MDC HOLDINGS INC
Form 10-K
February 07, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2007

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition period from to

Commission file number 1-08951

M.D.C. HOLDINGS, INC.

(Exact name of Registrant as specified in its charter)

Delaware	84-0622967
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4350 South Monaco Street, Suite 500

Denver, Colorado	**80237**
(Address of principal executive offices)	**(Zip code)**

(303) 773-1100

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $.01 par value	**New York Stock Exchange**
7% Senior Notes due December 2012	**New York Stock Exchange**
5 1/2% Senior Notes due May 2013	**New York Stock Exchange**
5 3/8% Senior Notes due December 2014	**New York Stock Exchange**
5 3/8% Senior Notes due July 2015	**New York Stock Exchange**

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 Section 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 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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicated 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, 2007, the aggregate market value of the Registrants common stock held by non-affiliates of the Registrants was $1.7 billion based on the closing sales price of $48.36 per share as reported on the New York Stock Exchange.

As of December 31, 2007, the number of shares outstanding of Registrant s common stock was 46,084,000.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of part III of this Form 10-K are incorporated by reference from the Registrant s 2008 definitive proxy statement to be filed with the Securities and Exchange Commission no later than 120 days after the end of the Registrant s fiscal year.

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M.D.C. HOLDINGS, INC.

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FOR THE YEAR ENDED DECEMBER 31, 2007

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(i)

M.D.C. HOLDINGS, INC.

FORM 10-K

PART I

Forward-Looking Statements.

Certain statements in this Annual Report on Form 10-K, the Company s Annual Report to Shareowners, as well as statements made by us in periodic press releases, oral statements made by our officials in the course of presentations about the Company and conference calls in connection with quarterly earnings releases, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements regarding our business, financial condition, results of operation, cash flows, strategies and prospects. Although we believe that the expectations reflected in the forward-looking statements contained in this Annual Report on Form 10-K are reasonable, we cannot guarantee future results. These statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from those expressed or implied by the forward-looking statements. These factors include those described under the caption Risk Factors Relating to our Business in Item 1A of this Annual Report on Form 10-K. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise. However, any further disclosures made on related subjects in subsequent reports on Forms 10-K, 10-Q and 8-K should be consulted.

Item 1. Business.

(a) General Development of Business

M.D.C. Holdings, Inc. is a Delaware corporation. We refer to M.D.C. Holdings, Inc. as the Company, MDC, we or our in this Annual Report on Form 10-K, and these designations include our subsidiaries unless we state otherwise. We have two primary operations, homebuilding and financial services. Our homebuilding operations consist of wholly-owned subsidiary companies that generally purchase finished lots for the construction and sale of single family detached homes to first-time and first-time move-up homebuyers under the name Richmond American Homes. Our homebuilding operations are comprised of many homebuilding subdivisions that we consider to be our operating segments. Homebuilding subdivisions in a given market are aggregated into reportable segments as follows: (1) West (Arizona, California and Nevada); (2) Mountain (Colorado and Utah); (3) East (Maryland and Virginia, which includes Virginia and West Virginia); and (4) Other Homebuilding (Florida, Illinois, Delaware Valley, which includes Pennsylvania, Delaware and New Jersey, and Texas, although during 2007 we completed our exit of the Texas market).

Our financial services operations primarily consist of our mortgage lending, title agency and insurance companies. These companies are aggregated together to form our Financial Services and Other reportable segment. Our Financial Services and Other segment consists of HomeAmerican Mortgage Corporation (HomeAmerican), which originates mortgage loans primarily for our homebuyers, American Home Insurance Agency, Inc. (American Home Insurance), which offers third-party insurance products to our homebuyers, and American Home Title and Escrow Company (American Home Title), which provides title agency services to the Company and our homebuyers in Colorado, Delaware, Florida, Illinois, Nevada, Maryland, Virginia and West Virginia. This segment also includes Allegiant Insurance Company, Inc., A Risk Retention Group (Allegiant), which provides to its customers, primarily certain subcontractors of MDC s homebuilding subsidiaries, general liability coverage during the construction of the Company s homes and for work performed in completed subdivisions, and StarAmerican Insurance Ltd. (StarAmerican), a Hawaii corporation and a wholly owned subsidiary of MDC. StarAmerican has

agreed to re-insure (1) all claims pursuant to two policies issued to the Company by a third-party; and (2) pursuant to agreements beginning in June 2004, all Allegiant claims in excess of $50,000 per occurrence, up to $3.0 million per occurrence, subject to various aggregate limits, not to exceed $18.0 million per year.

The following summarizes several significant business developments during the five most recently completed fiscal years:

Beginning in 2006 and continuing throughout 2007, we reduced our overall operations through Company-wide headcount reductions and reorganized our homebuilding operations through consolidation of homebuilding divisions and elimination of most of our regional offices. This right-sizing of our homebuilding operations included the consolidation of:

six California divisions into one;
two Nevada divisions into one;
three Phoenix divisions into one;
three Virginia divisions into one;
two Florida divisions into one; and
three Colorado divisions into two.

During 2007, we began reducing our homebuilding operations in Tampa through the disposition of a majority of the remaining assets as we initiated the exit of this sub-market.

During 2006 and 2007, we implemented a new customer service initiative, which is focused on making improvements in our customers home buying experience.

During 2006, we began exiting the Texas market, which we completed during 2007.

During 2004 and 2005, we initiated our Home Gallery concept, which improved sales support and offered more options and upgrades for homebuyers to personalize their new homes.

During 2004, we expanded our Florida operations through the purchase of the assets of Watson Home Builders, Inc. in Jacksonville.

During 2003, we entered the Delaware Valley and Illinois homebuilding markets, and re-entered the Florida homebuilding market through the purchase of assets of Crawford Homes, Inc. in Jacksonville.

(b) Available Information

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (SEC). Anyone seeking information about our business can receive copies of our 2007 Annual Report on Form 10-K, Annual Report to Shareholders, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, all amendments to those reports and other documents filed with the SEC at the public reference section of the SEC at 100 F Street, NE, Room 1580, Washington, D.C. 20549. These documents also may be obtained, free of charge, by: contacting our Investor Relations office at (720) 773-1100; writing to M.D.C. Holdings, Inc., Investor Relations, 4350 South Monaco Street, Suite 400, Denver, Colorado 80237; or accessing our website at www.richmondamerican.com. We make our Annual Report on

Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, available on our website as soon as reasonably practicable after we file or furnish the materials electronically with the SEC. To obtain any of this information, go to www.richmondamerican.com, select Investors, Financial Reports and SEC Filings. Our website also includes our: (1) Corporate Governance Guidelines; (2) Corporate Code of Conduct; (3) Rules for Senior Financial Officers; (4) Audit Committee Procedures for Handling Confidential Complaints; and (5) charters for the Audit, Compensation and Nominating and Corporate Governance Committees. These materials may be obtained, free of charge, at our website, http://ir.richmondamerican.com (select Corporate Governance).

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(c) Financial Information About Industry Segments

Note 3 to the Consolidated Financial Statements contains information regarding our reportable segments for each of the years ended December 31, 2007, 2006 and 2005.

(d) Narrative Description of Business

Our business consists of two primary operations, homebuilding and financial services. We build and sell primarily single-family detached homes, that are designed and built to meet local customer preferences. We are the general contractor for all of our projects and retain subcontractors for site development and home construction. The base selling prices for our homes closed during 2007 ranged primarily from approximately $200,000 to 500,000. We maintain a variety of home styles in each of our markets, targeting generally first-time and first-time move-up homebuyers. Also, we build a limited number of homes for the second-time move-up and luxury homebuyers.

When opening a new homebuilding subdivision, we seek to limit our supply of lots with the goal of avoiding overexposure to any single sub-market. When we acquire finished lots, we prefer using option contracts or paying in phases with cash. Also, we acquire entitled land for development into finished lots when we determine that the risk is justified. Additional information about our land acquisition practices may be found in the Homebuilding Operations, *Land Acquisition and Development* section.

Homebuilding Operations.

At December 31, 2007, our homebuilding operations had subdivisions in multiple sub-markets in ten markets within four reportable segments as follows.

Reportable Segment	Market	Sub-market	Reportable Segment	Market	Sub-market
West	Arizona	Phoenix East Valley	Mountain	Colorado	Denver Metro Area
		Phoenix West Valley			Colorado Springs
		Tucson			Northern Colorado
	California	Bay Area		Utah	Salt Lake City Metro Area
		Central Valley			
		Inland Empire	Other Homebuilding	Delaware Valley	Delaware - Dover Area
		Los Angeles			New Jersey - Burlington
		Orange County			Southeastern Pennsylvania
		San Diego			Southern Pennsylvania
	Nevada	Las Vegas		Florida	Jacksonville
					Tampa
East	Virginia	Northern Virginia			
		Shenandoah Valley		Illinois	Chicago Suburbs
		West Virginia			
	Maryland	Southern Maryland			
		Suburban Maryland			

Our home sales revenue for the years ended December 31, 2007, 2006 and 2005 is set forth in the table below for each market within our homebuilding segments (dollars in thousands).

	Total Homes Sales Revenue			Percent of Total		
	2007	2006	2005	2007	2006	2005
Arizona	$ 702,418	$ 980,409	$ 831,796	26%	21%	17%
California	588,562	998,471	1,075,900	21%	21%	23%
Nevada	385,751	872,970	920,728	14%	19%	19%
West	1,676,731	2,851,850	2,828,424	61%	61%	59%
Colorado	284,419	450,392	627,042	10%	10%	13%
Utah	255,273	277,743	204,496	9%	6%	4%
Mountain	539,692	728,135	831,538	19%	16%	17%
Maryland	149,917	246,492	191,365	6%	5%	4%
Virginia	167,194	378,373	539,519	6%	8%	11%
East	317,111	624,865	730,884	12%	13%	15%
Delaware Valley	80,057	80,966	12,196	3%	2%	0%
Florida	129,880	262,209	238,054	5%	6%	5%
Illinois	39,126	63,925	33,490	1%	1%	1%
Texas	3,369	65,560	128,289	0%	1%	3%
Other Homebuilding	252,432	472,660	412,029	9%	10%	9%
Intercompany adjustments	(19,985)	(26,954)	(10,175)	-1%	0%	0%
Total	$ 2,765,981	$ 4,650,556	$ 4,792,700	100%	100%	100%

Economies of Scale. We believe that our scale of operations has afforded us benefits such as:

- the ability to negotiate favorable contract terms associated with lot option contracts;
- the ability to sustain operations in our markets despite limiting or altogether eliminating the acquisition of new land until such time as land becomes available at reasonable prices;
- the ability to negotiate volume contracts with material suppliers and subcontractors;
- access to affordable insurance coverage; and

access to lower cost capital.

Operating Divisions. In our homebuilding segments, our primary functions include land acquisition and development, home construction, purchasing, sales and marketing, merchandising and customer service. Operating decisions are made on a subdivision-by-subdivision basis under the oversight of our Chief Operating Decision Makers (CODMs), defined as our Chief Executive Officer, Chief Operating Officer and Chief Financial Officer. Generally, each operating division consists of a division president; land procurement, sales, construction, customer service, finance and purchasing personnel; and office staff. The Company s underlying organizational structure i.e. the grouping and reporting of subdivisions and divisions changes based upon the current needs of the Company. At December 31, 2007 and 2006, we had 12 and 23 separate homebuilding operating divisions, respectively. Officers of our divisions generally receive performance-related bonuses based upon achieving targeted financial and operational results in their respective operating divisions.

Corporate Management. We manage our homebuilding business primarily through members of senior management in our Corporate segment and our Asset Management Committees (each an AMC). Each AMC is comprised of the COO and one of the Company s corporate officers or employees. The AMCs review and approve all

subdivision acquisition transactions in accordance with land resource allocation decisions made by the CODMs. Land acquisition transactions may not proceed without the approval by AMC and/or our CODMs. Generally, the role of our senior management team and/or AMCs includes:

- review and approval of division business plans and budgets;
- oversight of land and home inventory levels; and
- review of major personnel decisions.

Additionally, our corporate executives and corporate and national departments generally are responsible for establishing and monitoring compliance with our policies and procedures. Among other things, the corporate office also has primary responsibility for:

- asset management and capital allocation;
- accounting and internal audit functions;
- legal matters;
- information technology;
- merchandising and marketing;
- training and development;
- human resources and payroll;
- risk management; and
- treasury.

Housing. Generally, we build single family detached homes in a number of standardized series, designed to provide variety in the size and style of homes for our potential homebuyers. Within each series, we build several models, each with a different floor plan and standard and optional features. Differences in sales prices of similar models in any series depend primarily upon homebuyer demand, home prices offered by our competitors, location, optional features and design specifications. The series of homes offered at a particular location is based on perceived customer preferences, lot size, the area s demographics and, in certain cases, the requirements of major land sellers and local municipalities.

