AVATAR HOLDINGS INC
Form 10-K
March 16, 2010

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2009

OR

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

Commission File Number 0-7616

AVATAR HOLDINGS INC.
(Exact name of registrant as specified in its charter)

Delaware	**23-1739078**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
201 Alhambra Circle, Coral Gables, Florida	**33134**
(Address of principal executive offices)	*(Zip code)*

Registrant s telephone number, including area code (305) 442-7000

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

Title of each class	Name of each exchange on which registered
Common Stock, $1.00 Par Value	**The NASDAQ Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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 þ No o

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 o No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a 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. (Check one):

Large accelerated filer: o Accelerated filer: þ Non-accelerated filer: o

Smaller reporting company: o

(Do not check if a 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 o No þ

Aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was $113,972,270 as of June 30, 2009.

As of March 12, 2010, there were 11,355,451 shares of common stock, $1.00 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for its 2010 Annual Meeting of Stockholders are incorporated by reference into Part III.

AVATAR HOLDINGS INC.
2009 FORM 10-K ANNUAL REPORT
TABLE OF CONTENTS
TABLE OF CONTENTS

Table of Contents

FORWARD-LOOKING STATEMENTS

Certain statements discussed in Item 1 (Business), Item 3 (Legal Proceedings), Item 7 (Management s Discussion and Analysis of Financial Condition and Results of Operations), and elsewhere in this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements of results to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks, uncertainties and other important factors include, among others: the stability of certain financial markets; disruption of the credit markets and reduced availability and more stringent financing requirements for commercial and residential mortgages of all types; the number of investor and speculator resale homes for sale and homes in foreclosure in our communities and in the geographic areas in which we develop and sell homes; the increased level of unemployment; the decline in net worth and/or of income of potential buyers; the decline in consumer confidence; the failure to successfully implement our business strategy; shifts in demographic trends affecting demand for active adult and primary housing; the level of immigration and migration into the areas in which we conduct real estate activities; our access to financing; construction defect and home warranty claims; changes in, or the failure or inability to comply with, government regulations; and other factors as are described in Item 1A (Risk Factors) of this Form 10-K. At least 80% of active adult homes are intended for occupancy by at least one person 55 years or older.

Dollar amounts specified herein are in thousands, except per share amounts or as otherwise indicated.

PART I

Item 1. Business

General

Avatar Holdings Inc. was incorporated in the state of Delaware in 1970. Our principal executive offices are located at 201 Alhambra Circle, Coral Gables, Florida 33134 (telephone (305) 442-7000).

We are engaged in the business of real estate operations in Florida and Arizona. Our residential community development activities have been adversely affected in both markets, bringing development in our active adult and primary residential communities to a low level. We also engage in other real estate activities, such as the operation of amenities, the sale for third-party development of commercial and industrial land and the operation of a title insurance agency, which activities have also been adversely affected by economic conditions.

Table of Contents

Item 1. Business continued

Business Strategy

Our primary business strategy continues to be the development of lifestyle communities, including active adult and primary residential communities, as well as the development and construction of housing on scattered lots. However, due to the significant deterioration in the economy and the residential real estate business, we have increased our focus on maintaining the integrity of our balance sheet through preservation of capital, sustaining liquidity and reduction of overhead. Our development activities have been and will continue to be minimal as we work through the negative impacts on the homebuilding industry. We continue to evaluate the economic feasibility of other real estate activities or unrelated businesses. While our homebuilding operations are at a low level, our business remains capital intensive and requires or may require expenditures for land and infrastructure development, housing construction, funding of operating deficits and working capital, as well as potential new acquisition and development opportunities.

Recent Business Developments

We remain focused on maintaining sufficient liquidity. It is our intention to continue to monetize our inventory of unsold homes and many of our model homes in anticipation of introducing new homes and models. We expect that these new products will include smaller and less amenitized houses to enable us to sell homes at lower price points when the market recovers.

We have continued to defer the introduction of new housing products or recommencing development activities in most of our existing communities until such times as we believe that our markets would enable us to construct and sell new houses at an acceptable profit. However, we have recommenced construction in Solivita and Solivita West on a limited basis and we are analyzing new product models.

We continue to focus on acquiring real estate or real estate related assets as the fallout from the deleveraging of the economy continues to adversely affect real estate values. We have evaluated a substantial number of residential real estate properties in Florida and Arizona which we believe could represent opportunities to acquire real estate, or debt secured by real estate, at a substantial discount to its intrinsic value. On September 24, 2009, we acquired 87 completed and partially completed homes, 267 developed lots, 364 partially developed lots and approximately 400 undeveloped master planned lots in a residential community located at Seasons at Tradition in St. Lucie County, Florida. The purchase price was approximately $7,450. In addition, on December 3, 2009, we acquired 86 developed lots located at Estancias del Corazon, in Pima County, Arizona. The purchase price was approximately $3,725.

