

MDC HOLDINGS INC
Form 10-Q
October 29, 2013

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, 2013

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)

Delaware
(State or other jurisdiction
of incorporation or organization)

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

4350 South Monaco Street, Suite 500 80237
Denver, Colorado (Zip code)
(Address of principal executive offices)

(303) 773-1100

(Registrant's telephone number, including area 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 23, 2013, 48,874,476 shares of M.D.C. Holdings, Inc. common stock were outstanding.

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

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2013

INDEX

	Page No.
Part I. Financial Information:	
Item 1. Unaudited Consolidated Financial Statements:	
Consolidated Balance Sheets at September 30, 2013 and December 31, 2012	1
Consolidated Statements of Operations and Comprehensive Income for the three and nine months ended September 30, 2013 and 2012	2
Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012	3
Notes to Unaudited Consolidated Financial Statements	4
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3. Quantitative and Qualitative Disclosures About Market Risk	41
Item 4. Controls and Procedures	41
Part II. Other Information:	
Item 1. Legal Proceedings	42
Item 1A. Risk Factors	42
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	43
Item 3. Defaults Upon Senior Securities	43
Item 4. Mine Safety Disclosures	43

Item 5. Other Information	43
Item 6. Exhibits	44
Signature	45

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

	September 30,	December 31,
	2013	2012
	(Dollars in thousands, except per share amounts) (Unaudited)	
ASSETS		
Homebuilding:		
Cash and cash equivalents	\$ 149,580	\$ 129,535
Marketable securities	578,441	519,465
Restricted cash	2,186	1,859
Trade and other receivables	29,488	28,163
Inventories:		
Housing completed or under construction	634,159	512,949
Land and land under development	699,974	489,572
Total inventories	1,334,133	1,002,521
Property and equipment, net	31,608	33,125
Deferred tax asset, net of valuation allowance of \$25,046 and \$248,306 at September 30, 2013 and December 31, 2012, respectively	184,986	-
Metropolitan district bond securities (related party)	14,167	5,818
Other assets	50,937	38,959
Total homebuilding assets	2,375,526	1,759,445
Financial Services:		
Cash and cash equivalents	47,706	30,560
Marketable securities	21,816	32,473
Mortgage loans held-for-sale, net	74,340	119,953
Other assets	8,693	3,010
Total financial services assets	152,555	185,996
Total Assets	\$2,528,081	\$ 1,945,441
LIABILITIES AND EQUITY		
Homebuilding:		
Accounts payable	\$20,030	\$73,055
Accrued liabilities	135,434	118,456
Senior notes, net	1,095,421	744,842
Total homebuilding liabilities	1,250,885	936,353

Financial Services:

Accounts payable and accrued liabilities	57,852	51,864
Mortgage repurchase facility	38,912	76,327
Total financial services liabilities	96,764	128,191
Total Liabilities	1,347,649	1,064,544

Stockholders' Equity

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; 48,874,476 and 48,698,757 issued and outstanding at September 30, 2013 and December 31, 2012, respectively.	489	487
Additional paid-in-capital	910,218	896,861
Retained earnings (accumulated deficit)	262,387	(21,289)
Accumulated other comprehensive income	7,338	4,838
Total Stockholders' Equity	1,180,432	880,897
Total Liabilities and Stockholders' Equity	\$2,528,081	\$1,945,441

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

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

	Three Months Ended		Nine Months Ended	
	September 30, 2013	2012	September 30, 2013	2012
	(Dollars in thousands, except per share amounts)			
	(Unaudited)			
Homebuilding:				
Home sale revenues	\$433,693	\$320,647	\$1,165,768	\$761,857
Land sale revenues	25	15	1,832	3,420
Total home and land sale revenues	433,718	320,662	1,167,600	765,277
Home cost of sales	(354,889)	(271,067)	(956,892)	(649,941)
Land cost of sales	(35)	(2)	(1,470)	(3,210)
Inventory impairments	(350)	-	(350)	-
Total cost of sales	(355,274)	(271,069)	(958,712)	(653,151)
Gross margin	78,444	49,593	208,888	112,126
Selling, general and administrative expenses	(57,753)	(44,788)	(157,862)	(118,135)
Interest income	6,460	5,365	21,146	16,651
Interest expense	-	-	(1,726)	(808)
Other income (expense)	(488)	16	853	592
Homebuilding pretax income	26,663	10,186	71,299	10,426
Financial Services:				
Revenues	14,282	13,668	40,672	31,974
Expenses	(6,921)	(5,155)	(19,144)	(13,459)
Interest and other income	885	785	2,680	2,323
Financial services pretax income	8,246	9,298	24,208	20,838
Income before income taxes	34,909	19,484	95,507	31,264
Benefit from income taxes	1,342	642	188,169	1,765
Net income	\$36,251	\$20,126	\$283,676	\$33,029
Other comprehensive income related to available for sale securities, net of tax	1,960	5,095	2,500	10,945
Comprehensive income	\$38,211	\$25,221	\$286,176	\$43,974
Earnings per share:				
Basic	\$0.73	\$0.41	\$5.76	\$0.69
Diluted	\$0.73	\$0.41	\$5.71	\$0.68
Weighted average common shares outstanding				

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Basic	48,492,588	47,761,307	48,438,154	47,499,429
Diluted	48,767,834	47,940,038	48,867,055	47,610,195
Dividends declared per share	\$-	\$0.25	\$-	\$0.75

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

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

	Nine Months Ended	
	September 30, 2013	2012
	(Dollars in thousands)	
	(Unaudited)	
Operating Activities:		
Net income	\$283,676	\$33,029
Adjustments to reconcile net income to net cash used in operating activities:		
Stock-based compensation expense	8,240	12,628
Depreciation and amortization	2,960	3,708
Inventory impairments and write-offs of land option deposits	1,624	414
Amortization of discount (premiums) on marketable debt securities	816	279
Deferred income tax benefit	(189,657)	-
Net changes in assets and liabilities:		
Restricted cash	(327)	(1,417)
Trade and other receivables	(1,599)	(13,685)
Mortgage loans held-for-sale	45,613	(8,313)
Housing completed or under construction	(121,165)	(202,994)
Land and land under development	(210,218)	112,406
Other assets	(15,307)	(553)
Accounts payable and accrued liabilities	(30,516)	14,043
Net cash used in operating activities	(225,860)	(50,455)
Investing Activities:		
Purchases of marketable securities	(369,887)	(397,167)
Maturities of marketable securities	132,492	106,000
Sales of marketable securities	187,083	285,056
Purchases of property and equipment	(1,278)	(958)
Net cash used in investing activities	(51,590)	(7,069)
Financing Activities:		
Payments on mortgage repurchase facility	(195,760)	(137,529)
Advances on mortgage repurchase facility	158,345	135,715
Dividend payments	-	(36,046)
Proceeds from issuance of senior notes	346,938	-
Proceeds from exercise of stock options	5,118	15,820
Net cash provided by (used in) financing activities	314,641	(22,040)
Net increase (decrease) in cash and cash equivalents	37,191	(79,564)

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Cash and cash equivalents:

Beginning of period	160,095	343,361
End of period	\$197,286	\$263,797

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

- 3 -

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, 2013 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, 2012. Certain prior year amounts have been reclassified to conform to the current year's 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, 2012 Annual Report on Form 10-K.

2. Recently Adopted Accounting Standards

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, ("ASU 2013-02"). ASU 2013-02 amends Accounting Standards Codification ("ASC") 220, *Comprehensive Income* ("ASC 220"), and requires entities to present the changes in the components of accumulated other comprehensive income for the current period. Entities are required to present separately the amount of the change that is due to reclassifications, and the amount that is due to current period other comprehensive income. These changes are permitted to be shown either before or net-of-tax and can be displayed either on the face of the financial statements or in the footnotes. ASU 2013-02 was effective for our interim and annual periods beginning January 1, 2013. The adoption of ASU 2013-02 did not have a material effect on our consolidated financial position or results of operations.

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 division as an operating segment. Our operating segments have been aggregated into the reportable segments noted below 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, Florida, Illinois and Maryland, which includes Pennsylvania, Delaware and New Jersey)

Our Financial Services business consists of the operations of the following operating segments: (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, we consider HomeAmerican to be a reportable segment (“Mortgage operations”). 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.

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

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, legal 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.