We seek to maintain limited levels of inventories of unsold homes in our markets. Unsold homes in various stages of completion allow us to meet the immediate and near-term demands of prospective homebuyers. In order to mitigate the risk of carrying excess inventory, we have procedures and limits on the number of our unsold homes under construction and speculative homes resulting from home order cancellations. The table below shows the stage of construction for our homes completed or under construction, number of sold homes under construction and model homes (in units).

	December 31, 2007	December 31, 2006	December 31, 2005
Unsold Homes Under Construction - Final	515	476	258
Unsold Homes Under Construction - Frame	656	573	520
Unsold Homes Under Construction - Foundation	229	400	353
Total Unsold Homes Under Construction	1,400	1,449	1,131
Sold Homes Under Construction	1,350	2,430	5,093
Model Homes	730	757	667
Homes Completed or Under Construction	3,480	4,636	6,891

Land Acquisition and Development. We acquire our lots with the intention of constructing and selling homes on the acquired land. Generally, we purchase finished lots using option contracts, in phases or in bulk for cash. On a limited basis, we acquire entitled land for development into finished lots when we believe that the risk is justified. In

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making land purchases, we consider a number of factors, including projected rates of return, estimated Home Gross Margins (defined as home sales revenue less home cost of sales as a percent of home sales revenue), sales prices of the homes to be built, population and employment growth patterns, proximity to developed areas, estimated costs of development, estimated levels of competition and demographic trends. Generally, we acquire finished lots and land for development only in areas that will have, among other things, available building permits, utilities and suitable zoning. We attempt to maintain a supply of finished lots sufficient to enable us to start homes promptly after a contract for a home sale is executed. This approach is intended to minimize our investment in inventories. See **Forward-Looking Statements** above.

In our option contracts, we generally obtain the right to purchase lots in consideration for an option deposit in the form of cash or letters of credit. In the event we elect not to purchase the lots within a specified period of time, we forfeit the option deposit. Our option contracts generally do not contain provisions requiring our specific performance. During the years ended December 31, 2007, 2006 and 2005, we wrote-off lot option deposits and pre-acquisition costs of $23.4 million, $29.7 million and $10.4 million, respectively. At December 31, 2007, we had the right to acquire 3,615 lots under option contracts, with approximately $6.3 million and $6.5 million in non-refundable cash and letters of credit option deposits at risk, respectively. At December 31, 2007, the total purchase price for lots under option and total capitalized pre-acquisition costs were $419 million and $1.4 million, respectively.

We own or have the right under option contracts to acquire undeveloped parcels of real estate that we intend to develop into finished lots. We develop our land in phases (generally fewer than 100 lots at a time) in order to limit our risk in a particular subdivision and to efficiently employ available resources. Building permits and utilities are available and zoning is suitable for the current intended use of substantially all of our undeveloped land. When developed, these lots generally will be used in our homebuilding activities. See **Forward-Looking Statements** above.

The table below shows the carrying value of land and land under development, by homebuilding segment, at December 31, 2007, 2006 and 2005 (in thousands).

	December 31,		
	2007	**2006**	**2005**
West	$ 226,621	$ 980,666	$ 1,108,777
Mountain	205,983	282,063	216,729
East	87,118	185,627	187,999
Other Homebuilding	34,614	126,802	164,443
Total	$ 554,336	$ 1,575,158	$ 1,677,948

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The table below shows the number of lots owned and controlled under option (excluding lots in housing completed or under construction), by homebuilding segment, at December 31, 2007, 2006 and 2005 (in units).

	December 31,		
	2007	**2006**	**2005**
Lots Owned			
West	6,009	11,917	14,807
Mountain	3,855	4,664	4,603
East	671	1,171	1,462
Other Homebuilding	980	1,658	2,573
Total	11,515	19,410	23,445
Lots Controlled Under Option			
West	673	1,381	7,055
Mountain	262	892	2,616
East	1,869	3,341	4,397
Other Homebuilding	811	2,483	4,751
Total	3,615	8,097	18,819
Total Lots Owned and Controlled	15,130	27,507	42,264

The table below shows the amount of non-refundable option deposits (in thousands).

	December 31,		
	2007	**2006**	**2005**
Cash	$ 6,292	$ 20,228	$ 48,157
Letters of Credit	6,547	14,224	23,142
Total Non-refundable Option Deposits	$ 12,839	$ 34,452	$ 71,299

Labor and Raw Materials. For the most part, materials used in our homebuilding operations are standard items carried by major suppliers. We generally contract for our materials and labor at a fixed price for the anticipated construction period of our homes. This allows us to mitigate the risks associated with increases in building materials and labor costs between the time construction begins on a home and the time it is closed. Increases in the cost of building materials and subcontracted labor may reduce Home Gross Margins to the extent that market conditions prevent the recovery of increased costs through higher home sales prices. From time to time and to varying degrees, we may experience shortages in the availability of building materials and/or labor in each of our markets. These shortages and delays may result in delays in the delivery of homes under construction, reduced Home Gross Margins, or both. See **Forward-Looking Statements** above.

Warranty. Our homes are sold with limited third-party warranties that generally provide for ten years of structural coverage (structural warranty), two years of coverage for plumbing, electrical, heating, ventilation and air conditioning systems, and one year of coverage for workmanship and materials. Under our agreement with the issuer of the third-party warranties, we are responsible for performing all of the work for the first two years of the warranty coverage, and substantially all of the work required to be performed during years three through ten of the warranties. As a result, warranty reserves are established as homes close on a house-by-house basis in an amount estimated to be adequate to cover expected costs of materials and outside labor during warranty periods. Reserves are determined based upon historical experience with respect to similar home styles and geographical areas. Certain factors are considered in determining the per-house reserve amount, including: (1) the historical range of amounts paid per

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house; (2) the historical amount paid as a percent of home construction costs; (3) any warranty expenditures included in (1) and (2) not considered to be normal and recurring; (4) improvements in quality control and construction techniques expected to impact future warranty expenditures; and (5) conditions that may affect certain subdivisions and require higher per-house reserves for those specific subdivisions.

Seasonal Nature of Business. Prior to 2006, the Company experienced seasonality and quarter-to-quarter variability in homebuilding activity levels. The seasonal nature of our business is described in more detail in Item 6 Selected Financial and Other Data.

Backlog. At December 31, 2007 and 2006, homes under contract but not yet delivered (Backlog) totaled 1,947 and 3,638, respectively, with an estimated sales value of $650 million and $1.3 billion, respectively. Our Cancellation Rates (as defined below) were 48% and 43% for the years ended December 31, 2007 and 2006, respectively. We define Cancellation Rate as the approximate number of cancelled home order contracts during a reporting period as a percent of total home orders received during such reporting period. We anticipate the estimated Backlog sales value at December 31, 2007 will be realized during 2008 through closing homes in Backlog either under their existing home order contracts or through the replacement of an existing contract with a new home order contract. See **Forward-Looking Statements** above.

The table below discloses our Backlog for the years ended December 31, 2007 and 2006 for each market within our homebuilding segments (dollars in thousands).

	December 31,		2007 Increase (Decrease)	
	2007	**2006**	**Amount**	**%**
Backlog (*Units*)				
Arizona	592	1,504	(912)	-61%
California	203	427	(224)	-52%
Nevada	307	315	(8)	-3%
West	1,102	2,246	(1,144)	-51%
Colorado	213	253	(40)	-16%
Utah	178	465	(287)	-62%
Mountain	391	718	(327)	-46%
Maryland	126	187	(61)	-33%
Virginia	100	136	(36)	-26%
East	226	323	(97)	-30%
Delaware Valley	57	119	(62)	-52%
Florida	125	197	(72)	-37%
Illinois	46	23	23	100%
Texas	-	12	(12)	-100%
Other Homebuilding	228	351	(123)	-35%
Total	1,947	3,638	(1,691)	-46%
Estimated Backlog Sales Value	$ 650,000	$ 1,300,000	$ (650,000)	-50%
Estimated Average Sales Price in Backlog	$ 333.8	$ 357.3	$ (23.5)	-7%

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Our Backlog at December 31, 2007 decreased from levels at December 31, 2006 in each of our homebuilding segments and in nearly all markets in these segments. Contributing to the decrease in Backlog at December 31, 2007, were declines in net home orders during the last six months of 2007, compared with the last six months of 2006, in most markets within each homebuilding segment. Additionally, the decrease in Backlog at December 31, 2007 was most notable in our West segment, where Backlog declined by a combined 1,136 units from December 31, 2006 in Arizona and California. Backlog for Nevada at December 31, 2007 remained flat, compared with December 31, 2006, primarily due to sales incentives which were introduced in late November and December of 2007 that resulted in a significant number of new home orders received.

Estimated Backlog sales value at December 31, 2007 decreased from December 31, 2006, primarily due to a 46% decrease in the number of homes in Backlog and a 7% decrease in the estimated average sales price of homes in Backlog. The decline in the estimated average sales price of homes in Backlog is consistent with the decrease in the average selling prices of homes closed during 2007, which were impacted by factors contributing to the downturn in the homebuilding industry, as described in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

Customer Service and Quality Control. Our homebuilding divisions are responsible for pre-closing quality control inspections and responding to customers post-closing needs. During 2006, we created a product service and quality control task force, which designed and began implementation of a revised customer experience initiative. This is a multi-year initiative that is focused on making improvements in our customers complete home buying and homeownership experience. The initial phase of this initiative was rolled out to our Nevada market in the fourth quarter of 2006 and to all of our other markets during 2007.

Marketing and Sales. We evaluate our marketing and sales programs and initiatives in order to target homebuyers in a cost effective manner. To communicate our Richmond American brand and sales promotions, we have a centralized in-house advertising and marketing department that controls and monitors the communication of the Company s brand and promotion efforts. The main objective of this department is to direct potential homebuyers to our sales offices, Home Galleries, Homebuyer Resource Centers and website. We work towards these objectives through various advertising outlets, including, newspapers, magazines, signage, direct mailings and radio. In addition, our in-house corporate communications team manages our public relations and employee communications, and our interactive marketing team maintains our richmondamerican.com website.

To complement our marketing efforts, our in-house merchandising team furnishes our model homes and sales offices with the objective of providing a consistent presentation in furtherance of developing our Richmond American brand.

Home Gallery and Design Center. Another important part of our marketing presentation takes place in our design centers, which are located in most of our homebuilding markets. Homebuyers are able to customize certain features of their homes by selecting from a variety of options and upgrades. In 2004, we launched our new Home Gallery concept, which provides improved sales support and customized options for prospective homebuyers to personalize their new homes. These retail locations also serve as a resource to homebuyers who are interested in purchasing a new Richmond American home. Prospective homebuyers can receive individualized attention from a trained team of new home specialists, resulting in a more focused, efficient home search.

Competition. The homebuilding industry is fragmented and highly competitive. The competitive nature of our business is described in more detail in Item 1A, *Risk Factors Relating to our Business.*

Regulation. Our homebuilding operations are subject to compliance with applicable laws and regulations, which are described in more detail in Item 1A, *Risk Factors Relating to our Business.*

Bonds and Letters of Credit. In many cases, we are required to obtain bonds and/or letters of credit in support of obligations primarily related to subdivision improvements, homeowners association dues and start-up expenses, warranty work, contractors license fees and earnest money deposits. At December 31, 2007 and 2006, we had outstanding performance bonds totaling $281.6 million and $388.6 million, respectively, and letters of credit totaling $51.2 million and $83.8 million, respectively, including $16.4 million and $26.8 million, respectively, issued by HomeAmerican.

In certain states, unless we take measures to release state regulatory imposed restrictions on earnest money deposits (Deposits) received from a homebuyer in conjunction with a home sale, which may include posting blanket security bonds, we are restricted from using these Deposits for general purposes. In this regard, at December 31, 2007 and 2006, we had $8.5 million and $10.5 million outstanding in blanket security bonds used to release restrictions on certain Deposits. Additionally, we had $1.9 million and $2.6 million in restricted cash related to Deposits at December 31, 2007 and 2006, respectively. We monitor, on a regular basis, the amount of Deposits we hold in certain states to confirm that our blanket security bonds exceed the amount of the Deposits.

In the event performance bonds or letters of credit issued by third-parties are called, our indemnity obligations could require us to reimburse the issuer of the performance bond or letter of credit. See **Forward-Looking Statements** above.

Financial Services and Other Segment.

Mortgage Lending Operations.

General. HomeAmerican is a full-service mortgage lender and the principal originator of mortgage loans for our homebuyers. HomeAmerican has a centralized loan processing center where it originates mortgage loans primarily for our homebuyers. HomeAmerican also brokers mortgage loans for origination by outside lending institutions for our homebuyers.

