

MDC HOLDINGS INC  
Form 10-Q  
November 01, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2012

OR

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

Commission File No. 1-8951

**M.D.C. HOLDINGS, INC.**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**84-0622967**  
(I.R.S. employer  
identification no.)

**4350 South Monaco Street, Suite 500**

**Denver, Colorado**  
(Address of principal executive offices)

**(303) 773-1100**  
(Registrant's telephone number, including area code)

**80237**  
(Zip code)

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  No

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  (Do not check if a smaller reporting company) Smaller Reporting Company   
Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of October 25, 2012, 48,660,308 shares of M.D.C. Holdings, Inc. common stock were outstanding.

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**M.D.C. HOLDINGS, INC. AND SUBSIDIARIES**

**FORM 10-Q**

**FOR THE QUARTER ENDED September 30, 2012**

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**Table of Contents****ITEM 1. Unaudited Consolidated Financial Statements****M.D.C. HOLDINGS, INC.****Consolidated Balance Sheets**

|   | September 30,<br>2012  | December 31,<br>2011 |
|---|--|----------------------|
|   | (Dollars in thousands, except<br>per share amounts)<br>(Unaudited) |                      |
| <b>ASSETS</b>   |  |                      |
| <b>Homebuilding:</b>  |  |                      |
| Cash and cash equivalents   | \$ 235,273   | \$ 316,418           |
| Marketable securities   | 503,805  | 485,434              |
| Restricted cash   | 2,084  | 667                  |
| Trade and other receivables   | 35,768   | 21,593               |
| Inventories:  |  |                      |
| Housing completed or under construction   | 504,016  | 300,714              |
| Land and land under development   | 393,170  | 505,338              |
| Total inventories   | 897,186  | 806,052              |
| Property and equipment, net   | 33,789   | 36,277               |
| Deferred tax asset, net of valuation allowance of \$263,562 and \$281,178 at September 30, 2012 and December 31, 2011, respectively |  |                      |
| Prepaid expenses and other assets   | 47,616   | 50,423               |
| Total homebuilding assets   | 1,755,521  | 1,716,864            |
| <b>Financial Services:</b>  |  |                      |
| Cash and cash equivalents   | 28,524   | 26,943               |
| Marketable securities   | 32,915   | 34,509               |
| Mortgage loans held-for-sale, net   | 86,648   | 78,335               |
| Prepaid expenses and other assets   | 4,815  | 2,074                |
| Total financial services assets   | 152,902  | 141,861              |
| Total Assets  | \$ 1,908,423   | \$ 1,858,725         |
| <b>LIABILITIES AND EQUITY</b>   |  |                      |
| <b>Homebuilding:</b>  |  |                      |
| Accounts payable  | \$ 49,636  | \$ 25,645            |
| Accrued liabilities   | 106,457  | 119,188              |
| Senior notes, net   | 744,654  | 744,108              |
| Total homebuilding liabilities  | 900,747  | 888,941              |
| <b>Financial Services:</b>  |  |                      |
| Accounts payable and accrued liabilities  | 54,226   | 52,446               |
| Mortgage repurchase facility  | 46,888   | 48,702               |
| Total financial services liabilities  | 101,114  | 101,148              |
| Total Liabilities   | 1,001,861  | 990,089              |

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| <b>Stockholders Equity</b>  |                     |                     |
|---|---------------------|---------------------|
| Preferred stock, \$0.01 par value; 25,000,000 shares authorized; none issued or outstanding   |                     |                     |
| Common stock, \$0.01 par value; 250,000,000 shares authorized; 48,651,558 issued and outstanding at September 30, 2012 and 48,017,108 and 47,957,196 issued and outstanding, respectively, at December 31, 2011 |                     |                     |
|   | 487                 | 480                 |
| Additional paid-in-capital  | 892,461             | 863,128             |
| Retained earnings   | 9,909               | 12,927              |
| Accumulated other comprehensive income (loss)   | 3,705               | (7,240)             |
| Treasury stock, at cost; no shares at September 30, 2012 and 59,912 at December 31, 2011  |                     | (659)               |
| <b>Total Stockholders Equity</b>  | <b>906,562</b>      | <b>868,636</b>      |
| <b>Total Liabilities and Stockholders Equity</b>  | <b>\$ 1,908,423</b> | <b>\$ 1,858,725</b> |

The accompanying Notes are an integral part of these Unaudited Consolidated Financial Statements.

**Table of Contents****M.D.C. HOLDINGS, INC.****Consolidated Statements of Operations and Comprehensive Income**

|   | Three Months Ended<br>September 30,                             |             | Nine Months Ended<br>September 30, |             |
|---|---|-------------|------------------------------------|-------------|
|   | 2012  | 2011        | 2012                               | 2011        |
|   | (Dollars in thousands, except per share amounts)<br>(Unaudited) |             |                                    |             |
| <b>Homebuilding:</b>  |   |             |                                    |             |
| Home sale revenues  | \$ 320,647  | \$ 204,886  | \$ 761,857                         | \$ 574,432  |
| Land sale revenues  | 15  | 730         | 3,420                              | 3,499       |
| Total home sale and land sale revenues                          | 320,662   | 205,616     | 765,277                            | 577,931     |
| Home cost of sales  | (271,067)   | (170,443)   | (649,941)                          | (490,521)   |
| Land cost of sales  | (2)   | (724)       | (3,210)                            | (2,482)     |
| Inventory impairments   |   | (4,049)     |                                    | (12,682)    |
| Total cost of sales   | (271,069)   | (175,216)   | (653,151)                          | (505,685)   |
| Gross margin  | 49,593  | 30,400      | 112,126                            | 72,246      |
| Selling, general and administrative expenses                    | (44,788)  | (46,360)    | (118,135)                          | (143,171)   |
| Interest income   | 5,365   | 5,964       | 16,651                             | 19,437      |
| Interest expense  |   | (3,641)     | (808)                              | (19,642)    |
| Other income (expense)  | 16  | (20,102)    | 592                                | (20,985)    |
| Homebuilding pretax income (loss)                               | 10,186  | (33,739)    | 10,426                             | (92,115)    |
| <b>Financial Services:</b>                                      |   |             |                                    |             |
| Revenues  | 14,454  | 6,322       | 34,304                             | 20,480      |
| Expenses  | (5,156)   | (6,772)     | (13,466)                           | (16,061)    |
| Financial services pretax income (loss)                         | 9,298   | (450)       | 20,838                             | 4,419       |
| Income (loss) before income taxes                               | 19,484  | (34,189)    | 31,264                             | (87,696)    |
| Benefit for income taxes  | 642   | 2,479       | 1,765                              | 8,127       |
| Net income (loss)   | \$ 20,126   | \$ (31,710) | \$ 33,029                          | \$ (79,569) |
| Other comprehensive income (loss):                              |   |             |                                    |             |
| Unrealized gain (loss) related to available-for-sale securities | 5,095   | (20,237)    | 10,945                             | (18,905)    |
| Comprehensive income (loss)                                     | \$ 25,221   | \$ (51,947) | \$ 43,974                          | \$ (98,474) |
| Earnings (loss) per share:                                      |   |             |                                    |             |
| Basic   | \$ 0.42   | \$ (0.68)   | \$ 0.69                            | \$ (1.72)   |
| Diluted   | \$ 0.41   | \$ (0.68)   | \$ 0.68                            | \$ (1.72)   |
| Weighted Average Common Shares Outstanding:                     |   |             |                                    |             |
| Basic   | 47,761,307  | 46,736,638  | 47,499,429                         | 46,717,408  |
| Diluted   | 48,173,315  | 46,736,638  | 47,818,188                         | 46,717,408  |

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|                              |    |      |    |      |    |      |    |      |
|------------------------------|----|------|----|------|----|------|----|------|
| Dividends declared per share | \$ | 0.25 | \$ | 0.25 | \$ | 0.75 | \$ | 0.75 |
|------------------------------|----|------|----|------|----|------|----|------|

The accompanying Notes are an integral part of these Unaudited Consolidated Financial Statements.

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**Table of Contents****M.D.C. HOLDINGS, INC.****Consolidated Statements of Cash Flows**

|  | Nine Months Ended<br>September 30,<br>2012                  2011<br>(Dollars in thousands)<br>(Unaudited) |             |
|--|---|-------------|
| <b>Operating Activities:</b>   |   |             |
| Net income (loss)  | \$ 33,029   | \$ (79,569) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: |   |             |
| Loss on extinguishment of senior notes   |   | 18,559      |
| Stock-based compensation expense   | 12,628  | 12,092      |
| Depreciation and amortization  | 3,708   | 4,713       |
| Inventory impairments and write-offs of land option deposits                                       | 414   | 17,883      |
| Amortization of discount on marketable debt securities   | 279   | 1,604       |
| Net changes in assets and liabilities:   |   |             |
| Restricted cash  | (1,417)   | (262)       |
| Trade and other receivables  | (13,685)  | 16,114      |
| Mortgage loans held-for-sale   | (8,313)   | 22,813      |
| Housing completed or under construction  | (202,994)   | 53,861      |
| Land and land under development  | 112,406   | (105,154)   |
| Prepaid expenses and other assets  | (553)   | (2,782)     |
| Accounts payable   | 24,063  | (7,723)     |
| Accrued liabilities  | (10,020)  | (32,892)    |
| Net cash provided by (used in) operating activities  | (50,455)  | (80,743)    |
| <b>Investing Activities:</b>   |   |             |
| Purchase of marketable securities  | (397,167)   | (288,624)   |
| Maturity of marketable securities  | 106,000   | 453,071     |
| Sale of marketable securities  | 285,056   | 248,432     |
| Purchase of property and equipment and other   | (958)   | (31,717)    |
| Net cash provided by (used in) investing activities  | (7,069)   | 381,162     |
| <b>Financing Activities:</b>   |   |             |
| Extinguishment of senior notes   |   | (254,903)   |
| Payments on mortgage repurchase facility   | (137,529)   | (56,454)    |
| Advances on mortgage repurchase facility   | 135,715   | 41,728      |
| Dividend payments  | (36,046)  | (35,560)    |
| Proceeds from exercise of stock options  | 15,820  | 46          |
| Net cash provided by (used in) financing activities  | (22,040)  | (305,143)   |
| Net increase (decrease) in cash and cash equivalents   | (79,564)  | (4,724)     |
| Cash and cash equivalents:   |   |             |
| Beginning of period  | 343,361   | 572,225     |
| End of period  | \$ 263,797  | \$ 567,501  |

The accompanying Notes are an integral part of these Unaudited Consolidated Financial Statements.





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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**1. Basis of Presentation**

The Unaudited Consolidated Financial Statements of M.D.C. Holdings, Inc. ( MDC, the Company, we, us, or our which refers to M.D.C. Holdings, Inc. and its subsidiaries) have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ). Accordingly, they do not include all information and footnotes required by U.S. generally accepted accounting principles ( GAAP ) for complete financial statements. These statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary to present fairly the financial position, results of operations and cash flows of MDC at September 30, 2012 and for all periods presented. These statements should be read in conjunction with MDC s Consolidated Financial Statements and Notes thereto included in MDC s Annual Report on Form 10-K for the year ended December 31, 2011.

Certain prior year amounts in the consolidated financial statements have been reclassified to conform with the 2012 presentation.

Refer to the economic conditions described under the caption Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q and Risk Factors Relating to our Business in Item 1A of our December 31, 2011 Annual Report on Form 10-K.

**2. Recently Adopted Accounting Standards**

In May 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, ( ASU 2011-04 ). ASU 2011-04 amends Accounting Standards Codification ( ASC ) 820, *Fair Value Measurements* ( ASC 820 ), providing a consistent definition and measurement of fair value, as well as similar disclosure requirements between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles, clarifies the application of existing fair value measurement and expands the ASC 820 disclosure requirements, particularly for Level 3 fair value measurements. ASU 2011-04 was effective for our interim and annual periods beginning January 1, 2012. The adoption of ASU 2011-04 did not have a material effect on our consolidated financial position or results of operations.

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, ( ASU 2011-05 ), which improves the comparability, consistency, and transparency of financial reporting and increases the prominence of items reported in other comprehensive income ( OCI ) by eliminating the option to present components of OCI as part of the statement of changes in stockholders equity. The amendments in this standard require that all non-owner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this standard do not change the items that must be reported in OCI, when an item of OCI must be reclassified to net income, or change the option for an entity to present components of OCI gross or net of the effect of income taxes. The amendments in ASU 2011-05 were effective for our interim and annual periods beginning January 1, 2012 and were applied retrospectively. The adoption of the provisions of ASU 2011-05 did not have a material impact on our consolidated financial position or results of operations.

In September 2011, the FASB issued an amendment to ASC 350, *Intangibles Goodwill and Other* ( ASC 350 ), which simplifies how entities test goodwill for impairment. Previous guidance under ASC 350 required an entity to test goodwill for impairment using a two-step process on at least an annual basis. First, the fair value of a reporting unit was calculated and compared to its carrying amount, including goodwill. Second, if the fair value of a reporting unit was less than its carrying amount, the amount of impairment loss, if any, was required to be measured. Under the amendments in this update, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads the entity to determine that it is more likely than not that its fair value is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines that it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then the two-step impairment test is unnecessary. If the entity concludes otherwise, then it is required to test goodwill for impairment under the two-step process as described under ASC 350. The amendments are effective for us for annual and interim goodwill impairment tests performed for fiscal years beginning January 1, 2012, and early adoption is permitted. We adopted this standard in the 2012 first quarter. The adoption of the amended provisions of ASC 350 did not have a material impact on our consolidated financial position or results of operations.



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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**3. Segment Reporting**

Our operating segments are defined 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 two key executives the Chief Executive Officer and the Chief Operating Officer.

We have identified each homebuilding subdivision as an operating segment as 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. Our homebuilding reportable segments are as follows:

- (1) West (Arizona, California, Nevada and Washington)
  
- (2) Mountain (Colorado and Utah)
  
- (3) East (Virginia and Maryland, which includes Pennsylvania, Delaware and New Jersey)
  
- (4) Other (Florida and Illinois)

Our financial services operating segments are as follows: (1) HomeAmerican Mortgage Corporation ( HomeAmerican ); (2) Allegiant Insurance Company, Inc., A Risk Retention Group ( Allegiant ); (3) StarAmerican Insurance Ltd. ( StarAmerican ); (4) American Home Insurance Agency, Inc.; and (5) American Home Title and Escrow Company. Due to HomeAmerican s contributions to consolidated pretax income over the past few quarters, HomeAmerican is considered to be a reportable segment ( Mortgage operations ) as of the third quarter 2012. The remaining operating segments have been aggregated into one reportable segment because they do not individually exceed 10 percent of: (1) consolidated revenue; (2) the greater of (A) the combined reported profit of all operating segments that did not report a loss or (B) the positive value of the combined reported loss of all operating segments that reported losses; or (3) consolidated assets.

Corporate is a non-operating segment that develops and implements strategic initiatives and supports our operating divisions by centralizing key administrative functions such as finance and treasury, information technology, insurance and risk management, litigation and human resources. Corporate also provides the necessary administrative functions to support MDC as a publicly traded company. A portion of the expenses incurred by Corporate are allocated to the homebuilding operating segments based on their respective percentages of assets, and to a lesser degree, a portion of Corporate expenses are allocated to the financial services segments. A majority of Corporate s personnel and resources are primarily dedicated to activities relating to the homebuilding segments, and, therefore, the balance of any unallocated Corporate expenses is included in the homebuilding segment.