The following table summarizes home and land sale revenues for our homebuilding operations and revenues for our financial services operations.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Homebuilding				
West	\$188,456	\$148,037	\$487,949	\$335,002
Mountain	134,992	96,335	402,137	236,625
East	110,270	76,290	277,514	193,650
Total home and land sale revenues	\$433,718	\$320,662	\$1,167,600	\$765,277
Financial Services				
Mortgage operations	\$9,694	\$10,479	\$29,232	\$24,368
Other	4,588	3,189	11,440	7,606
Total financial services revenues	\$14,282	\$13,668	\$40,672	\$31,974

The following table summarizes pretax income for our homebuilding and financial services operations.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Homebuilding				
West	\$19,539	\$8,334	\$46,929	\$11,178
Mountain	12,203	6,951	39,341	13,746
East	6,657	4,907	12,708	7,143
Corporate	(11,736)	(10,006)	(27,679)	(21,641)
Total homebuilding pretax income	\$26,663	\$10,186	\$71,299	\$10,426
Financial Services				
Mortgage operations	\$5,936	\$7,430	\$18,790	16,518
Other	2,310	1,868	5,418	4,320
Total financial services pretax income	\$8,246	\$9,298	\$24,208	\$20,838
Total pretax income	\$34,909	\$19,484	\$95,507	\$31,264

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

The following table summarizes total assets for our homebuilding and financial services operations. The assets in our West, Mountain and East segments consist primarily of inventory while the assets in our Corporate segment primarily include cash and cash equivalents, marketable securities, and our net deferred tax asset.

	September 30,	December 31,
	2013	2012
	(Dollars in thousands)	
Homebuilding assets		
West	\$694,591	\$459,807
Mountain	403,711	332,939
East	309,678	274,199
Corporate	967,546	692,500
Total homebuilding assets	\$2,375,526	\$1,759,445
Financial services assets		
Mortgage operations	\$85,494	\$122,941
Other	67,061	63,055
Total financial services assets	\$152,555	\$185,996
Total assets	\$2,528,081	\$1,945,441

4. Earnings 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 per share ("EPS") unless the treasury stock method results in lower EPS. The two-class method is an allocation of earnings between the holders of common stock and a company's participating security holders. Under the two-class method, earnings 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,

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

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 Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
	(Dollars in thousands, except per share amounts)			
Numerator				
Net income	\$36,251	\$20,126	\$283,676	\$33,029
Less: distributed earnings allocated to participating securities	-	(280)	-	(450)
Less: undistributed earnings allocated to participating securities	(647)	(137)	(4,471)	-
Net income attributable to common stockholders (numerator for basic earnings per share)	35,604	19,709	279,205	32,579
Add back: undistributed earnings allocated to participating securities	647	137	4,471	-
Less: undistributed earnings reallocated to participating securities	(643)	(136)	(4,433)	-
Numerator for diluted earnings per share under two class method	\$35,608	\$19,710	\$279,243	\$32,579
Denominator				
Weighted-average common shares outstanding	48,492,588	47,761,307	48,438,154	47,499,429
Add: dilutive effect of stock options	275,246	178,731	428,901	110,766
Denominator for diluted earnings per share under two class method	48,767,834	47,940,038	48,867,055	47,610,195
Basic Earnings Per Common Share	\$0.73	\$0.41	\$5.76	\$0.69
Diluted Earnings Per Common Share	\$0.73	\$0.41	\$5.71	\$0.68

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

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. Diluted EPS for the three and nine months ended September 30, 2013 excluded options to purchase approximately 4.2 million shares and 3.4 million shares, respectively, of common stock because the effect of their inclusion would be anti-dilutive. For the same periods in 2012, diluted EPS excluded options to purchase approximately 3.7 million shares and 4.8 million shares, respectively.

5. Accumulated Other Comprehensive Income

The following table sets forth our changes in accumulated other comprehensive income:

	Three Months Ended		Nine Months Ended	
	September 30, 2013	2012	September 30, 2013	2012
	(Dollars in thousands)			
Unrealized gains (losses) on available-for-sale marketable securities ^a :				
Beginning balance	\$884	\$(1,390)	\$4,838	\$(7,240)
Other comprehensive income before reclassifications	1,766	5,377	(1,195)	12,027
Amounts reclassified from accumulated other comprehensive income ^b	194	(282)	(799)	(1,082)
Ending balance	\$2,844	\$3,705	\$2,844	\$3,705
Unrealized gains on available-for-sale metropolitan district bond securities ^a :				
Beginning balance	\$4,494	\$-	\$-	\$-
Other comprehensive income before reclassifications	-	-	4,494	-
Amounts reclassified from accumulated other comprehensive income	-	-	-	-
Ending balance	\$4,494	\$-	\$4,494	\$-
Total ending accumulated other comprehensive income	\$7,338	\$3,705	\$7,338	\$3,705

- (a) All amounts net-of-tax.
- (b) See separate table below for details about these reclassifications.

The following table sets forth the activity related to reclassifications out of accumulated other comprehensive income related to available for sale securities:

Affected Line Item in the Statements of Operations	Three Months Ended		Nine Months Ended	
	September 30, 2013	2012	September 30, 2013	2012
	(Dollars in thousands)			
Homebuilding interest income	\$(311)	\$317	\$560	\$1,235
Financial services interest and other income	(4)	(35)	118	(153)
Income before income taxes	(315)	282	678	1,082
Benefit from income taxes	121	-	121	-
Net income	\$(194)	\$282	\$799	\$1,082

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****6. Fair Value Measurements**

ASC 820, *Fair Value Measurements* (“ASC 820”) 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.

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, 2013	December 31, 2012
		(Dollars in thousands)	
Marketable securities (available-for-sale)			
Equity securities	Level 1	\$377,970	\$208,818
Debt securities - maturity less than 1 year	Level 2	84,791	54,388
Debt securities - maturity 1 to 5 years	Level 2	120,170	277,514
Debt securities - maturity greater than 5 years	Level 2	17,326	11,218
Total available-for-sale securities		\$600,257	\$551,938
Mortgage loans held-for-sale, net	Level 2	\$74,340	\$119,953
Metropolitan district bond securities (available-for-sale)*	Level 3	\$14,167	\$12,920

** These securities were recorded at their cost-basis at December 31, 2012 as they were still under the cost recovery method of accounting. As such, the fair value presented for December 31, 2012 does not equal the amount we have recorded in our accompanying consolidated balance sheets.*

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

Cash and Cash Equivalents. Fair value approximates carrying value.

Marketable Securities. Our marketable securities consist primarily of: (1) fixed and floating rate interest earning 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 of debt and equity securities; (3) holdings in corporate equities; and (4) deposit securities, which may include, among others, certificates of deposit and time deposits. As of September 30, 2013 and December 31, 2012, all of our marketable securities were treated as available-for-sale investments and, as such, we have recorded all of our marketable securities at fair value with changes in fair value being recorded as a component of accumulated other comprehensive income.

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

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

	September 30, 2013		December 31, 2012	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)			
Homebuilding:				
Equity security	\$371,253	\$373,990	\$208,279	\$208,818
Debt securities	202,771	204,451	306,793	310,647
Total homebuilding available-for-sale securities	\$574,024	\$578,441	\$515,072	\$519,465
Financial Services:				
Equity security	\$4,000	\$3,980	\$-	\$-
Debt securities	17,577	17,836	32,028	32,473
Total financial services available-for-sale debt securities	\$21,577	\$21,816	\$32,028	\$32,473
Total available-for-sale marketable securities	\$595,601	\$600,257	\$547,100	\$551,938

As of September 30, 2013 and December 31, 2012, our marketable securities (homebuilding and financial services in aggregate) were in a net unrealized gain position of \$4.7 million and \$4.8 million, respectively.

Mortgage Loans Held-for-Sale, Net. As of September 30, 2013, 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, 2013 and December 31, 2012, we had \$53.6 million and \$108.3 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, 2013 and December 31, 2012, we had \$17.9 million and \$11.7 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.

Metropolitan District Bond Securities (Related Party). Our Metropolitan District Bond Securities (“Metro Bonds”) are included in other assets in the Homebuilding section of our accompanying consolidated balance sheets. We acquired the Metro Bonds from a quasi-municipal corporation in the state of Colorado (the “Metro District”), which was formed to help fund and maintain the infrastructure associated with a master-planned community owned and operated by our Company. The Board of Directors of the Metro District currently is comprised of employees of the Company and therefore is a related party. Cash flows received by the Company from these securities reflect principal and interest payments from the Metro District that are supported by an annual levy on the taxable value of real estate and personal property within the Metropolitan District’s boundaries and a one-time fee assessed on new homes closed in the Metro District. The stated maturity date of the Metro Bonds is 2037. However, if the unpaid principal and all accrued interest are not paid off at that date, the Company will continue to receive principal and interest payments into perpetuity until the unpaid principal and accrued interest is paid in full. Through the first quarter of 2013, we accounted for these securities under the cost recovery method and they were not carried at fair value in accordance with ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality* (ASC 310-30).

In the second quarter of 2013, we determined that these securities no longer were required to be accounted for under the cost recovery method due to an increase in the number of new homes closed in the community coupled with the stabilization of property values within the Metro District. In accordance with ASC 310-30, we will adjust the bond principal balance on a prospective basis using an interest accretion model that utilizes future cash flows expected to be collected. Furthermore, as this investment is accounted for as an available-for-sale asset, we will update its fair value on a quarterly basis, with the adjustment being recorded through other comprehensive income. The fair value is based upon a discounted future cash flow model, which uses Level 3 inputs. The two primary unobservable inputs used in our discounted cash flow model are the forecasted number of homes to be closed, as they drive any increases to the tax base for the Metropolitan District, and the discount rate. The table on the following page provides quantitative data regarding each unobservable input and the sensitivity of fair value to potential changes in those unobservable inputs.