HomeAmerican is authorized to originate Federal Housing Administration-insured (FHA), Veterans Administration-guaranteed (VA), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC) (together the government sponsored entities) and other private investor mortgage loans. HomeAmerican also is an authorized loan servicer for FNMA and FHLMC and, as such, is subject to the rules and regulations of these organizations. Additionally, during 2006, HomeAmerican originated a significant number of second mortgage loans and Alternative A (Alt-A) loans (as defined below). However, during 2007, in response to the reduced liquidity in the mortgage lending industry, we tightened our mortgage loan underwriting criteria by: (1) discontinuing Alt-A mortgage loans, second mortgage loans, sub-prime mortgage loans (as defined below) and Non-Agency (defined as not being FNMA and FHLMC eligible) mortgage loans with combined-loan-to-values in excess of 95%; and (2) requiring larger down payments from homebuyers in communities where the market values of homes have been declining. We define Alt-A loans as loans that would otherwise qualify as prime loans except that they do not comply in all ways with the documentation standards of the government sponsored enterprise guidelines. We define sub-prime mortgage loans as mortgage loans that have Fair, Isaac & Company scores less than or equal to 620.

We use HomeAmerican s secured warehouse line of credit, other borrowings and Company generated funds to finance the origination of mortgage loans until they are sold. HomeAmerican generally sells originated mortgage loans to third-party purchasers on either a bulk or flow basis. Mortgage loans sold on a bulk basis generally include the sale of a package of substantially similar originated mortgage loans, while sales of mortgage loans on a flow basis generally are completed as HomeAmerican originates each loan. Mortgage loans sold to third-party purchasers

generally include HomeAmerican s representations and warranties with respect to certain borrower payment defaults, credit quality issues and/or misrepresentations on the part of the Company or our homebuyers. Substantially all of the mortgage loans originated by HomeAmerican are sold to third-party purchasers within 45 days of origination. Additionally, mortgage loans may be sold pursuant to an early purchase program, whereby we sell certain mortgage loans originated by HomeAmerican to a third-party purchaser shortly after the close of a home. This program improves our overall available funds by enabling us to sell mortgage loans originated by HomeAmerican more quickly. Accordingly, for mortgage loans sold pursuant to this program the number of days a loan is held in inventory is reduced from the historical 45 days to less than five days.

Concurrent with the sale of mortgage loans to third-party purchasers, HomeAmerican generally sells the rights to service those loans. HomeAmerican s portfolio of mortgage loan servicing for others at December 31, 2007 consisted of 597 loans with an unpaid principal balance of approximately $67.4 million, and did not contribute significantly to the results of operations of the Company.

Historically, a substantial portion of mortgage loans originated by HomeAmerican have been sold to one third-party purchaser. During the years ended December 31, 2007, 2006 and 2005, HomeAmerican sold approximately 51%, 54% and 68%, respectively, of the mortgage loans it originated to this third-party purchaser. Additionally, during 2007, HomeAmerican increased the volume of loans sold to a second third-party purchaser to approximately 23% of mortgage loans sold during 2007.

Pipeline. HomeAmerican s mortgage loans in process that had not closed (the Pipeline) at December 31, 2007 had an aggregate principal balance of approximately $387.6 million, of which $37.6 million were under interest rate lock commitments (IRLC) at an average interest rate of 6.0%. In addition, HomeAmerican had $100.1 million of mortgage loans in inventory available for sale at December 31, 2007. HomeAmerican uses forward sales of mortgage-backed securities and commitments to sell whole loans to hedge the interest rate risk inherent in the IRLC and its loan inventory available for sale. See **Forward-Looking Statements** above.

Forward Sales Commitments. HomeAmerican is exposed to market risks related to fluctuations in interest rates due to its mortgage loan inventory. Derivative instruments utilized in the normal course of business by HomeAmerican include forward sales of mortgage-backed securities, commitments to sell whole loans and commitments to originate mortgage loans. HomeAmerican utilizes forward mortgage securities contracts to manage the price risk due to fluctuations in interest rates on our mortgage loans owned and the IRLC. Such contracts are the only significant financial derivative instruments utilized by us and generally are settled within 60 days of origination. Due to this hedging philosophy, we believe the market risk associated with HomeAmerican s mortgages is limited. Reported gains on sales of mortgage loans may vary significantly from period to period depending on the volatility in the interest rate market. See **Forward-Looking Statements** above.

Competition. The mortgage industry is fragmented and highly competitive. The competitive nature of our business is described in more detail in Item 1A, *Risk Factors Relating to our Business.*

Regulation. Our mortgage lending operations are subject to compliance with applicable laws and regulations, which are described in more detail in Item 1A, *Risk Factors Relating to our Business.*

Insurance Operations.

Our insurance operations consist of three business divisions: (1) Allegiant; (2) StarAmerican; and (3) American Home Insurance.

Allegiant and StarAmerican were formed to provide insurance coverage for homebuilding risks as to which we believed insurance coverage was either too difficult or too expensive to obtain. Allegiant was organized as a risk

retention group under the Federal Liability Risk Retention Act of 1981. Allegiant, which began operations in June of 2004, is licensed as a Class 3 Stock Insurance Company by the Division of Insurance of the State of Hawaii and is subject primarily to the regulations of its state of incorporation. Allegiant generates revenue by providing to its customers, primarily certain subcontractors of MDC s homebuilding subsidiaries, general liability coverage during the construction of the Company s homes and for work performed in completed subdivisions. Allegiant seeks to provide to its customers coverage and insurance rates that are competitive with other insurers.

StarAmerican is a single parent captive insurance company licensed by the Division of Insurance of the State of Hawaii and is a wholly owned subsidiary of MDC. Pursuant to agreements beginning in June 2004, StarAmerican re-insures Allegiant for all claims in excess of $50,000 per occurrence up to $3,000,000 per occurrence, subject to various aggregate limits, which do not exceed $18,000,000 per year.

Allegiant and StarAmerican incur expenses for losses and loss adjustments based on actuarial studies that include known facts and interpretations of circumstances, including the Company s experience with similar insurance cases and historical trends involving insurance claim payment patterns, pending levels of unpaid insurance claims, mix or concentration of home styles, claim severity, claim frequency patterns such as those caused by natural disasters, fires, or accidents, depending on the business conducted, and changing regulatory and legal environments.

Regulations. Allegiant and StarAmerican are licensed in the State of Hawaii and, therefore, are subject to the regulation of the Hawaii Insurance Division. This regulation includes restrictions and oversight regarding: types of insurance provided; investment options; required capital and surplus; financial and information reporting; use of auditors, actuaries and other service providers; periodic examinations; and other operational items. As insurance companies organized under Hawaii s captive insurance laws, Allegiant and StarAmerican are subject to fewer regulations than non-captive insurance companies. As a risk retention group, Allegiant also is registered in other states where certain MDC subsidiaries do business. Allegiant must pay premium taxes and comply with financial and information reporting requirements of the insurance departments in these additional states.

American Home Insurance is an insurance agency, which provides homebuyers with personal lines property and casualty insurance products in the same markets as our homebuilding subsidiaries.

Title Operations.

American Home Title provides title agency services to the Company and our homebuyers in Colorado, Delaware, Florida, Illinois, Maryland, Nevada, Virginia and West Virginia.

Employees.

The table below summarizes the approximate number of employees for our homebuilding, Financial Services and Other and Corporate segments at December 31, 2007.

Homebuilding segments	1,700
Financial Services and Other	180
Corporate	290
Consolidated	2,170

Item 1A. Risk Factors Relating to our Business.

Adverse changes in general economic conditions could reduce the demand for homes and, as a result, could negatively impact our results of operations.

The homebuilding and mortgage lending industries continued to experience uncertainty and reduced demand for new homes, which negatively impacted our financial and operating results during the year ended December 31, 2007. Widespread national and international concern over instability in the credit markets has exacerbated the decline in demand for new homes. The conditions experienced during 2007 included, among other things: reduced consumer confidence; on-going homebuyer concerns about the housing market and the lack of home selling price stabilization; concerns over higher-risk mortgage loan products, such as Alt-A and sub-prime mortgage loans; and reduced availability of mortgage loan financing.

If the downturn in the homebuilding and mortgage lending industries continues, intensifies, or if the national economy weakens further and slips into a recession, we could continue to experience declines in the market value and demand for our homes, which could have a significant negative impact on our Home Gross Margins and financial and operational results.

Increased competition levels in the homebuilding and mortgage lending industries could result in lower net home orders, closings and decreases in the average selling prices of sold and closed homes, which could have a negative impact on our home sales revenue and results of operations.

The real estate industry is fragmented and highly competitive. Our homebuilding subsidiaries compete with numerous public and private homebuilders, including a number that are substantially larger and have greater financial resources than us. Our homebuilding subsidiaries also compete with subdivision developers and land development companies, some of which are themselves homebuilders or affiliates of homebuilders. Homebuilders compete for customers, land, building materials, subcontractor labor and desirable financing. Competition for home orders primarily is based upon price, home style, financing available to prospective homebuyers, location of property, quality of homes built, customer service and general reputation in the community, and may vary market-by-market and/or submarket-by-submarket. Additionally, competition within the homebuilding industry can be impacted through an excess supply of new and existing homes available for sale resulting from a number of factors including, among other things, increases in speculative homes available for sale and increases in home foreclosures. Increased competition, including lower home sales prices offered by our competitors as experienced during 2007, can result in decreases in our home sales prices and/or increases in home sales incentives in an effort to generate new home sales and maintain homes in Backlog until they close. These competitive pressures are likely to continue for some time and could affect our ability to maintain existing home sales prices and require that we provide additional incentives, which would negatively impact our future financial and operating results.

We, through our mortgage lending subsidiary, HomeAmerican, also compete with numerous banks, thrifts and other mortgage bankers and brokers, many of which are larger and may have greater financial resources than we do. Competitive factors include pricing, mortgage loan terms, underwriting criteria and customer service. To the extent that we are unable to adequately compete with other companies that originate mortgage loans, total revenue and the results of operations from our Financial Services and Other segment may be negatively impacted.

Further decline in the market value of our homes or carrying value of our land would have a negative impact on our results of operations and financial position.

Our homebuilding subsidiaries acquire land for the replacement of land inventory and/or expansion within our current markets and may, from time to time, purchase land for expansion into new markets. The fair value of our land

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and land under development and housing completed or under construction inventory depends on market conditions. Factors that can impact our determination of the fair value of our inventory primarily include homes sales prices, levels of home sales incentives and home construction costs. Our home sales prices and/or levels of home sales incentives can be impacted by, among other things, decreased demand for new homes, decreased home prices offered by our competitors, decreased ability of our homebuyers to obtain suitable mortgage loan financing and continued high levels of home order cancellations. Additionally, our home construction costs can be impacted by, among other things, shortages of subcontractor labor and changes in costs associated with subcontracted labor, building materials and other resources. If we are required to decrease home sales prices and/or increase incentives in an effort to generate new home sales, maintain homes in Backlog until they close or remain competitive with the home sales prices offered by our competitors, or if our home construction costs increase, we may not be able to recover the carrying costs of our inventory when our homebuilding subsidiaries build and sell homes. In such circumstances, we would be required to record additional impairments of our inventory. Additionally, due to the uncertainty in the homebuilding and mortgage lending industries, it is reasonably possible for us to experience further declines in the market value of our homes and, as a result, additional inventory impairments could be recorded in future reporting periods. Any such additional inventory impairments would have a negative impact on our financial position and results of operations in the future reporting period in which they were recorded.

Increases in our Cancellation Rate could have a negative impact on our Home Gross Margins and home sales revenue.

Our Cancellation Rate increased significantly during 2007 and 2006, compared with 2005 and 2004, which has negatively impacted the number of closed homes, net home orders, home sales revenue and our results of operations during 2007 and 2006, as well as the number of homes in Backlog at the end of each reporting period. Home order cancellations can result from a number of factors, including, declines in the market value of homes and/or slow appreciation in the market value of homes, increases in the supply of homes available to be purchased, increased competition, higher mortgage interest rates, homebuyers inability to sell their existing homes, homebuyers inability to obtain suitable financing, including providing sufficient down payments, and adverse changes in economic conditions. Continued high levels of home order cancellations would have a negative impact on our home sales revenue and financial and operating results in future reporting periods.

If land is not available at reasonable prices, our homes sales revenue and results of operations could be negatively impacted and/or we could be required to scale back our operations in a given market.

Our operations depend on our homebuilding subsidiaries ability to obtain land for the development of our residential communities at reasonable prices and with terms that meet our underwriting criteria. Our ability to obtain land for new residential communities may be adversely affected by changes in the general availability of land, the willingness of land sellers to sell land at reasonable prices given the deterioration in market conditions, competition for available land, availability of financing to acquire land, zoning, regulations that limit housing density and other market conditions. If the supply of land appropriate for development of residential communities becomes more limited because of these factors, or for any other reason, the number of homes that our homebuilding subsidiaries build and sell could be reduced. Additionally, the ability of our homebuilding subsidiaries to open new subdivisions could be impacted if we elect not to purchase lots under option contracts. To the extent that we are unable to timely purchase land or enter into new contracts for the purchase of land at reasonable prices, due to the lag time between the time we acquire land and the time we begin selling homes, our homes sales revenue and results of operations could be negatively impacted and/or we could be required to scale back our operations in a given market.

