MDC HOLDINGS INC
Form 10-Q
October 30, 2009
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

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	**84-0622967**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification no.)**

4350 South Monaco Street, Suite 500
Denver, Colorado

80237

(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ 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 x	**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 x

As of September 30, 2009, 46,972,000 shares of M.D.C. Holdings, Inc. common stock were outstanding.

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

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2009

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ITEM 1. Unaudited Consolidated Financial Statements

M.D.C. HOLDINGS, INC.

Consolidated Balance Sheets

(In thousands, except share and per share amounts)

(Unaudited)

	September 30, 2009	December 31, 2008
Assets		
Cash and cash equivalents	$ 1,448,875	$ 1,304,728
Marketable securities	151,260	54,864
Unsettled trades, net	2,133	57,687
Restricted cash	933	670
Receivables		
Home sales receivables	14,283	17,104
Income taxes receivable	3,119	170,753
Other receivables	9,981	16,697
Mortgage loans held-for-sale, net	42,704	68,604
Inventories, net		
Housing completed or under construction	325,257	415,500
Land and land under development	177,888	221,822
Property and equipment, net	37,721	38,343
Deferred tax asset, net of valuation allowance	-	-
Related party assets	28,839	28,627
Prepaid expenses and other assets, net	77,524	79,539
Total Assets	$ 2,320,517	$ 2,474,938
Liabilities		
Accounts payable	$ 45,910	$ 28,793
Accrued liabilities	309,457	332,825
Mortgage repurchase facility	13,010	34,873
Senior notes, net	997,872	997,527
Total Liabilities	1,366,249	1,394,018
Commitments and Contingencies	-	-
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; 47,025,000 and 46,972,000 issued and outstanding, respectively, at September 30, 2009 and 46,715,000 and 46,666,000 issued and outstanding, respectively, at December 31, 2008	470	467
Additional paid-in-capital	799,215	788,207
Retained earnings	155,242	292,905
Treasury stock, at cost; 53,000 and 49,000 shares at September 30, 2009 and December 31, 2008, respectively	(659)	(659)
Total Stockholders Equity	954,268	1,080,920

Total Liabilities and Stockholders Equity	$ 2,320,517	$ 2,474,938

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

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M.D.C. HOLDINGS, INC.

Consolidated Statements of Operations

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Revenue				
Home sales revenue	$ 186,816	$ 336,744	$ 539,352	$ 1,074,629
Land sales revenue	9,414	15,850	13,986	56,699
Other revenue	6,996	10,107	21,086	30,573
Total Revenue	203,226	362,701	574,424	1,161,901
Costs and Expenses				
Home cost of sales	151,596	285,367	445,039	937,947
Land cost of sales	9,433	14,775	12,274	49,559
Asset impairments, net	1,197	95,388	17,009	238,498
Marketing expenses	9,631	18,797	26,393	58,350
Commission expenses	6,808	12,297	20,119	40,389
General and administrative expenses	45,800	50,010	121,981	145,120
Other operating expenses	3,594	1,586	4,151	5,156
Related party expenses	5	3	14	13
Total Operating Costs and Expenses	228,064	478,223	646,980	1,475,032
Loss from Operations	(24,838)	(115,522)	(72,556)	(313,131)
Other income (expense)				
Interest income	2,724	9,315	9,763	28,338
Interest expense	(9,760)	(10,775)	(29,338)	(10,985)
Other income	56	8	177	38
Loss before income taxes	(31,818)	(116,974)	(91,954)	(295,740)
(Provision for) benefit from income taxes, net	(230)	(997)	(10,529)	4,223
NET LOSS	$ (32,048)	$ (117,971)	$ (102,483)	$ (291,517)
LOSS PER SHARE				
Basic	$ (0.69)	$ (2.55)	$ (2.20)	$ (6.32)
Diluted	$ (0.69)	$ (2.55)	$ (2.20)	$ (6.32)
WEIGHTED-AVERAGE SHARES OUTSTANDING				
Basic	46,597	46,219	46,515	46,094
Diluted	46,597	46,219	46,515	46,094

DIVIDENDS DECLARED PER SHARE	$	0.25	$	0.25	$	0.75	$	0.75

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

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M.D.C. HOLDINGS, INC.

Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Operating Activities		
Net loss	$ (102,483)	$ (291,517)
Adjustments to reconcile net loss to net cash provided by operating activities		
Asset impairments, net	17,009	238,498
Deferred tax asset, net of valuation allowance	-	147,060
Amortization of deferred marketing costs	5,973	19,929
Write-offs of land option deposits and pre-acquisition costs	1,458	5,253
Depreciation and amortization of long-lived assets	4,155	6,931
Stock-based compensation expense	11,044	9,717
Excess tax benefits from stock-based compensation	-	(1,832)
Gain on sale of assets, net	(1,512)	(7,178)
Other non-cash expenses	7,093	1,934
Net changes in assets and liabilities:		
Restricted cash	(263)	919
Home sales and other receivables	6,841	6,901
Income taxes receivable/payable	163,979	(60,793)
Mortgage loans held-for-sale, net	25,900	39,219
Housing completed or under construction	85,342	290,757
Land and land under development	34,353	147,008
Prepaid expenses and other assets, net	(10,439)	(43,118)
Accounts payable	17,117	(29,628)
Accrued liabilities	(21,061)	(51,711)
Net cash provided by operating activities	244,506	428,349
Investing Activities		
Purchase of marketable securities	(175,356)	(94,767)
Maturity of marketable securities	78,960	-
Unsettled trade	-	(115,135)
Proceeds from redemption requests on unsettled trades	55,554	-
Purchase of property and equipment	(6,096)	(413)
Net cash used in investing activities	(46,938)	(210,315)
Financing Activities		
Lines of credit - advances	-	125,273
Lines of credit - payments	-	(164,886)
Payment on mortgage repurchase facility	(63,164)	-
Advances on mortgage repurchase facility	41,301	-
Dividend payments	(35,180)	(34,735)
Proceeds from exercise of stock options	3,622	10,587
Excess tax benefits from stock-based compensation	-	1,832

Net cash used in financing activities	(53,421)	(61,929)
Net increase in cash and cash equivalents	144,147	156,105
Cash and cash equivalents		
Beginning of period	1,304,728	1,004,763
End of period	$ 1,448,875	$ 1,160,868

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

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements

1. Basis of Presentation

The Unaudited Consolidated Financial Statements of M.D.C. Holdings, Inc. (MDC or the Company, 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 accounting principles generally accepted in the United States of America for complete financial statements. The Company has evaluated subsequent events through October 30, 2009, the date the Unaudited Consolidated Financial Statements were filed with the SEC. 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, 2009 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, 2008, filed with the SEC on February 10, 2009.

The Consolidated Statements of Operations for the three and nine months ended September 30, 2009 and Consolidated Statement of Cash Flows for the nine months ended September 30, 2009 are not necessarily indicative of the results to be expected for the full year. 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 the Company s December 31, 2008 Annual Report on Form 10-K.

During the 2009 first quarter, the Company reclassified certain costs, primarily write-offs of pre-acquisition costs and deposits on lot option contracts that we elected not to exercise, from general and administrative expenses to other operating expenses on the Consolidated Statements of Operations. Accordingly, the Company has reclassified $1.6 million and $5.2 million of write-offs of pre-acquisition costs and deposits during the three and nine months ended September 30, 2008, respectively, in order to conform to the current year s presentation.

During the 2009 first quarter, the Company changed the composition of its reportable segments by reclassifying the Delaware Valley market from the Other Homebuilding segment to the East segment. This resulted primarily from a change in the internal reporting structure of the Company. As a result, the Company has restated all prior period financial and operating measures of the Delaware Valley market to the East segment in order to conform to the current year s presentation. Certain other prior period balances have been reclassified to conform to the current year s presentation.