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

Unobservable Input	Quantitative Data		Sensitivity Analysis	
	Range	Weighted Average	Movement in Fair Value from Increase in Input	Movement in Fair Value from Decrease in Input
Discount rate	6% to 15%	11.1%	Decrease	Increase
Number of homes closed per year	0 to 118	38	Increase	Decrease

The table set forth below summarizes the activity for the three and nine months ended September 30, 2013 and 2012 for our Metro Bonds.

	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
	(Dollars in thousands)			
Balance at beginning of period	\$13,835	\$6,663	\$5,818	\$6,663
Increase in fair value (recorded in other comprehensive income)	-	-	7,354	-
Change due to accretion of principal	332	-	995	-
Cash receipts	-	-	-	-
Balance at end of period	\$14,167	\$6,663	\$14,167	\$6,663

Mortgage Repurchase Facility. The debt associated with 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 and is based on level 2 inputs.

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

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

	September 30, 2013		December 31, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in thousands)			
5.375% Senior Notes due December 2014, net	\$249,765	\$262,350	\$249,621	\$267,208
5.375% Senior Notes due July 2015, net	249,925	264,313	249,895	268,867
5.625% Senior Notes due February 2020, net	245,731	257,031	245,326	273,125
6.000% Senior Notes due January 2043	350,000	304,719	-	-
Total	\$1,095,421	\$1,088,413	\$744,842	\$809,200

- 10 -

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****7. Inventories**

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

	September 30,	December 31,
	2013	2012
	(Dollars in thousands)	
Housing Completed or Under Construction:		
West	\$253,824	\$200,858
Mountain	192,176	183,522
East	188,159	128,569
Subtotal	634,159	512,949
Land and Land Under Development:		
West	407,442	230,344
Mountain	194,113	137,221
East	98,419	122,007
Subtotal	699,974	489,572
Total Inventories	\$1,334,133	\$1,002,521

Our inventories are primarily associated with communities where we intend to construct and sell homes on the land, including models and unsold started homes. 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. 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.

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 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, including sales commissions) for homes closed;
- estimated future undiscounted cash flows and Operating Margin;
- forecasted Operating Margin for homes in backlog;
- actual and trending net and gross home orders;
- base sales price and home sales incentive information for homes closed, homes in backlog and homes available for sale;
- market information for each sub-market, including competition levels, home foreclosure levels, the size and style of homes currently being offered for sale and lot size; 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 (including capitalized interest) 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 rates that are commensurate with the risk of the subdivision under evaluation. For both the three and nine months ended September 30, 2013, we recorded \$0.4 million in inventory impairment charges. For both the three and nine months ended September 30, 2012, we did not record any inventory impairment charges.

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****8. Capitalization of Interest**

We capitalize interest to inventories during the period of development in accordance with ASC 835, *Interest* (“ASC 835”). Homebuilding interest capitalized as a cost of inventories is included in cost of sales as related units or lots are sold. To the extent our homebuilding debt exceeds our qualified assets as defined in ASC 835, we expense a portion of the interest incurred by us. Qualified homebuilding assets consist of all lots and homes, excluding finished unsold homes or finished models, within projects that are actively selling or under development. The table set forth below summarizes homebuilding interest activity. The homebuilding interest expensed in the table below relates to the portion of interest incurred where our homebuilding debt exceeded our qualified inventory for such periods in accordance with ASC 835.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Homebuilding interest incurred	\$15,852	\$10,573	\$45,536	\$31,739
Less: Interest capitalized	(15,852)	(10,573)	(43,810)	(30,931)
Homebuilding interest expensed	\$-	\$-	\$1,726	\$808
Interest capitalized, beginning of period	\$74,547	\$67,101	\$69,143	\$58,742
Interest capitalized during period	15,852	10,573	43,810	30,931
Less: Previously capitalized interest included in home cost of sales	(15,567)	(8,655)	(38,121)	(20,654)
Interest capitalized, end of period	\$74,832	\$69,019	\$74,832	\$69,019

9. Homebuilding Other Assets

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

	September 30,	December 31,
	2013	2012
	(Dollars in thousands)	
Land option deposits	\$ 15,941	\$ 8,246
Deferred marketing costs	14,159	13,874
Prepaid expenses	6,032	5,575
Goodwill	6,008	6,008
Deferred debt issuance costs, net	6,003	2,641
Other	2,794	2,615
Total	\$ 50,937	\$ 38,959

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****10. Homebuilding Accrued Liabilities and Financial Services Accounts Payable and Accrued Liabilities**

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

	September 30,	December 31,
	2013	2012
	(Dollars in thousands)	
Accrued executive deferred compensation	\$31,956	\$28,475
Accrued compensation and related expenses	26,431	16,864
Warranty reserves	22,443	23,151
Accrued interest payable	15,191	13,698
Customer and escrow deposits	13,685	9,413
Land development and home construction accruals	6,919	9,545
Other accrued liabilities	18,809	17,310
Total accrued liabilities	\$135,434	\$118,456

The following table sets forth information relating to financial services accounts payable and accrued liabilities.

	September 30,	December 31,
	2013	2012
	(Dollars in thousands)	

Insurance reserves	\$49,162	\$47,852
Accounts payable and other accrued liabilities	8,690	4,012
Total accounts payable and accrued liabilities	\$57,852	\$51,864

11. Warranty Accrual

We accrue warranty expenses for normal and recurring warranty claims at the time of our home closings, based on our trends in historical warranty payment levels. We also accrue warranty expense for warranty claims not considered to be normal and recurring as we become aware of them. 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. We assess the adequacy of our warranty accrual on a quarterly basis and adjust the amounts recorded if necessary. The table set forth below summarizes warranty accrual and payment activity for the three and nine months ended September 30, 2013 and 2012. The adjustment in the nine month period ended September 30, 2013 was not material to our operations. Furthermore, the impact of the change in our warranty expense provision rates from the three months ended September 30, 2012 to 2013 and the nine months ended September 30, 2012 to 2013 did not materially affect our warranty expense or gross margin from home sales for the three and nine months ended September 30, 2013.

	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
	(Dollars in thousands)			
Balance at beginning of period	\$22,725	\$24,036	\$23,151	\$25,525
Expense provisions	1,367	1,479	3,643	3,122
Cash payments	(1,649)	(2,433)	(4,651)	(5,565)
Adjustments	-	-	300	-
Balance at end of period	\$22,443	\$23,082	\$22,443	\$23,082

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****12. Insurance Reserves**

The establishment of reserves for estimated losses associated with insurance policies issued by Allegiant and re-insurance agreements issued by StarAmerican 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 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, 2013 and 2012. 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		Nine Months Ended	
	September 30, 2013	2012	September 30, 2013	2012
	(Dollars in thousands)			
Balance at beginning of period	\$47,834	\$45,644	\$47,852	\$49,376
Expense provisions	1,885	1,063	5,187	2,752
Cash payments, net of recoveries	(557)	(1,797)	(3,877)	(7,218)
Balance at end of period	\$49,162	\$44,910	\$49,162	\$44,910

In the ordinary course of business, we make payments from our insurance reserves to settle litigation and claims arising primarily from our homebuilding activities. These payments are irregular in both their timing and their magnitude. As a result, the cash payments, net of recoveries shown for the three and nine months ended September 30, 2013, are not necessarily indicative of what future cash payments will be for subsequent periods. The increases in our expense provisions were driven by a higher number of homes delivered during the three and nine months ended September 30, 2013, when compared to the same periods in 2012, coupled with a higher expense provision rate per home closed as the result of updated actuarial studies.

13. Income Taxes

We recorded an income tax benefit of \$1.3 million and \$188.2 million for the three and nine months ended September 30, 2013, respectively, compared to a benefit of \$0.6 million and \$1.8 million for the same respective periods in 2012. In the second quarter of 2013, we recorded a \$187.6 million, or \$3.80 per diluted share, reversal of a portion of our deferred tax asset valuation allowance. A portion of our remaining valuation allowance as of June 30, 2013 was related to an amount expected to be reversed in the third and fourth quarter of 2013 as pretax income is realized as required by ASC 740-270, *Income Taxes - Interim Reporting*, when a change in a valuation allowance is recognized in an interim period. As a result of the valuation allowance release in the 2013 second quarter and the utilization of a portion of our remaining valuation allowance during the 2013 third quarter, our effective tax rates in 2013 and 2012 are not meaningful as the income tax benefit is not directly correlated to the amount of pretax income or loss.

Deferred income taxes reflect the net tax effects of temporary differences between (1) the carrying amounts of the assets and liabilities for financial reporting purposes and (2) 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 March 31, 2013, we had a full valuation allowance totaling \$238.8 million recorded against our net deferred tax asset. During the quarter ended June 30, 2013, we concluded that it was more likely than not that we would be able to realize substantially all of our operating loss carryforwards within the allowable carryforward periods and as such, we reversed substantially all of our deferred tax asset valuation allowance.