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If our potential homebuyers are not able to obtain suitable financing, our results of operations or cash flows may be impacted adversely.

Our business depends on the ability of our homebuyers to obtain affordable mortgages for the purchase of our homes, which includes being able to provide sufficient initial down payments for mortgage loan products currently available. Increases in the cost of mortgage financing and/or reductions in mortgage loan product offerings could prevent potential homebuyers from being able to obtain or qualify for mortgage loans. In addition, if our homebuyers must sell existing homes in order to buy homes from us, increases in mortgage costs or decreases in the market value of homes could interfere with such sales and result in our homebuyers inability to buy from us. Additionally, homebuyers ability to obtain suitable financing could be adversely impacted by tightening of our mortgage loan underwriting criteria in response to the decreased liquidity in the mortgage lending market. We are unable to predict future changes in home mortgage interest rates or the impact such changes may have on our operating activities and results of operations. However, these conditions can negatively impact our home sales revenue and results of operations through closing fewer homes and/or closing homes with lower average selling prices.

We have financial needs that we meet through the capital markets, including the debt and secondary mortgage markets, and continued disruptions in these markets could have an adverse impact on the Company s results of operations, financial position and/or cash flows.

We have financial needs that we meet through the capital markets, including the debt and secondary mortgage markets. The secondary markets currently are experiencing disruptions from reduced investor demand for mortgage loans and mortgage-backed securities, increased investor yield requirements for those loans and securities and the exit of third-party purchasers from the secondary market. In addition, the sources and terms and conditions of warehouse financing arrangements and other lending arrangements for the mortgage lending industry are changing. These changes can impact, among other things, availability of capital, terms and structures for debt and line of credit agreements, collateral requirements and collateral advance rates. Additionally, while certain governmental organizations and other mortgage industry participants have taken steps recently to ease the downturn in the credit and capital markets, the impact of their efforts, if any, on the homebuilding and mortgage lending industries is unknown. The foregoing disruptions and changes may have an adverse impact on the Company s results of operations, financial position and/or cash flows.

As is customary in the homebuilding industry, we often are required to provide surety bonds to secure our performance under construction contracts, development agreements and other arrangements. Our ability to obtain surety bonds primarily depends upon our credit rating, capitalization, working capital, past performance, management expertise and certain external factors, including the overall capacity of the surety market. While our credit ratings and liquidity position currently are strong, if we were unable to obtain surety bonds when required, our results of operations and/or cash flows could be impacted adversely.

In addition, the pricing matrix and the availability of advances and letters of credit under our homebuilding line of credit are dependent upon our credit ratings. While we currently have an investment grade credit rating from all three major ratings agencies, the lowering of any or all of these credit ratings could have an adverse impact on the cost of advances, letters of credit and unused commitment fees under our homebuilding line of credit. Lower credit ratings for MDC also could subject this line of credit to a borrowing base structure, which could limit our ability to obtain additional advances and issuances of letters of credit under this line. Under certain circumstances, these limitations could have an adverse impact on the Company s results of operations, financial position and/or cash flows.

Further uncertainty in the mortgage lending industry regarding the origination of mortgage loans could negatively impact our results of operations.

The Company is subject to risks associated with mortgage loans, including, among others, previously originated and sold Alt-A and sub-prime mortgage loans, second mortgage loans, high loan-to-value mortgage loans and jumbo mortgage loans (defined as a mortgage loan with a principal balance in excess of $417,000). These risks may include, among other things, compliance with mortgage loan underwriting criteria and the associated homebuyers performance, which could require HomeAmerican to repurchase certain of those mortgage loans or provide indemnification. Repurchased mortgage loans may impact HomeAmerican s results of operations, liquidity and cash flow as the existence of a defect that necessitated repurchase may require additional effort and expense incurred by HomeAmerican to cure the defect, the passage of time in order to cure or reduce the impact of an identified defect, a discounted sale of the repurchased loan due to the existence of a defect or, in the event that the loan has a defect and is non-performing, foreclosure and re-sale of the subject property.

Interest rate increases or changes in lending programs could lower demand for our homes and our mortgage lending services.

Our homebuilding and mortgage lending operations are impacted by the availability and cost of mortgage financing. Nearly all of our customers finance the purchase of their homes, and a significant number of these customers arrange their financing through HomeAmerican. Increases in home mortgage interest rates may reduce the demand for homes and home mortgages. We are unable to predict the extent to which recent or future changes in home mortgage interest rates will affect our operating activities and results of operations. Additionally, further tightening of mortgage loan underwriting criteria could have an adverse impact on our operating and financial results in future reporting periods.

In addition, we believe that the availability of FNMA, FHLMC, FHA and VA mortgage loans are an important factor in our marketing strategy. Any changes, limitations or restrictions on the availability of these types of financing could reduce our subsidiaries home sales and mortgage lending volume.

We depend on certain markets, and reduced home sales orders and closings for homes in these markets could have a negative impact on our revenue and results of operations. Additionally, we are reliant on a limited number of third-party purchasers of mortgage loans originated by HomeAmerican, which could impact our results of operations.

We conduct a significant portion of our business in the Arizona, California, Colorado, Nevada and Virginia markets and generate a disproportionate amount of our revenue in these markets. Demand for new homes and the market value of homes declined during 2007 and 2006 in each of these markets. If we continue to experience a slowdown in our operations within these markets, our results of operations and financial position in future reporting periods will continue to be negatively impacted.

Additionally, there are a limited number of third-party purchasers of mortgage loans and, at any given point in time, our business may be impacted adversely if one of them was no longer able or willing to purchase mortgage loans originated by HomeAmerican. Our operations could be impacted adversely due to reduced competition and having fewer bidders for originated mortgage loans we sell, which could result in us receiving a lower price for such originated mortgage loans.

Our business is subject to numerous federal, local, state laws and regulations concerning land development, construction of homes, sales, mortgage lending, environmental and other aspects of our business. These laws and regulations could give rise to additional liabilities or expenditures, or restrictions on our business.

Our operations are subject to continuing compliance requirements mandated by applicable federal, state and local statutes, ordinances, rules and regulations, including zoning and land use ordinances, building, plumbing and electrical codes, contractors licensing laws, state insurance laws, federal and state human resources laws and regulations and health and safety laws and regulations (including, but not limited to, those of the Occupational Safety & Health Administration). Various localities in which we operate have imposed (or may impose in the future) fees on developers to fund schools, road improvements and low and moderate-income housing.

From time to time, various municipalities in which our homebuilding subsidiaries operate restrict or place moratoria on the availability of utilities, including water and sewer taps. Additionally, certain jurisdictions in which our homebuilding subsidiaries operate have proposed or enacted slow growth or no growth initiatives and other measures that may restrict the number of building permits available in any given year. These initiatives or other slow or no growth measures could reduce our ability to open new subdivisions and build and sell homes in the affected markets and may create additional costs and administration requirements, which in turn could negatively impact our future home sales and results of operations. Although future conditions or governmental actions may impact our ability to obtain necessary permits or water and sewer taps, we currently believe that we have, or can obtain, water and sewer taps and building permits for our homebuilding subsidiaries land inventory and land held for development.

Our homebuilding operations also are affected by environmental laws and regulations pertaining to availability of water, municipal sewage treatment capacity, stormwater discharges, land use, hazardous waste disposal, dust controls, building materials, population density and preservation of endangered species, natural terrain and vegetation. Due to these considerations, our homebuilding subsidiaries generally obtain an environmental site assessment for parcels of land that they acquire. The particular environmental laws and regulations that apply to any given homebuilding project vary greatly according to a particular site s location, the site s environmental conditions and the present and former uses. These environmental laws may result in project delays, cause us to incur substantial compliance and other costs and/or prohibit or severely restrict homebuilding activity in certain environmentally sensitive locations.

The Company also is subject to rules and regulations with respect to originating, processing, selling and servicing mortgage loans, which, among other things: prohibit discrimination and establish underwriting guidelines; provide for audits and inspections; require appraisals, credit reports on prospective borrowers and disclosure of certain information concerning credit and settlement costs; establish maximum loan amounts; prohibit predatory lending practices; and regulate the referral of business to affiliated entities. Over time, the level of complexity in the mortgage lending business has increased significantly due to several factors, including: (1) an increase in the number of mortgage loan products as a result of the evolution of the secondary mortgage market and demand by borrowers; and (2) greater regulation of the industry. New rules and regulations, or revised interpretations of existing rules and regulations applicable to our mortgage lending operations could result in more stringent compliance standards, which may substantially increase costs of compliance.

Product liability litigation and warranty claims that arise in the ordinary course of business may be costly.

As a homebuilder, we are subject to construction defect and home warranty claims, including moisture intrusion and related mold claims, arising in the ordinary course of business. These claims are common to the homebuilding industry and can be costly. In addition, the costs of insuring against construction defect and product liability claims are high and the amount of coverage offered by insurance companies is currently limited. This coverage may be

further restricted and become more costly. If we are not able to obtain adequate insurance against these claims, we may incur additional expenses that would have a negative impact on our results of operations in future reporting periods.

Our income tax provision and other tax liabilities may be insufficient if taxing authorities are successful in asserting tax positions that are contrary to our position. Additionally, continued loss from operations in future reporting periods may require us to adjust the valuation allowance against our deferred tax assets.

From time to time, we are audited by various federal, state and local authorities regarding income tax matters. Significant judgment is required to determine our provision for income taxes and our liabilities for federal, state, local and other taxes. Our audits are in various stages of completion; however, no outcome for a particular audit can be determined with certainty prior to the conclusion of the audit, appeal and, in some cases, litigation process. Although we believe our approach to determining the appropriate tax treatment is supportable and in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, and FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, it is possible that the final tax authority will take a tax position that is materially different than that which is reflected in our income tax provision and other tax reserves. As each audit is conducted, adjustments, if any, are appropriately recorded in our Consolidated Financial Statements in the period determined. Such differences could have a material adverse effect on our income tax provision or benefit, or other tax reserves, in the reporting period in which such determination is made and, consequently, on our results of operations, financial position and/or cash flows for such period.

Our deferred tax assets should be reduced by a valuation allowance, if, based on the weight of available evidence, it is more-likely-than-not that some portion or all of the deferred tax assets will not be realized. In determining the more-likely-than-not criterion, we evaluate all positive and negative evidence as of the end of each reporting period. Future adjustments, either increases or decreases, to our deferred tax asset valuation allowance will be determined based upon changes in the expected realization of our net deferred tax assets. The realization of our deferred tax assets ultimately depends on the existence of sufficient taxable income in either the carryback or carryforward periods under the tax law. Due to significant estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances, it is reasonably possible that we will be required to record adjustments to the valuation allowance in future reporting periods. Our results of operations would be impacted negatively if we determine that increases to our deferred tax asset valuation allowance are required in a future reporting period.

Because of the seasonal nature of our business, our quarterly operating results can fluctuate.

Prior to 2006, we experienced seasonality and quarter-to-quarter variability in homebuilding activity levels. In general, the number of homes closed and associated home sales revenue increased during the third and fourth quarters, compared with the first and second quarters. We believe that this seasonality reflected the historical tendency of homebuyers to purchase new homes in the spring with closings scheduled in the fall or winter, as well as the scheduling of construction to accommodate seasonal weather conditions in certain markets. During 2007 and 2006, this seasonality pattern in the homebuilding industry was not apparent. The extent to which our historical seasonality pattern contributed to actual 2007 home sales and closing levels is unknown, and there can be no assurances that this seasonality pattern will be present in future reporting periods.

Labor and material shortages could cause delays in, and increase the costs of, the construction of our homes.

The residential construction industry experiences labor and material shortages from time to time, including: work stoppages; labor disputes and shortages in qualified trades people, insulation, drywall, concrete, steel and lumber; lack of availability of adequate utility infrastructure and services; our need to rely on local subcontractors who may not be

adequately capitalized or insured; and shortages, or delays in availability, or fluctuations in prices, of building materials. These labor and material shortages can be more severe during periods of strong demand for housing or during periods in which the markets where we operate experience natural disasters that have a significant impact on existing residential and commercial structures. Any of these circumstances could give rise to delays in the start or completion of our residential communities, increase the cost of developing one or more of our residential communities and increase the construction cost of our homes. To the extent that market conditions prevent the recovery of increased costs, including among other things, subcontracted labor, finished lots, building materials, and other resources, through higher selling prices, our Home Gross Margins and results of operations could be affected negatively.

Natural disasters could cause an increase in home construction costs, as well as delays, and could negatively impact our results of operations.