2. Unsettled Trades

On September 16, 2008, the Company delivered a timely redemption request to The Reserve Funds to redeem its investment in The Reserve s Primary money market fund. The Reserve announced on September 16, 2008 that all Primary Fund redemption requests received before 3:00 p.m. that day would be redeemed at $1.00 per share. Despite representations by The Reserve that the redemptions would be paid the same day as the redemption request, the amounts due to the Company were not distributed to the Company upon request of redemption. Accordingly, at September 30, 2009 and December 31, 2008, the Company has presented the amounts due from The Reserve as unsettled trades on the Consolidated Balance Sheets and has presented the settlement of its redemption request as a source of cash from investing activities in the Company s Consolidated Statements of Cash Flows. At

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

September 30, 2009, the Company had $2.1 million of unsettled trades, net with The Reserve Primary Fund. While the Company believes that it made a timely redemption request to settle its investment in The Reserve Primary Fund on September 16, 2008, there are no assurances that the Company will ultimately receive the entire $2.1 million and, as such, the Company had a valuation allowance of $374,000 against the unsettled trade associated with its redemption request of The Reserve Primary Fund as of September 30, 2009 and December 31, 2008.

3. Asset Impairment

The Company s held-for-development and held-for-sale inventories are included as a component of housing completed or under construction and land and land under development in the Consolidated Balance Sheets. The Company s held-for-sale inventories include inventory associated with subdivisions for which the Company intends to sell the assets in their current condition. At September 30, 2009 and December 31, 2008, the Company s inventories on the Consolidated Balance Sheets included $10.0 million and $12.1 million, respectively, of held-for-sale inventory.

The Company evaluates its held-for-development and held-for-sale inventory for impairment at each quarter-end. The following table sets forth, by reportable segment, the asset impairments recorded during the three and nine months ended September 30, 2009 and 2008 (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Land and Land Under Development (Held-for-Development)				
West	$ 172	$ 33,539	$ 9,963	$ 72,303
Mountain	-	20,467	254	47,154
East	-	8,667	1,600	15,365
Other Homebuilding	359	41	376	1,906
Subtotal	531	62,714	12,193	136,728
Housing Completed or Under Construction (Held-for-Development)				
West	111	10,115	3,387	43,288
Mountain	191	4,728	191	11,945
East	-	3,939	875	7,032
Other Homebuilding	270	1,844	537	3,941
Subtotal	572	20,626	4,990	66,206
Land and Land Under Development (Held-for-Sale)				
West	-	5,604	(557)	20,330
Mountain	-	-	-	150
East	-	520	-	1,270
Other Homebuilding	-	1,356	-	5,024
Subtotal	-	7,480	(557)	26,774
Other Assets	94	4,568	383	8,790
Consolidated Asset Impairments	$ 1,197	$ 95,388	$ 17,009	$ 238,498

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

The $1.1 million impairment of the Company s held-for-development inventories during the three months ended September 30, 2009, primarily related to three communities, one in each of our West, Mountain and Other Homebuilding segments. The impairments resulted primarily from declines in the average selling price of homes in each of these communities. The decline in average selling price resulted from an effort to generate new home sales. During the nine months ended September 30, 2009, the Company recorded consolidated asset impairments of $17.0 million, primarily in its West segment. These impairments, of which $14.6 million were recorded during the 2009 first quarter, were concentrated in the Nevada market of the West segment and resulted from a significant decrease in the average selling prices of closed homes during the 2009 first quarter, compared with the 2008 fourth quarter, in response to increased levels of competition in this market and continued high levels of home foreclosures. The impairments in the Mountain, East and Other Homebuilding segments primarily resulted from lower forecasted average selling prices for communities that are in the close-out phase.