At September 30, 2013 we have a remaining valuation allowance of \$25.0 million related to (1) an amount expected to be reversed in the fourth quarter of 2013 as pretax income is realized as required by ASC 740-270, *Income Taxes - Interim Reporting*, when a change in a valuation allowance is recognized in an interim period and (2) various state net operating loss carryforwards where realization is more uncertain at this time due to the more limited carryforward periods that exist in certain states.

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

In our evaluation of the need for, and level of, a valuation allowance recorded against our deferred tax assets at June 30, 2013, the most significant piece of evidence considered was the objective and direct positive evidence related to our recent financial results. Through June 30, 2013, we had generated pretax income in each of the six consecutive preceding quarters totaling \$121.7 million, with our second quarter 2013 pretax income being higher than any of the five previous quarters. In prior periods, a significant part of the negative evidence we considered was our three-year cumulative loss position. However, at June 30, 2013, when including expected earnings from homes currently in our backlog, we no longer anticipated being in a cumulative loss position at December 31, 2013. Lastly, if our quarterly income in future years remained consistent with earnings levels experienced in recent quarters, we estimated that we would utilize all of our current federal net operating losses by 2016. Other negative evidence considered was the recent rise in mortgage interest rates, caused largely by an expectation that the Federal Reserve may taper its use of quantitative easing as early as the second half of 2013. However, the Federal Reserve has also indicated that such tapering would likely only occur if economic conditions continue to improve, which would help to offset the impact of rising interest rates on the homebuilding industry. Based on our evaluation of both positive and negative evidence, we concluded that the objective and direct positive evidence related to operating results achieved during the recent challenging economic and housing market conditions and the sustainability of current pretax income levels outweighed the negative evidence and that it is more likely than not that the substantial majority of the Company's deferred tax assets will be realized. After considering the results of the quarter ended September 30, 2013, we have determined that these conclusions reached during the second quarter of 2013 remain appropriate.

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

	September 30,	December 31,
	2013	2012
	(Dollars in thousands)	
Deferred tax assets:		
Federal net operating loss carryforwards	\$95,131	\$129,695
State net operating loss carryforwards	46,081	49,551
Alternative minimum tax and other tax credit carryforwards	13,001	10,988
Stock-based compensation expense	30,729	29,196
Warranty, litigation and other reserves	15,717	14,556
Deferred compensation retirement plans	12,303	11,252
Asset impairment charges	7,171	14,080

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Inventory, additional costs capitalized for tax purposes	6,504	3,930
Other, net	2,976	2,063
Total deferred tax assets	229,613	265,311
Valuation allowance	(25,046)	(248,306)
Total deferred tax assets, net of valuation allowance	204,567	17,005
Deferred tax liabilities:		
Property, equipment and other assets	5,580	5,753
Discount on notes receivable	4,204	4,204
Deferred revenue	3,751	3,796
Unrealized gain on marketable securities	4,671	1,863
Other, net	1,375	1,389
Total deferred tax liabilities	19,581	17,005
Net deferred tax asset	\$ 184,986	\$-

- 15 -

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****14. Senior Notes**

The following table sets forth the carrying amount of our senior notes as of September 30, 2013 and December 31, 2012, net of applicable discounts:

	September 30,	December 31,
	2013	2012
	(Dollars in thousands)	
5.375% Senior Notes due December 2014, net	\$249,765	\$249,621
5.375% Senior Notes due July 2015, net	249,925	249,895
5.625% Senior Notes due February 2020, net	245,731	245,326
6.000% Senior Notes due January 2043	350,000	-
Total	\$1,095,421	\$744,842

On January 10, 2013, we issued \$250 million of 6% senior notes due 2043. On May 8, 2013, we issued an additional \$100 million of 6% senior notes due 2043, which are of the same series and have the same terms as the notes issued on January 10, 2013 (collectively the "6% Notes"). The 6% Notes, which pay interest semi-annually in arrears on January 15 and July 15 of each year, commencing July 15, 2013, are general unsecured obligations of MDC and rank equally and ratably with our other general unsecured and unsubordinated indebtedness. We received total proceeds of \$346.9 million, net of underwriting fees of \$3.1 million.

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.

15. 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, 2013, we recognized \$1.9 million and \$4.7 million, respectively, for option grants, compared to \$3.6 million and \$8.3 million, respectively, during the same periods in the prior year. The decrease in expense for the three and nine months ended September 30, 2013 was primarily driven by the expense recorded for the performance-based awards (discussed below) in the three and nine months ended September 30, 2012, which was not recorded in the second and third quarters of 2013 as these performance-based awards were fully vested in the 2013 first quarter. We recognized \$1.1 million and \$3.5 million, respectively, for restricted stock awards during the three and nine months ended September 30, 2013 compared to \$1.3 million and \$4.3 million, respectively, during the same periods in the prior year.

On March 8, 2012, the Company granted a 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 would vest as of March 1 following any fiscal year in which, in addition to the Company achieving a gross margin from home sales of at least 16.7% (as calculated in our 2011 Form 10-K, excluding warranty adjustments and interest), the Company achieved: (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 were not performance-vested by March 1, 2015 would 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 accordance with ASC 718, the performance-based awards were assigned a fair value of \$7.42 per share on the date of grant. The maximum potential expense that would be recognized by the Company if all of the performance targets were met was approximately \$7.4 million. At December 31, 2012 all performance targets had been achieved. Therefore, \$6.2 million of compensation expense was recognized related to the grant of these awards during the year ended December 31, 2012. The balance of the unamortized stock-based compensation expense was amortized during the first two months of 2013, based on the vesting date of March 1, 2013.

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****16. Commitments and Contingencies**

Surety Bonds and Letters of Credit. We are required to provide 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, 2013, we had issued and outstanding surety bonds and letters of credit totaling \$83.9 million and \$30.1 million, respectively, including \$15.5 million in letters of credit issued by HomeAmerican. The estimated cost to complete obligations related to these bonds and letters of credit was approximately \$34.4 million and \$10.1 million, respectively. Among our letter of credit facilities are three committed revolving facilities, the terms of which provide that up to \$65 million of letters of credit may be issued thereunder. In the event any such surety bonds or letters of credit issued by third parties are called, MDC would be obligated to reimburse the issuer of the bond or letter of credit. We believe that we were in compliance with the covenants in the letter of credit facilities at September 30, 2013.

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 from various loan document manufacturing quality assertions as well as 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. In addition to reserves established for mortgage loans previously sold to third-parties, we establish reserves for loans that we have repurchased if we believe the loss is likely and estimable. 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.

The following table summarizes mortgage loan loss reserve activity for the three and nine months ended September 30, 2013 and 2012.

Three Months Ended	Nine Months Ended
September 30,	September 30,

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

	2013	2012	2013	2012
	(Dollars in thousands)			
Balance at beginning of period	\$1,350	\$1,118	\$976	\$830
Expense provisions	651	153	1,226	604
Cash payments	(200)	(128)	(356)	(226)
Adjustments	-	-	(45)	(65)
Balance at end of period	\$1,801	\$1,143	\$1,801	\$1,143

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 construction defect claims, 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.

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 deposits. At September 30, 2013, we had cash deposits and letters of credit totaling \$12.6 million and \$3.7 million, respectively, at risk associated with the option to purchase 2,771 lots.

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

17. 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, 2013, we had \$145.5 million in interest rate lock commitments and \$95.5 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 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.

18. Mortgage Repurchase Facility

HomeAmerican has a Master Repurchase Agreement (the "Mortgage Repurchase Facility") with U.S. Bank National Association ("USBNA"). This agreement was amended on September 20, 2013 and extended until September 19, 2014. 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. The Mortgage Repurchase Facility had a maximum aggregate commitment of \$50 million as of September 30, 2013. At September 30, 2013 and December 31, 2012, we had \$38.9 million and \$76.3 million (the Mortgage Repurchase Facility had a temporary increase in the commitment up to \$80 million from December 31, 2012 through January 31, 2013), 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 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 2.75%, or (ii) 3.00%.

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 as of September 30, 2013.

19. Subsequent Events

In response to concerns expressed by significant institutional investors, and in accordance with the recommendation of an independent compensation consultant to the Company's Compensation Committee the, Company announced that it had reached agreements (collectively, the "Second Amendments") with its Chief Executive Officer, Larry A. Mizel, and its Chief Operating Officer, David D. Mandarich (collectively, the "Executive Officers"), for the early termination, effective on October 18, 2013, of the Retirement Benefits contained in their respective Employment Agreements restated as of August 1, 2008, as amended on March 8, 2012. Pursuant to the Second Amendments, the Company will pay each of Mr. Mizel and Mr. Mandarich a deferred lump sum in the amount of \$14.8 million and \$16.0 million, respectively, in full satisfaction of their past, present and future Retirement Benefits. The Company's termination of the Retirement Benefits is irrevocable. These payments, which equal the amounts accrued on the books of the Company through June 30, 2013 with respect to the Company's estimated liability to pay Retirement Benefits, will be made to the Executive Officers on October 20, 2014. As a result of the termination of the Retirement Benefits, the Company will no longer incur ongoing Retirement Benefit accruals.