The climates and geology of many of the markets in which we operate, including California and Florida, present increased risks of natural disasters. To the extent that hurricanes, severe storms, earthquakes, droughts, floods, heavy or prolonged precipitation, wildfires or other natural disasters or similar events occur, the financial and operating results of our business, in particular, may be negatively impacted. These, among other natural disasters, can affect an area in which we build, or one nearby, and result in a diversion of labor and materials in the area from new home construction to the rebuilding of the existing homes damaged or destroyed in the natural disaster. This can cause delays in construction and delivery of new homes and/or increase our construction costs.

We are dependent on the services of certain key employees, and the loss of their services could hurt our business.

Our future success depends, in part, on our ability to attract, train and retain skilled personnel. If we are unable to retain our key employees or attract, train and retain other skilled personnel in the future, it could have an adverse impact on our financial and operating results.

Increased domestic and international instability could have an adverse effect on our operations.

Adverse developments in the war on terrorism, future terrorist attacks against the United States, or increased domestic and international instability could adversely affect our business.

The interests of certain controlling shareholders may be adverse to investors.

Larry A. Mizel, David D. Mandarich and other of our affiliates own, directly or indirectly, in the aggregate, almost 25% of our outstanding common stock. To the extent they and their affiliates vote their shares in the same manner, their combined stock ownership may effectively give them the power to elect our entire board of directors and control our management, operations and affairs. Circumstances may occur in which the interest of these shareholders could be in conflict with the interests of other shareholders. The large percentage of stock held by these persons could also delay or prevent a change in control of the Company.

Item 1B. Unresolved Staff Comments.

None

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Item 2. Properties.

Our corporate headquarters is located at 4350 South Monaco Street, Denver, Colorado 80237, where we lease office space in a 144,000 square foot office building. Our homebuilding divisions and, in some markets, other MDC subsidiaries, including HomeAmerican, American Home Insurance and American Home Title, lease additional office space. The table below outlines the number of office facilities that are leased and the approximate square footage leased in each market at December 31, 2007. We are satisfied with the suitability and capacity of our office locations.

	Number of Leased Facilities	Total Square Footage Leased
Arizona	6	124,000
California	8	141,000
Colorado	9	305,000
Delaware Valley	3	16,000
Florida	4	43,000
Illinois	1	10,000
Maryland	2	16,000
Nevada	4	63,000
Texas	1	1,000
Utah	4	28,000
Virginia	5	81,000
Totals	47	828,000

Item 3. Legal Proceedings.

The Company and certain of its subsidiaries and affiliates have been named as defendants in various claims, complaints and other legal actions arising in the ordinary course of business, including moisture intrusion and related mold claims. In the opinion of management, the outcome of these matters will not have a material adverse effect upon the financial condition, results of operations or cash flows of the Company. See **Forward-Looking Statements** above.

The U.S. Environmental Protection Agency (EPA) filed an administrative action against Richmond American Homes of Colorado, Inc. (RAH Colorado), alleging that RAH Colorado violated the terms of RAH Colorado s general permit for discharges of stormwater from construction activities at two of RAH Colorado s development sites. In its complaint, the EPA sought civil penalties against RAH Colorado in the amount of $0.1 million. On November 11, 2003, the EPA filed a motion to withdraw the administrative action so that it could refile the matter in United States District Court as part of a consolidated action against RAH Colorado for alleged stormwater violations at not only the original two sites, but also two additional sites. The EPA s motion to withdraw was granted by the Administrative Law Judge on February 9, 2004. The EPA has not yet refiled the matter. The EPA has inspected 21 sites under development in Colorado and by RAH Colorado affiliates in Virginia, Maryland, Arizona and California, and claims to have found additional stormwater permit violations. RAH Colorado has substantial defenses to the allegations made by the EPA and the Company is exploring methods of resolving this matter with the EPA.

The EPA issued two Notices of Violation against Richmond American Homes of Arizona, Inc. (RAH Arizona) alleging violations of the Clean Air Act. The EPA asserted that RAH Arizona had not controlled dust generated at construction sites in Maricopa County in that it had not operated a water application system or other approved control measures, installed suitable track-out control devices and/or cleaned-up materials tracked-out from project sites. The EPA filed an action in the United States District Court, District of Arizona, against RAH Arizona based on these allegations. On September 17, 2007, RAH Arizona, without admitting any wrongdoing, reached a settlement with a release of civil liability

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for all alleged violations. After opportunity for public comment, the settlement agreement was approved by the Court, we paid a civil penalty of $155,000 and commenced implementation of various procedures to abate fugitive dust emissions.

Because of the nature of the homebuilding business, and in the ordinary course of its operations, the Company from time to time may be subject to product liability claims.

Item 4. Submission of Matters to a Vote of Security Holders.

No meetings of the Company s stockholders were held during the fourth quarter of 2007.

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

At December 31, 2007, MDC had 773 shareowners of record. The shares of MDC common stock are traded on the New York Stock Exchange. The following table sets forth, for the periods indicated, the price ranges of MDC s common stock.

	Three Months Ended			
	March 31	June 30	September 30	December 31
2007				
High	$ 60.00	$ 54.73	$ 50.33	$ 43.10
Low	$ 47.75	$ 47.54	$ 40.31	$ 32.34
2006				
High	$ 66.88	$ 68.10	$ 52.07	$ 57.31
Low	$ 58.72	$ 50.07	$ 40.43	$ 47.26

The following table sets forth the cash dividends declared and paid in 2007 and 2006 (dollars in thousands, except per share amounts).

	Date of Declaration	Date of Payment	Dividend per Share	Total Dividends Paid
2007				
First quarter	January 22, 2007	February 21, 2007	$ 0.25	$ 11,414
Second quarter	April 27, 2007	May 23, 2007	0.25	11,438
Third quarter	July 23, 2007	August 22, 2007	0.25	11,459
Fourth quarter	October 22, 2007	November 20, 2007	0.25	11,462
			$ 1.00	$ 45,773
2006				
First quarter	January 23, 2006	February 23, 2006	$ 0.25	$ 11,217
Second quarter	April 24, 2006	May 24, 2006	0.25	11,239
Third quarter	July 24, 2006	August 23, 2006	0.25	11,247
Fourth quarter	October 23, 2006	November 21, 2006	0.25	11,260
			$ 1.00	$ 44,963

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In connection with the declaration and payment of dividends, we are required to comply with certain covenants contained in our unsecured revolving line of credit agreement (as amended on January 24, 2008), which has a total commitment of $1.25 billion. Pursuant to the terms of this amended agreement, dividends may be declared or paid by us if we are in compliance with certain stockholders equity and debt coverage tests. As a result, effective January 24, 2008, we had a permitted dividend capacity of approximately $370 million pursuant to the most restrictive of these covenants.

On January 29, 2008, MDC s board of directors declared a quarterly cash dividend of twenty five cents ($0.25) per share. The dividend will be paid on February 26, 2008 to shareowners of record on February 12, 2008.

There were no shares of MDC common stock repurchased during the year ended December 31, 2007. At December 31, 2007, we were authorized to repurchase up to 4,000,000 shares of our common stock.

Performance Graph

Set forth below is a graph comparing the yearly change in the cumulative total return of the MDC s common stock with the cumulative total return of the Standard & Poor s 500 Stock Index and with that of a peer group of other homebuilders over the five-year period ending on December 31, 2007.

It is assumed in the graph that $100 was invested (1) in the Company s common stock; (2) in the stocks of the companies in the Standard & Poor s 500 Stock Index; and (3) in the stocks of the peer group companies, just prior to the commencement of the period and that all dividends received within a quarter were reinvested in that quarter. The peer group index is composed of the following companies: Beazer Homes USA, Inc., Centex Corporation, D.R. Horton, Inc., Hovnanian Enterprises, Inc., KB Home, Lennar Corporation, M/I Homes, Inc., Meritage Homes Corporation, NVR, Inc., Pulte Homes, Inc., The Ryland Group, Inc., Standard Pacific Corp. and Toll Brothers, Inc.

The stock price performance shown on the following graph is not indicative of future price performance.

COMPARISON OF CUMULATIVE TOTAL RETURN OF MDC COMMON STOCK, THE S&P 500 STOCK INDEX AND A SELECTED PEER GROUP

Item 6. Selected Financial and Other Data.

The data in these tables and related footnotes should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the Company s Consolidated Financial Statements (in thousands, except per share and unit amounts).

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SELECTED FINANCIAL DATA

	Year Ended December 31,				
	2007	2006	2005	2004	2003
INCOME STATEMENT DATA					
Home sales revenue	$ 2,765,981	$ 4,650,556	$ 4,792,700	$ 3,922,837	$ 2,846,220
Total revenue	$ 2,933,249	$ 4,801,742	$ 4,892,589	$ 4,012,894	$ 2,922,595
Home cost of sales	$ 2,380,427	$ 3,619,656	$ 3,436,035	$ 2,834,092	$ 2,159,979
Asset impairments	$ 726,621	$ 112,027	$ -	$ -	$ -
General and administrative expenses	$ 306,715	$ 418,879	$ 401,184	$ 327,812	$ 237,648
(Loss) income before income taxes	$ (756,464)	$ 333,137	$ 808,763	$ 636,914	$ 348,223
Net (loss) income[(1)]	$ (636,940)	$ 214,253	$ 505,723	$ 391,165	$ 212,229
Basic (loss) earnings per common share	$ (13.94)	$ 4.77	$ 11.48	$ 9.19	$ 5.11
Diluted (loss) earnings per common share	$ (13.94)	$ 4.66	$ 10.99	$ 8.79	$ 4.90
Weighted-average shares outstanding					
Basic	45,687	44,952	44,046	42,560	41,521
Diluted[(2)]	45,687	45,971	46,036	44,498	43,333
Dividends declared per share	$ 1.00	$ 1.00	$ 0.76	$ 0.43	$ 0.28

(1) Net loss for the year ended December 31, 2007 includes the impact of recording a valuation allowance of $160.0 million against our deferred tax assets.
(2) 758,899 shares of common stock equivalents have been excluded from the diluted weighted-average shares outstanding for the year ended December 31, 2007 because the effect of their inclusion would be anti-dilutive, or would decrease the reported diluted loss per share.

	December 31,				
	2007	2006	2005	2004	2003
BALANCE SHEET DATA					
Assets					
Cash and cash equivalents	$ 1,004,763	$ 507,947	$ 214,531	$ 400,959	$ 170,289
Housing completed or under construction	$ 902,221	$ 1,178,671	$ 1,320,106	$ 887,002	$ 769,762
Land and land under development	$ 554,336	$ 1,575,158	$ 1,677,948	$ 1,129,266	$ 785,541
Total assets	$ 2,956,237	$ 3,909,875	$ 3,859,850	$ 2,844,731	$ 2,028,790
Debt and Lines of Credit					
Senior notes	$ 997,091	$ 996,682	$ 996,297	$ 746,310	$ 497,700
Notes payable	-	-	-	-	2,479
Homebuilding line of credit	-	-	-	-	-
Mortgage line of credit	70,147	130,467	156,532	135,478	79,240
Total debt and lines of credit	$ 1,067,238	$ 1,127,149	$ 1,152,829	$ 881,788	$ 579,419
Stockholders Equity	$ 1,476,013	$ 2,161,882	$ 1,952,109	$ 1,418,821	$ 1,015,920
Stockholders Equity per Outstanding Share	$ 32.05	$ 47.87	$ 43.74	$ 32.80	$ 24.06

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	Year Ended December 31,				
	2007	2006	2005	2004	2003
OPERATING DATA					
Homes closed (units)	8,195	13,123	15,307	13,876	11,211
Average selling price per home closed	$ 337.5	$ 354.4	$ 313.1	$ 282.7	$ 253.9
Orders for homes, net (units)	6,504	10,229	15,334	14,248	12,630
Homes in Backlog at period end (units)	1,947	3,638	6,532	6,505	5,593
Estimated Backlog sales value at period end	$ 650,000	$ 1,300,000	$ 2,440,000	$ 1,920,000	$ 1,600,000
Estimated average selling price of homes in Backlog	$ 333.8	$ 357.3	$ 373.5	$ 295.2	$ 286.1
Active subdivisions at year-end	278	306	292	242	198
Average active subdivisions	302	298	273	222	195
Cash Flows From					
Operating activities	$ 592,583	$ 363,048	$ (424,929)	$ (27,779)	$ 82,322
Investing activities	$ (1,447)	$ (10,221)	$ (22,889)	$ (29,917)	$ (6,785)
Financing activities	$ (94,320)	$ (59,411)	$ 261,390	$ 288,366	$ 67,481

Seasonality and Variability in Quarterly Results

Prior to 2006, the Company experienced seasonality and quarter-to-quarter variability in homebuilding activity levels. During 2007, this seasonal pattern in the homebuilding industry was not apparent. The seasonal nature of our homebuilding and mortgage lending business are described in more detail in Item 1A, *Risk Factors Relating to Our Business*. The following table reflects our unaudited summarized quarterly consolidated financial and operational information for the two years ended December 31, 2007 (in thousands, except per share and unit amounts). See **Forward-Looking Statements** above.

