water storage facilities, water treatment facilities, and other appurtenant facilities) to deliver water to and among the 10 members of the SMWA, Denver Water and Aurora Water. We have entered into the Rangeview/ Pure Cycle WISE Project Financing Agreement (the "WISE Financing Agreement"), which obligates us to fund Rangeview's cost of participating in WISE. We anticipate that we will be investing approximately $5.2 million in total over the next five fiscal years to fund Rangeview's purchase of its share of the water transmission line and additional facilities, water and related assets for WISE. In exchange for funding Rangeview's obligations in WISE, we will have the sole right to use and reuse Rangeview's 7% share of the WISE water and infrastructure to provide water service to Rangeview's customers and to receive the revenue from such service. At full capacity, we will be entitled to approximately three million gallons per day of transmission pipeline capacity and 500 acre feet per year of water.

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Summary Cash Flows Table

Table 6 - Summary Cash Flows Table

	Three Months Ended February 28,			
	2018	2017	$ Change	% Change
Cash (used in) provided by:				
Operating activities	$(1,039,700)	$(536,300)	$(503,400)	(94%)
Investing activities	$(247,100)	$2,592,400	$(2,839,500)	(110%)
Financing activities	$(1,201,100)	$(1,900)	$(1,199,200)	(63116%)

Changes in Operating Activities – Operating activities include revenues we receive from the sale of wholesale water and wastewater services and costs incurred in the delivery of those services, G&A expenses, and depletion/ depreciation expenses.

Cash used in operations in the three months ended February 28, 2018, increased by approximately $503,400 compared to the six months ended February 28, 2017, which is primarily due to the payment of approximately $1.1 million for a collateral deposit paid to the Southeast Metro Stormwater Authority in association of with the grading, erosion and sediment control permit application for Sky Ranch, anticipated to be refunded within twelve months, and payments of approximately $245,700 of accounts payable, offset by an increase of net income of $658,800 and an increase in deferred oil and gas lease payments of $156,000 for the six months ended February 28, 2018.

Changes in Investing Activities – The use of cash in investing activities during the six months ended February 28, 2018, consisted of the sale of short-term investments of $2.9 million, the purchase of long-term investments of $1.2 million, the investment in our water system of $1.8 million and the purchase of equipment of $160,700. Cash provided by investing activities in the six months ended February 28, 2017 consisted of the sale of available for sale securities for $7.2 million, the investment in our water system of $4.6 million of which approximately $2.9 million (of the total estimated $4.2 million cost) related to construction of the Sky Ranch pipeline, $1.6 million related to the Wild Pointe purchase and approximately $0.1 million related to the WISE infrastructure, and the purchase of equipment of $29,500.

Changes in Financing Activities – Cash used in financing activities during the six months ended February 28, 2018 consisted of a funding payment of $1.5 million for Sky Ranch Community Authority Board to begin construction on Sky Ranch, a payment to contingent liability holders of $1,600 offset by a receipt of a note receivable - related party of $215,500 from a Sky Ranch District and proceeds from the exercise of stock options of $75,000. Cash used in financing activities during the six months ended February 28, 2017 consisted of a payment to contingent liability holders of $1,900.

Off-Balance Sheet Arrangements

Our off-balance sheet arrangements consist entirely of the contingent portion of the CAA as described in Note 4 – Long-Term Obligations and Operating Lease – Participating Interests in Export Water Supply to the accompanying financial statements. The contingent liability is not reflected on our balance sheet because the obligation to pay the CAA is contingent on sales of Export Water, the amounts and timing of which are not reasonably determinable.

Critical Accounting Policies and Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The most significant accounting estimates inherent in the preparation of our financial statements include estimates associated with the timing of revenue recognition, the impairment of water assets and other long-lived assets, fair value estimates and share-based compensation. Below is a summary of these critical accounting policies.