The deductibility of the Second Amendment payments for tax purposes under Internal Revenue Code ("IRC") Section 162(m) will be determined at the end of the taxable year in which the payments are made. However, because the Company believes that it is more likely than not that the payments will not be deductible, as part of its 2013 fourth quarter income tax expense determination, the Company will record a valuation allowance of approximately \$11.9 million against its deferred tax asset. Whether or not the payments are deductible under IRC Section. 162(m), the Board of Directors believes that the early termination of the Retirement Benefits is in the best interests of the Company and its shareholders.

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

20. Supplemental Guarantor Information

Our senior notes are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by the following subsidiaries (collectively, the “Guarantors”), which are 100%-owned subsidiaries of the Company.

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.
Richmond American Homes of Washington, Inc.

The senior note indentures do not provide for a suspension of the guarantees, but do provide that any Guarantor may be released from its guarantee so long as (1) no default or event of default exists or would result from release of such guarantee, (2) the Guarantor being released has consolidated net worth of less than 5% of the Company’s consolidated net worth as of the end of the most recent fiscal quarter, (3) the Guarantors released from their guarantees in any year-end period comprise in the aggregate less than 10% (or 15% if and to the extent necessary to permit the cure of a default) of the Company’s consolidated net worth as of the end of the most recent fiscal quarter, (4) such release would not have a material adverse effect on the homebuilding business of the Company and its subsidiaries and (5) the Guarantor is released from its guarantee(s) under all Specified Indebtedness (other than by reason of payment under its guarantee of Specified Indebtedness). Upon delivery of an officers’ certificate and an opinion of counsel stating that all conditions precedent provided for in the indenture relating to such transactions have been complied with and the release is authorized, the guarantee will be automatically and unconditionally released. “Specified Indebtedness” means indebtedness under the senior notes and the Company’s Indenture dated as of December 3, 2002, and any refinancing, extension, renewal or replacement of any of the foregoing.

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.

During the first quarter of 2013, the Company determined that it should have classified the non-cash impact of equity income (loss) of subsidiaries as a non-cash reconciling item in the Supplemental Condensed Combining Statements of Cash Flows. As reported, the Company classified the non-cash equity income (loss) of subsidiaries in the net cash provided by (used in) operating activities in the MDC parent column (along with a corresponding elimination of this amount in the eliminating entries column). As revised, the non-cash equity income (loss) of subsidiaries is classified as a non-cash reconciling item in the MDC parent column and this item is no longer reported as an eliminating entry in the eliminating entries column of the Supplemental Condensed Combining Statements of Cash Flows statements. This change in reporting had no impact on (a) the net increase (decrease) in cash and cash equivalents column of the MDC column; (b) the previously reported consolidated net cash provided by (used in) (i) operating activities, (ii) financing activities or (iii) investing activities; or (c) the total net increase (decrease) in cash and cash equivalents line items in the consolidated MDC column.

None of the above changes in reporting had any impact on any amounts in the previously reported Supplemental Condensed Combining Statements of Operations.

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

Following are reconciliations of the amounts previously reported to the reclassified amounts as stated in the following components of the Supplemental Condensed Combining Statements of Cash Flows for the nine months ended September 30, 2012.

MDC Column for the Nine Months Ended September 30, 2012	As Previously Reported	Reclassify the non-cash equity income (loss) of subsidiaries	As Reclassified
	(Dollars in thousands)		
Net Cash provided by (used in) operating activities	\$39,291	\$ (46,776)	\$ (7,485)
Payments from (advances to) subsidiaries	\$(92,930)	\$ 46,776	\$ (46,154)
Net cash provided by (used in) financing activities	\$(113,156)	\$ 46,776	\$ (66,380)
Net increase (decrease) in cash and cash equivalents	\$(81,971)	\$ -	\$ (81,971)

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

	September 30, 2013				
	MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
	Dollars in thousands				
ASSETS					
Homebuilding:					
Cash and cash equivalents	\$ 145,491	\$ 4,089	\$ -	\$-	\$ 149,580
Marketable securities	578,441	-	-	-	578,441
Restricted cash	-	2,186	-	-	2,186
Trade Receivables	9,881	21,937	-	(2,330)	29,488
Inventories:					
Housing completed or under construction	-	634,159	-	-	634,159
Land and land under development	-	699,974	-	-	699,974
Total inventories	-	1,334,133	-	-	1,334,133
Intercompany receivables	1,109,004	2,578	16	(1,111,598)	-
Investment in subsidiaries	280,233	-	-	(280,233)	-
Deferred tax asset	181,728	-	-	3,258	184,986
Other assets, net	51,076	45,636	-	-	96,712
Total Homebuilding Assets	2,355,854	1,410,559	16	(1,390,903)	2,375,526
Financial Services:					
Cash and cash equivalents	-	-	47,706	-	47,706
Marketable securities	-	-	21,816	-	21,816
Trade Receivables	-	-	1,831	-	1,831
Intercompany receivables	-	-	12,043	(12,043)	-
Mortgage loans held-for-sale, net	-	-	74,340	-	74,340
Other assets, net	-	-	10,120	(3,258)	6,862
Total Financial Services Assets	-	-	167,856	(15,301)	152,555
Total Assets	\$ 2,355,854	\$ 1,410,559	\$ 167,872	\$ (1,406,204)	\$ 2,528,081

LIABILITIES AND EQUITY**Homebuilding:**

Accounts payable	\$-	\$ 20,030	\$ -	\$-	\$ 20,030
Accrued liabilities	65,368	67,050	65	2,951	135,434
Advances and notes payable to parent and subsidiaries	14,633	1,085,845	18	(1,100,496)	-
Senior notes, net	1,095,421	-	-	-	1,095,421
Total Homebuilding Liabilities	1,175,422	1,172,925	83	(1,097,545)	1,250,885

Financial Services:

Accounts payable and other liabilities	-	-	63,133	(5,281)	57,852
Advances and notes payable to parent and subsidiaries	-	-	23,145	(23,145)	-
Mortgage repurchase facility	-	-	38,912	-	38,912
Total Financial Services Liabilities	-	-	125,190	(28,426)	96,764
Total Liabilities	1,175,422	1,172,925	125,273	(1,125,971)	1,347,649

Equity:

Total Stockholders' Equity	1,180,432	237,634	42,599	(280,233)	1,180,432
Total Liabilities and Stockholders' Equity	\$ 2,355,854	\$ 1,410,559	\$ 167,872	\$ (1,406,204)	\$ 2,528,081

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

	December 31, 2012				
	MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
	(Dollars in thousands)				
ASSETS					
Homebuilding:					
Cash and cash equivalents	\$ 125,904	\$ 3,308	\$ 323	\$-	\$ 129,535
Marketable securities	519,465	-	-	-	519,465
Restricted cash	-	1,859	-	-	1,859
Trade Receivables	6,563	18,846	2,754	-	28,163
Inventories:					
Housing completed or under construction	-	469,495	43,454	-	512,949
Land and land under development	-	467,915	21,657	-	489,572
Total inventories	-	937,410	65,111	-	1,002,521
Intercompany receivables	812,731	2,589	-	(815,320)	-
Investment in subsidiaries	198,465	-	-	(198,465)	-
Other assets, net	40,565	28,524	8,813	-	77,902
Total Homebuilding Assets	1,703,693	992,536	77,001	(1,013,785)	1,759,445
Financial Services:					
Cash and cash equivalents	-	-	30,560	-	30,560
Marketable securities	-	-	32,473	-	32,473
Intercompany receivables	-	-	9,779	(9,779)	-
Mortgage loans held-for-sale, net	-	-	119,953	-	119,953
Other assets, net	-	-	4,710	(1,700)	3,010
Total Financial Services Assets	-	-	197,475	(11,479)	185,996
Total Assets	\$ 1,703,693	\$ 992,536	\$ 274,476	\$(1,025,264)	\$ 1,945,441

LIABILITIES AND EQUITY

Homebuilding:

Accounts payable	\$-	\$ 67,257	\$ 5,798	\$-	\$ 73,055
Accrued liabilities	63,886	46,761	7,809	-	118,456
Advances and notes payable to parent and subsidiaries	14,068	758,155	52,839	(825,062)	-
Senior notes, net	744,842	-	-	-	744,842
Total Homebuilding Liabilities	822,796	872,173	66,446	(825,062)	936,353

Financial Services:

Accounts payable and other liabilities	-	-	51,864	-	51,864
Advances and notes payable to parent and subsidiaries	-	-	1,737	(1,737)	-
Mortgage repurchase facility	-	-	76,327	-	76,327
Total Financial Services Liabilities	-	-	129,928	(1,737)	128,191
Total Liabilities	822,796	872,173	196,374	(826,799)	1,064,544