	Quarter			
	Fourth	Third	Second	First
2007				
Home sales revenue	$ 715,244	$ 651,124	$ 687,813	$ 711,800
Total revenue	$ 784,756	$ 686,661	$ 716,708	$ 745,124
Asset impairments	$ 175,199	$ 248,950	$ 161,050	$ 141,422
General and administrative expenses[(1)]	$ 59,486	$ 76,482	$ 80,090	$ 90,657
Net loss[(2)]	$ (281,092)	$ (155,378)	$ (106,072)	$ (94,398)
Orders for homes, net (units)	748	1,228	1,970	2,558
Homes closed (units)	2,200	1,963	2,031	2,001
Homes in Backlog at period end (units)	1,947	3,399	4,134	4,195
Estimated Backlog sales value at period end	$ 650,000	$ 1,210,000	$ 1,480,000	$ 1,500,000
Loss per share				
Basic	$ (6.14)	$ (3.40)	$ (2.32)	$ (2.07)
Diluted	$ (6.14)	$ (3.40)	$ (2.32)	$ (2.07)
Weighted-Average Shares Outstanding				
Basic	45,772	45,751	45,722	45,501
Diluted	45,772	45,751	45,722	45,501

(1) General and administrative expenses for the 2007 fourth quarter include the impact of approximately $10 million of accruals from prior quarters which were reversed in the fourth quarter due to changes in the estimated and actual 2007 bonus payments.

(2) Net loss in the 2007 fourth quarter includes the impact of recording a valuation allowance of $160.0 million against our deferred tax assets.

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	Quarter			
	Fourth	Third	Second	First
2006				
Home sales revenue	$ 1,294,140	$ 1,050,700	$ 1,188,561	$ 1,117,155
Total revenue	$ 1,343,413	$ 1,080,923	$ 1,231,981	$ 1,145,425
Asset impairments	$ 91,252	$ 19,915	$ 260	$ 600
General and administrative expenses	$ 92,284	$ 99,779	$ 115,551	$ 111,265
Net (loss) income	$ (6,365)	$ 48,706	$ 76,491	$ 95,421
Orders for homes, net (units)	1,571	2,120	2,738	3,800
Homes closed (units)	3,594	2,955	3,376	3,198
Homes in Backlog at period end (units)	3,638	5,661	6,496	7,134
Estimated Backlog sales value at period end	$ 1,300,000	$ 2,100,000	$ 2,440,000	$ 2,700,000
(Loss) earnings per share				
Basic	$ (0.14)	$ 1.08	$ 1.70	$ 2.13
Diluted	$ (0.14)	$ 1.06	$ 1.66	$ 2.08
Weighted-Average Shares Outstanding				
Basic	45,073	44,972	44,939	44,820
Diluted	45,073	45,868	45,972	45,970

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion should be read in conjunction with, and is qualified in its entirety by, the Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-K. This item contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those indicated in such forward-looking statements. Factors that may cause such a difference include, but are not limited to, those discussed in Item 1A: Risk Factors Relating to our Business.

EXECUTIVE SUMMARY

The 2006 calendar year reflected the acceleration of a dramatic downturn in the homebuilding industry. The challenges we encountered intensified significantly during 2007 and expanded beyond homebuilding into the mortgage lending industry and the credit and capital markets. As a result, during 2007, the homebuilding sector experienced what appeared to be an extraordinary absence of consumer demand for new homes. We responded to these conditions in a number of ways. However, we were not immune to the uncertainties in the wider credit and capital markets. We believe that the stability of these markets will play a major role in the timing, strength and sustainability of a turnaround in the homebuilding and mortgage lending industries. Additionally, while certain governmental agencies and other mortgage industry participants have taken steps recently to ease the downturn in the credit, capital and homebuilding markets, we cannot provide any assurance as to the impact their efforts will have on our Company or the homebuilding industry as a whole, as the on-going severity and duration of this downturn continues to be unknown. See **Forward-Looking Statements** below.

Each of our homebuilding segments and our Financial Services and Other segment continued to be impacted by the downturn in the homebuilding and mortgage lending industries, which we believe included, among other things, on-going homebuyer concerns about declines in the market value of homes, as well as reduced availability of credit for homebuyers caused by tightening mortgage loan underwriting criteria and an overall reduction in liquidity in the mortgage industry. We believe these and other factors contributed to, among other things: (1) significant increases in competition for new home orders driven by builders that significantly cut new home sales prices; (2) continued high levels of home sales incentives and, in many cases, increased home sales incentives offered to stimulate new home orders and maintain previous home orders in Backlog (as defined below) until they close; (3) high levels of foreclosures, which contributed to an excess supply of homes available to be purchased; (4) prospective homebuyers

having a more difficult time selling their existing homes in this increasingly competitive environment; and (5) reduced affordability of homes, partially due to the increased difficulty confronted by homebuyers in trying to qualify for mortgage loans or provide sufficient down payments for mortgage loans for which they qualify.

For MDC, these conditions resulted in an increased Cancellation Rate (as defined below), fewer closed homes, decreased new home orders, reduced year-over-year Backlog and lower Home Gross Margins (as defined below) in 2007, resulting in asset impairments of $726.6 million recorded during the year ended December 31, 2007. As a consequence, we incurred a pre-tax loss of $756.5 million during 2007, compared with pre-tax income of $333.1 million during 2006. Additionally, we incurred a net loss of $636.9 million during 2007, which includes the impact of a $160.0 million valuation allowance recorded against our deferred tax assets, compared with net income of $214.3 million during 2006. Because of the uncertainty surrounding the severity and duration of the downturn in the homebuilding and mortgage lending industries, we are unable to determine the potential for net losses in future reporting periods. See **Forward-Looking Statements** below.

Recognizing the challenges presented by the downturn in the homebuilding and mortgage lending businesses, our management focused on the following throughout 2007:

- We continued our efforts to right-size our operations in an attempt to reduce our general and administrative expenses in response to significant decreases in the number of homes sold and closed by:
  - consolidating homebuilding divisions in several of our markets;
  - eliminating most of our regional homebuilding offices;
  - consolidating office space and vacating a number of office facilities in many of our markets; and
  - reducing Company-wide headcount across all departments.
- We increased our efforts to control costs through continued renegotiations of material and labor costs with our suppliers and subcontractors.
- We lowered our portfolio of lots owned and controlled in each market by:
  - limiting the purchase of lots;
  - selling land that no longer met our strategic objectives;
  - terminating option contracts to purchase lots that no longer satisfied our underwriting criteria; and
  - constructing, selling and closing homes in the ordinary course of business;

We limited our cash outflows through tighter controls over:

- land acquisition expenditures;
- land development and home construction costs; and
- construction of speculative inventories and new home starts.

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We strengthened our management of risks associated with the origination and subsequent sales of mortgage loan products by:

tightening our mortgage loan underwriting criteria;

originating mortgage loan products for which our customers might qualify, such as government loans, that conform to HomeAmerican s tightened mortgage underwriting criteria;

limiting representations and warranties, including certain borrower payment default provisions on mortgage loans HomeAmerican sold to third-party purchasers; and

reducing and/or eliminating the origination of higher risk mortgage loans, including Alt-A (as defined below), second mortgages and sub-prime (as defined below) loans.

We focused more closely on sales initiatives intended to generate traffic, new home orders and maintain home orders in Backlog until they close, including targeted sales and marketing programs and increased home sales incentives.

We expanded the scope of our national customer experience initiative, which is intended to improve the home buying and home ownership experience.

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

The preparation of financial statements in conformity with accounting policies generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Management evaluates such estimates and judgments on an on-going basis and makes adjustments as deemed necessary. Actual results could differ from these estimates using different estimates and assumptions, or if conditions are significantly different in the future. See **Forward-Looking Statements** above.

Listed below are those estimates and policies that we believe are critical and require the use of complex judgment in their application. Our critical accounting estimates and policies are as follows and should be read in conjunction with the Notes to our Consolidated Financial Statements.

Homebuilding Inventory Valuation (Held-for-Development). Our homebuilding inventories accounted for on a held-for-development basis include assets associated with subdivisions in which we intend to construct and sell homes on the land. Each such subdivision represents the lowest level of identifiable cash flows. The inventory in our held-for-development subdivisions also includes assets associated with model and speculative homes. Homebuilding inventories that are accounted for as held-for-development are carried at cost unless events and circumstances indicate that the carrying value of the underlying subdivision may not be recoverable. In making this determination, we review, among other things, the following for each subdivision:

actual and trending Operating Profit (which is defined as home sales revenue less home cost of sales and all direct incremental costs associated with the home closing) for homes closed in the (1) prior two completed fiscal quarters on an individual basis; (2) current fiscal quarter; (3) last six months; and (4) last twelve months;
estimated future undiscounted cash flows and Operating Profit;
forecasted Operating Profit for homes in Backlog;

actual and trending net and gross home orders;

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- base sales price and home sales incentive information for homes that (1) closed in the prior two completed fiscal quarters; (2) closed in the current fiscal quarter; (3) are in Backlog as of the end of the current fiscal quarter; and (4) are forecasted to close over the remaining life of the subdivision;
- market information for each sub-market, including competition levels and the size and style of homes currently being offered for sale; and
- known or probable events indicating that the carrying value may not be recoverable.

On a quarterly basis, if events or circumstances indicate that the carrying value of our held-for-development inventory may not be recoverable, such assets are reviewed for impairment by comparing the undiscounted estimated future cash flows from an individual subdivision to its carrying value in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). The evaluation for the recoverability of the carrying value of the assets for each individual subdivision can be impacted significantly by the following:

- estimates of future base selling prices;
- estimates of future home sales incentives; and
- estimates of future home construction and land development costs.

These estimates are dependent on specific market or sub-market conditions for each subdivision. While we consider available information to determine what we believe to be our best estimates as of the end of a reporting period, these estimates are subject to change in future reporting periods as facts and circumstances change. Local market-specific conditions that may impact these estimates for a subdivision include:

- historical subdivision results, and actual and trending Operating Profit, base selling prices and home sales incentives;
- forecasted Operating Profit for homes in Backlog;
- the intensity of competition within a market or sub-market, including publicly available home sales prices and home sales incentives offered by our competitors;
- the current sales pace for active subdivisions;
- subdivision specific attributes, such as location, availability of lots in the sub-market, desirability and uniqueness of subdivision location and the size and style of homes currently being offered;
- potential for alternative home styles to respond to local market conditions;
- changes by management in the sales strategy of a given subdivision; and
- current local market economic and demographic conditions and related trends and forecasts.

These and other local market-specific conditions that may be present are considered by personnel in our homebuilding divisions as they prepare or update the forecasted assumptions for each subdivision. Quantitative and qualitative factors other than home sales prices could significantly impact the potential for future impairments. The sales objectives can differ between subdivisions, even within a given sub-market. For example, facts and circumstances in a given subdivision may lead us to price our homes with the objective of yielding a higher sales absorption pace, while facts and circumstances in another subdivision may lead us to price our homes to minimize deterioration in our Home Gross Margins,

although, it may result in a slower sales absorption pace. Furthermore, the key assumptions included in our estimated future undiscounted cash flows may be interrelated. For example, a decrease in estimated base sales price or an increase in home sales incentives may result in a corresponding increase in sales absorption pace. Additionally, a decrease in the average sales price of homes to be sold and closed in future reporting periods for one subdivision that has not been generating what management believes to be an adequate sales

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absorption pace may impact the estimated cash flow assumptions of a nearby subdivision. Changes in our key assumptions, including estimated construction and development costs, absorption pace, selling strategies or discount rates could materially impact future cash flow and fair value estimates. Due to the number of possible scenarios that would result from various changes in these factors, we do not believe it is possible to develop a sensitivity analysis with a level of precision that would be meaningful to an investor.

If the undiscounted future cash flows of a subdivision are less than its carrying value, the carrying value of the subdivision is written down to its then estimated fair value. For subdivisions that continue to be held-for-development, the carrying value is not written up for increases in the estimated fair value of such subdivisions in subsequent reporting periods.

Management determines the estimated fair value of each held-for-development subdivision by determining the present value of the estimated future cash flows at discount rates that are commensurate with the risk of the subdivision under evaluation. The estimated future cash flows are the same for both our recoverability and fair value assessments. Factors we consider when determining the discount rate to be used for each subdivision include, among others:

- the number of lots in a given subdivision;
- the amount of future land development costs to be incurred;
- risks associated with the home construction process, including the stage of completion for the entire subdivision and the number of owned lots under construction;
- market risks, including volatility in home prices and risks associated with markets with high average selling prices of homes; and
- the estimated remaining lifespan of the subdivision.