Revenue Recognition

Our revenues consist mainly of monthly service fees, tap fees, construction fees, and consulting fees. Additionally, we receive other income from oil and gas leases and related royalties on our properties. Monthly metered water usage fees, monthly wastewater treatment fees, consulting fees and oil and gas royalties are recognized in income each month as earned.

Until September 1, 2017, as further described in Note 2 – Summary of Significant Accounting Policies in Part II, Item 8 of the 2017 Annual Report, tap and construction fees derived from agreements for which we constructed infrastructure owned by others were deferred upon receipt and recognized as revenue pursuant to the percentage-of-completion method. Tap and construction fees derived from agreements for which we owned the infrastructure were recognized as revenue ratably over the estimated service life (30 years or more) of the assets constructed with such fees.

In the three-month period ended November 30, 2017, we completed our review of the adoption of ASU 2014-09 and the related impact on each of our revenue streams (water and wastewater usage fees, consulting fees, tap fees, special facility or construction fees, and oil and gas revenues). Upon completion of our evaluation of the standard, we determined to early adopt the new revenue recognition standard beginning September 1, 2017, in accordance with the transition provisions in ASU 2014-09, utilizing the modified retrospective method. We concluded that the adoption did have a material impact on our financial statements.

We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of accumulated deficit, which resulted in a reduction of our accumulated deficit of approximately $1.1 million. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. The most significant impact of the standard relates to our accounting for tap fees and special facility or construction fees, which revenues are expected to be recognized in earlier periods under the new revenue standard. Revenue recognition related to our water and wastewater usage fees and consulting fees will remain substantially unchanged. Monthly wholesale water usage charges are assessed to our customers based on actual metered usage each month plus a base monthly service fee. We recognize wholesale water usage revenues upon delivering water to our customers or our governmental customer's end-use customers, as applicable. We invoice sales of Export Water directly, and revenues we recognize from such sales are shown gross of royalties to the Land Board. Sales of water on the Lowry Range are invoiced directly by the Rangeview District, and a percentage of such collections are then paid to us by the Rangeview District. Water revenues from such sales are shown net of royalties paid to the Land Board and amounts retained by the Rangeview District.

We recognize wastewater treatment fees monthly based on usage. The monthly wastewater treatment fees are shown net of amounts retained by the Rangeview District. Costs of delivering water and providing wastewater services to customers are recognized as incurred.

Revenues received pursuant to the Rangeview Lease, the Sky Ranch O&G Lease and the Bison Lease consisting of up-front payments were recognized as other income on a straight-line basis over the initial term or extension of term, as applicable, of the leases.

Impairment of Water Assets and Other Long-Lived Assets

We review our long-lived assets for impairment whenever management believes events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. We measure recoverability of assets to be held and used by a comparison of the carrying amount of an asset to estimated future undiscounted net cash flows we expect to be generated by the eventual use of the asset. If such assets are considered to be impaired and, therefore, the costs of the assets deemed to be unrecoverable, the impairment to be recognized would be the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

Our water assets will be utilized in the provision of water services that inevitably will encompass many housing and economic cycles. Our service capacities are quantitatively estimated based on an average single family home utilizing .4 acre feet of water per year. Average water deliveries are approximately .4 acre feet; however, approximately 50% or .2 acre feet are returned and available for reuse. Our water supplies are legally decreed to us through the water court. The water court decree allocates a specific amount of water (subject to continued beneficial use), which historically has not changed. Thus, individual housing and economic cycles typically do not have an impact on the number of connections we can serve with our supplies or the amount of water legally decreed to us relating to these supplies.

We report assets to be disposed of at the lower of the carrying amount or fair value less costs to sell. See further discussion regarding our land held for sale in Note 4 – Water and Land Assets to Part II, Item 8 of our 2017 Annual Report.