Equity:

Total Stockholders' Equity	880,897	120,363	78,102	(198,465)	880,897
Total Liabilities and Stockholders' Equity	\$ 1,703,693	\$ 992,536	\$ 274,476	\$(1,025,264)	\$ 1,945,441

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****Supplemental Condensed Combining Statements of Operations and Comprehensive Income**

	Three Months Ended September 30, 2013				
	MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
	(Dollars in thousands)				
Homebuilding:					
Revenues	\$-	\$ 433,718	\$ -	\$ -	\$ 433,718
Cost of Sales	-	(354,924)	-	-	(354,924)
Inventory impairments	-	(350)	-	-	(350)
Gross margin	-	78,444	-	-	78,444
Selling, general, and administrative expenses	(18,067)	(39,594)	2	(94)	(57,753)
Equity income of subsidiaries	29,421	-	-	(29,421)	-
Interest income	6,458	2	-	-	6,460
Interest expense	-	-	-	-	-
Other income (expense), net	(27)	(472)	11	-	(488)
Homebuilding pretax income (loss)	17,785	38,380	13	(29,515)	26,663
Financial Services:					
Financial services pretax income	-	-	8,152	94	8,246
Income before income taxes	17,785	38,380	8,165	(29,421)	34,909
(Provision) benefit for income taxes	18,466	(13,820)	(3,304)	-	1,342
Net income	\$36,251	\$ 24,560	\$ 4,861	\$ (29,421)	\$ 36,251
Other comprehensive income related to available for sale securities, net of tax	1,874	-	86	-	1,960
Comprehensive income	\$38,125	\$ 24,560	\$ 4,947	\$ (29,421)	\$ 38,211

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Three Months Ended September 30, 2012

MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
-----	---------------------------	-----------------------------------	------------------------	---------------------

(Dollars in thousands)

Homebuilding:

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 of subsidiaries	26,656	-	-	(26,656)	-
Interest income	5,364	1	-	-	5,365
Interest expense	-	-	-	-	-
Other income (expense), net	97	132	(213)	-	16
Homebuilding pretax income (loss)	16,656	17,150	3,036	(26,656)	10,186

Financial Services:

Financial services pretax income	-	-	9,298	-	9,298
Income 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	\$20,126	\$ 17,736	\$ 8,920	\$ (26,656)	\$ 20,126
Other comprehensive income related to available for sale securities, net of tax	4,909	-	186	-	5,095
Comprehensive income	\$25,035	\$ 17,736	\$ 9,106	\$ (26,656)	\$ 25,221

M.D.C. HOLDINGS, INC.**Notes to Unaudited Consolidated Financial Statements****Supplemental Condensed Combining Statements of Operations and Comprehensive Income**

	Nine Months Ended September 30, 2013				
	MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
	(Dollars in thousands)				
Homebuilding:					
Revenues	\$-	\$ 1,168,848	\$ -	\$ (1,248)	\$ 1,167,600
Cost of Sales	-	(959,610)	-	1,248	(958,362)
Inventory impairments	-	(350)	-	-	(350)
Gross margin	-	208,888	-	-	208,888
Selling, general, and administrative expenses	(48,163)	(109,439)	(1)	(259)	(157,862)
Equity income of subsidiaries	99,079	-	-	(99,079)	-
Interest income	21,139	7	-	-	21,146
Interest expense	(1,726)	-	-	-	(1,726)
Other income (expense), net	1,341	(499)	11	-	853
Homebuilding pretax income (loss)	71,670	98,957	10	(99,338)	71,299
Financial Services:					
Financial services pretax income	-	-	23,949	259	24,208
Income before income taxes	71,670	98,957	23,959	(99,079)	95,507
(Provision) benefit for income taxes	212,006	(14,646)	(9,191)	-	188,169
Net income	\$283,676	\$84,311	\$ 14,768	\$ (99,079)	\$283,676
Other comprehensive income related to available for sale securities, net of tax	2,706	-	(206)	-	2,500
Comprehensive income	\$286,382	\$84,311	\$ 14,562	\$ (99,079)	\$286,176

Nine Months Ended September 30, 2012

	MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
Homebuilding:					
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 of subsidiaries	46,776	-	-	(46,776)	-
Interest income	16,642	9	-	-	16,651
Interest expense	(778)	(30)	-	-	(808)
Other income (expense), net	535	208	(151)	-	592
Homebuilding pretax income (loss)	25,145	26,933	5,124	(46,776)	10,426
Financial Services:					
Financial services pretax income	-	-	20,838	-	20,838
Income 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	\$33,029	\$ 28,452	\$ 18,324	\$ (46,776)	\$ 33,029
Other comprehensive income related to available for sale securities, net of tax	10,735	-	210	-	10,945
Comprehensive income	\$43,764	\$ 28,452	\$ 18,534	\$ (46,776)	\$ 43,974

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

	Nine Months Ended September 30, 2013				
	MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
	(Dollars in thousands)				
Net cash provided by (used in) operating activities	\$5,851	\$ (357,618)	\$ 125,907	\$ -	\$ (225,860)
Net cash used in investing activities	(61,032)	(881)	10,323	-	(51,590)
Financing activities:					
Payments from (advances to) subsidiaries	(277,288)	359,280	(81,992)	-	-
Mortgage repurchase facility	-	-	(37,415)	-	(37,415)
Proceeds from issuance of senior notes	346,938	-	-	-	346,938
Proceeds from the exercise of stock options	5,118	-	-	-	5,118
Net cash provided by (used in) financing activities	74,768	359,280	(119,407)	-	314,641
Net increase in cash and cash equivalents	19,587	781	16,823	-	37,191
Cash and cash equivalents:					
Beginning of period	125,904	3,308	30,883	-	160,095
End of period	\$ 145,491	\$ 4,089	\$ 47,706	\$ -	\$ 197,286

	Nine Months Ended September 30, 2012				
	MDC	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
	(Dollars in thousands)				
Net cash provided by (used in) operating activities	\$(7,485)	\$(37,887)	\$(5,083)	\$ -	\$(50,455)

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Net cash used in investing activities	(8,106)	(719)	1,756	-	(7,069)
Financing activities:					
Payments from (advances to) subsidiaries	(46,154)	39,310	6,844	-	-
Mortgage repurchase facility	-	-	(1,814)	-	(1,814)
Proceeds from the exercise of stock options	15,820	-	-	-	15,820
Dividend payments	(36,046)	-	-	-	(36,046)
Net cash provided by (used in) financing activities	(66,380)	39,310	5,030	-	(22,040)
Net increase (decrease) in cash and cash equivalents	(81,971)	704	1,703	-	(79,564)
Cash and cash equivalents:					
Beginning of period	313,566	2,771	27,024	-	343,361
End of period	\$231,595	\$ 3,475	\$ 28,727	\$ -	\$ 263,797

- 25 -

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, 2012 and this Quarterly Report on Form 10-Q.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2013	2012	2013	2012
	(Dollars in thousands, except per share amounts)			
Homebuilding:				
Home sale revenues	\$433,693	\$320,647	\$1,165,768	\$761,857
Land sale revenues	25	15	1,832	3,420
Total home and land sale revenues	433,718	320,662	1,167,600	765,277
Home cost of sales	(354,889)	(271,067)	(956,892)	(649,941)
Land cost of sales	(35)	(2)	(1,470)	(3,210)
Inventory impairments	(350)	-	(350)	-
Total cost of sales	(355,274)	(271,069)	(958,712)	(653,151)
Gross margin	78,444	49,593	208,888	112,126
Gross margin %	18.1 %	15.5 %	17.9 %	14.7 %
Selling, general and administrative expenses	(57,753)	(44,788)	(157,862)	(118,135)
Interest income	6,460	5,365	21,146	16,651
Interest expense	-	-	(1,726)	(808)
Other income (expense)	(488)	16	853	592
Homebuilding pretax income	26,663	10,186	71,299	10,426
Financial Services:				
Revenues	14,282	13,668	40,672	31,974
Expenses	(6,921)	(5,155)	(19,144)	(13,459)
Interest and other income	885	785	2,680	2,323
Financial services pretax income	8,246	9,298	24,208	20,838

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Income before income taxes	34,909	19,484	95,507	31,264
Benefit from income taxes	1,342	642	188,169	1,765
Net income	\$36,251	\$20,126	\$283,676	\$33,029
Earnings per share:				
Basic	\$0.73	\$0.41	\$5.76	\$0.69
Diluted	\$0.73	\$0.41	\$5.71	\$0.68
Weighted average common shares outstanding:				
Basic	48,492,588	47,761,307	48,438,154	47,499,429
Diluted	48,767,834	47,940,038	48,867,055	47,610,195
Dividends declared per share	\$-	\$0.25	\$-	\$0.75
Cash provided by (used in):				
Operating Activities	\$(79,617)	\$(34,865)	\$(225,860)	\$(50,455)
Investing Activities	\$37,421	\$(45,314)	\$(51,590)	\$(7,069)
Financing Activities	\$(9,936)	\$17,852	\$314,641	\$(22,040)

- 26 -

Overview

For the three and nine months ended September 30, 2013, our operating results improved year-over-year in nearly all operating metrics. However, the recent increase in mortgage interest rates from historically low levels, combined with the significant year-over-year home price increases, and the economic uncertainty created by the government shutdown, debt ceiling debates, and the potential for tapering of federal stimulus, have recently dampened near-term housing demand and may slow the rate of improvement and create volatility in the recovery of the homebuilding industry. We, however, continue to believe that a solid housing recovery is ongoing, supported by attractive affordability levels and a historically low inventory of available-for-sale housing. Similar to our 2013 second quarter, our homebuilding pretax income increased considerably for the three and nine months ended September 30, 2013, compared to the same periods in the prior year, due to strong growth in home sale revenues and an expansion of operating margins. Additionally, our financial services business also generated strong financial results for both periods as a result of increased origination volumes and strong margins.