For the year ended December 31, 2007, discount rates used in our estimated discounted cash flow assessments ranged from 10% to 18%. For our held-for-development inventory, we recorded $169.9 million and $515.6 million, respectively, of impairments to our housing completed or under construction and land and land under development during the year ended December 31, 2007. The Company allocates the impairments recorded between housing completed or under construction and land and land under development for each impaired subdivision based upon the status of construction of a home on each lot (i.e. if the lot is in housing completed or under construction, the impairment for that lot is recorded against housing completed or under construction). The allocation of impairment is the same to each lot in a given subdivision. These impairments, together with impairments of our held-for-sale inventory and intangible assets, are presented as a separate line in the Consolidated Statements of Operations. Changes in management s estimates, particularly the timing and amount of the estimated future cash inflows and outflows, forecasted average selling prices of homes to be sold and closed and the present value discount rate used in the fair value calculation, can materially affect any impairment calculation. Because our forecasted cash flows are impacted significantly by changes in market conditions, it is reasonably possible that actual results could differ from those estimates.

Homebuilding Inventory Valuation (Held-for-Sale). We record land held-for-sale at the lower of its carrying value or fair value less costs to sell. In accordance with SFAS 144, the classification of land as held-for-sale is based on the following criteria:

- management, having the authority to approve the action, commits to a plan to sell the asset;
- the asset is available for immediate sale in its present condition, subject only to terms that are usual and customary for sales of such assets;

- an active program to locate a buyer and other actions required to complete the plan to sell the asset have been initiated;
- the sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale, within one year;
- the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value; and
- actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Additionally, in certain circumstances, management will re-evaluate the best use of an asset that is currently being accounted for as held-for-development. In such situations, management will review, among other things: (1) average sales prices for homes that have closed, are in Backlog and forecasted for future sales; (2) current competition levels and estimated levels of competition in future reporting periods; (3) estimated development costs that have yet to be incurred; and (4) the total number of lots owned in each subdivision and surrounding areas. If, based upon this evaluation, management believes that the best use of the asset is the sale of the asset in its current condition, all or portions of the subdivision will be accounted for as held-for-sale, assuming all of the foregoing held-for-sale criteria have been met at the end of the applicable reporting period.

In performing the impairment evaluation for land accounted for on a held-for-sale basis, management considers, among other things, prices for land in recent comparable sale transactions, market analysis studies, which include the estimated price a willing buyer would pay for the land (other than in a forced liquidation) and recent bona fide offers received from outside third-parties. If the estimated fair value less cost to sell an asset is less than the current carrying value, the asset is written down to its estimated fair value less cost to sell. We monitor the fair value of held-for-sale assets on a periodic basis through the disposition date. Subsequent increases in the fair value less cost to sell of a held-for-sale asset, if any, is recognized as a decrease to impairments in our Consolidated Statements of Operations during such subsequent period, but not in excess of the cumulative impairment that was recorded previously while it was a held-for-sale asset. During the years ended December 31, 2007 and 2006, we recorded impairments on our held-for-sale inventories of $40.7 million and $2.5 million, respectively.

Income Taxes Valuation Allowance. In accordance with SFAS No. 109, Accounting for Income Taxes, a valuation allowance is recorded against a deferred tax asset if, based on the weight of available evidence, it is more-likely-than-not (a likelihood of more than 50%) that some portion, or all, of the deferred tax asset will not be realized. The realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income in either the carryback or carryforward periods under tax law. The four sources of taxable income to be considered in determining whether a valuation allowance is required include:

- future reversals of existing taxable temporary differences (i.e., offset gross deferred tax assets against gross deferred tax liabilities);
- taxable income in prior carryback years;
- tax planning strategies; and
- future taxable income exclusive of reversing temporary differences and carryforwards.

Determining whether a valuation allowance for deferred tax assets is necessary requires an analysis of both positive and negative evidence regarding realization of the deferred tax assets. Examples of positive evidence may include:

a strong earnings history exclusive of the loss that created the deductible temporary differences, coupled with evidence indicating that the loss is the result of an aberration rather than a continuing condition;

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- an excess of appreciated asset value over the tax basis of a company s net assets in an amount sufficient to realize the deferred tax asset; and
- existing Backlog that will produce more than enough taxable income to realize the deferred tax asset based on existing sales prices and cost structures.

Examples of negative evidence may include:

- the existence of cumulative losses (defined as a pre-tax cumulative loss for the current and previous two years);
- an expectation of being in a cumulative loss position in a future reporting period;
- a carryback or carryforward period that is so brief that it would limit the realization of tax benefits;
- a history of operating loss or tax credit carryforwards expiring unused; and
- unsettled circumstances that, if unfavorably resolved, would adversely affect future operations and profit levels on a continuing basis.

The weight given to the potential effect of negative and positive evidence should be commensurate with the extent to which it can be objectively verified. A company must use judgment in considering the relative impact of positive and negative evidence. At December 31, 2007, after considering a number of factors, most notably our expectation of being in a three-year cumulative operating loss position during 2008, we established a valuation allowance of $160.0 million against our deferred tax assets.

Future adjustments, either increases or decreases, to our deferred tax asset valuation allowance will be determined based upon changes in the expected realization of our net deferred tax assets. For example, the valuation allowance could change significantly if the $160.6 million of net deferred tax assets still remaining at December 31, 2007 is not realized during fiscal 2008 through federal or state carryback or reversals of existing taxable temporary differences. This could occur if actual levels of home closings and/or land sales during 2008 are less than currently projected. Additionally, our December 31, 2007 valuation allowance may be further impacted by, among other things:

- additional inventory impairments;
- additional pre-tax operating losses; or
- the utilization of tax planning strategies that could accelerate the realization of certain deferred tax assets (for example, funding certain accrued liabilities such as employee vacation accruals or pension liabilities).

Because our valuation allowance can be impacted by any one or a combination of the foregoing factors, we do not believe it is possible to develop a sensitivity analysis associated with potential adjustments to the valuation allowance on our deferred tax assets. Additionally, due to the considerable estimates utilized in establishing the valuation allowance and the potential for changes in facts and circumstances in future reporting periods, it is reasonably possible that we will be required to either increase or decrease our valuation allowance in future reporting periods.

Income Taxes FIN 48 (as defined below). We apply the interpretations prescribed by FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in Income Taxes (FIN 48) in accounting for the uncertainty in income taxes recognized in our Consolidated Financial Statements. FIN 48 provides guidance for the recognition and measurement in financial statements for uncertain tax positions taken or expected to be taken in a tax return.

The evaluation of a tax position in accordance with FIN 48 is a two-step process, the first step being recognition. We determine whether it is more-likely-than-not that a tax position will be sustained upon tax examination, including resolution of any related appeals or litigation, based on only the technical merits of the position. The technical merits of a tax position derive from both statutory and judicial authority (legislation and statutes, legislative intent, regulations, rulings, and case law) and their applicability to the facts and circumstances of the tax position. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements.

The second step is measurement. A tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate resolution with a taxing authority.

Revenue Recognition. We recognize revenue from home closings and land sales in accordance with SFAS No. 66, Accounting for Sales of Real Estate (SFAS 66). Accordingly, revenue is recognized when: (1) the closing has occurred; (2) title has passed to the buyer; (3) possession and other attributes of ownership have been transferred to the buyer; (4) we are not obligated to perform significant additional activities after closing and delivery; and (5) the buyer demonstrates a commitment to pay for the property through an adequate initial and continuing investment. In accordance with SFAS 66, the buyer s initial investment shall include: (1) cash paid as a down payment; (2) the buyer s notes supported by irrevocable letters of credit; (3) payments made by the buyer to third-parties to reduce existing indebtedness on the property; and (4) other amounts paid by the buyer that are part of the sales value of the property. For home closings, we evaluate the initial investment for home purchase financing provided under Federal Housing Administration (FHA)-insured and Veterans Administration (VA)-guaranteed loans in accordance with Emerging Issues Task Force (EITF) No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds, and for all other home purchase financing in accordance with SFAS 66 and EITF No. 88-24, Effect of Various Forms of Financing under FASB Statement No. 66.

For home closings, if the homebuyer has sufficient initial and continuing investment, and all other revenue recognition criteria have been met, revenue is recognized using the full accrual method as provided in SFAS 66 on the date of closing. For a home closing in which HomeAmerican originates the mortgage loan and the homebuyer does not provide a sufficient initial and continuing investment, we utilize the installment method of accounting in accordance with SFAS 66. Accordingly, the corresponding Operating Profit is deferred and subsequently recognized on the date that HomeAmerican sells the homebuyer s loan, or loans, to a third-party purchaser. We had $1.4 million and $23.1 million in deferred Operating Profits associated with homes that closed for which the initial or continuing investment criteria were not met as of December 31, 2007 and December 31, 2006, respectively. The deferral of Operating Profits is recorded as a reduction to home sales revenue in the Consolidated Statements of Operations.

In accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140), a sale of a homebuyer loan has occurred when the following criteria have been met: (1) the payment from the third-party purchaser is not subject to future subordination; (2) we have transferred all the usual risks and rewards of ownership that is in substance a sale; and (3) we do not have a substantial continuing involvement with the loan. Factors that we consider in assessing whether a sale of a mortgage loan has occurred in accordance with SFAS 140 include, among other things: (1) the recourse, if any, to HomeAmerican for credit and interest rate risk; (2) the right or obligation, if any, of HomeAmerican to repurchase the loan; and (3) the control HomeAmerican retains, or is perceived to retain, over the administration of the loan post-closing.

Income with respect to loan origination fees, net of certain direct loan origination costs incurred, and loan commitment fees are deferred and amortized over the life of the loan. Revenue from the sale of mortgage loan

servicing is recognized upon the exchange of consideration for the mortgage loans and related servicing rights between us and the third-party purchaser in accordance with the provisions of SFAS 140. Based upon the current terms of HomeAmerican s contracts, exchange of consideration is deemed effective when we receive the proceeds from the third-party purchaser and when the specified records are delivered, either electronically or manually, to the third-party purchaser.

Segment Reporting. The application of SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131), requires significant judgment in determining our operating segments. SFAS 131 defines operating segments as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the chief operating decision-maker, or decision-making group, to evaluate performance and make operating decisions. We have identified our chief operating decision-makers (CODMs) as three key executives the Chief Executive Officer, Chief Operating Officer and Chief Financial Officer.

We have identified each homebuilding subdivision as an operating segment in accordance with SFAS 131. Each homebuilding subdivision engages in business activities from which it earns revenue primarily from the sale of single-family detached homes, generally to first-time and first-time move-up homebuyers. Subdivisions in the reportable segments noted below have been aggregated because they are similar in the following regards: (1) economic characteristics; (2) housing products; (3) class of homebuyer; (4) regulatory environments; and (5) methods used to construct and sell homes. In making the determination of whether or not our markets demonstrate similar economic characteristics, we review, among other things, actual and trending Home Gross Margins for homes closed within each market and forecasted Home Gross Margins. Accordingly, we may be required to reclassify our reportable segments if markets that currently are being aggregated do not continue to demonstrate similar economic characteristics.

Our homebuilding reportable segments are as follows:

- West (Arizona, California and Nevada);
- Mountain (Colorado and Utah);
- East (Virginia and Maryland); and
- Other Homebuilding (Delaware Valley, Florida and Illinois)

Stock-Based Compensation. We account for share-based payment awards, generally grants of stock options and restricted stock, in accordance with the provisions of SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)), which can require significant judgment in estimating the fair value of the share-based payment awards and related compensation. Stock-based compensation expense was $12.5 million and $16.6 million for the years ended December 31, 2007 and 2006, respectively, and was recorded to general and administrative expenses in the Consolidated Statements of Operations. See Note 14 to the Consolidated Financial Statements for a further discussion on share-based payment awards.

Determining the appropriate fair value model and calculating the fair value of share-based payment awards requires judgment, including estimating stock price volatility, annual forfeiture rates and the expected life of an award. We estimated the fair value for stock options granted during the twelve months ended December 31, 2007 and 2006 using the Black-Scholes option pricing model. The Black-Scholes option pricing model calculates the estimated fair value of stock options based upon the following inputs: (1) closing price of the Company s common stock on the measurement date (generally the date of grant); (2) exercise price; (3) expected stock option life; (4) expected volatility; (5) risk-free interest rate; and (6) dividend yield rate. The expected volatility is based on the historical volatility in the price of our common stock over the most recent period commensurate with the estimated expected life of our employee stock options, adjusted for the impact of unusual fluctuations not reasonably expected to recur and other relevant factors. The risk-free interest rate assumption is determined based upon observed interest rates appropriate for the expected term of our employee stock options. The dividend yield assumption is based on our

historical and expected dividend payouts. The expected life of employee stock options represents the weighted-average period for which the stock options are expected to remain outstanding and is derived primarily from historical exercise patterns. We determine the estimated fair value of the share-based payment awards in accordance with the provisions of SFAS 123(R) on the date they were granted. The fair values of previously granted share-based payment awards are not adjusted as subsequent changes in the foregoing assumptions occur, for example, an increase or decrease in the price of the Company s common stock. However, changes in the foregoing inputs, particularly the price of the Company s common stock, expected stock option life and expected volatility, significantly change the estimated fair value of future grants of stock options.