We have an experienced residential real estate development group which is able to expeditiously underwrite portfolios of residential real estate ranging from large undeveloped/unentitled parcels of land to finished lots, and acquire these properties or the debt secured by these properties from financial institutions or others. We believe our cash position and our ability to plan, permit, develop and sell land, as well as to design, permit and build highly amenitized residential communities enable us to have a competitive advantage in buying such properties over financial buyers and developers not having extensive experience in Florida or Arizona. However, we compete for opportunities to acquire real estate or real estate related assets and there can be no assurance that we will identify and be able to acquire such assets or that any such assets we were to acquire would result in a desirable return on our investment.

Table of Contents

Item 1. Business continued

Recent Business Developments continued

On December 11, 2009, Frenchman s Yacht Club Developers, LLC (Frenchman s), a Florida limited liability company in which our wholly-owned subsidiary, Avatar Properties Inc. (Properties), is the sole member, sold its interest in the proposed development known as Frenchman s Yacht Club to an unrelated third party for cash and a purchase money note of $4,208. The amount of cash we received did not meet the criteria in authoritative accounting guidance to record this sale under the full accrual method of profit recognition. As a result, this transaction is accounted for under the cost recovery method. Under the cost recovery method, no profit is recognized until cash payments by the buyer, including principal and interest on the purchase money note due to us, exceeds the cost of the property sold. In the Frenchman s transaction, since we sold the property at a loss, in accordance with authoritative accounting guidance we recognized the loss of approximately $3,800 in full. The note receivable was discounted by $1,291 to the fair value for purposes of measuring the loss on this transaction. Additionally, future interest cash receipts will be recorded as deferred income, and presented as a reduction to the note receivable until such time that the cumulative cash payments by the buyer exceed Avatar s book value in the property at the time of sale.

On December 21, 2009, Properties entered into three separate agreements with unrelated third parties providing for the formation of three separate limited liability companies (LLCs). Banyan Bay Development Corporation, a wholly owned subsidiary of Properties, sold partially developed lots and unplatted land to one of the LLCs for cash and a purchase money note. Properties also entered into a land option contract with the LLC for certain of the Banyan Bay land. Properties sold its partially developed but unplatted lots in Cory Lake Isles to another of the LLCs for cash. Properties sold its Terralargo club facilities, developed and undeveloped platted lots and undeveloped land to the third LLC for cash and a purchase money note. Properties also entered into a land option contract with the LLC for certain of the Terralargo land. Properties acquired a minority equity interest in each of the LLCs and participates in the management of each of the LLCs. The land option contracts provide us the right, but not the obligation, to acquire a specified number of developed lots at agreed upon prices.

In accordance with authoritative accounting guidance, we determined that these LLC s qualify as variable interest entities (VIEs) which requires consolidation by the entity determined to be the primary beneficiary. The primary beneficiary is the party determined to absorb the majority of the VIE s expected losses, receives a majority of the VIE s expected residual returns, or both. As a result of our analyses, we determined Avatar holds a variable interest in the VIEs through the purchase money notes, the land option contracts and an economic interest in these LLCs. Based on our analysis, we determined that we are the primary beneficiary of the LLCs related to the Banyan bay and Terralargo transactions. As a result, for financial reporting purposes, these transactions were not sales and therefore the assets remain in our financial statements. Avatar recorded an impairment charge of approximately $11,919 for the year ended December 31, 2009 related to the inventory of these properties.

During 2009, we filed a shelf registration statement on Form S-3 for $500,000 of debt and equity securities, which was supplemented in September 2009 by a supplemental prospectus for a public offering of shares of our Common Stock, underwritten by Barclays Capital Inc. (the Underwriter). We agreed to sell to the Underwriter 2,250,000 shares of our Common Stock, which were offered to the public at a price of $18.00 per share and discounted to the Underwriter to a price of $17.10 per share. The Underwriter was granted an over-allotment option to purchase up to an additional 337,500 shares of Common Stock, at the same offering price to the public and subject to the same underwriting discount. The closing on the sale of the 2,250,000 shares of Common Stock occurred on September 28, 2009. Net proceeds to us before expenses were $38,475. On October 6, 2009, we closed on the sale of an additional 264,391 shares of our Common Stock pursuant to the Underwriter s partial exercise of its option to purchase additional shares, which option expired on October 23, 2009. Net proceeds of the partial exercise of the option were $4,521, resulting in total net proceeds of the offering, after approximately $700 of offering expenses, of approximately $42,296. We intend to use the proceeds from the sale for general corporate purposes, including, without limitation, potential acquisitions of real estate and real estate-related assets.

Table of Contents

Item 1. Business continued

Real Estate Operations

We are engaged in real estate operations as summarized below. For further information please see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Active Adult Community Development

Within the Central Florida master-planned community of Poinciana we have developed the highly-amenitized active adult communities of Solivita and Solivita West. Solivita and Solivita West incorporate the natural topography of the land, including more than 1,200 acres of wetlands and an oak hammock. These communities currently include approximately 126,000 square feet of recreation facilities, as well as two 18-hole golf courses and an active park housing a variety of sporting and games facilities.