For the 2013 third quarter, we reported net income of \$36.3 million, or \$0.73 per diluted share, compared to net income of \$20.1 million, or \$0.41 per diluted share for the year earlier period. The improvement in our performance was driven primarily by a 35% increase in home sale revenues, a 260 basis point improvement in our gross margin from homes sales and a 70 basis point reduction in our homebuilding selling, general and administrative (“SG&A”) expenses as a percentage of home sale revenues (“SG&A rate”). The combination of these factors led to a 200 basis point year-over-year improvement in our total pretax operating margin to 7.8%.

For the nine months ended September 30, 2013, we reported net income of \$283.7 million, or \$5.71 per diluted share, compared to net income of \$33.0 million, or \$0.68 per diluted share for the year earlier period. The improvement in our performance was driven primarily by the \$187.6 million reversal of our deferred tax asset valuation allowance in the 2013 second quarter, a 53% increase in home sale revenues, a 320 basis point improvement in our gross margin from homes sales, a 200 basis point reduction in our SG&A rate and a \$3.4 million increase in our financial services segment pretax income. The combination of these factors, excluding the deferred tax asset valuation allowance reversal, drove a 400 basis point year-over-year improvement in our total pretax operating margin to 7.9%.

During the 2013 third quarter, net new home orders decreased 8% year-over-year to 924 homes, driven largely by a 19% decrease in our average active communities, which was partially offset by a 14% improvement in our monthly absorption pace per active community. For the nine months ended September 30, 2013, our net new home orders increased 3% year-over-year to 3,575 homes, driven by a 31% improvement in our monthly absorption pace per active community that was mostly offset by a 21% decrease in our average active communities. During both periods, the Company actively managed the absorption pace of home orders through routine price increases in most active subdivisions, with a goal of creating an appropriate balance between gross margins and absorption pace. In addition to lower active community counts, home orders during the 2013 third quarter were adversely impacted by a significant increase in mortgage interest rates.

Our active community count as of September 30, 2013 decreased by 19% year-over-year, due in large part to an accelerated sell-out of many communities based on high homebuyer demand and various delays in opening new communities. However, our investment in new homebuilding projects over the past year, including 2,117 lots purchased in 55 communities during the 2013 third quarter and 6,652 lots in 139 communities for the first nine months of 2013, has helped to increase our total supply of lots owned and under option to over 15,800 at September 30, 2013, an increase of 52% year-over-year. We believe that this increase in acquisition activity, combined with the lots acquired in the second half of 2012, will help drive growth in our active community count in future periods. See “**Forward-Looking Statements**” below.

Our financial position remained strong at the end of the quarter, as evidenced by our total cash and marketable securities of \$797.5 million, which increased by \$85.5 million since the start of the year. The increase was driven by the issuance of \$350 million of 30-year 6% senior unsecured notes due 2043 during the first half of 2013, partially offset by investments made in new homebuilding inventories. 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.

*Homebuilding**Pretax Income*

	Three Months Ended				Nine Months Ended			
	September 30,		Change		September 30,		Change	
	2013	2012	Amount	%	2013	2012	Amount	%
(Dollars in thousands)								
Homebuilding pretax income (loss):								
West	\$19,539	\$8,334	\$11,205	134%	\$46,929	\$11,178	\$35,751	320%
Mountain	12,203	6,951	5,252	76%	39,341	13,746	25,595	186%
East	6,657	4,907	1,750	36%	12,708	7,143	5,565	78%
Corporate	(11,736)	(10,006)	(1,730)	17%	(27,679)	(21,641)	(6,038)	28%
Total homebuilding pretax income	\$26,663	\$10,186	\$16,477	162%	\$71,299	\$10,426	\$60,873	584%

The \$16.5 million improvement in our homebuilding financial performance for the 2013 third quarter was driven primarily by a 35% increase in home sale revenues, a 260 basis point improvement in our gross margin from home sales and a 70 basis point reduction in our SG&A rate. The \$60.9 million improvement in our homebuilding financial performance for the nine months ended September 30, 2013 was primarily the result of a 53% increase in home sale revenues, a 320 basis point improvement in our gross margin from home sales and a 200 basis point reduction in our SG&A rate.

Each of our homebuilding reportable segments showed substantial improvements in pretax income for both the three and nine months ended September 30, 2013 as compared with the same periods in 2012, benefiting from significant increases in home sale revenues and gross margins from home sales. Also, excluding a \$2.5 million legal recovery in the first quarter of 2012 for our East segment, our SG&A rates for all homebuilding segments in both periods presented showed strong improvements. Our pretax loss for our non-operating Corporate reportable segment increased by \$1.7 million and \$6.0 million for the three and nine months ended September 30, 2013, respectively, driven primarily by increases in our general and administrative expenses related to our accrual for higher incentive-based compensation and higher legal expenses, which was partially offset by reduced stock-based compensation expense.

Assets

	September 30, 2013	December 31, 2012	Change	
			Amount	%
(Dollars in thousands)				
Homebuilding assets:				
West	\$694,591	\$459,807	\$234,784	51%
Mountain	403,711	332,939	70,772	21%
East	309,678	274,199	35,479	13%
Corporate	967,546	692,500	275,046	40%
Total homebuilding assets	\$2,375,526	\$1,759,445	\$616,081	35%

Homebuilding assets in all of our reportable segments, most notably our West segment, increased considerably from December 31, 2012 to September 30, 2013, as higher construction and land acquisition activity drove an increase in our inventory balances. Homebuilding assets in our Corporate segment increased \$275.0 million from December 31, 2012 to September 30, 2013, primarily due to an increase in our deferred tax asset after the \$187.6 million reversal of our deferred tax asset valuation allowance in the 2013 second quarter. The remainder of the increase in our Corporate segment is primarily due to cash flows from our issuance of \$350 million of 30-year 6% senior unsecured notes, offset by significant investments in homebuilding inventories.

Revenues

	Three Months Ended				Nine Months Ended			
	September 30,		Change		September 30,		Change	
	2013	2012	Amount	%	2013	2012	Amount	%
	(Dollars in thousands)							
Home and land sale revenues								
West	\$188,456	\$148,037	\$40,419	27%	\$487,949	\$335,002	\$152,947	46%
Mountain	134,992	96,335	38,657	40%	402,137	236,625	165,512	70%
East	110,270	76,290	33,980	45%	277,514	193,650	83,864	43%
Total home and land sale revenues	\$433,718	\$320,662	\$113,056	35%	\$1,167,600	\$765,277	\$402,323	53%

The increases in home and land sale revenues for both the three and nine month periods ended September 30, 2013 were driven primarily by 21% and 37% increases in new home deliveries, respectively, and 12% and 11% increases in average selling price, respectively.