The impairments of the Company s held-for-development inventories incurred during the three and nine months ended September 30, 2008, primarily resulted from decreases in home sales prices and/or increases in home sales incentives offered as a result of: (1) lower home sales prices that were offered by the Company s competitors; (2) efforts to maintain homes in Backlog (defined as homes under contract but not yet delivered) until they close; (3) high levels of foreclosures; (4) affordability issues for new homes as homebuyers were experiencing difficulty in qualifying for mortgage loans; and (5) efforts to stimulate new home orders in order to sell and close the remaining homes in subdivisions that are in the close-out phase.

The impairments of held-for-development inventories in the West and Mountain segments during the 2008 periods were significantly higher than impairments recorded in the Company s other homebuilding segments, primarily resulting from: (1) competition within the sub-markets of these segments appeared to be more pronounced than in the other homebuilding segments and, as a result, the Company generally experienced more significant reductions in its average selling prices of homes within these segments; and (2) the total homebuilding inventories for the West and Mountain segments comprised 36% and 37%, respectively, of the Company s consolidated homebuilding inventories at September 30, 2008. The Company also believes that buyers of the Company s homes in the West segment were largely comprised of entry level homebuyers, compared with a wider range of homebuyers in the other homebuilding segments and, as such, their ability to obtain suitable mortgage loan financing was impacted more adversely by the decreased availability of mortgage loan products, which contributed to the relatively higher impairments in this segment. Also contributing to the impairments in the Mountain segment was a more pronounced decline in demand for new homes during 2008, particularly in the Company s Utah market, where the demand for new homes has decreased from its peak during 2006.

During the three and nine months ended September 30, 2008, the Company recorded impairments of $7.5 million and $26.8 million, respectively, on its held-for-sale inventory, primarily in the West segment. The 2008 third quarter impairments, which related to approximately 450 lots in 8 subdivisions, primarily resulted from significant decreases in the fair market values of new homes being sold, as this caused corresponding declines in the fair market values of land available for sale. Also contributing to these impairments were decisions that the best use of these assets was to sell them in their current condition at fair values that were significantly below their current carrying value.

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Notes to Unaudited Consolidated Financial Statements (Continued)

4. Recent Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (SFAS 167). SFAS 167, which is incorporated in Accounting Standards Codification (ASC) Topic 810, Consolidation, requires a qualitative approach to identifying a controlling financial interest in a variable interest entity (VIE), and requires ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder the primary beneficiary of the VIE. SFAS 167 is effective for the Company s fiscal year beginning January 1, 2010. The Company is currently reviewing the effect of SFAS 167 on its consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (SFAS 168). SFAS 168, which is incorporated in ASC Topic 105, Generally Accepted Accounting Principles, identifies the ASC as the authoritative source of generally accepted accounting principles in the United States. Rules and interpretive releases of the SEC under federal securities laws are also sources of authoritative GAAP for SEC registrants. We adopted SFAS No. 168 in 2009 third quarter.

In June 2009, the FASB issued SFAS No. 166, Accounting for Transfers of Financial Assets an amendment of FASB Statement No. 140 (SFAS 166). SFAS 166, removes the concept of a qualifying special-purpose entity and removes the exception from applying FASB Interpretation No. 46 (revised December 2003), Consolidation of Variable Interest Entities, to qualifying special-purpose entities. SFAS 166 determines whether a transferor and all of the entities included in the transferor s financial statements being presented have surrendered control over transferred financial assets. That determination must consider the transferor s continuing involvement in the transferred financial asset, including all arrangements or agreements made contemporaneously with, or in contemplation of, the transfer, even if they were not entered into at the time of the transfer. SFAS 166 modifies the financial-components approach and limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements being presented and/or when the transferor has continuing involvement with the transferred financial asset.

SFAS 166 defines the term *participating interest* to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. If the transfer does not meet those conditions, a transferor should account for the transfer as a sale only if it transfers an entire financial asset or a group of entire financial assets and surrenders control over the entire transferred asset(s). If a transfer of financial assets does not meet the requirements for sale accounting, the securitized mortgage loans should continue to be classified as loans in the transferor s statement of financial position. SFAS 166 requires that a transferor recognize and initially measure at fair value all assets obtained (including a transferor s beneficial interest) and liabilities incurred as a result of a transfer of financial assets accounted for as a sale.