We have continued to defer the introduction of new housing products or recommencing development activities in most of our existing communities until such times as we believe that our markets would enable us to construct and sell new houses at an acceptable profit. However, we have commenced construction in Solivita and Solivita West on a limited basis and we are analyzing new product models.

On September 24, 2009, we acquired 87 completed and partially completed homes, 267 developed lots, 364 partially developed lots and approximately 400 undeveloped master planned lots in an active adult community named Seasons at Tradition located in St. Lucie County, Florida. We are actively marketing the sale of the inventory homes in Seasons.

Information relating to our backlog is incorporated herein by reference to Item 7 of Part II of this Report under the heading Results of Operations.

Primary Residential Community Development

We continue to defer the introduction of new housing products or recommencing development activities in our primary communities, both on scattered lots and on contiguous parcels as part of planned communities, in Florida and southeast Arizona, until such times as we believe that our markets would enable us to construct and sell new houses at an acceptable profit. On December 3, 2009, we acquired 86 developed lots located at Estancias del Corazon, in Pima County, Arizona.

Information relating to our backlog is incorporated herein by reference to Item 7 of Part II of this Report under the heading Results of Operations.

Poinciana Parkway and Toll Road

In December 2006, we entered into agreements with Osceola County, Florida and Polk County, Florida for us to develop and construct at our cost a 9.66 mile four-lane road in Osceola and Polk Counties, to be known as the Poinciana Parkway (the Poinciana Parkway). The Poinciana Parkway is to include a 4.15 mile segment to be operated as a toll road. We have acquired right-of-way and federal and state environmental permits necessary to construct the Poinciana Parkway. In July 2008 and August 2008, we entered into amended and restated agreements with Osceola County and Polk County, pursuant to which construction is to be commenced by February 14, 2011. Construction was to be completed by December 31, 2011 subject to extension for Force Majeure. We have notified the Counties that the completion date has been extended to October 14, 2013 due to Force Majeure related to the economic downturn. We advised the Counties that the current economic downturn has resulted in our inability to: (i) conclude negotiations with potential investors; or (ii) obtain financing for the construction of the Poinciana Parkway.

Table of Contents

Item 1. Business   continued

Real Estate Operations   continued

If funding for the Poinciana Parkway is not obtained so that construction of the Poinciana Parkway can be commenced by February 14, 2011 as required by our agreements with Osceola County and Polk County, the Counties have no right to obtain damages or sue Avatar for specific performance. Polk County s sole remedy under its agreement with Avatar is to cancel such agreement if Avatar does not construct the Poinciana Parkway. If the construction of the Parkway is not funded and commenced by February 14, 2011, (i) a portion of Avatar s land in Osceola County will become subject to Osceola traffic concurrency requirements applicable generally to other home builders in the County and (ii) Avatar will be required to contribute approximately $1,900 towards the construction cost of certain traffic improvements in Osceola County that it otherwise might have been obligated to build or fund if it had not agreed to construct the Poinciana Parkway. Avatar is investigating the availability of an extension of the Poinciana Parkway permits and the related deadlines in its agreements with the Counties.

Osceola County and Avatar were unsuccessful in their attempt to obtain a federal grant for construction of the Parkway. Osceola County and Avatar are still attempting to obtain other federal funds for development of the Poinciana Parkway, including tax appropriation and a federal loan. We cannot predict whether any federal funds will be available.

For the Poinciana Parkway, indicators of impairment are general economic conditions, rate of population growth and estimated change in traffic levels. If indicators are present, we perform an impairment test in which the asset is reviewed for impairment by comparing the estimated future undiscounted cash flows to be generated by the asset to its carrying value. If such cash flows are less than the asset s carrying value, the carrying value is written down to its estimated fair value. In determining estimated future cash flows for purposes of the impairment test, we incorporate current market assumptions based on general economic conditions such as anticipated estimated revenues and estimated costs. These assumptions can significantly affect our estimates of future cash flows.

Our estimate of the right-of-way acquisition, development and construction costs for the Poinciana Parkway approximates $175,000 to $200,000. However, no assurance of the ultimate costs can be given at this stage. As of December 31, 2009, approximately $47,000 has been expended. During fiscal year 2008, we recorded impairment charges of $30,228, associated with the Poinciana Parkway.

We review the recoverability of the carrying value of the Poinciana Parkway on a quarterly basis in accordance with authoritative accounting guidance. Based on our reviews during 2009, we determined the estimated future undiscounted cash flows of the Poinciana Parkway were less than its carrying value. During 2009, we recognized impairment losses of $8,108. At December 31, 2009, the carrying value of the Poinciana Parkway is $8,482. In addition, non-capitalizable expenditures of $341 related to the Poinciana Parkway were expensed during 2009.