Our Front Range Water Rights – We determine the undiscounted cash flows for our Denver-based assets by estimating tap sales to potential new developments in our service area and along the Front Range, using estimated future tap fees less estimated costs to provide water services, over an estimated development period. Actual new home development in our service area and the Front Range, actual future tap fees, and actual future operating costs inevitably will vary significantly from our estimates, which could have a material impact on our financial statements as well as our results of operations. We performed an impairment analysis as of August 31, 2017, and determined that there were no material changes and that our Denver-based assets are not impaired and their costs are deemed recoverable. Our impairment analysis is based on development occurring within areas in which we have service agreements (e.g., Sky Ranch and the Lowry Range) as well as in surrounding areas, including the Front Range and the I-70 corridor. Our combined Lowry Water Supply and Sky Ranch water assets have a carrying value of $34.7 million as of February 28, 2018. Based on the carrying value of our water rights, the long-term and uncertain nature of any development plans, current tap fees of $24,620 and estimated gross margins, we estimate that we would need to add 2,300 new water connections (requiring 3.5% of our portfolio) to generate net revenues sufficient to recover the costs of our Lowry Water Supply assets. If tap fees increase 5%, we would need to add 2,100 new water taps (requiring 3.4% of our portfolio) to recover the costs of our Lowry Water Supply assets. If tap fees decrease 5%, we would need to add 2,400 new water taps (requiring 3.7% of our portfolio) to recover the costs of our Lowry Water Supply assets.

Changes in the housing market throughout the Front Range can vary from our estimated tap sale projections; however, these changes do not alter our water ownership, our service obligations to existing properties or the number of SFEs we can service.

Share-Based Compensation

We estimate the fair value of share-based payment awards made to key employees and directors on the date of grant using the Black-Scholes option pricing model. We then expense the fair value over the vesting period of the grant using a straight-line expense model. The fair value of share-based payments requires management to estimate or calculate various inputs such as the volatility of the underlying stock, the expected dividend rate, the estimated forfeiture rate and an estimated life of each option. We do not expect any forfeiture of option grants; therefore, the compensation expense has not been reduced for estimated forfeitures. These assumptions are based on historical trends and estimated future actions of option holders and may not be indicative of actual events, which may have a material impact on our financial statements. For further details on share-based compensation expense, see Note 5 – Shareholders' Equity to the accompanying financial statements.

Recently Adopted and Issued Accounting Pronouncements

See Note 1 – Presentation of Interim Information to the accompanying financial statements for recently adopted and issued accounting pronouncements.

Disclosure Regarding Forward-Looking Statements

Statements that are not historical facts contained in or incorporated by reference into this Quarterly Report on Form 10-Q are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements involve risks and uncertainties that could cause actual results to differ from projected results. The words "anticipate," "goal," "seek," "project," "strategy," "future," "likely," "may," "will," "believe," "estimate," "expect," "plan," "intend" and similar expressions and references to future periods, as they relate us, are intended to identify forward-looking statements. Forward-looking statements reflect our current views with respect to future events and are subject to certain risks, uncertainties and assumptions. We cannot assure you that any of our expectations will be realized. Forward-looking statements include, among others, statements we make regarding:

material changes to unrecognized tax positions;

the impact of new accounting pronouncements;

our intent to sell certain farms in due course and hold the related mineral interest for future development;

receipt of the first priority payout under the CAA;

the timing and impact on our financial statements of new home construction and other development in the areas where we may sell our water;

utilization of our water assets;

growth in our targeted service area;

plans to continue to provide water and wastewater services to commercial and industrial customers;

projected capital spending for the first phase of Sky Ranch;

timing of delivery of finished lots at Sky Ranch;

sufficiency of our working capital to fund our operations for the next 12 months;

our ability to fund improvements needed to deliver finished lots to home builders at Sky Ranch by phasing construction and delivery of lots and utilizing progress payments from builders;

the potential for frack sales;

consistency of director compensation;

deferred recognition of water tap and construction fee revenue from Arapahoe County;

costs associated with the use of the ECCV system;

infrastructure to be constructed over the next several years;

investments over the next five years for the WISE project;

estimated transmission pipeline capacity of, and decreed amount of water from, the WISE project upon its completion;

estimates associated with revenue recognition, asset impairments, and cash flows from our water assets;

variance in our estimates of future tap fees and future operating costs;

estimated number of SFE connections that can be served by our water systems;

number of new water connections necessary to recover costs;

expected vesting and forfeitures of stock options;

timing and type of continued expenses related to the discontinued agricultural operations;

objectives of our investment activities; and

timing of the recognition of income related to the Bison Lease.