**Table of Contents****M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements**

The following table summarizes revenues and pretax income (loss) for our homebuilding and financial services operations.

|  | Three Months Ended<br>September 30, |                    | Nine Months Ended<br>September 30, |                    |
|--|-------------------------------------|--------------------|------------------------------------|--------------------|
|  | 2012                                | 2011               | 2012                               | 2011               |
| (Dollars in thousands)                               |                                     |                    |                                    |                    |
| <b>Homebuilding</b>                                  |                                     |                    |                                    |                    |
| Home and land sale revenues:                         |                                     |                    |                                    |                    |
| West   | \$ 148,037                          | \$ 70,676          | \$ 335,002                         | \$ 181,129         |
| Mountain   | 96,335                              | 81,945             | 236,625                            | 229,879            |
| East   | 63,463                              | 36,390             | 160,360                            | 129,667            |
| Other  | 12,827                              | 16,605             | 33,290                             | 37,256             |
| <b>Total home and land sale revenues</b>             | <b>\$ 320,662</b>                   | <b>\$ 205,616</b>  | <b>\$ 765,277</b>                  | <b>\$ 577,931</b>  |
| Pretax income (loss):                                |                                     |                    |                                    |                    |
| West   | \$ 8,334                            | \$ (2,584)         | \$ 11,178                          | \$ (18,981)        |
| Mountain   | 6,951                               | 2,988              | 13,746                             | 552                |
| East   | 4,417                               | (2,518)            | 6,717                              | (6,819)            |
| Other  | 490                                 | (1,514)            | 426                                | (3,206)            |
| Corporate  | (10,006)                            | (30,111)           | (21,641)                           | (63,661)           |
| <b>Total homebuilding pretax income (loss)</b>       | <b>\$ 10,186</b>                    | <b>\$ (33,739)</b> | <b>\$ 10,426</b>                   | <b>\$ (92,115)</b> |
| <b>Financial Services</b>                            |                                     |                    |                                    |                    |
| Revenues:  |                                     |                    |                                    |                    |
| Mortgage operations                                  | \$ 10,892                           | \$ 3,855           | \$ 25,407                          | \$ 13,034          |
| Other  | 3,562                               | 2,467              | 8,897                              | 7,446              |
| <b>Total financial services revenues</b>             | <b>\$ 14,454</b>                    | <b>\$ 6,322</b>    | <b>\$ 34,304</b>                   | <b>\$ 20,480</b>   |
| Pretax income (loss):                                |                                     |                    |                                    |                    |
| Mortgage operations                                  | \$ 7,428                            | \$ (1,610)         | \$ 16,518                          | \$ 781             |
| Other  | 1,870                               | 1,160              | 4,320                              | 3,638              |
| <b>Total financial services pretax income (loss)</b> | <b>\$ 9,298</b>                     | <b>\$ (450)</b>    | <b>\$ 20,838</b>                   | <b>\$ 4,419</b>    |

The following table summarizes total assets for our homebuilding and financial services operations. The assets in our Corporate segment primarily include cash and cash equivalents, marketable securities, and property and equipment.

|                             | September 30,<br>2012 | December 31,<br>2011 |
|-----------------------------|-----------------------|----------------------|
| (Dollars in thousands)      |                       |                      |
| <b>Homebuilding assets:</b> |                       |                      |
| West                        | \$ 376,167            | \$ 346,442           |

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|  |                     |                     |
|--|---------------------|---------------------|
| Mountain                               | 329,436             | 262,787             |
| East                                   | 229,478             | 223,606             |
| Other                                  | 33,995              | 31,468              |
| Corporate                              | 786,445             | 852,561             |
| <b>Total homebuilding assets</b>       | <b>\$ 1,755,521</b> | <b>\$ 1,716,864</b> |
| Financial services assets:             |                     |                     |
| Mortgage operations                    | \$ 91,055           | \$ 80,097           |
| Other                                  | 61,847              | 61,764              |
| <b>Total financial services assets</b> | <b>\$ 152,902</b>   | <b>\$ 141,861</b>   |

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**Table of Contents****M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements****4. Earnings (Loss) Per Share**

A company that has participating security holders (for example, unvested restricted stock that has non-forfeitable dividend rights) is required to utilize the two-class method for purposes of calculating earnings (loss) per share (EPS). The two-class method is an allocation of earnings/(loss) between the holders of common stock and a company's participating security holders. Under the two-class method, earnings/(loss) for the reporting period are allocated between common shareholders and other security holders, based on their respective rights to receive distributed earnings (i.e., dividends) and undistributed earnings (i.e., net income or loss). Currently, we have one class of security and we have participating security holders consisting of shareholders of unvested restricted stock. The following table shows basic and diluted EPS calculations:

|   | Three Months<br>Ended September 30,              |             | Nine Months<br>Ended September 30, |             |
|---|--|-------------|------------------------------------|-------------|
|   | 2012   | 2011        | 2012                               | 2011        |
|   | (Dollars in thousands, except per share amounts) |             |                                    |             |
| <b>Basic and Diluted Earnings (Loss) Per Common Share:</b>  |  |             |                                    |             |
| Net income (loss)   | \$ 20,126  | \$ (31,710) | \$ 33,029                          | \$ (79,569) |
| Less: distributed and undistributed earnings allocated to participating securities                  | (280)  | (215)       | (450)                              | (580)       |
| Earnings (loss) attributable to common stockholders   | \$ 19,846  | \$ (31,925) | \$ 32,579                          | \$ (80,149) |
| Basic weighted-average shares outstanding   | 47,761,307                                       | 46,736,638  | 47,499,429                         | 46,717,408  |
| Dilutive effect of common stock equivalents   | 412,008  |             | 318,759                            |             |
| Diluted weighted-average common shares outstanding, assuming conversion of common stock equivalents | 48,173,315                                       | 46,736,638  | 47,818,188                         | 46,717,408  |
| Basic Earnings (Loss) Per Common Share  | \$ 0.42  | \$ (0.68)   | \$ 0.69                            | \$ (1.72)   |
| Diluted Earnings (Loss) Per Common Share  | \$ 0.41  | \$ (0.68)   | \$ 0.68                            | \$ (1.72)   |

Diluted EPS includes the dilutive effect of common stock equivalents and is computed using the weighted-average number of common stock and common stock equivalents outstanding during the reporting period. Common stock equivalents include stock options and unvested restricted stock. A total of 1.0 million unvested performance-based stock options were excluded from the calculation of diluted EPS for both the three and nine months ended September 30, 2012 as the performance-based conditions were not met during such periods. Diluted EPS for the three and nine months ended September 30, 2012 also excluded options to purchase approximately 3.7 million shares and 4.9 million shares, respectively, of common stock because the effect of their inclusion would be anti-dilutive. There was no dilutive effect of common stock equivalents for the three and nine months ended September 30, 2011 because the effect of their inclusion would decrease the reported loss per share.

**5. Fair Value Measurements**

ASC 820, as updated and amended by ASU 2011-04, defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. ASC 820 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.





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The following table sets forth the fair values and methods used for measuring the fair values of financial instruments on a recurring basis:

| Financial Instrument                              | Hierarchy | Fair Value         |                   |
|---|-----------|--------------------|-------------------|
|   |           | September 30, 2012 | December 31, 2011 |
| (Dollars in thousands)                            |           |                    |                   |
| <b>Marketable Securities (available-for-sale)</b> |           |                    |                   |
| Equity securities                                 | Level 1   | \$ 204,377         | \$ 160,021        |
| Debt securities                                   | Level 2   | 332,343            | 359,922           |
| Total available-for-sale securities               |           | \$ 536,720         | \$ 519,943        |
| Mortgage Loans Held-For-Sale, net                 | Level 2   | \$ 86,648          | \$ 78,335         |

The following methods and assumptions were used to estimate the fair value of each class of financial instruments.

*Cash and Cash Equivalents.* For cash and cash equivalents, the fair value approximates carrying value.

*Marketable Securities.* Our marketable securities consist of fixed rate and floating rate interest earning securities, primarily: (1) debt securities, which may include, among others, United States government and government agency debt and corporate debt; (2) holdings in mutual fund equity securities which consist primarily of debt securities; and (3) deposit securities, which may include, among others, certificates of deposit and time deposits. As of September 30, 2012 and December 31, 2011, all of our marketable securities were treated as available-for-sale investments and, as such, we have recorded all of its marketable securities at fair value with changes in fair value being recorded as a component of accumulated other comprehensive income (loss).

The following tables set forth the amortized cost and estimated fair value of our available-for-sale marketable securities.

|   | September 30, 2012 |            | December 31, 2011 |            |
|---|--------------------|------------|-------------------|------------|
|   | Amortized Cost     | Fair Value | Amortized Cost    | Fair Value |
| (Dollars in thousands)                                      |                    |            |                   |            |
| <b>Homebuilding:</b>  |                    |            |                   |            |
| Equity security   | \$ 205,764         | \$ 204,377 | \$ 169,565        | \$ 160,021 |
| Debt securities   | 294,890            | 299,428    | 323,454           | 325,413    |
| Total homebuilding available-for-sale securities            | \$ 500,654         | \$ 503,805 | \$ 493,019        | \$ 485,434 |
| <b>Financial Services:</b>                                  |                    |            |                   |            |
| Total financial services available-for-sale debt securities | \$ 32,361          | \$ 32,915  | \$ 34,164         | \$ 34,509  |
| Total available-for-sale marketable securities              | \$ 533,015         | \$ 536,720 | \$ 527,183        | \$ 519,943 |

As of September 30, 2012 and December 31, 2011, our marketable securities (homebuilding and financial services in aggregate) were in an unrealized gain position of \$3.7 million and an unrealized loss position of \$7.2 million, respectively. The equity securities, which consist of four mutual funds which primarily invest in corporate bonds and other fixed income securities, had a combined unrealized loss of \$1.4 million as of September 30, 2012. Management currently does not have the intent to sell any of its securities that are currently in an unrealized loss position,

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and it is currently not likely that we will need to sell these marketable securities before the recovery of their cost basis. The unrealized loss related to these mutual funds at December 31, 2011 was \$9.5 million. Given the significant improvement in the unrealized loss since December, 31, 2011 and the fact that the decline in market value occurred during a period of overall decline in market values, the unrealized loss is believed to be temporary.

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**Notes to Unaudited Consolidated Financial Statements**

*Mortgage Loans Held-for-Sale, Net.* As of September 30, 2012, the primary components of our mortgage loans held-for-sale that are measured at fair value on a recurring basis are: (1) mortgage loans held-for-sale under commitments to sell; and (2) mortgage loans held-for-sale not under commitments to sell. At September 30, 2012 and December 31, 2011, we had \$80.0 million and \$77.5 million, respectively, of mortgage loans held-for-sale under commitments to sell for which fair value was based upon Level 2 inputs, which were the quoted market prices for those mortgage loans. At September 30, 2012 and December 31, 2011, we had \$6.6 million and \$0.8 million, respectively, of mortgage loans held-for-sale that were not under commitments to sell. The fair value for those loans was primarily based upon the estimated market price received from an outside party which is a Level 2 fair value input.

*Inventories.* Our inventories consist of housing completed or under construction and land and land under development. Inventories are primarily associated with subdivisions where we intend to construct and sell homes on the land, including model and unsold started homes. Components of housing completed or under construction primarily include: (1) land costs transferred from land and land under development; (2) direct construction costs associated with a house; (3) real property taxes, engineering fees, permits and other fees; (4) capitalized interest; and (5) indirect construction costs, which include field construction management salaries and benefits, utilities and other construction related costs. Land costs are transferred from land and land under development to housing completed or under construction at the point in time that construction of a home on an owned lot begins. Costs capitalized to land and land under development primarily include: (1) land costs; (2) land development costs; (3) entitlement costs; (4) capitalized interest; (5) engineering fees; and (6) title insurance, real property taxes and closing costs directly related to the purchase of the land parcel.

Homebuilding inventories are carried at cost unless events and circumstances indicate that the carrying value of the underlying subdivision may not be recoverable. We determine impairments on a subdivision level basis as each such subdivision represents the lowest level of identifiable cash flows. In making this determination, we review, among other things, the following for each subdivision:

actual and trending Operating Margin (which is defined as home sale revenues less home cost of sales and all direct incremental costs associated with the home closing) for homes closed;

estimated future undiscounted cash flows and Operating Margin;

forecasted Operating Margin for homes in Backlog (which is defined as homes under contract but not yet delivered);

actual and trending net and gross home orders;

base sales price and home sales incentive information for homes closed and homes in backlog;

market information for each sub-market; and

known or probable events indicating that the carrying value may not be recoverable.

If events or circumstances indicate that the carrying value of our inventory may not be recoverable, assets are reviewed for impairment by comparing the undiscounted estimated future cash flows from an individual subdivision to its carrying value. If the undiscounted future cash flows are less than the subdivision's carrying value, the carrying value of the subdivision is written down to its then estimated fair value. We generally determine the estimated fair value of each subdivision by determining the present value of the estimated future cash flows at discount

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rates that are commensurate with the risk of the subdivision under evaluation. For both the three months and nine months ended September 30, 2011, we recognized inventory impairment charges of \$4.0 million and \$12.7 million, respectively. The discount rates used to estimate discounted cash flows ranged from 12% to 20% during the three months and nine months ended September 30, 2011. We did not record any inventory impairments during the three and nine months ended September 30, 2012.

*Related Party Assets.* Related party assets are included in prepaid expenses and other assets in our accompanying consolidated balance sheets. Our related party assets are debt security bonds ( Metro District Bond Securities ) that we acquired from a quasi-municipal corporation in the state of Colorado. We estimated the fair value of the related party assets based upon discounted cash flows as we do not believe there is a readily available market for such assets. The estimated cash flows from the bonds are ultimately based upon our estimated cash flows associated with building, selling and closing homes in one of our Colorado communities. The estimated fair values of these assets are based upon Level 3 cash flow inputs. Based upon this evaluation, the estimated fair value of the related party assets approximates its carrying value which was \$6.7 million as of September 30, 2012 and December 31, 2011.

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*Mortgage Repurchase Facility.* Our Mortgage Repurchase Facility is at floating rates or at fixed rates that approximate current market rates and have relatively short-term maturities, generally within 30 days. The fair value approximates carrying value.

*Senior Notes.* The estimated values of the senior notes in the following table are based on Level 2 inputs, including market prices of other homebuilder bonds.

|                              | September 30, 2012     |            | December 31, 2011 |            |
|------------------------------|------------------------|------------|-------------------|------------|
|                              | Carrying Amount        | Fair Value | Carrying Amount   | Fair Value |
|                              | (Dollars in thousands) |            |                   |            |
| 5.375% Senior Notes due 2014 | \$ 249,574             | \$ 263,967 | \$ 249,438        | \$ 254,667 |
| 5.375% Senior Notes due 2015 | 249,885                | 266,467    | 249,857           | 252,083    |
| 5.625% Senior Notes due 2020 | 245,195                | 271,050    | 244,813           | 227,467    |
| Total                        | \$ 744,654             | \$ 801,484 | \$ 744,108        | \$ 734,217 |

**6. Inventories**

The following table sets forth, by reportable segment, information relating to our homebuilding inventories:

|   | September 30,          | December 31,      |
|---|------------------------|-------------------|
|   | 2012                   | 2011              |
|   | (Dollars in thousands) |                   |
| <b>Housing Completed or Under Construction:</b> |                        |                   |
| West  | \$ 199,344             | \$ 121,343        |
| Mountain  | 177,913                | 80,964            |
| East  | 105,631                | 81,623            |
| Other   | 21,128                 | 16,784            |
| Subtotal  | 504,016                | 300,714           |
| <b>Land and Land Under Development:</b>         |                        |                   |
| West  | 142,158                | 199,941           |
| Mountain  | 133,100                | 164,961           |
| East  | 106,691                | 127,291           |
| Other   | 11,221                 | 13,145            |
| Subtotal  | 393,170                | 505,338           |
| <b>Total Inventories</b>                        | <b>\$ 897,186</b>      | <b>\$ 806,052</b> |

In accordance with ASC 360, *Property, Plant, and Equipment* ( ASC 360 ), homebuilding inventories are carried at cost unless events and circumstances indicate that the carrying value of the underlying subdivision may not be recoverable. We evaluate inventories for impairment at each quarter end. Please see *Inventories* in Note 5 for more detail on the methods and assumptions that were used to estimate the fair value of

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our inventories. Based on the impairment review, we did not record any inventory impairments during the three and nine months ended September 30, 2012.

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Inventory impairments recognized for the three and nine months ended September 30, 2011 are shown in the table below:

|   | Three<br>Months<br>Ended September 30,<br>2011 | Nine Months<br>Ended September 30,<br>2011 |
|---|--|--|
| (Dollars in thousands)                          |  |  |
| <b>Housing Completed or Under Construction:</b> |  |  |
| West  | \$ 484   | \$ 1,438                                   |
| Mountain  | 210  | 449  |
| East  |  |  |
| Other   | 93   | 93   |
| Subtotal  | 787  | 1,980                                      |
| <b>Land and Land Under Development:</b>         |  |  |
| West  | 1,193  | 7,112                                      |
| Mountain  | 550  | 1,786                                      |
| East  |  | 285  |
| Other   | 1,519  | 1,519                                      |
| Subtotal  | 3,262  | 10,702                                     |
| <b>Inventory Impairments</b>                    | <b>\$ 4,049</b>                                | <b>\$ 12,682</b>                           |

The inventory impairments recorded during the three and nine months ended September 30, 2011 resulted from a decline in the market value of land and homes primarily in our California, Nevada and Utah markets.