Commercial and Industrial

We may generate revenues through the sale of commercial and industrial land for third-party development, primarily in Poinciana. Demand for, and values of, commercial, industrial and other land has decreased significantly since 2008.

Real Estate Assets

Our assets consist primarily of real estate in the states of Florida and Arizona. As of December 31, 2009, we own more than 16,000 acres and have a minority ownership interest in an additional 830 acres of developed, partially developed or developable residential, commercial and industrial property. Avatar is required to consolidate these LLCs in accordance with authoritative accounting guidance. Some portion of these acres may be developed as roads, retention ponds, parks, school sites, community amenities or for other similar uses.

Table of Contents

Item 1. Business continued

Real Estate Assets continued

Within Florida and Arizona we also own more than 15,000 acres of preserves, wetlands, open space and other areas that at this time are not developable, permitable and/or economically feasible to develop, but may at some future date have an economic value for preservation or conservation purposes.

For further description of the various communities and the operations conducted therein, please see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Following is a breakdown of our land holdings (not including our housing inventory) as of December 31, 2009 (dollars in thousands):

			Estimated Planned Lots/Units (1)			
Acquisition Date	Contract Date	Developed	Partially Developed	Raw (2)	Total	Book Value
Residential						
Osceola County, Florida						
Pre-1980		200		2,200	2,400	$ 5,199
1999-2001		500	700		1,200	45,198
2003	2002-2003			1,000	1,000	7,880
2004	2002-2003			1,400	1,400	19,307
2006	2002-2003			1,600	1,600	19,256
Total Osceola County		700	700	6,200	7,600	96,840
Polk County, Florida						
Pre-1980		900	1,000	2,400	4,300	20,002
2003	2002-2003	900		100	1,000	32,670
2004	2002-2003			2,500	2,500	19,966
Total Polk County		1,800	1,000	5,000	7,800	72,638
St. Lucie County, Florida						
2009	2009	267	364	400	1,031	2,020
Hernando County, Florida						
2004-2005	2003		5		5	30
Collier County, Florida						
Pre-1980		50			50	191
Highlands County, Florida						
Pre-1980		40		40	80	102
Santa Cruz County,(Rio Rico), Arizona						
Pre-1980		600	300	3,700	4,600	10,630
Pima County, Arizona						
2009	2009	86			86	3,725
Total Residential		3,543	$ 2,369	15,340	21,252	$ 186,176

***Consolidated LLCs* (4)**						
Polk County, Florida						
2005	2004	200	300	500	$	1,774
Martin County, Florida						
1981-1987		75	200	275		1,666
Total Consolidated LLCs		275	500	775	$	3,440

Table of Contents

Item 1. Business continued
Real Estate Assets continued

	Acquisition Date	Contract Date	Estimated Acres	Book Value
Commercial/Industrial/Institutional				
Florida				
	Pre-1980		1,300	$ 7,105
	2004 (3)	2004	300	14,765
	2005 (3)	2004	400	15,620
Total Florida			2,000	37,490
Arizona				
	Pre-1980		200	267
Total Commercial/Industrial/Institutional			2,200	$ 37,757
Other				
Preserves, wetlands, open space				
	Pre-1980			$ 3,176
Other				4,847
Total Other				$ 8,023

(1) Estimated planned lots/units are based on historical densities for our land. New projects may ultimately be developed into more or less than the number of lots/units stated.

(2) We anticipate that with respect to our inventory of undeveloped land, new lots developed over the next several years are likely to be developed at greater density per acre than the density per acre we have undertaken over the past several years. We anticipate evolving market demand for smaller and/or more affordable homes. Accordingly, the number of lots we ultimately develop per acre from our inventory of raw land may exceed the units set forth

in this schedule.

(3) During the 4th quarter 2008, our plans for this property changed from developing it as single family housing to permitting as commercial/industrial/institutional land.

(4) These landholdings were sold during 2009 to two newly formed LLCs in which we own a minority interest. These LLCs are consolidated for accounting purposes. As a result, the transactions did not qualify as sales for financial reporting purposes.

Title Insurance Agency

Prominent Title Insurance Agency, Inc., a subsidiary of Avatar Properties Inc., maintains operations in Poinciana, Florida. Services are offered to purchasers of homes from Avatar as well as unrelated parties. Due to the substantial reduction in real estate transactions, our title insurance agency operations in 2009 experienced a substantial decline in revenues.

Table of Contents

Item 1. Business continued

Business Segment Information

Our business segment information regarding revenues, results of operations and assets is incorporated herein by reference to Note P to the Consolidated Financial Statements included in Item 8 of Part II of this Report.

Employees

As of December 31, 2009, we employed approximately 233 individuals (almost half of whom are support staff for amenity operations and maintenance) on a full-time or part-time basis compared to 585 individuals as of December 31, 2005. Relations with our employees are satisfactory and there have been no work stoppages.