Factors that may cause actual results to differ materially from those contemplated by such forward-looking statements include, without limitation:

the timing of new home construction and other development in the areas where we may sell our water;

population growth;

employment rates;

timing of oil and natural gas development in the areas where we sell our water;

general economic conditions;

the market price of water;

the market price of oil and natural gas;

changes in customer consumption patterns;

changes in applicable statutory and regulatory requirements;

changes in governmental policies and procedures;

uncertainties in the estimation of water available under decrees;

uncertainties in the estimation of costs of delivery of water and treatment of wastewater;

uncertainties in the estimation of the service life of our systems;

uncertainties in the estimation of costs of construction projects;

the strength and financial resources of our competitors;

our ability to find and retain skilled personnel;

climatic and weather conditions, including floods, droughts and freezing conditions;

labor relations;

turnover of elected and appointed officials and delays caused by political concerns and government procedures;

availability and cost of labor, material and equipment;

delays in anticipated permit and construction dates;

engineering and geological problems;

environmental risks and regulations;

our ability to raise capital;

volatility in the price of our common stock;

our ability to negotiate contracts with new customers;

the outcome of any litigation and arbitration proceedings;

uncertainties in water court rulings;

our ability to collect on any judgments; and

factors described under “Risk Factors” in our 2017 Annual Report.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. All forward-looking statements are expressly qualified by these cautionary statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

General

We have limited exposure to market risks from instruments that may impact the Consolidated Balance Sheets, Consolidated Statements of Operations and Comprehensive Income (Loss), and Consolidated Statements of Cash Flows. Such exposure is due primarily to changing interest rates.

Interest Rates

The primary objective for our investment activities is to preserve principal while maximizing yields without significantly increasing risk. This is accomplished by investing in diversified short-term interest-bearing investments. As of February 28, 2018, we own five certificates of deposit and 12 U. S. Treasury securities with stated maturity dates and locked interest rates. Therefore, we are not subject to interest rate fluctuations. We have no investments denominated in foreign currencies; therefore, our investments are not subject to foreign currency exchange rate risk.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures as defined in Rule 13a-15(e) of the Exchange Act that are designed to ensure that information required to be disclosed in our reports filed or submitted to the SEC under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by the SEC’s rules and forms, and that information is accumulated and communicated to management, including the principal executive and financial officer, as appropriate to allow timely decisions regarding required disclosures. The President and Chief Financial Officer evaluated the effectiveness of disclosure controls and procedures as of February 28, 2018, pursuant to Rule 13a-15(b) under the Exchange Act. Based on that evaluation, the President and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company’s disclosure controls and procedures were effective. A system of controls, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the system of controls are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Changes in Internal Control Over Financial Reporting

No changes were made to our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 6.
Exhibits

Exhibit Number	Description
3.1	Articles of Incorporation of the Company. Incorporated by reference to Appendix B to the Proxy Statement on Schedule 14A filed on December 14, 2007.
3.2	Bylaws of the Company. Incorporated by reference to Appendix C to the Proxy Statement on Schedule 14A filed on December 14, 2007.
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document. *
101.SCH	XBRL Taxonomy Extension Schema Document. *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. *
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. *
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. *
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. *

*
Filed herewith.

**
Furnished herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

	PURE CYCLE CORPORATION	
April 6, 2018	By:	/s/ Mark W. Harding Mark W. Harding President and Chief Financial Officer