SFAS 123(R) requires an annual forfeiture rate to be estimated at the time of grant for all awards granted subsequent to January 1, 2006, and revised, if necessary, in subsequent periods if the actual forfeiture rate differs from our estimate. In accordance with SFAS 123(R), we have estimated an annual forfeiture rate to be applied to all share-based payment awards that were unvested at December 31, 2005 in determining the number of awards expected to vest in the future. We estimated the annual forfeiture rate generally to be 25% for share-based payment awards granted to Non-Executives (as defined in Note 14 to our Consolidated Financial Statements) and 0% for share-based payment awards granted to Executives and Directors (as defined in Note 14 to our Consolidated Financial Statements), based on the terms of their awards, as well as historical forfeiture experience.

Home Cost of Sales. Home cost of sales includes the specific construction costs of each home and all applicable land acquisition, land development and related costs, both incurred and estimated to be incurred, warranty costs and finance and closing costs. We use the specific identification method for the purpose of accumulating home construction costs and an average cost method to allocate land acquisition and development costs to each home. We record all home cost of sales when a home is closed on a house-by-house basis.

When a home is closed, we generally have not yet paid and recorded all costs necessary to complete the construction of the home and certain land development costs. At the time of a home closing, we compare our home construction budgets to actual recorded costs to determine the additional costs remaining to be paid on each closed home. For amounts not incurred or paid as of the time of closing a home, we record an estimated accrual associated with certain land development and home construction costs. Generally, these accruals are established based upon contracted work for which payment has yet to be made, open work orders not paid at the time of home closing, punch list items identified during the course of the homebuyer s final walkthrough of the home, as well as land completion costs. These accruals represent estimates believed to be adequate to cover the expected remaining home construction and land development costs. We monitor the adequacy of these accruals on a house-by-house basis and in the aggregate on both a market-by-market and consolidated basis. At December 31, 2007 and 2006, we had $42.3 million and $64.2 million, respectively, of land development and home construction accruals for closed homes. Actual results could differ from such estimates.

Warranty Costs. Our homes are sold with limited third-party warranties. Warranty reserves are established as homes close on a house-by-house basis in an amount estimated to be adequate to cover expected costs of materials and outside labor during warranty periods. Reserves are determined based upon historical experience with respect to similar home designs and geographical areas. Certain factors are considered in determining the per-house reserve amount, including (1) the historical range of amounts paid per house; (2) the historical amount paid as a percent of home construction costs; (3) any warranty expenditures included in (1) and (2) not considered to be normal and recurring; (4) improvements in quality control and construction techniques expected to impact future warranty expenditures; and (5) conditions that may affect certain subdivisions and require higher per-house reserves for those specific subdivisions. Accordingly, the process of determining our warranty reserves balance necessarily requires estimates associated with various assumptions, each of which can positively or negatively impact the warranty reserves balance.

Warranty payments are tracked on a house-by-house basis and are charged against the warranty reserve established for the house. Payments incurred after the close of a home are monitored to determine their nature and, to the extent they are warranty-related payments, they are recorded against the warranty reserve. To the extent this evaluation determines the payments made are related to completion of a home or land development, the payments are then recorded against our land development and home construction accruals. Additional reserves are established for known, unusual warranty-related expenditures not covered by the general warranty reserves. General warranty reserves not utilized for a particular house are evaluated on a monthly basis for reasonableness in the aggregate on both a market-by-market and consolidated basis. Warranty payments for an individual house may exceed the related reserve. Payments in excess of the reserve are evaluated on a monthly basis in the aggregate to determine if an adjustment to the warranty reserve should be recorded, which could result in a corresponding adjustment to home cost of sales.

Generally, warranty reserves are reviewed monthly, using historical data and other relevant information, to determine the reasonableness and adequacy of both the aggregate reserve and the per unit reserve amount originally included in home cost of sales, as well as the timing of any reversals of the original reserve. We continue to evaluate the adequacy of the warranty reserves and, based on historical results, believe that our existing estimation process is materially accurate and do not anticipate the process to change materially in the future. Because our warranty reserves can be impacted by a significant number of factors, we do not believe it is possible to develop a sensitivity analysis with a level of precision that would be meaningful to an investor. However, it is at least reasonably possible that changes to our assumptions could have a material impact on our warranty reserves balance.

Insurance Reserves. We record expenses and liabilities for losses and loss adjustment expenses for claims associated with: (1) insurance policies issued by StarAmerican and Allegiant; (2) self-insurance; and (3) deductible amounts under the Company s insurance policies. The establishment of the provisions for outstanding losses and loss adjustment expenses is based on actuarial studies that include known facts and interpretation of circumstances, including our experience with similar cases and historical trends involving claim payment patterns, pending levels of unpaid claims, product mix or concentration, claim severity, frequency patterns (such as those caused by natural disasters), fires or accidents, depending on the business conducted and changing regulatory and legal environments. The process of determining our insurance reserve balances necessarily requires estimates associated with various assumptions, each of which can positively or negatively impact our insurance reserve balances. Accordingly, we do not believe it is possible to develop a sensitivity analysis with a level of precision that would be meaningful to an investor. However, it is at least reasonably possible that changes in the claim rate or the average cost per claim used to estimate the self-insured reserves could have a material impact on our insurance reserve balances.

Land Option Contracts. In the normal course of business, we enter into lot option purchase contracts, generally through a deposit of cash or letter of credit, for the right to purchase land or lots at a future point in time with predetermined terms. Option deposits and pre-acquisition costs we incur related to our lot option purchase contracts are capitalized in accordance with SFAS No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, if all of the of the following conditions have been met: (1) the costs are directly identifiable with the specific property; (2) the costs would be capitalized if the property were already acquired; and (3) acquisition of the property is probable meaning we are actively seeking and have the ability to acquire the property and there is no indication that the property is not available for sale. We also consider the following when determining if the acquisition of the property is probable: (1) changes in market conditions subsequent to contracting for the purchase of the land; (2) current contract terms, including, per lot price and required purchase dates; and (3) our current land position in the given market or sub-market. Option deposits and capitalized pre-acquisition costs are expensed to general and administrative expense in the Consolidated Statements of Operations when we believe it is no longer probable that we will acquire the lots under option. We expensed $23.4 million, $29.7 million and $10.4 million for the years ended December 31, 2007, 2006 and 2005, respectively, related to the write-off of option deposits and

capitalized pre-acquisition costs. At December 31, 2007, we had the right to acquire 3,615 lots under option contracts, with approximately $6.3 million and $6.5 million in non-refundable cash and letters of credit option deposits at risk, respectively, and $1.4 million in capitalized pre-acquisition costs.

We also evaluate these transactions in accordance with revised FIN 46, Consolidation of Variable Interest Entities, as amended (FIN 46R). Our obligation with respect to option contracts generally is limited to forfeiture of the related non-refundable cash deposits and/or letters of credit. At December 31, 2007, the total purchase price for lots under option was $419 million. Pursuant to FIN 46R, certain of these contracts could create a variable interest, with the land seller being the variable interest entity (VIE) and, as such, could require us to consolidate the assets and liabilities of the VIE. We have evaluated all lot option purchase contracts that were executed or had significant modifications during 2007 pursuant to FIN 46R, and considered (1) what investments were at risk; (2) contractual obligations to perform; (3) expected changes in market prices of land over a given period; and (4) annual risk free interest rates. Based on these evaluations, we determined that our interests in these VIEs did not result in significant variable interests or require us to consolidate the VIEs. Due to the nature of the assumptions used in our evaluation process, it is possible that our evaluation of lot option contracts in the future could result in MDC being identified as the primary beneficiary, which could result in our consolidation of a VIE.

Since we own no equity interest in any of the unaffiliated VIEs that we must evaluate pursuant to FIN 46R, certain assumptions about the assets and liabilities of such entities are required. In most cases, the fair values of the assets of the evaluated VIEs have been assumed to be the remaining contractual purchase price of the land or lots we are purchasing.

We periodically enter into lot option arrangements with third-parties that will purchase or have purchased property at our direction which we may later acquire. We evaluate these transactions in accordance with FIN 46R, as well as under SFAS No. 49, Accounting for Product Financing Arrangements (SFAS 49), to determine if we should record an asset and liability at the time we enter into the lot option contract. Factors considered include (1) amount of deposit at risk; (2) loss of anticipated future operating income associated with selling homes; (3) unreimbursed commitments to incur costs associated with lots; and (4) the uniqueness or location of the lots. Based upon these evaluations of lot option purchase contracts executed during 2007, we determined that no asset or liability was required to be recorded prior to the date of purchase.

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RESULTS OF OPERATIONS

The following discussion compares results for the year ended December 31, 2007 with the year ended December 31, 2006.

(Loss) *Income Before Income Taxes.* The table below summarizes our (loss) income before income taxes by reportable segment (dollars in thousands).

	Years Ended December 31,		2007 Increase (Decrease)	
	2007	2006	Amount	%
Homebuilding				
West	$ (621,774)	$ 235,954	$ (857,728)	-364%
Mountain	(11,395)	43,490	(54,885)	-126%
East	(38,748)	104,706	(143,454)	-137%
Other Homebuilding	(92,251)	(12,709)	(79,542)	-626%
Total Homebuilding	(764,168)	371,441	(1,135,609)	-306%
Financial Services and Other	23,062	45,186	(22,124)	-49%
Corporate	(15,358)	(83,490)	68,132	82%
Consolidated	$ (756,464)	$ 333,137	$ (1,089,601)	-327%

We recognized a loss before income taxes in our homebuilding segments during the year ended December 31, 2007, primarily resulting from: (1) asset impairments of $726.6 million; (2) significant decreases in Home Gross Margins in most of our homebuilding segments; and (3) closing fewer homes in each of our homebuilding segments during the twelve months ended December 31, 2007. Partially offsetting these items were decreases in general and administrative, commission and marketing expenses of $69.7 million, $53.2 million and $11.8 million, respectively, during 2007.

In our West segment, the loss before income taxes during 2007 primarily was due to: (1) asset impairments of $581.5 million; (2) a 1,000 basis point decrease in Home Gross Margins; and (3) closing 2,670 fewer homes. These items partially were offset by a combined decrease in general and administrative, marketing and commission expenses of $75.9 million during the year ended December 31, 2007. In our Mountain segment, the loss before income taxes during the twelve months ended December 31, 2007 primarily resulted from asset impairments of $30.1 million and closing 854 fewer homes. These items in our Mountain segment partially were offset by a combined decrease in general and administrative and commission expenses of $5.9 million.

In our East segment, we recognized losses before income taxes during 2007 primarily due to: (1) asset impairments of $42.1 million; (2) a decrease in Home Gross Margins of 1,290 basis points; and (3) closing 519 fewer homes. These items partially were offset by a combined decrease in general and administrative and commission expenses of $27.3 million during the year ended December 31, 2007. We recognized losses before income taxes during 2007 in our Other Homebuilding segment primarily resulting from: (1) asset impairments of $73.0 million; (2) closing 885 fewer homes; and (3) a decrease in Home Gross Margins of 380 basis points. These items partially were offset by a combined decrease in general and administrative, marketing and commission expenses of $26.1 million during 2007.

Income before income taxes in our Financial Services and Other segment was lower during the twelve months ended December 31, 2007 due to a combined decrease of $30.2 million in gains on sales of mortgage loans and broker origination fees. These declines partially were offset by decreases of $17.6 million in general and administrative expenses during 2007.

Loss before income taxes in our Corporate segment during the year ended December 31, 2007 decreased primarily as a result of: (1) a $29.0 million increase in interest income, net; (2) $10.3 million in gains recognized on the sale of two aircraft; and (3) decreases of $24.9 million in general and administrative expense.

Total Revenue. The table below summarizes total revenue by reportable segment (dollars in thousands).

	Years Ended December 31,		2007 Increase (Decrease)	
	2007	2006	Amount	%
Homebuilding				
West	$ 1,725,766	$ 2,871,040	$ (1,145,274)	-40%
Mountain	549,771	730,489	(180,718)	-25%
East	318,723	628,508	(309,785)	-49%
Other Homebuilding	253,627	493,628	(240,001)	-49%
Total Homebuilding	2,847,887	4,723,665	(1,875,778)	-40%
Financial Services and Other	63,508	103,243	(39,735)	-38%
Corporate	41,839	1,788	40,051	N/A
Intercompany adjustments	(19,985)	(26,954)	6,969	26%