Investor Information

We are subject to the informational requirements of the Securities Exchange Act of 1934 (the Exchange Act). Accordingly, we file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the SEC). You may read and copy materials that we have filed with the SEC at the Public Reference Room of the SEC at 100 F Street, NE, Washington, D.C. 20549 or by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding issuers that file electronically.

You can access financial and other information on our website, at www.avatarholdings.com. The information on or accessible through our website is not incorporated by reference in this Form 10-K. We make available, free of charge, copies of our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after filing such material electronically or otherwise with the SEC. You may download this information from our website or may request us to mail specific information to you. Information regarding equity transactions by our directors, officers and 10% holders may also be obtained on our website.

Regulation

Our business is subject to extensive federal, state and local statutes, ordinances and regulations that affect every aspect of our business such as environmental, hazardous waste and land use requirements and can result in substantial expense to the company.

Competition

Our residential homebuilding, planned community development and other real estate operations are subject to significant competition from distressed sellers. We currently compete with foreclosure sales as well as resales by investors, speculators, foreclosing lenders and residents in our communities. For the sales of new housing units, we compete, as to price and product, with several national and regional homebuilding companies.

Table of Contents

Item 1A. Risk Factors

In addition to risks and uncertainties in the ordinary course of business that are common to all businesses, important factors that are specific to our industry and our company could materially impact our future performance and results. We have provided below a list of these risk factors. These are not all of the risks that we face, and other factors, including those currently considered immaterial or unknown to us, may impact our future operations.

The economic downturn we have been experiencing may continue for an extended period, has created greater uncertainty in our ability to forecast our business needs, and has adversely affected our business and results of operations compared to prior periods

Since 2008, the market for homes in the geographic areas in which our developments are located have been severely and negatively impacted. Unemployment has increased significantly and consumer confidence has continued to erode. In the geographic areas in which we conduct our real estate operations, there has been a significant increase in the number of homes for sale or available for purchase or rent through foreclosures or otherwise. The price points at which these homes are available have put downward pressure on our margins.

Since the fourth quarter of 2008, most of our sales contracts have been signed at selling prices that have resulted or will result in financial losses upon closing when factoring in operating costs such as sales and marketing and divisional overhead. During 2009 and 2008, we recorded impairment charges of $1,820 and $5,168, respectively, for housing communities relating to homes completed or under construction.

Our industry is highly cyclical and is affected by general economic conditions and other factors beyond our control

The real estate industry is highly cyclical and is affected by changes in national, global and local economic conditions and events, such as employment and income levels, availability of financing, interest rates, consumer confidence and demand. We are subject to various risks, many of which are outside our control, including real estate market conditions (both where our communities and homebuilding operations are located and in areas where potential customers reside), changing demographic conditions, adverse weather conditions and natural disasters, such as hurricanes, tornadoes and wildfires, delays in construction schedules, cost overruns, changes in government regulations or requirements, and increases in real estate taxes and other local government fees. We are in the midst of a severe downturn in the real estate market. The market for new single-family and multi-family residences has been weak for some time and continues to be weak.

The current economic environment has increased our deficit funding obligations for club and homeowner association obligations

Because we fund homeowners association operating deficits and we operate our club amenities, defaults in payments of club dues and homeowner association assessments by home owners have caused us to expend additional available cash to maintain the homeowner association and club operations at their current levels. Further, due to lower than anticipated sales of homes in certain of our master planned communities, our obligations to fund our club and homeowner association operating deficits are greater than projected as there are fewer new home sales in these communities to absorb these obligations.

Table of Contents

Item 1A. Risk Factors (dollars in thousands except share and per share data) continued

A further decline in real estate values could result in additional impairment write-downs

A further decline in the real estate market could result in future impairments (as defined by FASB authoritative accounting guidance) to certain of our land and other inventories and of our investments in unconsolidated entities. The value of our land and other inventory and land owned by unconsolidated entities depends on market conditions, including estimates of future demand for, and the revenues that can be generated from, such inventory. The downturn in the real estate market has caused the fair value of certain of our inventory to fall below its carrying value. Because of our assessments of fair value, we have written down the carrying value of certain of our inventory, and take corresponding non-cash charges against our earnings to reflect the impaired value. If the current downturn in the real estate market continues, we may need to take additional charges against our earnings for inventory impairments and/or a write-down of our investments in unconsolidated entities and our other assets. Any such non-cash charges could have an adverse effect on our consolidated results of operations.

We are concentrated geographically, which could adversely affect our business

Our land and development activities are located in Florida and Arizona, which are among the states most adversely affected by the downturn in the residential real estate market. Development activities depend to a significant degree on the levels of immigration to Florida from outside the United States, migration to Florida from within the United States and purchases in Florida of second and/or vacation homes. Our understanding is that recently there has been substantially less migration into Florida from within the United States than there had been in previous years.