**7. Capitalization of Interest**

We capitalize interest on our senior notes associated with our qualified assets, which includes land and land under development that is actively being developed and homes under construction through the completion of construction. When construction of an unsold home is complete, such home is no longer considered to be a qualified asset and interest is no longer capitalized on that home. We expensed no interest and \$0.8 million of interest for the three and nine months ended September 30, 2012, respectively, and expensed \$3.7 million and \$19.6 million of interest primarily associated with interest incurred on our homebuilding debt during the three and nine months ended September 30, 2011, respectively. The table set forth below summarizes homebuilding interest activity.

|   | Three Months<br>Ended September 30, |                  | Nine Months<br>Ended September 30, |                  |
|---|-------------------------------------|------------------|------------------------------------|------------------|
|   | 2012                                | 2011             | 2012                               | 2011             |
| (Dollars in thousands)                    |                                     |                  |                                    |                  |
| <b>Interest incurred</b>                  | <b>\$ 10,573</b>                    | <b>\$ 14,474</b> | <b>\$ 31,709</b>                   | <b>\$ 50,744</b> |
| Interest capitalized, beginning of period | \$ 67,101                           | \$ 49,058        | \$ 58,742                          | \$ 38,446        |

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|  |           |           |           |           |
|--|-----------|-----------|-----------|-----------|
| Interest capitalized during period                                   | 10,573    | 10,833    | 30,931    | 31,102    |
| Less: Previously capitalized interest included in home cost of sales | (8,655)   | (5,140)   | (20,654)  | (14,797)  |
| Interest capitalized, end of period                                  | \$ 69,019 | \$ 54,751 | \$ 69,019 | \$ 54,751 |

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The following table sets forth the components of homebuilding prepaid expenses and other assets.

|  | September 30,<br>2012  | December 31,<br>2011 |
|--|------------------------|----------------------|
|  | (Dollars in thousands) |                      |
| Deferred marketing costs                       | \$ 16,333              | \$ 20,786            |
| Land option deposits                           | 7,867                  | 6,952                |
| Deferred debt issuance costs, net              | 2,792                  | 3,235                |
| Prepaid expenses                               | 5,274                  | 4,376                |
| Metro district bond securities (related party) | 6,663                  | 6,663                |
| Goodwill and intangible assets, net            | 6,140                  | 6,308                |
| Other  | 2,547                  | 2,103                |
| <br>Total                                      | <br>\$ 47,616          | <br>\$ 50,423        |

**9. Homebuilding Accrued Liabilities**

The following table sets forth information relating to homebuilding accrued liabilities.

|   | September 30,<br>2012  | December 31,<br>2011 |
|---|------------------------|----------------------|
|   | (Dollars in thousands) |                      |
| Warranty reserves                               | \$ 23,082              | \$ 25,525            |
| Accrued interest payable                        | 10,182                 | 13,698               |
| Accrued executive deferred compensation         | 27,140                 | 24,136               |
| Liability for unrecognized tax benefits         | 917                    | 3,303                |
| Legal accruals                                  | 1,750                  | 9,360                |
| Land development and home construction accruals | 8,705                  | 10,619               |
| Accrued compensation and related expenses       | 15,299                 | 11,350               |
| Customer and escrow deposits                    | 9,683                  | 5,468                |
| Other accrued liabilities                       | 9,699                  | 15,729               |
| <br>Total accrued liabilities                   | <br>\$ 106,457         | <br>\$ 119,188       |

**10. Warranty Accrual**

We record expenses and warranty accruals for general and structural warranty claims, as well as reserves for known, unusual warranty-related expenditures. Management estimates the warranty accruals based on our trends in historical warranty payment levels and warranty payments for claims not considered to be normal and recurring. Warranty payments incurred for an individual house may differ from the related accrual established for the home at the time it was closed. The actual disbursements for warranty claims are evaluated in the aggregate. The table set forth below summarizes warranty accrual and payment activity for the three and nine months ended September 30, 2012 and 2011.

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|                                | Three Months Ended     |           | Nine Months Ended |           |
|--------------------------------|------------------------|-----------|-------------------|-----------|
|                                | September 30,          |           | September 30,     |           |
|                                | 2012                   | 2011      | 2012              | 2011      |
|                                | (Dollars in thousands) |           |                   |           |
| Balance at beginning of period | \$ 24,036              | \$ 31,200 | \$ 25,525         | \$ 34,704 |
| Expense provisions             | 1,479                  | 1,265     | 3,122             | 3,140     |
| Cash payments                  | (2,433)                | (2,707)   | (5,565)           | (5,823)   |
| Adjustments                    |                        | (955)     |                   | (3,218)   |
| Balance at end of period       | \$ 23,082              | \$ 28,803 | \$ 23,082         | \$ 28,803 |

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During the three and nine months ended September 30, 2011, we experienced lower warranty payments on previously closed homes as compared to the same periods in 2010. We believe the lower warranty payment experience rate in the 2011 periods were driven by, among other things, tighter focus and controls over our warranty expenditures, a significant drop in sales volumes over the last several years, which resulted in fewer homes under warranty, and better quality controls and construction practices. As a result of favorable warranty payment experience relative to our estimates at the time of home closing, partially offset by increases in specific warranty reserves established for warranty-related issues in a limited number of subdivisions, we recorded adjustments to reduce our warranty reserve by \$1.0 million and \$3.2 million for the three and nine months ended September 30, 2011, respectively.

**11. Insurance Reserves**

We record expenses and liabilities for losses and loss adjustment expenses for claims associated with: (1) insurance policies issued by Allegiant and re-insurance agreements issued by StarAmerican; (2) self-insurance, including workers compensation; and (3) deductible amounts under our insurance policies. The establishment of the provisions for outstanding losses and loss adjustment expenses is based on actuarial or internally developed studies that include known facts and interpretations 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 table set forth below summarizes the insurance reserve activity for the three and nine months ended September 30, 2012 and 2011. The insurance reserve is included as a component of accrued liabilities in the Financial Services section of the accompanying consolidated balance sheets.

|                                | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--------------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                                | 2012                                | 2011      | 2012                               | 2011      |
|                                | (Dollars in thousands)              |           |                                    |           |
| Balance at beginning of period | \$ 45,831                           | \$ 52,310 | \$ 50,459                          | \$ 52,901 |
| Expense provisions             | 1,037                               | 645       | 2,590                              | 2,060     |
| Cash payments                  | (1,850)                             | (1,380)   | (8,031)                            | (3,386)   |
| Balance at end of period       | \$ 45,018                           | \$ 51,575 | \$ 45,018                          | \$ 51,575 |

In the ordinary course of business, we make payments from our insurance reserves to settle litigation claims arising primarily from our homebuilding activities. These payments are irregular in both their timing and their magnitude. As a result, the cash payments shown for the three and nine months ended September 30, 2012 are not necessarily indicative of what future cash payments will be for subsequent periods. This is exemplified by the increase in cash payments for the nine months ended September 30, 2012 compared to the same period in 2011 which were driven by resolution of several significant covered claims in the first two quarters of 2012.

**12. Income Taxes**

At the end of each interim period, we are required to estimate our annual effective tax rate for the fiscal year and use that rate to provide for income taxes for the current year-to-date reporting period. Due to the effects of the deferred tax valuation allowance and changes in unrecognized tax benefits, our effective tax rates in 2012 and 2011 are not meaningful as the income tax benefit is not directly correlated to the amount of pretax income or loss. The income tax benefits of \$0.6 million and \$1.8 million during the three and nine months ended September 30, 2012, respectively, resulted primarily from the release of reserves attributable to the expiration of statute of limitations periods. The income tax benefits of \$2.5 million and \$8.1 million for the three and nine months ended September 30, 2011, respectively, resulted primarily from our 2011 second quarter settlement of various state income tax matters and our 2011 first quarter settlement with the IRS on the

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audit of our 2004 and 2005 federal income tax returns.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. 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. At September 30, 2012 and December 31, 2011, we had a full valuation allowance recorded against our net deferred tax asset. Future realization of our deferred tax

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assets ultimately depends upon the existence of sufficient taxable income in the carryforward periods under the tax laws. We will continue analyzing, in subsequent reporting periods, the positive and negative evidence in determining the expected realization of our deferred tax assets.

The components of our net deferred tax asset were as follows.

|  | September 30,<br>2012  | December 31,<br>2011 |
|--|------------------------|----------------------|
|  | (Dollars in thousands) |                      |
| <b>Deferred tax assets:</b>  |                        |                      |
| Federal net operating loss carryforwards                                 | \$ 133,796             | \$ 133,454           |
| State net operating loss carryforwards                                   | 52,576                 | 53,350               |
| Stock-based compensation expense   | 28,944                 | 26,771               |
| Accrued liabilities  | 26,391                 | 29,600               |
| Asset impairment charges   | 20,613                 | 31,137               |
| Alternative minimum tax and other tax credit carryforwards               | 10,726                 | 10,296               |
| Inventory, additional costs capitalized for tax                          | 3,833                  | 3,466                |
| Unrealized loss on marketable securities                                 |                        | 2,787                |
| Other  | 1,606                  | 1,522                |
| <b>Total deferred tax assets</b>   | <b>278,485</b>         | <b>292,383</b>       |
| Valuation allowance  | (263,561)              | (281,178)            |
| <b>Total deferred tax assets, net of valuation allowance</b>             | <b>14,924</b>          | <b>11,205</b>        |
| <b>Deferred tax liabilities:</b>   |                        |                      |
| Property, equipment and other assets                                     | 4,440                  | 706                  |
| Deferred revenue   | 3,445                  | 5,589                |
| Unrealized gain on marketable securities                                 | 1,426                  |                      |
| Inventory, additional costs capitalized for financial statement purposes | 482                    | 542                  |
| Accrued liabilities  | 758                    | 32                   |
| Other, net   | 4,373                  | 4,336                |
| <b>Total deferred tax liabilities</b>                                    | <b>14,924</b>          | <b>11,205</b>        |
| <b>Net deferred tax asset</b>  | <b>\$</b>              | <b>\$</b>            |

**13. Senior Notes**

Our senior notes are not secured and, while the senior note indentures contain some restrictions on secured debt and other transactions, they do not contain financial covenants. Our senior notes are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by substantially all of our homebuilding segment subsidiaries. The following table sets forth the carrying amount of our senior notes as of September 30, 2012 and December 31, 2011, net of applicable discounts:

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|                              | September 30,<br>2012  | December 31,<br>2011 |
|------------------------------|------------------------|----------------------|
|                              | (Dollars in thousands) |                      |
| 5.375% Senior Notes due 2014 | \$ 249,574             | \$ 249,438           |
| 5.375% Senior Notes due 2015 | 249,885                | 249,857              |
| 5.625% Senior Notes due 2020 | 245,195                | 244,813              |
| Total                        | \$ 744,654             | \$ 744,108           |

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**14. Stock Based Compensation**

We account for share-based awards in accordance with ASC 718, *Compensation-Stock Compensation* ( ASC 718 ), which requires the fair value of stock-based compensation awards to be amortized as an expense over the vesting period. Stock-based compensation awards are valued at fair value on the date of grant.

During the three and nine months ended September 30, 2012, we recognized \$3.6 million and \$8.4 million, respectively, for option grants, compared to \$3.1 million and \$7.3 million, respectively, during the same periods in the prior year. We recognized \$1.3 million and \$4.3 million for restricted stock awards during the three and nine months ended September 30, 2012, respectively, compared to \$2.3 million and \$4.8 million, respectively, during the same periods in the prior year.

On March 8, 2012, we granted a long term performance-based non-qualified stock option to each of our Chief Executive Officer and our Chief Operating Officer for 500,000 shares of common stock under our 2011 Equity Incentive Plan. The terms of the performance-based options provide that, over a three year period, one third of the option shares will vest as of March 1 following any fiscal year in which, in addition to the Company achieving a Home Gross Margin of at least 16.7% (as calculated in our 2011 Form 10-K, excluding warranty adjustments and interest), the Company achieves: (1) at least a 10% increase in total revenue over 2011 (166,667 option shares vest); (2) at least a 15% increase in total revenue over 2011 (166,667 option shares vest); or (3) at least a 20% increase in total revenue over 2011 (166,666 option shares vest). Any of the three tranches of option shares that are not performance vested by March 1, 2015 shall be forfeited. ASC 718 prohibits recognition of expense associated with performance based stock awards until achievement of the performance targets are probable of occurring. In the 2012 second quarter, we concluded that achievement of all the performance targets had met the level of probability required to record compensation expense at that time. At September 30, 2012, the achievement of all performance targets continues to be probable. As such, \$1.8 million and \$4.3 million of compensation expense was recognized related to the grant of these awards during the three and nine months ended September 30, 2012, respectively.

In accordance with ASC 718, the performance-based awards were valued at the fair value on the date of grant. The grant date fair value of these awards was \$7.42 per share. The maximum potential expense that would be recognized by us if all of the performance targets were met would be approximately \$7.4 million.

**15. Commitments and Contingencies**

*Surety Bonds and Letters of Credit.* We are required to obtain surety bonds and letters of credit in support of our obligations for land development and subdivision improvements, homeowner association dues, warranty work, contractor license fees and earnest money deposits. At September 30, 2012, we had issued and outstanding surety bonds and letters of credit totaling \$56.0 million and \$18.0 million, respectively, including \$7.1 million in letters of credit issued by HomeAmerican. The estimated cost to complete obligations related to these bonds and letters of credit was approximately \$27.4 million and \$3.1 million, respectively. In the event any such surety bonds or letters of credit issued by third parties are called, MDC could be obligated to reimburse the issuer of the bond or letter of credit.

*Mortgage Loan Loss Reserves.* In the normal course of business, we establish reserves for potential losses associated with HomeAmerican's sale of mortgage loans to third-parties. These reserves are created to address repurchase and indemnity claims by third-party purchasers of the mortgage loans, which claims arise primarily out of allegations of homebuyer fraud at the time of origination of the loan. These reserves are based upon, among other things: (1) pending claims received from third-party purchasers associated with previously sold mortgage loans; and (2) a current assessment of the potential exposure associated with future claims of fraud in mortgage loans originated in prior periods. Our mortgage loan reserves are reflected as a component of accrued liabilities in the Financial Services section of the accompanying consolidated balance sheets, and the associated expenses are included in Expenses in the Financial Services section of the accompanying consolidated statements of operations.

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The following table summarizes the mortgage loan loss reserve activity for the three months and nine months ended September 30, 2012 and 2011.

|                                | Three Months           |          | Nine Months            |          |
|--------------------------------|------------------------|----------|------------------------|----------|
|                                | Ended September 30,    |          | Ended September 30,    |          |
|                                | 2012                   | 2011     | 2012                   | 2011     |
|                                | (Dollars in thousands) |          | (Dollars in thousands) |          |
| Balance at beginning of period | \$ 799                 | \$ 4,100 | \$ 442                 | \$ 6,881 |
| Expense provisions             | 160                    | 3,035    | 615                    | 4,332    |
| Cash payments                  | (128)                  | (174)    | (226)                  | (4,252)  |
| Balance at end of period       | \$ 831                 | \$ 6,961 | \$ 831                 | \$ 6,961 |

During 2011, HomeAmerican reached settlements with third parties concerning claims and potential claims to repurchase certain previously sold mortgage loans, including a comprehensive settlement with Bank of America. We believe that the settlements substantially reduce our future exposure to liabilities associated with previously sold mortgage loans, as our experience was significantly worse for the mortgage loans sold that were covered by the Bank of America settlement when compared to the mortgage loans sold that were not covered by the settlement.

*Legal Accruals.* Because of the nature of the homebuilding business, we have been named as defendants in various claims, complaints and other legal actions arising in the ordinary course of business, including product liability claims and claims associated with the sale and financing of homes. In the opinion of management, the outcome of these ordinary course matters will not have a material adverse effect upon our financial condition, results of operations or cash flows.

For the three and nine months ended September 30 2012, we had a legal recovery of \$2.2 million and various significant legal recoveries totaling \$9.8 million, respectively, which were included in selling, general and administrative expenses. These recoveries were realized primarily from prior claims we had made in connection with various construction defect cases.

*Lot Option Contracts.* In the normal course of business, we enter into lot option purchase contracts ( Option Contracts ), generally through a deposit of cash or a letter of credit, for the right to purchase land or lots at a future point in time with predetermined terms. The use of such land option and other contracts generally allows us to reduce the risks associated with direct land ownership and development, reduces our capital and financial commitments and minimizes the amount of our land inventories on our consolidated balance sheets. Our obligation with respect to Option Contracts generally is limited to forfeiture of the related cash deposits and/or letters of credit. At September 30, 2012, we had cash deposits and letters of credit totaling \$6.2 million and \$3.3 million, respectively, at risk associated with the option to purchase 1,450 lots.

**16. Derivative Financial Instruments**

We utilize certain derivative instruments in the normal course of business, which primarily include commitments to originate mortgage loans (interest rate lock commitments or locked pipeline) and forward sales of mortgage-backed securities commitments, both of which typically are short-term in nature. Forward sales securities commitments and private investor sales commitments are utilized to hedge changes in fair value of mortgage loan inventory and commitments to originate mortgage loans. At September 30, 2012, we had \$76.1 million in interest rate lock commitments and \$45.5 million in forward sales of mortgage-backed securities.

We record our mortgage loans held-for-sale at fair value to achieve matching of the changes in the fair value of our derivative instruments with the changes in fair values of hedged loans, without having to designate our derivatives as hedging instruments. For forward sales commitments, as well as commitments to originate mortgage loans that are still outstanding at the end of a reporting period, we record the fair value of the



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derivatives in Financial Services revenues in the consolidated statements of operations with an offset to Financial Services prepaid expenses and other assets or accrued liabilities in the accompanying consolidated balance sheets, depending on the nature of the change.

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**M.D.C. HOLDINGS, INC.**

**Notes to Unaudited Consolidated Financial Statements**

**17. Mortgage Repurchase Facility**

*Mortgage Lending.* HomeAmerican has a Master Repurchase Agreement (the Mortgage Repurchase Facility ) with U.S. Bank National Association ( USBNA ). This agreement was amended on September 21, 2012 and extended until September 20, 2013. The Mortgage Repurchase Facility provides liquidity to HomeAmerican by providing for the sale of eligible mortgage loans to USBNA with an agreement by HomeAmerican to repurchase the mortgage loans at a future date. Until such mortgage loans are transferred back to HomeAmerican, the documents relating to such loans are held by USBNA, as custodian, pursuant to the Custody Agreement ( Custody Agreement ), dated as of November 12, 2008, by and between HomeAmerican and USBNA. As of September 30, 2012, the Mortgage Repurchase Facility had a maximum aggregate commitment of \$50 million. At September 30, 2012 and December 31, 2011, we had \$46.9 million and \$48.7 million, respectively, of mortgage loans that we were obligated to repurchase under our Mortgage Repurchase Facility. Mortgage loans that we are obligated to repurchase under the Mortgage Repurchase Facility are accounted for as a debt financing arrangement and are reported as mortgage repurchase facility on the consolidated balance sheets. Advances under the Mortgage Repurchase Facility carry a Pricing Rate equal to the greater of (i) the LIBOR Rate (as defined in the Mortgage Repurchase Facility) plus 2.5%, or (ii) 3.25%. The Mortgage Repurchase Facility contains various representations, warranties and affirmative and negative covenants customary for agreements of this type. The negative covenants include, among others, (i) an Adjusted Tangible Net Worth requirement, (ii) a minimum Adjusted Tangible Net Worth Ratio, (iii) an Adjusted Net Income requirement, and (iv) a minimum Liquidity requirement. The foregoing terms are defined in the Mortgage Repurchase Facility. We believe we were in compliance with the representations, warranties and covenants included in the Mortgage Repurchase Facility.