New Home Deliveries:

	Three Months Ended September 30,			2012			% Change			
	2013		Average	2012		Average	% Change	Homes	Dollar Value	Average Price
	Homes	Dollar Value		Homes	Dollar Value					
	(Dollars in thousands)									
Arizona	173	\$42,029	\$242.9	203	\$44,877	\$221.1	(15)%	(6)%	10%	
California	156	57,852	370.8	131	46,580	355.6	19%	24%	4%	
Nevada	187	53,017	283.5	178	37,679	211.7	5%	41%	34%	
Washington	110	35,558	323.3	63	18,894	299.9	75%	88%	8%	
West	626	188,456	301.0	575	148,030	257.4	9%	27%	17%	
Colorado	320	120,402	376.3	229	81,706	356.8	40%	47%	5%	
Utah	45	14,565	323.7	53	14,632	276.1	(15)%	(0)%	17%	
Mountain	365	134,967	369.8	282	96,338	341.6	29%	40%	8%	
Maryland	100	43,574	435.7	65	29,382	452.0	54%	48%	(4)%	

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Virginia	90	46,866	520.7	67	34,069	508.5	34 %	38%	2 %
Florida	76	19,830	260.9	50	12,828	256.6	52 %	55%	2 %
East	266	110,270	414.5	182	76,279	419.1	46 %	45%	(1)%
Total	1,257	\$433,693	\$ 345.0	1,039	\$320,647	\$ 308.6	21 %	35%	12 %

- 29 -

New Home Deliveries:

	Nine Months Ended September 30,						% Change					
	2013			2012			Homes		Dollar		Average	
	Homes	Dollar Value	Average Price	Homes	Dollar Value	Average Price	Homes	Dollar Value	Average Price	Homes	Dollar Value	Average Price
	(Dollars in thousands)											
Arizona	443	\$ 105,662	\$ 238.5	418	\$ 89,920	\$ 215.1	6 %	18 %	11 %			
California	469	168,640	359.6	319	107,768	337.8	47 %	56 %	6 %			
Nevada	481	127,611	265.3	439	87,735	199.9	10 %	45 %	33 %			
Washington	269	86,034	319.8	166	48,060	289.5	62 %	79 %	10 %			
West	1,662	487,947	293.6	1,342	333,483	248.5	24 %	46 %	18 %			
Colorado	933	347,211	372.1	539	192,923	357.9	73 %	80 %	4 %			
Utah	171	53,097	310.5	151	41,874	277.3	13 %	27 %	12 %			
Mountain	1,104	400,308	362.6	690	234,797	340.3	60 %	70 %	7 %			
Maryland	237	100,685	424.8	156	67,953	435.6	52 %	48 %	-2 %			
Virginia	248	123,335	497.3	196	92,395	471.4	27 %	33 %	5 %			
Florida	207	53,493	258.4	133	32,678	245.7	56 %	64 %	5 %			
Illinois	-	-	-	2	551	275.5	N/M	N/M	N/M			
East	692	277,513	401.0	487	193,577	397.5	42 %	43 %	1 %			
Total	3,458	\$ 1,165,768	\$ 337.1	2,519	\$ 761,857	\$ 302.4	37 %	53 %	11 %			

N/M- Not meaningful

The increase in the dollar value of new home deliveries for the three and nine months ended September 30, 2013 was primarily attributable to an increase of 19% and 76%, respectively, in the dollar value of homes in backlog to start those periods as compared to the prior year resulting from improved housing demand over the prior several quarters. Excluding our Arizona and Utah markets for the 2013 third quarter, all markets in which we operate showed year-over-year improvements in the dollar value of new home deliveries for both periods presented. Decreases in our Arizona and Utah markets for the 2013 third quarter resulted largely from lower average active community counts in these divisions during the first half of 2013, which drove year-over-year reductions in the dollar value of homes in backlog to start the quarter.

The year-over-year increases in our average selling price for the three and nine month periods ended September 30, 2013 were primarily driven by price increases instituted at most of our communities throughout our operations over the past 18 months combined with a decrease in incentives due to improved homebuyer demand.

Gross Margin

Gross margin from home sales for the 2013 third quarter was 18.1% versus 15.5% for the year earlier period and 18.1% for the second quarter 2013. Year to date through September 30, 2013, our gross margin from home sales was up 320 basis points to 17.9% versus 14.7% for the year earlier period. The increase in our gross margin percentage for the quarter and year to date period ended September 30, 2013, when compared to the year earlier period, was primarily due to increased prices, resulting from high homebuyer demand due to low inventory supply levels, and reduced incentives in many of our markets, particularly in Arizona, Nevada, California and Colorado.

Excluding inventory impairments, warranty accrual adjustments and interest in cost of sales, our adjusted gross margin percentage from home sales for the three months ended September 30, 2013 was 21.8%, compared to 18.2% for the same period in 2012 and 21.3% for the 2013 second quarter. The adjusted gross margin percentage from home sales for the nine months ended September 30, 2013 was 21.3%, compared to 17.5% for the same period in 2012. The table set forth on the following page 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, which is a non-GAAP measure.

	Three Months Ended September 30,				Nine Months Ended September 30,			
	<i>Gross</i>		<i>Gross</i>		<i>Gross</i>		<i>Gross</i>	
	2013	Margin	2012	Margin	2013	Margin	2012	Margin
		%		%		%		%
	(Dollars in thousands)							
Gross Margin	\$78,444	18.1%	\$49,593	15.5%	\$208,888	17.9%	\$112,126	14.7%
Less: Land Sales Revenue	(25)		(15)		(1,832)		(3,420)	
Add: Land Cost of Sales	35		2		1,470		3,210	
Gross Margin from Home Sales	\$78,454	18.1%	\$49,580	15.5%	\$208,526	17.9%	\$111,916	14.7%
Add: Inventory Impairments	350		-		350		-	
Add: Interest in Cost of Sales	15,567		8,655		38,121		20,654	
Add: Warranty Adjustments	-		-		300		-	
Adjusted Gross Margin from Home Sales (1)	\$94,371	21.8%	\$58,235	18.2%	\$247,297	21.2%	\$132,570	17.4%

(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 was used by us in 2012 as one financial metric criteria for performance-based stock options awarded to certain executive officers.

Inventory Impairments

We recognized \$0.4 million in impairments for the three and nine months ended September 30, 2013. We did not recognize any impairments for the three and nine months ended September 30, 2012.

The following table shows the number of subdivisions and carrying value of the inventory we tested for impairment during the first three quarters of 2013 and 2012.

Three Months Ended	Total Carrying Value of Inventory Tested for Impairment During	Carrying Value of Impaired Inventory	Inventory Impairments	Fair Value of Inventory After	Number of Subdivisions Impaired During the Quarter	Number of Lots Impaired

Selling, General and Administrative Expenses

Our SG&A rate decreased 70 basis points from 14.0% in the 2012 third quarter to 13.3% in the 2013 third quarter. For the nine months ended September 30, 2013, our SG&A rate decreased 200 basis points from 15.5% in 2012 to 13.5%. The decrease in our SG&A rate for both 2013 periods was primarily driven by improved operating leverage that resulted from higher revenues for both periods. The impact of the improved SG&A rates was partially offset by various legal recoveries generated during the three and nine month periods ended September 30, 2012 (discussed below), that did not recur for the same periods in 2013, and certain additional 2013 legal expense accruals discussed below.

For the 2013 third quarter, our SG&A expenses were \$57.8 million, compared to \$44.8 million for the 2012 third quarter. For the nine months ended September 30, 2013, our SG&A expenses were \$157.9 million, compared to \$118.1 million for the same period in 2012. The increases in SG&A expenses for both the three and nine month periods were largely attributable to higher incentive-based compensation expense, due to increased profitability, higher commissions expense resulting from increased sales volume, and increased headcount due to our recent growth. In addition, the three and nine months ended September 30, 2012 benefited from significant legal recoveries totaling \$2.2 million and \$9.8 million, respectively, whereas the comparable 2013 periods did not benefit from any significant legal recoveries and, in fact, included additional legal expense accruals for certain matters in the normal course of business that totaled \$1.2 million and \$3.7 million, respectively. These increases to our 2013 SG&A expenses were slightly offset by lower stock-based compensation expense related to our performance-based non-qualified stock options as expense related to these options was only recorded during the first two months of 2013 versus the entire second and third quarters of 2012.

*Other Homebuilding Operating Data***Net New Orders**

	Three Months Ended September 30,								% Change						
	2013		2012		2013		2012		2013		2012				
Homes	Dollar Value	Average Price	Monthly Absorption Rate *	Homes	Dollar Value	Average Price	Monthly Absorption Rate *	Homes	Dollar Value	Average Price	Monthly Absorption Rate *	Homes	Dollar Value	Average Price	Monthly Absorption Rate *
(Dollars in thousands)															
Arizona	185	\$49,009	\$264.9	3.11	136	\$30,441	\$223.8	2.96	36 %	61 %	18 %	5 %			
California	91	37,654	413.8	2.81	173	56,507	326.6	3.15	(47)%	(33)%	27 %	(11)%			
Nevada	119	39,276	330.1	2.87	131	30,944	236.2	2.50	(9)%	27 %	40 %	15 %			
Washington	75	24,596	327.9	2.17	71	21,998	309.8	2.06	6 %	12 %	6 %	5 %			
West	470	150,535	320.3	2.81	511	139,890	273.8	2.73	(8)%	8 %	17 %	3 %			

Edgar Filing: MDC HOLDINGS INC - Form 10-Q

Colorado	251	101,385	403.9	2.23	251	84,575	337.0	1.81	0 %	20 %	20 %	23 %
Utah	28	8,481	302.9	2.17	66	20,220	306.4	1.33	(58)%	(58)%	(1)%	63 %
Mountain	279	109,866	393.8	2.22	317	104,795	330.6	1.68	(12)%	5 %	19 %	32 %
Maryland	50	23,459	469.2	0.94	39	18,031	462.3	0.72	28 %	30 %	1 %	31 %
Virginia	48	22,262	463.8	1.55	88							