Our access to financing may be limited

While we have curtailed our homebuilding operations, our business is still capital intensive and requires expenditures for land and infrastructure development, housing construction, and working capital, as well as potential development opportunities. As of December 31, 2009, total consolidated indebtedness was $119,002, including $63,010 carrying amount of our 4.50% Convertible Senior Notes due 2024 (the 4.50% Notes) and borrowings of $55,881 outstanding under our amended unsecured credit facility, which matures on September 20, 2010, as well as letters of credit totaling $22,535 of which $21,053 were financial/maintenance letters of credit. On November 7, 2008, Franklin Bank SSB (Franklin Bank), one of the participating financial institutions in our amended unsecured credit facility, was closed by the Texas Department of Savings and Mortgage Lending and the Federal Deposit Insurance Corporation (FDIC) was named receiver. On January 13, 2010, we received notification from the FDIC that Franklin Bank is no longer a participant in our amended credit facility. Franklin Bank was a 20% participant.

On July 23, 2009, Guaranty Bank, one of the participating financial institutions in our amended unsecured credit facility, announced that it no longer believed it could raise sufficient capital, therefore, it was not probable that it would be able to continue as a going concern. Guaranty Bank is a 25% or $25,000 participant in our amended unsecured credit facility. On August 21, 2009, BBVA Compass acquired the banking operations of Guaranty Bank from the FDIC. BBVA Compass acquired the assets and assumed the deposits and entered into a loss sharing arrangement with the FDIC that covers all of the acquired loans. BBVA Compass/Guaranty Bank continues to participate in our Amended Unsecured Credit Facility. The outstanding borrowings under our amended unsecured credit facility include participation from BBVA Compass/Guaranty Bank in the amount of approximately $17,877.

We are in preliminary discussions with the administrative agent for our unsecured credit facility regarding an extension. Should we reach an agreement on an extension it is expected to result in a reduction in the line of credit to approximately $50,000 and higher costs for outstanding borrowings and letters of credit. Further, we anticipate that the facility will be converted to a secured facility and provide for a paydown of outstanding borrowings while we have cash exceeding a specified level. These discussions are in preliminary stages, and there can be no assurance that we will reach an agreement.

Table of Contents

Item 1A. Risk Factors (dollars in thousands except share and per share data) continued

We anticipate, but cannot assure, that the amounts available from internally generated funds, cash on hand, the sale of non-core assets, and existing and future financing will be sufficient to fund our anticipated operating deficit and our operations, meet debt service and working capital requirements, and provide sufficient liquidity. We may seek additional capital in the form of equity or debt financing from a variety of potential sources, including additional bank financing and sales of debt or equity securities. However, we cannot assure that such financing will be available or, if available, will be on favorable terms. In addition, from time to time we have obtained the necessary or desirable amendments to our amended unsecured credit facility. There can be no assurance that we will be able to obtain future amendments at favorable terms and costs.

Higher interest rates could have a further adverse effect on our business

A significant majority of the purchasers of our homes finance their purchases through third-party lenders providing mortgage financing or, to some extent, rely upon investment income. In general, housing demand is dependent on home equity, consumer savings and third-party financing and has been adversely affected by less favorable mortgage terms, including requirements for higher deposits and higher credit scores, the tightening of underwriting standards, and declining employment. Certain lenders are imposing more stringent credit requirements.

Our success significantly depends on our key personnel and our ability to retain personnel

Our business strategy requires, among other things, the retention of experienced management personnel and employees. The loss of the services of certain members of the senior and middle management teams could have a material adverse effect on the success of our business strategy.

Our joint ventures and equity partnerships may not achieve anticipated results

We may seek additional joint venture or equity partnership arrangements. A joint venture or equity partnership may involve special risks associated with the possibility that a partner or partnership at any time (i) may have economic or business interests or goals that are inconsistent with ours, (ii) may take actions contrary to our instructions or requests or contrary to our policies or objectives with respect to our real estate investments or (iii) could experience financial difficulties. Actions by a partner may have the result of subjecting property owned by the joint venture or equity partnership to liabilities in excess of those contemplated by the terms of the joint venture or equity partnership agreement or have other adverse consequences. We cannot assure that any joint venture or equity partnership arrangements will achieve the results anticipated or otherwise prove successful.

Our business is subject to substantial competition

The residential homebuilding industry is competitive and other national, regional and local homebuilders compete with us in markets where we are selling homes. Further, our residential homebuilding, planned community development and other real estate operations are subject to significant competition from distressed sellers. We currently compete with foreclosure sales as well as resales by investors, speculators, foreclosing lenders and residents in our communities. For sales of new housing units, we compete, as to price and product, with several national and regional homebuilding companies.