**18. Supplemental Guarantor Information**

Our senior notes are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by the following subsidiaries (collectively, the Guarantor Subsidiaries ), which are 100% owned by us.

M.D.C. Land Corporation

RAH of Florida, Inc.

Richmond American Construction, Inc.

Richmond American Homes of Arizona, Inc.

Richmond American Homes of Colorado, Inc.

Richmond American Homes of Delaware, Inc.

Richmond American Homes of Florida, LP

Richmond American Homes of Illinois, Inc.

Richmond American Homes of Maryland, Inc.

Richmond American Homes of Nevada, Inc.

Richmond American Homes of New Jersey, Inc.

Richmond American Homes of Pennsylvania, Inc.

Richmond American Homes of Utah, Inc.

Richmond American Homes of Virginia, Inc.

Subsidiaries that do not guarantee our senior notes (collectively, the Non-Guarantor Subsidiaries ) primarily include:

American Home Insurance

American Home Title

HomeAmerican

StarAmerican

Allegiant

Richmond American Homes of West Virginia, Inc.

Richmond American Homes of Washington, Inc.

We have determined that separate, full financial statements of the Guarantor Subsidiaries would not be material to investors and, accordingly, supplemental financial information for the Guarantor and Non-Guarantor Subsidiaries is presented below.

**Table of Contents****M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements****Supplemental Condensed Combining Balance Sheets**

|   | September 30, 2012     |                           |                                   |                        |                     |
|---|------------------------|---------------------------|-----------------------------------|------------------------|---------------------|
|   | MDC                    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
|   | (Dollars in thousands) |                           |                                   |                        |                     |
| <b>ASSETS</b>   |                        |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                                  |                        |                           |                                   |                        |                     |
| Cash and cash equivalents                             | \$ 231,595             | \$ 3,475                  | \$ 203                            | \$                     | \$ 235,273          |
| Marketable securities                                 | 503,805                |                           |                                   |                        | 503,805             |
| Restricted cash                                       |                        | 2,084                     |                                   |                        | 2,084               |
| Trade and other receivables                           | 8,594                  | 25,986                    | 1,188                             |                        | 35,768              |
| Inventories:  |                        |                           |                                   |                        |                     |
| Housing completed or under construction               |                        | 469,618                   | 34,398                            |                        | 504,016             |
| Land and land under development                       |                        | 376,059                   | 17,111                            |                        | 393,170             |
| Investment in subsidiaries                            | 172,975                |                           |                                   | (172,975)              |                     |
| Other assets, net                                     | 42,454                 | 29,956                    | 8,995                             |                        | 81,405              |
| Total homebuilding assets                             | 959,423                | 907,178                   | 61,895                            | (172,975)              | 1,755,521           |
| <b>Financial Services:</b>                            |                        |                           |                                   |                        |                     |
| Cash and cash equivalents                             |                        |                           | 28,524                            |                        | 28,524              |
| Marketable securities                                 |                        |                           | 32,915                            |                        | 32,915              |
| Mortgage loans held-for-sale, net                     |                        |                           | 86,648                            |                        | 86,648              |
| Prepaid expenses and other assets                     |                        |                           | 6,515                             | (1,700)                | 4,815               |
| Total financial services assets                       |                        |                           | 154,602                           | (1,700)                | 152,902             |
| Total Assets  | \$ 959,423             | \$ 907,178                | \$ 216,497                        | \$ (174,675)           | \$ 1,908,423        |
| <b>LIABILITIES AND EQUITY</b>                         |                        |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                                  |                        |                           |                                   |                        |                     |
| Accounts payable                                      | \$                     | \$ 46,958                 | \$ 2,678                          |                        | \$ 49,636           |
| Accrued liabilities                                   | 56,840                 | 46,277                    | 3,340                             |                        | 106,457             |
| Advances and notes payable to parent and subsidiaries | (748,633)              | 721,772                   | 33,776                            | (6,915)                |                     |
| Senior notes, net                                     | 744,654                |                           |                                   |                        | 744,654             |
| Total homebuilding liabilities                        | 52,861                 | 815,007                   | 39,794                            | (6,915)                | 900,747             |
| <b>Financial Services:</b>                            |                        |                           |                                   |                        |                     |
| Accounts payable and other liabilities                |                        |                           | 54,226                            |                        | 54,226              |
| Advances and notes payable to parent and subsidiaries |                        |                           | (5,215)                           | 5,215                  |                     |
| Mortgage repurchase facility                          |                        |                           | 46,888                            |                        | 46,888              |
| Total financial services liabilities                  |                        |                           | 95,899                            | 5,215                  | 101,114             |
| Total Liabilities                                     | 52,861                 | 815,007                   | 135,693                           | (1,700)                | 1,001,861           |

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**Equity:**

|   |            |            |            |              |              |
|---|------------|------------|------------|--------------|--------------|
| Total Stockholder s Equity                | 906,562    | 92,171     | 80,804     | (172,975)    | 906,562      |
| Total Liabilities and Stockholders Equity | \$ 959,423 | \$ 907,178 | \$ 216,497 | \$ (174,675) | \$ 1,908,423 |

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**Table of Contents****M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements****Supplemental Condensed Combining Balance Sheets**

|   | December 31, 2011      |                           |                                   |                        |                     |
|---|------------------------|---------------------------|-----------------------------------|------------------------|---------------------|
|   | MDC                    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
|   | (Dollars in thousands) |                           |                                   |                        |                     |
| <b>ASSETS</b>   |                        |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                                  |                        |                           |                                   |                        |                     |
| Cash and cash equivalents                             | \$ 313,566             | \$ 2,771                  | \$ 81                             | \$                     | \$ 316,418          |
| Marketable securities                                 | 485,434                |                           |                                   |                        | 485,434             |
| Restricted cash                                       |                        | 667                       |                                   |                        | 667                 |
| Trade and other receivables                           | 8,368                  | 12,740                    | 485                               |                        | 21,593              |
| Inventories:  |                        |                           |                                   |                        |                     |
| Housing completed or under construction               |                        | 280,932                   | 19,782                            |                        | 300,714             |
| Land and land under development                       |                        | 489,305                   | 16,033                            |                        | 505,338             |
| Investment in subsidiaries                            | 126,768                |                           |                                   | (126,768)              |                     |
| Other assets, net                                     | 45,287                 | 33,074                    | 8,435                             | (96)                   | 86,700              |
| Total homebuilding assets                             | 979,423                | 819,489                   | 44,816                            | (126,864)              | 1,716,864           |
| <b>Financial Services:</b>                            |                        |                           |                                   |                        |                     |
| Cash and cash equivalents                             |                        |                           | 26,943                            |                        | 26,943              |
| Marketable securities                                 |                        |                           | 34,509                            |                        | 34,509              |
| Mortgage loans held-for-sale, net                     |                        |                           | 78,335                            |                        | 78,335              |
| Prepaid expenses and other assets                     |                        |                           | 3,774                             | (1,700)                | 2,074               |
| Total financial services assets                       |                        |                           | 143,561                           | (1,700)                | 141,861             |
| Total Assets  | \$ 979,423             | \$ 819,489                | \$ 188,377                        | \$ (128,564)           | \$ 1,858,725        |
| <b>LIABILITIES AND EQUITY</b>                         |                        |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                                  |                        |                           |                                   |                        |                     |
| Accounts payable                                      | \$                     | \$ 23,409                 | \$ 2,236                          |                        | \$ 25,645           |
| Accrued liabilities                                   | 67,199                 | 50,271                    | 1,814                             | (96)                   | 119,188             |
| Advances and notes payable to parent and subsidiaries | (700,520)              | 682,088                   | 21,998                            | (3,566)                |                     |
| Senior notes, net                                     | 744,108                |                           |                                   |                        | 744,108             |
| Total homebuilding liabilities                        | 110,787                | 755,768                   | 26,048                            | (3,662)                | 888,941             |
| <b>Financial Services:</b>                            |                        |                           |                                   |                        |                     |
| Accounts payable and other liabilities                |                        |                           | 52,446                            |                        | 52,446              |
| Advances and notes payable to parent and subsidiaries |                        |                           | (1,866)                           | 1,866                  |                     |
| Mortgage repurchase facility                          |                        |                           | 48,702                            |                        | 48,702              |
| Total financial services liabilities                  |                        |                           | 99,282                            | 1,866                  | 101,148             |
| Total Liabilities                                     | 110,787                | 755,768                   | 125,330                           | (1,796)                | 990,089             |

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**Equity:**

|   |            |            |            |              |              |
|---|------------|------------|------------|--------------|--------------|
| Total Stockholder s Equity                | 868,636    | 63,721     | 63,047     | (126,768)    | 868,636      |
| Total Liabilities and Stockholders Equity | \$ 979,423 | \$ 819,489 | \$ 188,377 | \$ (128,564) | \$ 1,858,725 |

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**Table of Contents****M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements****Supplemental Condensed Combining Statements of Operations**

|   | Three Months Ended September 30, 2012 |                           |                                   |                        |                     |
|---|---------------------------------------|---------------------------|-----------------------------------|------------------------|---------------------|
|   | MDC                                   | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
| (Dollars in thousands)                        |                                       |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                          |                                       |                           |                                   |                        |                     |
| Revenues                                      | \$                                    | \$ 303,503                | \$ 18,919                         | \$ (1,760)             | \$ 320,662          |
| Cost of Sales                                 |                                       | (257,322)                 | (15,507)                          | 1,760                  | (271,069)           |
| Inventory impairments                         |                                       |                           |                                   |                        |                     |
| Gross margin                                  |                                       | 46,181                    | 3,412                             |                        | 49,593              |
| Selling, general, and administrative expenses | (15,461)                              | (29,164)                  | (163)                             |                        | (44,788)            |
| Equity income (loss) of subsidiaries          | 26,656                                |                           |                                   | (26,656)               |                     |
| Interest income                               | 5,364                                 | 1                         |                                   |                        | 5,365               |
| Interest expense                              |                                       |                           |                                   |                        |                     |
| Other income (expense)                        | 97                                    | 132                       | (213)                             |                        | 16                  |
| Homebuilding pretax income (loss)             | 16,656                                | 17,150                    | 3,036                             | (26,656)               | 10,186              |
| <b>Financial Services:</b>                    |                                       |                           |                                   |                        |                     |
| Financial services pretax income              |                                       |                           | 9,298                             |                        | 9,298               |
| Income (loss) before income taxes             | 16,656                                | 17,150                    | 12,334                            | (26,656)               | 19,484              |
| (Provision) benefit for income taxes          | 3,470                                 | 586                       | (3,414)                           |                        | 642                 |
| Net income (loss)                             | \$ 20,126                             | \$ 17,736                 | \$ 8,920                          | \$ (26,656)            | \$ 20,126           |

|   | Three Months Ended September 30, 2011 |                           |                                   |                        |                     |
|---|---------------------------------------|---------------------------|-----------------------------------|------------------------|---------------------|
|   | MDC                                   | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
| (Dollars in thousands)                        |                                       |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                          |                                       |                           |                                   |                        |                     |
| Revenues                                      | \$                                    | \$ 193,857                | \$ 13,155                         | \$ (1,396)             | \$ 205,616          |
| Cost of Sales                                 |                                       | (161,751)                 | (10,812)                          | 1,396                  | (171,167)           |
| Inventory impairments                         |                                       | (4,049)                   |                                   |                        | (4,049)             |
| Gross margin                                  |                                       | 28,057                    | 2,343                             |                        | 30,400              |
| Selling, general, and administrative expenses | (15,106)                              | (28,704)                  | (2,550)                           |                        | (46,360)            |
| Equity income (loss) of subsidiaries          | (4,022)                               |                           |                                   | 4,022                  |                     |
| Interest income                               | 5,958                                 | 6                         |                                   |                        | 5,964               |
| Interest expense                              | (3,641)                               |                           |                                   |                        | (3,641)             |
| Other income (expense)                        | (17,318)                              | (2,742)                   | (42)                              |                        | (20,102)            |



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|   |             |            |          |          |             |
|---|-------------|------------|----------|----------|-------------|
| Homebuilding pretax income (loss)       | (34,129)    | (3,383)    | (249)    | 4,022    | (33,739)    |
| <b>Financial Services:</b>              |             |            |          |          |             |
| Financial services pretax income (loss) |             |            | (450)    |          | (450)       |
| Income (loss) before income taxes       | (34,129)    | (3,383)    | (699)    | 4,022    | (34,189)    |
| (Provision) benefit for income taxes    | 2,419       | (1)        | 61       |          | 2,479       |
| Net income (loss)                       | \$ (31,710) | \$ (3,384) | \$ (638) | \$ 4,022 | \$ (31,710) |

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**Table of Contents****M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements****Supplemental Condensed Combining Statements of Operations**

|   | Nine Months Ended September 30, 2012 |                           |                                   |                        |                     |
|---|--------------------------------------|---------------------------|-----------------------------------|------------------------|---------------------|
|   | MDC                                  | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
| (Dollars in thousands)                        |                                      |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                          |                                      |                           |                                   |                        |                     |
| Revenues                                      | \$                                   | \$ 720,358                | \$ 49,632                         | \$ (4,713)             | \$ 765,277          |
| Cost of Sales                                 |                                      | (616,077)                 | (41,787)                          | 4,713                  | (653,151)           |
| Inventory impairments                         |                                      |                           |                                   |                        |                     |
| Gross margin                                  |                                      | 104,281                   | 7,845                             |                        | 112,126             |
| Selling, general, and administrative expenses | (38,030)                             | (77,535)                  | (2,570)                           |                        | (118,135)           |
| Equity income (loss) of subsidiaries          | 46,776                               |                           |                                   | (46,776)               |                     |
| Interest income                               | 16,642                               | 9                         |                                   |                        | 16,651              |
| Interest expense                              | (778)                                | (30)                      |                                   |                        | (808)               |
| Other income (expense)                        | 535                                  | 208                       | (151)                             |                        | 592                 |
| Homebuilding pretax income (loss)             | 25,145                               | 26,933                    | 5,124                             | (46,776)               | 10,426              |
| <b>Financial Services:</b>                    |                                      |                           |                                   |                        |                     |
| Financial services pretax income (loss)       |                                      |                           | 20,838                            |                        | 20,838              |
| Income (loss) before income taxes             | 25,145                               | 26,933                    | 25,962                            | (46,776)               | 31,264              |
| (Provision) benefit for income taxes          | 7,884                                | 1,519                     | (7,638)                           |                        | 1,765               |
| Net income (loss)                             | \$ 33,029                            | \$ 28,452                 | \$ 18,324                         | \$ (46,776)            | \$ 33,029           |

|   | Nine Months Ended September 30, 2011 |                           |                                   |                        |                     |
|---|--------------------------------------|---------------------------|-----------------------------------|------------------------|---------------------|
|   | MDC                                  | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
| (Dollars in thousands)                        |                                      |                           |                                   |                        |                     |
| <b>Homebuilding:</b>                          |                                      |                           |                                   |                        |                     |
| Revenues                                      | \$                                   | \$ 556,078                | \$ 26,938                         | \$ (5,085)             | \$ 577,931          |
| Cost of Sales                                 |                                      | (475,005)                 | (23,083)                          | 5,085                  | (493,003)           |
| Inventory impairments                         |                                      | (12,682)                  |                                   |                        | (12,682)            |
| Gross margin                                  |                                      | 68,391                    | 3,855                             |                        | 72,246              |
| Selling, general, and administrative expenses | (48,170)                             | (90,527)                  | (4,474)                           |                        | (143,171)           |
| Equity income (loss) of subsidiaries          | (23,295)                             |                           |                                   | 23,295                 |                     |
| Interest income                               | 19,413                               | 24                        |                                   |                        | 19,437              |
| Interest expense                              | (19,642)                             |                           |                                   |                        | (19,642)            |
| Other income (expense)                        | (15,255)                             | (5,755)                   | 25                                |                        | (20,985)            |

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|                                      |             |             |          |           |             |
|--------------------------------------|-------------|-------------|----------|-----------|-------------|
| Homebuilding pretax income (loss)    | (86,949)    | (27,867)    | (594)    | 23,295    | (92,115)    |
| <b>Financial Services:</b>           |             |             |          |           |             |
| Financial services pretax income     |             |             | 4,419    |           | 4,419       |
| Income (loss) before income taxes    | (86,949)    | (27,867)    | 3,825    | 23,295    | (87,696)    |
| (Provision) benefit for income taxes | 7,380       | 2,583       | (1,836)  |           | 8,127       |
| Net income (loss)                    | \$ (79,569) | \$ (25,284) | \$ 1,989 | \$ 23,295 | \$ (79,569) |