Item 1A. Risk Factors (dollars in thousands except share and per share data) continued

We continue to focus on acquiring real estate or real estate related assets as the fallout from the deleveraging of the economy continues to adversely affect real estate values. We have analyzed a substantial number of residential real estate properties in Florida and Arizona and debt secured by real estate. During September 2009, we acquired completed and partially completed homes, developed and partially developed lots and undeveloped lots in St. Lucie County, Florida for approximately $7,450. During December 2009, we acquired 86 developed lots in Pima County, Arizona for approximately $3,725. We compete for opportunities to acquire real estate or real estate related assets with investors, other residential land developers and home builders, and real estate funds, and there can be no assurance that we will identify and be able to acquire appropriate assets or that any such assets we were to acquire would result in a desirable return on our investment.

We are subject to extensive governmental regulation and environmental considerations

Our business is subject to extensive federal, state and local statutes, ordinances and regulations. The broad discretion that governmental agencies have in administering those requirements and no growth or slow growth policies, can prevent, delay, make uneconomic or significantly increase the costs of development. Various governmental approvals and permits are required throughout the development process, and no assurance can be given as to the receipt (or timing of receipt) of these approvals or permits. Furthermore, governmental approvals may be affected by changes in the policies of government entities or modifications to policies to address current economic conditions. The incurrence of substantial compliance costs and the imposition of delays and other regulatory burdens could have a material adverse effect on our operations. In addition, various federal, state and local laws subject property owners or operators to liability for the costs of removal or remediation of certain hazardous substances located or released on a property. Such laws often impose liability without regard to whether the owner knew of, or was responsible for, the hazardous substances. The presence of such hazardous substances at one or more properties, and the requirement to remove or remediate such substances, may result in significant cost.

Further, some laws require us to provide roads and other off-site improvements concurrent with new construction. In some cases, counties and municipalities will also charge us impact or other similar fees and assessments to pay for concurrent infrastructure to serve new development. Development projects may also be subject to assessments for schools, parks, highways and other public improvements, the costs of which can be substantial. These laws are subject to frequent change and frequently result in higher construction costs.

Both Florida and Arizona have laws respecting statutory disclosures and requirements that must be complied with in the marketing and selling of new homes. Other states require us to register our Florida and Arizona projects with such states before we can locally market our homes to residents of such states. There are also Federal laws and regulations that we must comply with in order to allow our home buyers to obtain federally insured mortgages. If certain Federal and state laws are not complied with, home buyers may have a right to cancel their contracts and to a return of their deposit.

Certain events could trigger the acceleration of payment of our 4.50% Notes

Certain events could result in a default under our 4.50% Notes. These include cessation of trading of our common stock, failure to pay interest when due on our 4.50% Notes, and final judgment(s) for the payment of money in excess of $20,000 rendered against us or any of our subsidiaries if not discharged for any periods of 30 consecutive days during which a stay of enforcement is not in effect. Such default would result in the requirement for payment of the 4.50% Notes prior to the due date thereof. In addition, holders may require us to repurchase the 4.50% Notes for cash on April 1, 2011, April 1, 2014 and April 1, 2019. Our inability to make such accelerated payment could have a material adverse effect upon our business.

Item 1A. Risk Factors (dollars in thousands except share and per share data) continued

Failure to purchase replacement property or obtain an extension of time in which to do so could result in a reduction in available cash

In 2006, we closed on substantially all of the land sold under the threat of condemnation, and in 2007 we closed on the remainder. We believe these transactions entitled us to defer the payment of income taxes of $24,355 from the gain on these sales. During October 2009, we received from the Internal Revenue Service a final extension until December 31, 2010 to obtain replacement property to defer the payment of income taxes. It is our intention to acquire replacement property by December 31, 2010. It is possible that we may not identify and purchase adequate replacement property within the required time period, which could require us to make this income tax payment plus interest of approximately $7,000 as of December 31, 2010. This would result in a reduction in available cash.

We are subject to construction defect and home warranty claims arising in the ordinary course of business, which may lead to additional reserves or expenses

Despite our commitment to quality, from time to time we discover construction defects in our homes either as a result of our own inspections or in response to customer service requests. To address possible defects that may occur during construction, we set aside a warranty reserve in connection with every home closing. We also maintain general liability insurance and require our subcontractors and professional service providers to maintain insurance coverage and indemnify us for liabilities in connection with their services. Historically, our home warranty reserves have been sufficient to cover all claims for construction defects. Nonetheless, it is possible that our warranty reserves, insurance and/or indemnities will not be adequate to cover all construction defects and home warranty claims for which we may be held liable in the future.

On August 11, 2009, we determined that one of our homes, constructed on a scattered lot in Poinciana, contains reactive drywall manufactured in China (Chinese drywall). The Chinese drywall in this home was provided to our drywall contractor by a secondary supplier of such drywall contractor. We reached a settlement with the secondary supplier who reimbursed Avatar for a substantial portion of the cost to repair the home and extends the same financial reimbursement to other homes containing reactive drywall from such secondary supplier. The repairs to the home are complete or about to be completed. Although we received no more customer service calls regarding reactive drywall from customers in Poinciana, we recently surveyed other owners whose homes contained drywall provided by the secondary supplier in the approximate time period such supplier had reactive drywall in its warehouse. As a result of this process, which is ongoing, we have determined that at least two more Poinciana homes contain reactive drywall. We have notified the secondary supplier of our determination and we believe the costs to repair those homes will be substantially reimbursed by such supplier. If and to the extent the scope of the Chinese drywall issues in Poinciana prove to be significantly greater than we currently believe, and our existing warranty reserves together with our insurance and any recovery from the secondary supplier as to Poinciana is not sufficient to cover claims, losses or other issues related to the reactive drywall, we could incur costs or liabilities related to this issue that could have a material adverse effect on our results of operations, financial position and cash flows.

If we do not secure funding for our Poinciana Parkway project on commercially acceptable terms and commence construction by February 14, 2011, we will be in default under our agreements with Polk and Osceola Counties regarding the Poinciana Parkway, and we may not recover our investment in the Poinciana Parkway, which has already been substantially impaired

In July 2008 and August 2008, we entered into amended and restated agreements with Osceola County and Polk County (the Counties), pursuant to which construction of the Poinciana Parkway is to be commenced by February 14, 2011. Construction was to be completed by December 31, 2011 subject to extension for specified Force Majeure events. We have notified the Counties that the completion date has been extended to October 14, 2013 due to Force Majeure events related to the economic downturn. We advised the Counties that the current economic downturn has resulted in our inability to: (i) conclude negotiations with potential investors; or (ii) obtain financing for the construction of the Poinciana Parkway.

Table of Contents

Item 1A. Risk Factors (dollars in thousands except share and per share data) continued

If funding for the Poinciana Parkway is not obtained so that construction of the Poinciana Parkway can be commenced by February 14, 2011 as required by our agreements with Osceola County and Polk County, the Counties have no right to obtain damages or sue Avatar for specific performance. Polk County s sole remedy under its agreement with us is to cancel such agreement if we do not construct the Poinciana Parkway. If the construction of the Poinciana Parkway is not funded and commenced by February 14, 2011, (i) a portion of our land in Osceola County will become subject to Osceola traffic concurrency requirements applicable generally to other home builders in the County and (ii) we will be required to contribute approximately $1,900 towards the construction cost of certain traffic improvements in Osceola County that we otherwise might have been obligated to build or fund if we had not agreed to construct the Poinciana Parkway. Avatar is investigating the availability of an extension of the Poinciana Parkway permits and the related deadlines in its agreements with the Counties.

Our estimate of the right-of-way acquisition, development and construction costs for the Poinciana Parkway approximates $175,000 to $200,000. However, no assurance of the ultimate costs can be given at this stage. As of December 31, 2009, approximately $47,000 has been expended. During 2009 and 2008 we recorded impairment charges of $8,108 and $30,228, respectively, associated with the Poinciana Parkway. At December 31, 2009, the carrying value of the Poinciana Parkway is $8,482. If we cannot obtain funding for construction of the Poinciana Parkway and commence construction by February 14, 2011, or obtain amendments of our agreements with the Counties regarding the Poinciana Parkway and permit extensions, it is unlikely that we will recover our investment in the Poinciana Parkway at any time in the foreseeable future.

We have never paid dividends on our common stock, and we do not anticipate paying any cash dividends in the foreseeable future

We have never paid cash dividends on our common stock to date, and we intend to retain our future earnings, if any, to fund the development and growth of our business. In addition, the terms of existing or any future debt may preclude us from paying these dividends. As a result, capital appreciation, if any, of our common stock is likely to be your sole source of gain for the foreseeable future.

Item 1B. Unresolved Staff Comments

None.

Table of Contents

Item 2. Properties

Avatar s real estate operations are summarized in Item 1. Business above and described in Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. Land developed and in the process of being developed, or held for investment and/or future development, is set forth in Note C of the Notes to Consolidated Financial Statements in Item 8.

Our corporate headquarters are located at 201 Alhambra Circle, Coral Gables, Florida, in 16,810 square feet of leased office space. For additional information concerning properties leased by Avatar, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations and Item 8. Notes to Consolidated Financial Statements.

Item 3. Legal Proceedings

The information set forth in Note N (Commitments and Contingencies) of the Notes to Consolidated Financial Statements included in Item 8 of Part II of this Report is incorporated herein by reference.

We are involved in various pending litigation matters primarily arising in the normal course of our business. These cases are in various procedural stages. Although the outcome of these matters cannot be determined, Avatar believes it is probable in accordance with authoritative accounting standards, that certain claims may result in costs and expenses estimated at approximately $334 and $1,600 which have been accrued in the accompanying consolidated balance sheets as of December 31, 2009 and 2008, respectively. Liabilities or costs arising out of these and other currently pending litigation should not have a material adverse effect on our business or consolidated financial position or results of operations.

We have no tax-related penalties required to be disclosed in this Item 3 pursuant to Section 67