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**Table of Contents****M.D.C. HOLDINGS, INC.****Notes to Unaudited Consolidated Financial Statements****Supplemental Condensed Combining Statements of Cash Flows**

|  | Nine Months Ended September 30, 2012 |                           |                           |                        |                     |
|--|--------------------------------------|---------------------------|---------------------------|------------------------|---------------------|
|  | MDC                                  | Guarantor<br>Subsidiaries | Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
|  | (Dollars in thousands)               |                           |                           |                        |                     |
| Net cash provided by (used in) operating activities  | \$ 39,291                            | \$ (37,887)               | \$ (5,083)                | \$ (46,776)            | \$ (50,455)         |
| Net cash provided by (used in) investing activities  | (8,106)                              | (719)                     | 1,756                     |                        | (7,069)             |
| <b>Financing activities:</b>                         |                                      |                           |                           |                        |                     |
| Payments from (advances to) subsidiaries             | (92,930)                             | 39,310                    | 6,844                     | 46,776                 |                     |
| Mortgage repurchase facility                         |                                      |                           | (1,814)                   |                        | (1,814)             |
| Dividend payments                                    | (36,046)                             |                           |                           |                        | (36,046)            |
| Proceeds from the exercise of stock options          | 15,820                               |                           |                           |                        | 15,820              |
| Net cash provided by (used in) financing activities  | (113,156)                            | 39,310                    | 5,030                     | 46,776                 | (22,040)            |
| Net increase (decrease) in cash and cash equivalents | (81,971)                             | 704                       | 1,703                     |                        | (79,564)            |
| <b>Cash and cash equivalents:</b>                    |                                      |                           |                           |                        |                     |
| Beginning of period                                  | 313,566                              | 2,771                     | 27,024                    |                        | 343,361             |
| End of period  | \$ 231,595                           | \$ 3,475                  | \$ 28,727                 | \$                     | \$ 263,797          |
|  | Nine Months Ended September 30, 2011 |                           |                           |                        |                     |
|  | MDC                                  | Guarantor<br>Subsidiaries | Guarantor<br>Subsidiaries | Eliminating<br>Entries | Consolidated<br>MDC |
|  | (Dollars in thousands)               |                           |                           |                        |                     |
| Net cash provided by (used in) operating activities  | \$ (39,482)                          | \$ (77,129)               | \$ 12,567                 | \$ 23,301              | \$ (80,743)         |
| Net cash provided by (used in) investing activities  | 413,999                              | (20)                      | (32,817)                  |                        | 381,162             |
| <b>Financing activities:</b>                         |                                      |                           |                           |                        |                     |
| Extinguishment of senior notes                       | (254,903)                            |                           |                           |                        | (254,903)           |
| Payments from (advances to) subsidiaries             | (86,833)                             | 75,707                    | 34,427                    | (23,301)               |                     |
| Mortgage repurchase facility                         |                                      |                           | (14,726)                  |                        | (14,726)            |
| Dividend payments                                    | (35,560)                             |                           |                           |                        | (35,560)            |
| Proceeds from the exercise of stock options          | 46                                   |                           |                           |                        | 46                  |
| Net cash provided by (used in) financing activities  | (377,250)                            | 75,707                    | 19,701                    | (23,301)               | (305,143)           |
| Net increase (decrease) in cash and cash equivalents | (2,733)                              | (1,442)                   | (549)                     |                        | (4,724)             |
| <b>Cash and cash equivalents:</b>                    |                                      |                           |                           |                        |                     |
| Beginning of period                                  | 535,035                              | 4,287                     | 32,903                    |                        | 572,225             |

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|               |            |          |           |    |            |
|---------------|------------|----------|-----------|----|------------|
| End of period | \$ 532,302 | \$ 2,845 | \$ 32,354 | \$ | \$ 567,501 |
|---------------|------------|----------|-----------|----|------------|

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**Table of Contents****ITEM 2. 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 Unaudited Consolidated Financial Statements and Notes thereto included elsewhere in this Quarterly Report on Form 10-Q. 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 of our Annual Report on Form 10-K for the year ended December 31, 2011 and this Quarterly Report on Form 10-Q.

**M.D.C. HOLDINGS, INC.****Selected Financial Information (unaudited)**

|  | Three Months Ended<br>September 30,              |             | Nine Months Ended<br>September 30, |             |
|--|--|-------------|------------------------------------|-------------|
|  | 2012   | 2011        | 2012                               | 2011        |
|  | (Dollars in thousands, except per share amounts) |             |                                    |             |
| <b>Homebuilding:</b>                         |  |             |                                    |             |
| Home sale revenues                           | \$ 320,647                                       | \$ 204,886  | \$ 761,857                         | \$ 574,432  |
| Land sale revenues                           | 15   | 730         | 3,420                              | 3,499       |
| Total home sale and land revenues            | 320,662  | 205,616     | 765,277                            | 577,931     |
| Home cost of sales                           | (271,067)  | (170,443)   | (649,941)                          | (490,521)   |
| Land cost of sales                           | (2)  | (724)       | (3,210)                            | (2,482)     |
| Inventory impairments                        |  | (4,049)     |                                    | (12,682)    |
| Total cost of sales                          | (271,069)  | (175,216)   | (653,151)                          | (505,685)   |
| Gross margin                                 | 49,593   | 30,400      | 112,126                            | 72,246      |
| Gross margin %                               | 15.5%  | 14.8%       | 14.7%                              | 12.5%       |
| Selling, general and administrative expenses | (44,788)   | (46,360)    | (118,135)                          | (143,171)   |
| Interest income                              | 5,365  | 5,964       | 16,651                             | 19,437      |
| Interest expense                             |  | (3,641)     | (808)                              | (19,642)    |
| Other income (expense)                       | 16   | (20,102)    | 592                                | (20,985)    |
| Homebuilding pretax income (loss)            | 10,186   | (33,739)    | 10,426                             | (92,115)    |
| <b>Financial Services:</b>                   |  |             |                                    |             |
| Revenues                                     | 14,454   | 6,322       | 34,304                             | 20,480      |
| Expenses                                     | (5,156)  | (6,772)     | (13,466)                           | (16,061)    |
| Financial services pretax income (loss)      | 9,298  | (450)       | 20,838                             | 4,419       |
| Income (loss) before income taxes            | 19,484   | (34,189)    | 31,264                             | (87,696)    |
| Benefit from income taxes                    | 642  | 2,479       | 1,765                              | 8,127       |
| Net income (loss)                            | \$ 20,126  | \$ (31,710) | \$ 33,029                          | \$ (79,569) |
| <b>Earnings (loss) per share:</b>            |  |             |                                    |             |
| Basic  | \$ 0.42  | \$ (0.68)   | \$ 0.69                            | \$ (1.72)   |
| Diluted                                      | \$ 0.41  | \$ (0.68)   | \$ 0.68                            | \$ (1.72)   |

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Weighted Average Common Shares Outstanding:

|                              |             |              |             |              |
|------------------------------|-------------|--------------|-------------|--------------|
| Basic                        | 47,761,307  | 46,736,638   | 47,499,429  | 46,717,408   |
| Diluted                      | 48,173,315  | 46,736,638   | 47,818,188  | 46,717,408   |
| Dividends declared per share | \$ 0.25     | \$ 0.25      | \$ 0.75     | \$ 0.75      |
| Cash provided by (used in):  |             |              |             |              |
| Operating Activities         | \$ (34,865) | \$ (11,486)  | \$ (50,455) | \$ (80,743)  |
| Investing Activities         | \$ (45,314) | \$ 88,203    | \$ (7,069)  | \$ 381,162   |
| Financing Activities         | \$ 17,852   | \$ (265,051) | \$ (22,040) | \$ (305,143) |

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### ***Overview***

Over the past few quarters, we implemented a series of strategic initiatives designed to help us achieve a goal of generating full-year profitability in 2012. These initiatives were previously discussed in detail under Management's Discussion and Analysis of Financial Condition and Results of Operations in the Company's Form 10-K for the year ended December 31, 2011. In addition, during the first nine months of 2012, we took advantage of a recovering housing market and better overall economic conditions in most of our markets.

As a result, we achieved our third consecutive quarterly operating profit during the 2012 third quarter, with net income increasing by more than \$50 million over the prior year. Our favorable results were largely attributable to improved operating profits from our homebuilding segment, which experienced significant revenue growth as well as operating margin expansion. In addition, our financial services segment produced considerably better results as we took advantage of favorable mortgage market conditions, including increased volume and margins for our mortgage loan products.

For the 2012 third quarter, we reported net income of \$20.1 million, or \$0.41 per diluted share, compared to a net loss of \$31.7 million, or \$0.68 per diluted share for the year earlier period. The improvement in our quarterly performance was driven primarily by a 57% increase in home sale revenues, an 860 basis point reduction in our homebuilding selling, general and administrative (SG&A) expenses as a percentage of home sale revenues, a \$4.0 million reduction in inventory impairments, a \$3.6 million decrease in interest expense and a \$9.7 million increase in our financial services segment pretax income.

For the nine months ended September 30, 2012, we reported net income of \$33.0 million, or \$0.68 per diluted share, compared to a net loss of \$79.6 million, or \$1.72 per diluted share for the year earlier period. The improvement in our performance was driven primarily by a 33% increase in home sale revenues, a 940 basis point reduction in our homebuilding SG&A expenses as a percentage of home sale revenues, an \$18.8 million decrease in interest expense, a \$12.7 million reduction in impairments, and a \$16.4 million increase in our financial services segment pretax income.

Both the three and nine month periods ended September 30, 2012 also benefited from a decrease in other expense, which was higher for the three and nine months ended September 30, 2011 due to an \$18.6 million charge related to the early extinguishment of debt.

As the overall housing market has continued to show signs of recovery over the last several quarters, our efforts to improve our sales process, product offering and cancellation rate has also helped us drive significantly improved sales results. During the 2012 third quarter, net new orders increased 69% year-over-year to 1,008 homes, driven by a 78% improvement in our absorption pace per community and a 1,700 basis point reduction in our cancellation rate. At the same time, we have worked to balance our improved absorption pace by increasing home prices and reducing incentives in many subdivisions across the country. This effort has helped us improve our gross margin from home sales both year-over-year and sequentially for the 2012 third quarter.

For the nine months ended September 30, 2012, our net orders were up 47% year-over-year to 3,473 homes. With our quarter-end backlog up 52% over the prior year, coupled with the positive net income recorded to date in 2012, we believe we are well positioned to achieve our goal of reaching profitability for 2012.

Our financial position remained strong at the end of the quarter, as evidenced by our total cash and marketable securities of \$801 million, which exceeded the amount of our senior note debt by \$56 million. We believe that our strong financial position gives us a competitive advantage as we pursue attractive land acquisition opportunities as the housing market improves, which can help us further grow our operations in the future.



**Table of Contents****Homebuilding**

|  | Three Months Ended<br>September 30, |                    |                  | Nine Months Ended<br>September 30, |                    |                   |
|--|-------------------------------------|--------------------|------------------|------------------------------------|--------------------|-------------------|
|  | 2012                                | 2011               | Change           | 2012                               | 2011               | Change            |
| (Dollars in thousands)                         |                                     |                    |                  |                                    |                    |                   |
| <b>Homebuilding pretax income (loss):</b>      |                                     |                    |                  |                                    |                    |                   |
| West   | \$ 8,334                            | \$ (2,584)         | \$ 10,918        | \$ 11,178                          | \$ (18,981)        | \$ 30,159         |
| Mountain                                       | 6,951                               | 2,988              | 3,963            | 13,746                             | 552                | 13,194            |
| East   | 4,417                               | (2,518)            | 6,935            | 6,717                              | (6,819)            | 13,536            |
| Other  | 490                                 | (1,514)            | 2,004            | 426                                | (3,206)            | 3,632             |
| Corporate                                      | (10,006)                            | (30,111)           | 20,105           | (21,641)                           | (63,661)           | 42,020            |
| <b>Total homebuilding pretax income (loss)</b> | <b>\$ 10,186</b>                    | <b>\$ (33,739)</b> | <b>\$ 43,925</b> | <b>\$ 10,426</b>                   | <b>\$ (92,115)</b> | <b>\$ 102,541</b> |

For the 2012 third quarter, we reported homebuilding pretax income of \$10.2 million, compared to a pretax loss of \$33.7 million for the third quarter of 2011. The \$43.9 million improvement in our homebuilding financial performance was driven primarily by a 57% increase in home sale revenues, a 70 basis point improvement in our gross margin from home sales, an 860 basis point reduction in our SG&A expenses as a percentage of home sale revenues and a \$3.6 million decrease in our interest expense.

For the nine months ended September 30, 2012, we reported homebuilding pretax income of \$10.4 million, compared to a pretax loss of \$92.1 million for the same period in 2011. The \$102.5 million improvement in our homebuilding financial performance was driven primarily by a 33% increase in home sale revenues, a 230 basis point improvement in our gross margin from home sales, a \$25 million reduction in our SG&A expenses and an \$18.8 million decrease in our interest expense.

In addition, both the three and nine month periods ended September 30, 2011 were negatively impacted by an \$18.6 million charge related to the early extinguishment of \$237 million of debt.

Our West, Mountain, East and Other segments all showed improvements in pretax results for the three and nine months ended September 30, 2012 when compared with the same periods in 2011. The improvements in each of these segments were driven by reductions in SG&A expenses and improvements in our gross margins in certain markets. The improvements in pretax results were also aided by increases in our homebuilding revenues in our West, Mountain and East segments due to increases in homebuilding deliveries and average price per home delivered. Our pretax results for our non-operating Corporate segment improved \$20.1 million and \$42.0 million, respectively, for the three and nine months ended September 30, 2012 due primarily to reductions in both interest and SG&A expenses, which included a legal recovery of \$2.2 million and various significant legal recoveries totaling \$9.8 million, respectively, and an \$18.6 million reduction in loss on extinguishment of senior debt that was recorded in the third quarter 2011.

|                                  | September 30,<br>2012 | December 31,<br>2011 |
|----------------------------------|-----------------------|----------------------|
| (Dollars in thousands)           |                       |                      |
| <b>Homebuilding assets:</b>      |                       |                      |
| West                             | \$ 376,167            | \$ 346,442           |
| Mountain                         | 329,436               | 262,787              |
| East                             | 229,478               | 223,606              |
| Other                            | 33,995                | 31,468               |
| Corporate                        | 786,445               | 852,561              |
| <b>Total homebuilding assets</b> | <b>\$ 1,755,521</b>   | <b>\$ 1,716,864</b>  |

Homebuilding assets in the West and Mountain segments increased \$29.7 million and \$66.6 million, respectively, from December 31, 2011 to September 30, 2012, primarily due to increases in construction activity and related inventory balances. Homebuilding assets in the Corporate segment decreased \$66.1 million from December 31, 2011 to September 30, 2012, primarily due to a \$64 million decrease in cash and

marketable securities related to further investments in inventories.

**Table of Contents***Revenues*

|                                    | Three Months Ended<br>September 30, |            | Change     |      | Nine Months Ended<br>September 30, |            | Change     |      |
|------------------------------------|-------------------------------------|------------|------------|------|------------------------------------|------------|------------|------|
|                                    | 2012                                | 2011       | Amount     | %    | 2012                               | 2011       | Amount     | %    |
| (Dollars in thousands)             |                                     |            |            |      |                                    |            |            |      |
| <b>Home and land sale revenues</b> |                                     |            |            |      |                                    |            |            |      |
| West                               | \$ 148,037                          | \$ 70,676  | \$ 77,361  | 109% | \$ 335,002                         | \$ 181,129 | \$ 153,873 | 85%  |
| Mountain                           | 96,335                              | 81,945     | 14,390     | 18%  | 236,625                            | 229,879    | 6,746      | 3%   |
| East                               | 63,463                              | 36,390     | 27,073     | 74%  | 160,360                            | 129,667    | 30,693     | 24%  |
| Other                              | 12,827                              | 16,605     | (3,778)    | -23% | 33,290                             | 37,256     | (3,966)    | -11% |
| Total home and land sale revenues  | \$ 320,662                          | \$ 205,616 | \$ 115,046 | 56%  | \$ 765,277                         | \$ 577,931 | \$ 187,346 | 32%  |

Total home and land sale revenues for the 2012 third quarter increased 56% to \$320.7 million compared to \$205.6 million for the prior year period. For the nine months ended September 30, 2012, total home and land sales revenues increased 32% to \$765.3 million compared to \$577.9 million for the prior year period. The increase in revenues for both periods was driven primarily by changes to the number and average price of new home deliveries as shown in the table below.

**New Home Deliveries**

|                        | 2012  |              | Average  |       | 2011         |          | % Change |              | Average Price |
|------------------------|-------|--------------|----------|-------|--------------|----------|----------|--------------|---------------|
|                        | Homes | Dollar Value | Price    | Homes | Dollar Value | Price    | Homes    | Dollar Value |               |
| (Dollars in thousands) |       |              |          |       |              |          |          |              |               |
| Arizona                | 203   | \$ 44,877    | \$ 221.1 | 126   | \$ 25,272    | \$ 200.6 | 61%      | 78%          | 10%           |
| California             | 131   | 46,580       | 355.6    | 58    | 17,883       | 308.3    | 126%     | 160%         | 15%           |
| Nevada                 | 178   | 37,679       | 211.7    | 77    | 14,387       | 186.8    | 131%     | 162%         | 13%           |
| Washington             | 63    | 18,894       | 299.9    | 49    | 13,135       | 268.1    | 29%      | 44%          | 12%           |
| West                   | 575   | 148,030      | 257.4    | 310   | 70,677       | 228.0    | 85%      | 109%         | 13%           |
| Colorado               | 229   | 81,706       | 356.8    | 189   | 65,234       | 345.2    | 21%      | 25%          | 3%            |
| Utah                   | 53    | 14,632       | 276.1    | 58    | 16,712       | 288.1    | -9%      | -12%         | -4%           |
| Mountain               | 282   | 96,338       | 341.6    | 247   | 81,946       | 331.8    | 14%      | 18%          | 3%            |
| Maryland               | 65    | 29,382       | 452.0    | 47    | 21,020       | 447.2    | 38%      | 40%          | 1%            |
| Virginia               | 67    | 34,069       | 508.5    | 36    | 15,370       | 426.9    | 86%      | 122%         | 19%           |
| East                   | 132   | 63,451       | 480.7    | 83    | 36,390       | 438.4    | 59%      | 74%          | 10%           |
| Florida                | 50    | 12,828       | 256.6    | 63    | 14,592       | 231.6    | -21%     | -12%         | 11%           |
| Illinois               |       |              |          | 4     | 1,281        | 320.3    | N/M      | N/M          | N/M           |
| Other Homebuilding     | 50    | 12,828       | 256.6    | 67    | 15,873       | 236.9    | -25%     | -19%         | 8%            |
| Total                  | 1,039 | \$ 320,647   | \$ 308.6 | 707   | \$ 204,886   | \$ 289.8 | 47%      | 57%          | 6%            |

N/M - Not meaningful



**Table of Contents****New Home Deliveries**

|                           | Homes        | 2012<br>Dollar<br>Value | Average<br>Price | Nine Months Ended September 30, |                         |                          | Homes       | % Change<br>Dollar<br>Value | Average<br>Price |
|---------------------------|--------------|-------------------------|------------------|---------------------------------|-------------------------|--------------------------|-------------|-----------------------------|------------------|
|                           |              |                         |                  | 2011<br>Homes                   | 2011<br>Dollar<br>Value | 2011<br>Average<br>Price |             |                             |                  |
| (Dollars in thousands)    |              |                         |                  |                                 |                         |                          |             |                             |                  |
| Arizona                   | 418          | \$ 89,920               | \$ 215.1         | 301                             | \$ 57,183               | \$ 190.0                 | 39%         | 57%                         | 13%              |
| California                | 319          | 107,768                 | 337.8            | 168                             | 52,554                  | 312.8                    | 90%         | 105%                        | 8%               |
| Nevada                    | 439          | 87,735                  | 199.9            | 223                             | 42,150                  | 189.0                    | 97%         | 108%                        | 6%               |
| Washington                | 166          | 48,060                  | 289.5            | 100                             | 26,912                  | 269.1                    | 66%         | 79%                         | 8%               |
| <b>West</b>               | <b>1,342</b> | <b>333,483</b>          | <b>248.5</b>     | <b>792</b>                      | <b>178,799</b>          | <b>225.8</b>             | <b>69%</b>  | <b>87%</b>                  | <b>10%</b>       |
| Colorado                  | 539          | 192,923                 | 357.9            | 537                             | 180,256                 | 335.7                    | 0%          | 7%                          | 7%               |
| Utah                      | 151          | 41,874                  | 277.3            | 178                             | 49,185                  | 276.3                    | -15%        | -15%                        | 0%               |
| <b>Mountain</b>           | <b>690</b>   | <b>234,797</b>          | <b>340.3</b>     | <b>715</b>                      | <b>229,441</b>          | <b>320.9</b>             | <b>-3%</b>  | <b>2%</b>                   | <b>6%</b>        |
| Maryland                  | 156          | 67,953                  | 435.6            | 153                             | 65,506                  | 428.1                    | 2%          | 4%                          | 2%               |
| Virginia                  | 196          | 92,395                  | 471.4            | 151                             | 64,161                  | 424.9                    | 30%         | 44%                         | 11%              |
| <b>East</b>               | <b>352</b>   | <b>160,348</b>          | <b>455.5</b>     | <b>304</b>                      | <b>129,667</b>          | <b>426.5</b>             | <b>16%</b>  | <b>24%</b>                  | <b>7%</b>        |
| Florida                   | 133          | 32,678                  | 245.7            | 154                             | 34,951                  | 227.0                    | -14%        | -7%                         | 8%               |
| Illinois                  | 2            | 551                     | 275.5            | 5                               | 1,574                   | 314.8                    | -60%        | -65%                        | -12%             |
| <b>Other Homebuilding</b> | <b>135</b>   | <b>33,229</b>           | <b>246.1</b>     | <b>159</b>                      | <b>36,525</b>           | <b>229.7</b>             | <b>-15%</b> | <b>-9%</b>                  | <b>7%</b>        |
| <b>Total</b>              | <b>2,519</b> | <b>\$ 761,857</b>       | <b>\$ 302.4</b>  | <b>1,970</b>                    | <b>\$ 574,432</b>       | <b>\$ 291.6</b>          | <b>28%</b>  | <b>33%</b>                  | <b>4%</b>        |

The increase in new home deliveries for the three and nine months ended September 30, 2012 was primarily attributable to increases of 42% and 24%, respectively, in the number of homes in backlog to start those periods as compared to the prior year. The West segment was the primary driver of the increase, as beginning backlog rose 71% and 91% year-over-year for the three and nine months ended September 30, 2012, respectively, due to increased demand, particularly in our Arizona, California and Nevada markets.

Our consolidated average home price increased 6% and 4%, respectively, for the three and nine months ended September 30, 2012, primarily due to a mix shift in closings to more desirable communities within individual markets, coupled with increased prices and lower incentives in certain of our markets, particularly in the West segment.

*Gross Margin*

Gross margin from home sales for the 2012 third quarter was 15.5% versus 14.8% for the year earlier period. The increase in our gross margin was attributable in part to a reduction in impairment charges from \$4.0 million in the 2011 third quarter to no impairments in the 2012 third quarter, which was offset by a \$6.4 million benefit recorded in the 2011 third quarter from the settlement of a construction defect claim and the impact of project close-out adjustments. In addition, the 2011 third quarter also benefited from a \$1.0 million warranty accrual reduction, while the 2012 third quarter did not include any warranty accrual adjustments. These positive 2011 third quarter adjustments more than offset the impairments recorded during that quarter.

On a sequential basis, our 2012 third quarter gross margin from home sales was up 130 basis points to 15.5% as compared to 14.2% for the 2012 second quarter. The sequential improvement in our gross margins from home sales was driven by increasing home prices and reducing incentives in many of our communities.

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Gross margin from home sales for the nine months ended September 30, 2012 was 14.7% versus 12.4% for the year earlier period. The primary reason for the increase was a reduction in impairment charges from \$12.7 million for the nine months ended September 30, 2011 to no impairments in the same period for 2012. The nine months ended September 30, 2011 also included a \$3.2 million benefit related to a warranty accrual reduction and a \$6.4 million benefit adjustment referenced above, which partially offset the decrease in impairments, while the 2012 nine month period did not include any similar benefits.

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Excluding inventory impairments, warranty accrual adjustments and interest in cost of sales, our adjusted gross margin percentage from home sales for the three and nine months ended September 30, 2012 was 18.2% and 17.4%, respectively, compared to 18.9% and 16.6% for the same periods in 2011 (please see table set forth below reconciling this non-GAAP measure to our gross margin from home sales). Both 2011 periods included the \$6.4 million benefit discussed above related to the settlement of a construction defect claim and the impact of project close-out adjustments, while both 2012 periods were positively impacted by delivering a higher percentage of homes started with a buyer under contract, which historically have been more profitable than homes that are started without a buyer under contract. In addition, our gross margin percentage for the 2012 periods benefited from a reduction in incentives as well as price increases in many of our communities across the country, partially offset by reduced spending on home upgrades, as we are including a higher level of upgrades in our base home price in communities across the country.

The table set forth below is a reconciliation of our gross margin and gross margin percentage, as reported, to gross margin from home sales and gross margins from home sales excluding inventory impairments, warranty adjustments and interest in home cost of sales.

|  | Three Months Ended     |                                    |                       |                                    | Nine Months Ended      |                                    |                       |                                    |
|--|------------------------|------------------------------------|-----------------------|------------------------------------|------------------------|------------------------------------|-----------------------|------------------------------------|
|  | September 30,<br>2012  | <i>Gross</i><br><i>Margin</i><br>% | September 30,<br>2011 | <i>Gross</i><br><i>Margin</i><br>% | September 30,<br>2012  | <i>Gross</i><br><i>Margin</i><br>% | September 30,<br>2011 | <i>Gross</i><br><i>Margin</i><br>% |
|  | (Dollars in thousands) |                                    |                       |                                    | (Dollars in thousands) |                                    |                       |                                    |
| Gross Margin                                 | \$ 49,593              | 15.5%                              | \$ 30,400             | 14.8%                              | \$ 112,126             | 14.7%                              | \$ 72,246             | 12.5%                              |
| Less: Land Sales Revenue                     | (15)                   |                                    | (730)                 |                                    | (3,420)                |                                    | (3,499)               |                                    |
| Add: Land Cost of Sales                      | 2                      |                                    | 724                   |                                    | 3,210                  |                                    | 2,482                 |                                    |
| Gross Margin from Home Sales                 | \$ 49,580              | 15.5%                              | \$ 30,394             | 14.8%                              | \$ 111,916             | 14.7%                              | \$ 71,229             | 12.4%                              |
| Add: Inventory Impairments                   |                        |                                    | 4,049                 |                                    |                        |                                    | 12,682                |                                    |
| Add: Interest in Cost of Sales               | 8,655                  |                                    | 5,140                 |                                    | 20,654                 |                                    | 14,797                |                                    |
| Less: Warranty Adjustments                   |                        |                                    | (955)                 |                                    |                        |                                    | (3,218)               |                                    |
| Adjusted Gross Margin from Home Sales<br>(1) | \$ 58,235              | 18.2%                              | \$ 38,628             | 18.9%                              | \$ 132,570             | 17.4%                              | \$ 95,490             | 16.6%                              |

- (1) Adjusted gross margin from home sales is a non-GAAP financial measure. We believe this information is meaningful as it isolates the impact that inventory impairments, warranty adjustments and interest have on our Gross Margin from Home Sales and permits investors to make better comparisons with our competitors, who also break out and adjust gross margins in a similar fashion. Furthermore, this measure is used by us as one financial metric criteria for which performance-based stock options for certain executive officers are based on.

**Table of Contents***Inventory Impairments*

We did not recognize any impairments for the three and nine months ended September 30, 2012. Impairments recognized for the three and nine months ended September 30, 2011 are shown in the table below:

|   | Three<br>Months<br>Ended September 30,<br>2011 | Nine Months<br>Ended September 30,<br>2011 |
|---|--|--|
| (Dollars in thousands)                          |  |  |
| <b>Housing Completed or Under Construction:</b> |  |  |
| West  | \$ 484   | \$ 1,438                                   |
| Mountain  | 210  | 449  |
| East  |  |  |
| Other   | 93   | 93   |
| Subtotal  | 787  | 1,980                                      |
| <b>Land and Land Under Development:</b>         |  |  |
| West  | 1,193  | 7,112                                      |
| Mountain  | 550  | 1,786                                      |
| East  |  | 285  |
| Other   | 1,519  | 1,519                                      |
| Subtotal  | 3,262  | 10,702                                     |
| <b>Inventory Impairments</b>                    | <b>\$ 4,049</b>                                | <b>\$ 12,682</b>                           |

The impairments resulted from a decline in the market value of land and homes, primarily in our California, Nevada, Utah, and Illinois markets.

The following table shows the number of subdivisions and carrying value of the inventory we tested for impairment during the first three quarters of 2012 and 2011. The table also includes impairments that we recorded during such periods, as well as the quarter-end fair value, number of lots and number of subdivisions for the impaired inventories:

| Three Months Ended     | Total<br>Subdivisions<br>Tested<br>for<br>Impairment<br>During<br>Quarter | Carrying<br>Value<br>of Inventory<br>Tested for<br>Impairment<br>During<br>Quarter | Carrying<br>Value<br>of Impaired<br>Inventory<br>Before<br>Impairment at<br>Quarter End | Inventory<br>Impairments | Fair Value of<br>Impaired<br>Inventory<br>at<br>Quarter<br>End | Number<br>of<br>Subdivisions<br>Impaired<br>During<br>the Quarter | Number of<br>Lots<br>Impaired<br>During<br>the Quarter |
|------------------------|---|--|---|--------------------------|--|---|--|
| (Dollars in thousands) |   |  |   |                          |  |   |  |
| March 31, 2012         | 33  | \$ 81,492  | \$  | \$                       | \$   |   |  |
| June 30, 2012          | 27  | 63,616   |   |                          |  |   |  |
| September 30, 2012     | 22  | 62,681   |   |                          |  |   |  |
| Nine Month Total       | 82  | \$ 207,789   | \$  | \$                       | \$   |   |  |
| March 31, 2011         | 10  | \$ 80,915  | \$  | \$                       | \$   |   |  |
| June 30, 2011          | 49  | 95,407   | 29,205  | 8,633                    | 20,572   | 9   | 392  |
| September 30, 2011     | 50  | 109,247  | 22,613  | 4,049                    | 18,564   | 11  | 313  |



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|                  |     |            |           |           |           |    |     |
|------------------|-----|------------|-----------|-----------|-----------|----|-----|
| Nine Month Total | 109 | \$ 285,569 | \$ 51,818 | \$ 12,682 | \$ 39,136 | 20 | 705 |
|------------------|-----|------------|-----------|-----------|-----------|----|-----|

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### *Selling, General and Administrative Expenses*

Our 2012 third quarter SG&A expenses fell slightly to \$44.8 million, compared to \$46.4 million for the 2011 third quarter. The decrease in SG&A was attributable to a \$4.6 million decrease in general and administrative expenses, including a \$2.2 million legal recovery and reductions in salaries and other overhead costs, partially offset by a \$3.8 million increase in commission expenses, which was driven by our increase in home sale revenues.

For the nine months ended September 30, 2012, SG&A expenses decreased 18%, or \$25.0 million, to \$118.1 million, compared to \$143.2 million for same period in 2011. The decrease in SG&A is attributable to a \$27.1 million decrease in general and administrative expenses, including \$9.8 million in various significant legal recoveries and reductions in salaries and other overhead costs, as well as a \$3.7 million decline in our marketing expenses. These items were partially offset by a \$5.8 million increase in commission expenses, which was driven by our increase in home sale revenues.

The decreased SG&A expenses, combined with increased revenues, resulted in better operating leverage, with SG&A expenses as a percentage of home sales revenues decreasing to 14.0% and 15.5%, respectively, for the three and nine months ended September 30, 2012, versus 22.6% and 24.9%, respectively, for the same periods in 2011.

### *Interest Income*

Our interest income for the three and nine months ended September 30, 2012 was \$5.4 million and \$16.7 million, respectively, compared to \$6.0 million and \$19.4 million, respectively, for the same periods in 2011. The decreases were attributable to a year-over-year decline in our cash and cash equivalents and marketable securities balance resulting from the repayment of \$500 million of senior notes during the second half of 2011, which was partially offset by an increase in the overall rate of return earned by us on those balances.

### *Interest Expense*

We expensed no interest and \$0.8 million of interest for the three and nine months ended September 30, 2012, respectively, related to the portion of our homebuilding debt that exceeded our qualified assets, compared to \$3.6 million and \$19.6 million, respectively for the three and nine months ended September 30, 2011. The significant year-over-year decreases in interest expense related primarily to our repayment of \$500 million of senior debt during the last half of 2011, which significantly reduced the amount by which our homebuilding debt exceeded our qualified assets. During the third quarter of 2012, qualified assets exceeded homebuilding debt, resulting in no interest charge for the 2012 third quarter.

### *Other Income (Expense)*

For the three and nine months ended September 30, 2012, our other income was \$16,000 and \$0.6 million, respectively, compared to other expense of \$20.1 million and \$21.0 million for the three and nine months ended September 30, 2011. Other expense in both the three and nine month periods ended September 30, 2011 was largely related to an \$18.6 million charge for the early extinguishment of \$237 million of debt.

**Table of Contents***Other Homebuilding Operating Data***Net New Orders:**

|              | Homes        | 2012<br>Dollar<br>Value | Average<br>Price | Three Months Ended September 30, |                   |                  | Homes      | % Change<br>Dollar<br>Value | Average<br>Price |
|--------------|--------------|-------------------------|------------------|----------------------------------|-------------------|------------------|------------|-----------------------------|------------------|
|              |              |                         |                  | 2011<br>(Dollars in thousands)   |                   |                  |            |                             |                  |
|              |              |                         |                  | Homes                            | Dollar<br>Value   | Average<br>Price |            |                             |                  |
| Arizona      | 136          | \$ 30,441               | \$ 223.8         | 104                              | \$ 19,127         | \$ 183.9         | 31%        | 59%                         | 22%              |
| California   | 173          | 56,507                  | 326.6            | 53                               | 16,526            | 311.8            | 226%       | 242%                        | 5%               |
| Nevada       | 131          | 30,944                  | 236.2            | 107                              | 18,220            | 170.3            | 22%        | 70%                         | 39%              |
| Washington   | 71           | 21,998                  | 309.8            | 42                               | 10,737            | 255.6            | 69%        | 105%                        | 21%              |
| West         | 511          | 139,890                 | 273.8            | 306                              | 64,610            | 211.1            | 67%        | 117%                        | 30%              |
| Colorado     | 251          | 84,575                  | 337.0            | 147                              | 51,812            | 352.5            | 71%        | 63%                         | -4%              |
| Utah         | 66           | 20,220                  | 306.4            | 38                               | 10,604            | 279.1            | 74%        | 91%                         | 10%              |
| Mountain     | 317          | 104,795                 | 330.6            | 185                              | 62,416            | 337.4            | 71%        | 68%                         | -2%              |
| Maryland     | 39           | 18,031                  | 462.3            | 48                               | 25,178            | 524.5            | -19%       | -28%                        | -12%             |
| Virginia     | 88           | 42,554                  | 483.6            | 42                               | 18,586            | 442.5            | 110%       | 129%                        | 9%               |
| East         | 127          | 60,585                  | 477.0            | 90                               | 43,764            | 486.3            | 41%        | 38%                         | -2%              |
| Florida      | 53           | 12,918                  | 243.7            | 16                               | 4,379             | 273.7            | 231%       | 195%                        | -11%             |
| Illinois     |              |                         |                  | (2)                              | (564)             | 282.0            | N/M        | N/M                         | N/M              |
| Other        | 53           | 12,918                  | 243.7            | 14                               | 3,815             | 272.5            | 279%       | 239%                        | -11%             |
| <b>Total</b> | <b>1,008</b> | <b>\$ 318,188</b>       | <b>\$ 315.7</b>  | <b>595</b>                       | <b>\$ 174,605</b> | <b>\$ 293.5</b>  | <b>69%</b> | <b>82%</b>                  | <b>8%</b>        |

N/M - Not meaningful

|            | Homes | 2012<br>Dollar Value | Average<br>Price | Nine Months Ended September 30, |                 |                  | Homes | % Change<br>Dollar<br>Value | Average<br>Price |
|------------|-------|----------------------|------------------|---------------------------------|-----------------|------------------|-------|-----------------------------|------------------|
|            |       |                      |                  | 2011<br>(Dollars in thousands)  |                 |                  |       |                             |                  |
|            |       |                      |                  | Homes                           | Dollar<br>Value | Average<br>Price |       |                             |                  |
| Arizona    | 569   | \$ 124,723           | \$ 219.2         | 390                             | \$ 74,007       | \$ 189.8         | 46%   | 69%                         | 15%              |
| California | 511   | 175,533              | 343.5            | 247                             | 73,341          | 296.9            | 107%  | 139%                        | 16%              |
| Nevada     | 522   | 114,823              | 220.0            | 349                             | 64,256          | 184.1            | 50%   | 79%                         | 20%              |
| Washington | 216   | 64,040               | 296.5            | 68                              | 17,464          | 256.8            | 218%  | 267%                        | 15%              |
| West       | 1,818 | 479,119              | 263.5            | 1,054                           | 229,068         | 217.3            | 72%   | 109%                        | 21%              |
| Colorado   | 797   | 276,767              | 347.3            | 560                             | 190,560         | 340.3            | 42%   | 45%                         | 2%               |
| Utah       | 203   | 60,491               | 298.0            | 214                             | 59,154          | 276.4            | -5%   | 2%                          | 8%               |
| Mountain   | 1,000 | 337,258              | 337.3            | 774                             | 249,714         | 322.6            | 29%   | 35%                         | 5%               |

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|          |       |              |          |       |            |          |      |      |     |
|----------|-------|--------------|----------|-------|------------|----------|------|------|-----|
| Maryland | 235   | 103,079      | 438.6    | 168   | 75,626     | 450.2    | 40%  | 36%  | -3% |
| Virginia | 276   | 136,740      | 495.4    | 205   | 88,669     | 432.5    | 35%  | 54%  | 15% |
| East     | 511   | 239,819      | 469.3    | 373   | 164,295    | 440.5    | 37%  | 46%  | 7%  |
| Florida  | 142   | 33,502       | 235.9    | 158   | 36,339     | 230.0    | -10% | -8%  | 3%  |
| Illinois | 2     | 550          | 275.0    | 5     | 1,477      | 295.4    | -60% | -63% | -7% |
| Other    | 144   | 34,052       | 236.5    | 163   | 37,816     | 232.0    | -12% | -10% | 2%  |
| Total    | 3,473 | \$ 1,090,248 | \$ 313.9 | 2,364 | \$ 680,893 | \$ 288.0 | 47%  | 60%  | 9%  |

Net new orders for the 2012 third quarter increased 69% to 1,008 homes, compared with 595 homes during the 2011 third quarter. For the nine months ended September 30, 2012, net new orders increased 47% to 3,473 homes, compared with 2,364 homes during the same period in 2011. Our monthly sales absorption rates for the three and nine month ended September 30, 2012 were 2.0 and 2.2 per community, respectively, compared to 1.1 and 1.6 per community for the three and nine months ended September 30, 2011. We experienced substantial order growth

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in most of our homebuilding segments due to a combination of a change in our sales processes and procedures, and the overall improvement in housing market conditions. Our West and Mountain segments experienced the most significant increases, due to particularly strong demand.

**Active Subdivisions:**

|                                      | September 30, |            | % Change    |
|--------------------------------------|---------------|------------|-------------|
|                                      | 2012          | 2011       |             |
| Arizona                              | 14            | 26         | -46%        |
| California                           | 18            | 16         | 13%         |
| Nevada                               | 16            | 20         | -20%        |
| Washington                           | 12            | 10         | 20%         |
| <b>West</b>                          | <b>60</b>     | <b>72</b>  | <b>-17%</b> |
| Colorado                             | 45            | 47         | -4%         |
| Utah                                 | 16            | 21         | -24%        |
| <b>Mountain</b>                      | <b>61</b>     | <b>68</b>  | <b>-10%</b> |
| Maryland                             | 17            | 14         | 21%         |
| Virginia                             | 13            | 13         | 0%          |
| <b>East</b>                          | <b>30</b>     | <b>27</b>  | <b>11%</b>  |
| Florida                              | 15            | 15         | 0%          |
| <b>Other Homebuilding</b>            | <b>15</b>     | <b>15</b>  | <b>0%</b>   |
| <b>Total</b>                         | <b>166</b>    | <b>182</b> | <b>-9%</b>  |
| <b>Average for quarter ended</b>     | <b>170</b>    | <b>179</b> | <b>-5%</b>  |
| <b>Average for nine months ended</b> | <b>177</b>    | <b>165</b> | <b>7%</b>   |

At September 30, 2012, we had 166 active subdivisions, down 9% from 182 active subdivisions at September 30, 2011. The decrease was primarily caused by our decision to slow the pace of new community acquisitions during the second half of 2011 in light of uncertainties regarding future economic conditions at that time. In addition, higher than expected sales for the first nine months of 2012 resulted in certain subdivisions selling out more quickly than anticipated.

**Cancellation Rate:**

|            | Three Months Ended |                    | Change in Percentage | Nine Months Ended  |                    | Change in Percentage |
|------------|--------------------|--------------------|----------------------|--------------------|--------------------|----------------------|
|            | September 30, 2012 | September 30, 2011 |                      | September 30, 2012 | September 30, 2011 |                      |
| Arizona    | 24%                | 41%                | -17%                 | 19%                | 31%                | -12%                 |
| California | 24%                | 51%                | -27%                 | 22%                | 38%                | -16%                 |
| Nevada     | 20%                | 43%                | -23%                 | 17%                | 33%                | -16%                 |
| Washington | 23%                | 25%                | -2%                  | 18%                | 24%                | -6%                  |

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|          |     |     |      |     |     |      |
|----------|-----|-----|------|-----|-----|------|
| West     | 23% | 42% | -19% | 19% | 33% | -14% |
| Colorado | 28% | 37% | -9%  | 24% | 35% | -11% |
| Utah     | 23% | 55% | -32% | 22% | 37% | -15% |
| Mountain | 27% | 42% | -15% | 24% | 36% | -12% |
| Maryland | 57% | 41% | 16%  | 33% | 39% | -6%  |
| Virginia | 22% | 42% | -20% | 27% | 27% | 0%   |
| East     | 37% | 42% | -5%  | 30% | 33% | -3%  |
| Florida  | 24% | 76% | -52% | 0%  | 40% | -40% |
| Illinois | 0%  | 0%  | 0%   | 24% | 58% | -34% |
| Other    | 24% | 76% | -52% | 23% | 41% | -18% |
| Total    | 27% | 44% | -17% | 22% | 35% | -13% |

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Our cancellation rate for the three and nine months ended September 30, 2012 was 27% and 22%, respectively, compared to 44% and 35%, respectively, for the same periods in the prior year. The improvement in our cancellation rate reflects overall improvement in housing market conditions and the implementation of more strict underwriting standards for recognizing new home orders as a part of our efforts to improve our sales processes. We experienced our highest cancellation rate in the East segment, due in our Maryland market resulting from efforts to reduce contingent buyers in backlog, and we experienced our lowest cancellation rate in the West segment, due to strong demand in each market within this segment.

**Backlog:**

|                        | Homes | 2012<br>Dollar<br>Value | Average<br>Price | September 30, |                         |                  | Homes | % Change<br>Dollar<br>Value | Average<br>Price |
|------------------------|-------|-------------------------|------------------|---------------|-------------------------|------------------|-------|-----------------------------|------------------|
|                        |       |                         |                  | Homes         | 2011<br>Dollar<br>Value | Average<br>Price |       |                             |                  |
| (Dollars in thousands) |       |                         |                  |               |                         |                  |       |                             |                  |
| Arizona                | 279   | \$ 62,902               | \$ 225.5         | 173           | \$ 34,474               | \$ 199.3         | 61%   | 82%                         | 13%              |
| California             | 310   | 104,825                 | 338.1            | 158           | 48,476                  | 306.8            | 96%   | 116%                        | 10%              |
| Nevada                 | 239   | 56,902                  | 238.1            | 202           | 39,432                  | 195.2            | 18%   | 44%                         | 22%              |
| Washington             | 104   | 33,885                  | 325.8            | 44            | 11,675                  | 265.3            | 136%  | 190%                        | 23%              |
| West                   | 932   | 258,514                 | 277.4            | 577           | 134,057                 | 232.3            | 62%   | 93%                         | 19%              |
| Colorado               | 491   | 179,779                 | 366.1            | 296           | 105,850                 | 357.6            | 66%   | 70%                         | 2%               |
| Utah                   | 120   | 35,745                  | 297.9            | 105           | 29,667                  | 282.5            | 14%   | 20%                         | 5%               |
| Mountain               | 611   | 215,524                 | 352.7            | 401           | 135,517                 | 337.9            | 52%   | 59%                         | 4%               |
| Maryland               | 192   | 80,876                  | 421.2            | 141           | 61,567                  | 436.6            | 36%   | 31%                         | -4%              |
| Virginia               | 183   | 91,993                  | 502.7            | 124           | 56,480                  | 455.5            | 48%   | 63%                         | 10%              |
| East                   | 375   | 172,869                 | 461.0            | 265           | 118,047                 | 445.5            | 42%   | 46%                         | 3%               |
| Florida                | 79    | 20,052                  | 253.8            | 68            | 16,926                  | 248.9            | 16%   | 18%                         | 2%               |
| Illinois               |       |                         |                  | 1             | 329                     | 329.1            | N/M   | N/M                         | N/M              |
| Other Homebuilding     | 79    | 20,052                  | 253.8            | 69            | 17,255                  | 250.1            | 14%   | 16%                         | 1%               |
| Total                  | 1,997 | \$ 666,959              | \$ 334.0         | 1,312         | \$ 404,876              | \$ 308.6         | 52%   | 65%                         | 8%               |

N/M - Not meaningful

We ended the 2012 third quarter with 1,997 homes in backlog, with an estimated sales value of \$667.0 million, compared with a backlog of 1,312 homes with an estimated sales value of \$404.9 million at September 30, 2011. The 52% increase in the number of homes in our backlog was primarily the result of the increase in net orders during the three and nine months ended September 30, 2012. Our West segment experienced the strongest growth in backlog due to improved market conditions.

**Homes Completed or Under Construction (WIP lots):**

|           | September 30, |      | % Change |
|-----------|---------------|------|----------|
|           | 2012          | 2011 |          |
| Unsold    |               |      |          |
| Completed | 137           | 85   | 61%      |

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|  |              |              |            |
|--|--------------|--------------|------------|
| Under construction - frame                         | 391          | 314          | 25%        |
| Under construction - foundation                    | 233          | 85           | 174%       |
| <b>Total unsold started homes</b>                  | <b>761</b>   | <b>484</b>   | <b>57%</b> |
| Sold homes under construction or completed         | 1,463        | 871          | 68%        |
| Model homes  | 229          | 220          | 4%         |
| <b>Total homes completed or under construction</b> | <b>2,453</b> | <b>1,575</b> | <b>56%</b> |

Our total homes completed or under construction increased to 2,453 at September 30, 2012 from 1,575 at September 30, 2011, primarily relating to a higher number of sold homes started in light of our year-over-year increase in backlog. We also intentionally increased our inventory of unsold started homes based on the overall improvement in housing market conditions and increased demand for started homes.



**Table of Contents****Lots Owned and Optioned (including homes completed or under construction):**

|                 | September 30, 2012 |               |               | September 30, 2011 |               |               |
|-----------------|--------------------|---------------|---------------|--------------------|---------------|---------------|
|                 | Lots Owned         | Lots Optioned | Total         | Lots Owned         | Lots Optioned | Total         |
| Arizona         | 938                | 63            | 1,001         | 981                | 96            | 1,077         |
| California      | 1,065              | 112           | 1,177         | 1,306              |               | 1,306         |
| Nevada          | 994                | 61            | 1,055         | 1,091              | 75            | 1,166         |
| Washington      | 524                | 212           | 736           | 312                | 182           | 494           |
| <b>West</b>     | <b>3,521</b>       | <b>448</b>    | <b>3,969</b>  | <b>3,690</b>       | <b>353</b>    | <b>4,043</b>  |
| Colorado        | 3,325              | 433           | 3,758         | 3,103              | 464           | 3,567         |
| Utah            | 557                | 13            | 570           | 545                | 273           | 818           |
| <b>Mountain</b> | <b>3,882</b>       | <b>446</b>    | <b>4,328</b>  | <b>3,648</b>       | <b>737</b>    | <b>4,385</b>  |
| Maryland        | 584                | 358           | 942           | 446                | 730           | 1,176         |
| Virginia        | 547                | 103           | 650           | 566                | 192           | 758           |
| <b>East</b>     | <b>1,131</b>       | <b>461</b>    | <b>1,592</b>  | <b>1,012</b>       | <b>922</b>    | <b>1,934</b>  |
| Florida         | 321                | 95            | 416           | 233                | 373           | 606           |
| Illinois        | 123                |               | 123           | 123                |               | 123           |
| <b>Other</b>    | <b>444</b>         | <b>95</b>     | <b>539</b>    | <b>356</b>         | <b>373</b>    | <b>729</b>    |
| <b>Total</b>    | <b>8,978</b>       | <b>1,450</b>  | <b>10,428</b> | <b>8,706</b>       | <b>2,385</b>  | <b>11,091</b> |

During the last half of 2011, we reduced our land acquisition activities and terminated options to purchase lots in certain markets, as we determined we had a sufficient lot supply to satisfy existing demand. As a result, our supply of lots owned and optioned at September 30, 2012 decreased 4% year-over-year. The most significant decreases occurred in our Utah, Maryland, Florida and California markets, partially offset by increases in our Washington market and Colorado. However, on a sequential basis, our lot supply increased for the first time in six quarters, as the number of lots we acquired increased 140% from approximately 500 during the 2012 second quarter to more than 1,200 in the 2012 third quarter. Given the recent improvement in industry conditions, we are actively looking to increase our lot supply in all of our markets.

**Financial Services**

We reported financial services pretax income of \$9.3 million and \$20.8 million, respectively, for the three and nine months ended September 30, 2012, compared to a pretax loss of \$0.5 million and pretax income of \$4.4 million, respectively, for the same periods in 2011. The increase in our financial services pretax income was primarily driven by increases of \$9.0 million and \$15.5 million in our mortgage operation's pretax income for the three and nine months ended September 30, 2012, respectively, when compared to the same periods in 2011. The improvement in our mortgage operation's profitability was driven largely by year-over-year increases in the gains on sales of mortgage loans and the corresponding servicing rights and higher origination income for the three and nine months ended September 30, 2012 of \$6.3 million and \$12.6 million, respectively. These increases were due to favorable mortgage market conditions, increases in the volume of loans locked and originated, and a decrease in the level of special financing programs that we offered our homebuyers. Our mortgage operation's profitability for the three and nine months ended September 30, 2012 also benefited from a year-over-year decrease in our loan loss reserve expense activity of \$2.9 million and \$3.7 million, respectively, due to reduced repurchase and indemnity claims received from third-party purchasers of our mortgage loans. The balance of our financial services segment's pretax income, which consisted of income from our insurance and title operations, was \$1.9 million and \$4.3 million for the three and nine months ended September 30, 2012, as compared with \$1.2 million and \$3.6 million, respectively for the same periods in the prior year.



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The following table sets forth information relating to the sources of revenues for our Financial Services segment.

|   | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|---|-------------------------------------|-----------------|------------------------------------|------------------|
|   | 2012                                | 2011            | 2012                               | 2011             |
|   | (Dollars in thousands)              |                 |                                    |                  |
| <b>Financial services revenue:</b>      |                                     |                 |                                    |                  |
| Mortgage revenue                        | \$ 10,892                           | \$ 3,855        | \$ 25,407                          | \$ 13,034        |
| Insurance revenue                       | 2,956                               | 2,122           | 7,434                              | 6,246            |
| Title and other revenue                 | 606                                 | 345             | 1,463                              | 1,200            |
| <b>Total financial services revenue</b> | <b>\$ 14,454</b>                    | <b>\$ 6,322</b> | <b>\$ 34,304</b>                   | <b>\$ 20,480</b> |

The following table sets forth information for our mortgage operations relating to mortgage loans originated, mortgage loans brokered and capture rate. The Capture Rate is defined as the number of mortgage loans originated by our mortgage operations for our homebuyers as a percent of our total home closings, excluding closings with cash buyers.

|   | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|------------|------------------------------------|------------|
|   | 2012                                | 2011       | 2012                               | 2011       |
|   | (Dollars in thousands)              |            |                                    |            |
| <b>Total Originations (including transfer loans):</b> |                                     |            |                                    |            |
| Loans   | 718                                 | 491        | 1,725                              | 1,459      |
| Principal   | \$ 199,979                          | \$ 129,005 | \$ 474,456                         | \$ 390,660 |
| Capture Rate  | 71%                                 | 75%        | 71%                                | 82%        |
| <b>Loans Sold to Third Parties:</b>                   |                                     |            |                                    |            |
| Loans   | 662                                 | 470        | 1728                               | 1539       |
| Principal   | \$ 180,044                          | \$ 126,227 | \$ 466,727                         | \$ 414,844 |
| <b>Mortgage Loan Origination Product Mix:</b>         |                                     |            |                                    |            |
| FHA loans   | 35%                                 | 42%        | 36%                                | 42%        |
| Other government loans (VA & USDA)                    | 26%                                 | 21%        | 27%                                | 27%        |
| Total government loans                                | 61%                                 | 63%        | 63%                                | 69%        |
| Conventional loans                                    | 39%                                 | 37%        | 37%                                | 31%        |
|   | 100%                                | 100%       | 100%                               | 100%       |
| <b>Loan Type:</b>                                     |                                     |            |                                    |            |
| Fixed rate  | 98%                                 | 96%        | 98%                                | 96%        |
| ARM   | 2%                                  | 4%         | 2%                                 | 4%         |
| <b>Credit Quality:</b>                                |                                     |            |                                    |            |
| Average FICO Score                                    | 739                                 | 735        | 736                                | 735        |
| <b>Other Data:</b>                                    |                                     |            |                                    |            |
| Average Combined LTV ratio                            | 89%                                 | 90%        | 90%                                | 91%        |
| Full documentation loans                              | 100%                                | 100%       | 100%                               | 100%       |
| Non-full documentation loans                          | 0%                                  | 0%         | 0%                                 | 0%         |

**Income Taxes**

We had income tax benefits of \$0.6 million and \$1.8 million during the three and nine months ended September 30, 2012, respectively, primarily from the release of reserves attributable to the expiration of statute of limitations periods and our 2011 settlements with various taxing authorities. For the three and nine months ended September 30, 2011, we had income tax benefits of \$2.5 million and \$8.1 million, respectively, resulting primarily from our 2011 second and third quarter settlement of various state income tax matters and our 2011 first quarter settlement with the IRS on its audit of the 2004 and 2005 federal income tax returns.



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**CRITICAL ACCOUNTING ESTIMATES AND POLICIES**

The preparation of financial statements in conformity with accounting policies generally accepted in the United States of America ( GAAP ) 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 periods. 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 if conditions are significantly different in the future. Additionally, using different estimates or assumptions in our critical accounting estimates and policies could have a material impact to our consolidated financial statements. See **Forward-Looking Statements** below.

Our critical accounting estimates and policies have not changed from those reported in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2011.

**LIQUIDITY AND CAPITAL RESOURCES**

We use our liquidity and capital resources to (1) support our operations, including the purchase of land, land development and construction of homes; (2) provide working capital; and (3) provide mortgage loans for our homebuyers. Our liquidity includes our cash and cash equivalents, marketable securities and Mortgage Repurchase Facility (as defined below). Additionally, we have an existing effective shelf registration statement that allows us to issue equity, debt or hybrid securities up to \$1.0 billion.

Our marketable securities consist of fixed rate and floating rate interest earning securities, primarily: (1) debt securities, which may include, among others, United States government and government agency debt and corporate debt; (2) holdings in equity securities consisting of four mutual funds, which primarily invest in corporate bonds and other fixed income securities; and (3) deposit securities, which may include, among others, certificates of deposit and time deposits.

**Capital Resources**

Our capital structure is primarily a combination of (1) permanent financing, represented by stockholders' equity; (2) long-term financing, represented by our publicly traded 5.375% senior notes due 2014 and 2015 and 5.625% senior notes due 2020; and (3) our Mortgage Repurchase Facility. Because of our current balance of cash, cash equivalents, marketable securities and available capacity under our Mortgage Repurchase Facility, we believe that our capital resources are adequate to satisfy our short and long-term capital requirements, including meeting future payments on our senior notes as they become due. See **Forward-Looking Statements** below.

We may from time to time seek to retire or purchase our outstanding senior notes through cash purchases, whether in open market purchases, privately negotiated transactions or otherwise. Such repurchases, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material.

**Senior Notes and Mortgage Repurchase Facility**

*Senior Notes.* Our senior notes are not secured and, while the senior note indentures contain some restrictions on secured debt and other transactions, they do not contain financial covenants. Our senior notes are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by most of our homebuilding segment subsidiaries. We believe that we are in compliance with the representations, warranties and covenants in the senior note indentures, and we are not aware of any covenant violations.

*Mortgage Lending.* HomeAmerican has a Master Repurchase Agreement, (the Mortgage Repurchase Facility ), with U.S. Bank National Association ( USBNA ) which was amended on September 21, 2012 and extended until September 20, 2013. The Mortgage Repurchase Facility provides liquidity to HomeAmerican by providing for the sale of eligible mortgage loans to USBNA with an agreement by HomeAmerican to repurchase the mortgage loans at a future date. Until such mortgage loans are transferred back to HomeAmerican, the documents

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relating to such loans are held by USBNA, as custodian, pursuant to the Custody Agreement ( Custody Agreement ), dated as of November 12, 2008, by and between HomeAmerican and USBNA. As of September 30, 2012, the Mortgage Repurchase Facility has a maximum aggregate commitment of \$50 million.

At September 30, 2012 and December 31, 2011, we had \$46.9 million and \$48.7 million, respectively, of mortgage loans that we were obligated to repurchase under our Mortgage Repurchase Facility. Mortgage loans that we are obligated to repurchase under the Mortgage Repurchase Facility are accounted for as a debt financing arrangement and are reported as mortgage repurchase facility in the accompanying consolidated balance sheets. Advances under the Mortgage Repurchase Facility carry a Pricing Rate equal to the greater of (i) the LIBOR Rate (as defined in the Mortgage Repurchase Facility) plus 2.5%, or (ii) 3.25%. The Mortgage Repurchase Facility contains various representations, warranties and affirmative and negative covenants customary for agreements of this type. The negative covenants include, among others, (i) an Adjusted Tangible Net Worth requirement, (ii) a minimum Adjusted Tangible Net Worth Ratio, (iii) an Adjusted Net Income requirement, and (iv) a minimum Liquidity requirement. The foregoing terms are defined in the Mortgage Repurchase Facility. We believe we are in compliance with the representations, warranties and covenants included in the Mortgage Repurchase Facility and we are not aware of any covenant violations.

### **MDC Common Stock Repurchase Program**

At September 30, 2012, we were authorized to repurchase up to 4,000,000 shares of our common stock. We did not repurchase any shares of our common stock during the nine months ended September 30, 2012 and 2011.

### **Consolidated Cash Flow**

During the nine months ended September 30, 2012, we used \$50.5 million of cash in operating activities. We used \$90.6 million to increase our inventory levels during the nine months ended 2012, partially offset by the sale and closing of homes, and \$13.7 million was used due to an increase in accounts receivable related to home closings that occurred at the end of the 2012 third quarter. These uses of cash were partially offset by a \$24.1 million increase in accounts payable.

During the nine months ended September 30, 2012, we used \$7.1 million in cash for investing activities, primarily attributable to the purchase of \$397.2 million of marketable securities, partially offset by the maturity or sale of \$391.1 million of marketable securities.

During the nine months ended September 30, 2012, we used \$22.0 million in cash for financing activities primarily attributable to \$36.0 million associated with cash dividends that were paid during the first nine months of 2012, partially offset by \$15.8 million in proceeds received from the exercise of stock options.

### **Off-Balance Sheet Arrangements**

In the ordinary course of business, we enter into lot option purchase contracts in order to procure lots for the construction of homes. Lot option contracts enable us to control lot positions with a minimal capital investment, which substantially reduces the risks associated with land ownership and development. At September 30, 2012, we had deposits of \$6.2 million in the form of cash and \$3.3 million in the form of letters of credit that were at risk to secure option contracts to purchase 1,450 lots.

At September 30, 2012, we had issued and outstanding surety bonds and letters of credit totaling approximately \$56.0 million and \$18.0 million, respectively, including \$7.1 million in letters of credit issued by HomeAmerican. The estimated cost to complete obligations related to these bonds and letters of credit was approximately \$27.4 million and \$3.1 million, respectively. We expect that the obligations secured by these performance bonds and letters of credit generally will be performed in the ordinary course of business and in accordance with the applicable contractual terms. To the extent that the obligations are performed, the related performance bonds and letters of credit should be released and we should not have any continuing obligations. However, in the event any such performance bonds or letters of credit are called, our indemnity obligations could require us to reimburse the issuer of the performance bond or letter of credit.

We have made no material guarantees with respect to third-party obligations.

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**IMPACT OF INFLATION, CHANGING PRICES AND ECONOMIC CONDITIONS**

The impact of inflation and changing prices have not changed materially from the disclosure in our December 31, 2011 Annual Report on Form 10-K.

**OTHER**

**Forward-Looking Statements**

Certain statements in this Quarterly Report on Form 10-Q, 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. These forward-looking statements may be identified by terminology such as likely, may, will, should, expects, plans, anticipates, believes, estimates, or continue, or the negative of such terms and other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained in this Report 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. 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. Additionally, information about issues that could lead to material changes in performance and risk factors that have the potential to affect us is contained under the caption Risk Factors Relating to our Business in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011 and Item 1A of Part II of this Quarterly Report on Form 10-Q.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

At September 30, 2012, we had approximately \$536.7 million invested in marketable securities. Because these marketable securities are accounted for as available-for-sale, changes in the market value are reported as a component of other comprehensive income each quarter. During the 2012 third quarter, we experienced a \$5.1 million net increase in the market value of these securities, while for the nine months ended September 30, 2012 we experienced a net increase of approximately \$10.9 million in the market value of these securities. As of September 30, 2012 and December 31, 2011, our marketable securities (homebuilding and financial services in aggregate) were in an unrealized gain position of \$2.9 million and an unrealized loss position of \$7.2 million, respectively. The equity securities, which consist of four mutual funds which primarily invest in bonds, had a combined unrealized loss of \$1.4 million as of September 30, 2012. While we believe that the ultimate cost basis of these investments will be recovered in the future, there can be no assurances to that effect. In the event we elect to sell, or are otherwise required to sell these securities, we may be required to record losses in the event the market value does not increase prior to any sale. Such losses, if any, would be recorded as a component of our results of operations and comprehensive income.

**Item 4. Controls and Procedures**

(a) *Conclusion regarding the effectiveness of disclosure controls and procedures* - An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was performed under the supervision, and with the participation, of our management, including the Chief Executive Officer and the Chief Financial Officer. Based on that evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective at September 30, 2012.

(b) *Changes in internal control over financial reporting* - In several of our homebuilding divisions, we began operating under our new enterprise resource planning ( ERP ) system during 2011 and 2010. As a result, our financial and operating transactions in these divisions now utilize the functionality provided by the new ERP system with oversight as to the completeness and accuracy of the information being performed through the ERP system. The full implementation of the ERP system in the remaining homebuilding divisions is scheduled to take place over the course of the next year. There was no other change in our internal control over financial reporting that occurred during 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**M.D.C. HOLDINGS, INC.**

**FORM 10-Q**

**PART II**

**Item 1. Legal Proceedings**

Because of the nature of the homebuilding business, we and certain of our subsidiaries and affiliates have been named as defendants in various claims, complaints and other legal actions arising in the ordinary course of business, including product liability claims and claims associated with the sale and financing of our homes. In the opinion of management, the outcome of these ordinary course matters will not have a material adverse effect upon our financial condition, results of operations or cash flows.

**Item 1A. Risk Factors**

There have been no significant changes in the risk factors previously identified as being attendant to our business in our Annual Report on Form 10-K for the year ended December 31, 2011. For a more complete discussion of other risk factors that affect our business, see Risk Factors Relating to our Business in our Form 10-K for the year ended December 31, 2011, which include the following:

*The homebuilding industry has experienced a significant downturn, and its duration and ultimate severity are uncertain. A continuation or further deterioration in industry conditions or in the broader economic conditions could have additional adverse effects on our business and financial results.*

*Our strategies in responding to the adverse conditions in the homebuilding industry and in the U.S. economy have had limited success, and the continued implementation of these and other strategies may not be successful.*

*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 would have a negative impact on our home sales revenue and results of operations.*

*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.*

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

*If land is not available at reasonable prices or terms, 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.*

*If mortgage interest rates rise or if mortgage financing otherwise becomes less affordable, it could adversely affect our sales and business, and the duration and ultimate severity of the effects are uncertain.*



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*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 our results of operations, financial position and/or cash flows.*

*In the ordinary course of business, we are required to obtain performance bonds, the unavailability of which could adversely affect our results of operations and/or cash flows.*

*Further uncertainty in the mortgage lending industry, including repurchase requirements associated with HomeAmerican's sale of mortgage loans, could negatively impact our results of operations.*

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*Decreases in the market value of our investments in marketable securities could have an adverse impact on our results of operations.*

*As of December 31, 2011, we are utilizing a new Enterprise Resource Planning ( ERP ) system in all but two of our homebuilding divisions, and, if we encounter significant problems with this implementation or implementation throughout our remaining homebuilding divisions, it could have an adverse impact on our operating activities and/or financial reporting capabilities.*

*Our financial services operations have concentration risks that could impact our results of operations.*

*Our business is subject to numerous federal, local and 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.*

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

*Our income tax provision or benefit and other tax liabilities may be insufficient if taxing authorities are successful in asserting tax positions that are contrary to our position.*

*The homebuilding industry is cyclical and affected by changes in general economic, real estate or other business conditions that could adversely affect our business or financial results.*

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

*Supply shortages and other risks related to the demand for skilled labor and building materials could increase costs and delay deliveries.*

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

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

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

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The Company did not repurchase any shares during the three and nine months ended September 30, 2012. Additionally, there were no sales of unregistered equity securities during either period.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

On October 22, 2012, MDC's Board of Directors declared a quarterly cash dividend of twenty five cents (\$0.25) per share. The dividend will be paid on November 21, 2012 to shareowners of record on November 7, 2012.

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**Item 6. Exhibits**

- 10.1 Fifth Amendment to Master Repurchase Agreement between HomeAmerican Mortgage Corporation, as Seller, and U.S. Bank National Association, as Agent and Buyer, dated as of January 31, 2012.
- 10.2 Sixth Amendment to Master Repurchase Agreement between HomeAmerican Mortgage Corporation, as Seller, and U.S. Bank National Association, as Agent and Buyer, dated as of September 21, 2012 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed September 24, 2012).\*
- 31.1 Certification of Chief Executive Officer required by 17 CFR 240.13a-14(a), pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer required by 17 CFR 240.13a-14(a), pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer required by 17 CFR 240.13a-14(b), pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer required by 17 CFR 240.13a-14(b), pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following financial statements, formatted in XBRL: (i) Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (ii) Consolidated Statements of Operations for the three months and nine months ended September 30, 2012 and 2011, (iii) Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011; and (iv) Notes to the Unaudited Consolidated Financial Statements, tagged as blocks of text.

\* Incorporated by reference.

**SIGNATURE**

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

Date: November 1, 2012

**M.D.C. HOLDINGS, INC.**  
(Registrant)

By: /s/ John M. Stephens  
John M. Stephens  
*Senior Vice President, Chief Financial Officer and  
Principal Accounting Officer (principal financial officer and duly  
authorized officer)*

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| <b>Exhibit<br/>Number</b> | <b>Description</b>  |
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\* Incorporated by reference.