SFAS 166 shall be effective as of the beginning of each reporting entity s first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

recognition and measurement provisions of SFAS 166 shall be applied to transfers that occur on or after the effective date. The Company is currently evaluating the impact that SFAS 166 may have on its financial position, results of operations and cash flows.

5. Fair Value Measurements

In September 2006, the FASB issued ASC 820 Fair Value Measurements and Disclosures (ASC 820), which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. ASC 820 does not require any new fair value measurements, but rather eliminates inconsistencies in guidance found in certain preceding accounting pronouncements. The Company adopted ASC 820 for financial and non-financial instruments during the 2008 and 2009 first quarters, respectively. Although the adoption of ASC 820 did not materially impact its financial condition, results of operations, or cash flow, the Company now is required to provide additional disclosures as part of its financial statements as set forth below.

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

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

Marketable securities. The Company classifies its marketable securities as held-to-maturity as it has both the ability and intent to hold these investments until their maturity date. Accordingly, the Company s marketable securities are reported at amortized cost in the Consolidated Balance Sheets. At September 30, 2009, the Company s marketable securities consisted primarily of: (1) debt securities, which may include, among others, United States government and government agency debt, corporate debt and bankers acceptances; and (2) deposit securities which may include, among others, certificates of deposit and time deposits. The following table shows the Company s carrying value of its marketable securities at September 30, 2009, by both security type and maturity date as well as the estimated fair value for each security type (in thousands). The fair value of the Company s marketable securities are based upon Level 1 fair value inputs.

	September 30, 2009	
	Recorded Amount	Estimated Fair Value
Debt securities - maturity less than 1 year	$ 43,228	$ 44,745
Debt securities - maturity 1 to 5 years	18,056	17,516
Deposit securities - maturity less than 1 year	54,945	54,872
Deposit securities - maturity 1 to 3 years	35,031	34,746
Total marketable securities	$ 151,260	$ 151,879

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Notes to Unaudited Consolidated Financial Statements (Continued)

Mortgage Loans Held-for-Sale, Net. As of September 30, 2009, the primary components of the Company s 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, 2009 and December 31, 2008, the Company had $21.3 million and $47.0 million, respectively, in mortgage loans held-for-sale under commitments to sell for which fair value was based upon a Level 2 input being the quoted market prices for those mortgage loans. At September 30, 2009 and December 31, 2008, the Company had $21.0 million and $21.6 million, respectively, of mortgage loans held-for-sale that were not under commitments to sell and, as such, their fair value was based upon Level 2 fair value inputs, primarily estimated market price received from an outside party.

Inventories. The Company s assets measured at fair value on a nonrecurring basis are those assets for which the Company has recorded impairments during the current period and primarily relate to the Company s housing completed or under construction and land and land under development. The following table sets forth the current carrying value (in thousands) of the Company s inventory that was impaired at September 30, 2009. Accordingly, these carrying values represent the fair value of such inventory at September 30, 2009 and were based upon Level 3 fair value inputs.

	Land and Land Under Development (Held-for-Development)	Housing Completed or Under Construction (Held-for-Development)	Total Fair Value of Impaired Inventory
West	$ 220	$ 1,598	$ 1,818
Mountain	-	1,320	1,320
East	-	-	-
Other Homebuilding	259	775	1,034
Consolidated	$ 479	$ 3,693	$ 4,172

Lines of Credit. The Company s lines of credit are at floating rates or at fixed rates that approximate current market rates and have relatively short-term maturities. The fair value approximates carrying value.

Senior Notes. The estimated fair values of the senior notes in the following table are considered to be Level 2 fair value inputs pursuant to ASC 820 and are an estimated fair value of the bonds when compared with bonds in the homebuilding sector (in thousands).

	September 30, 2009	
	Recorded Amount	Estimated Fair Value
7% Senior Notes due 2012	$ 149,413	$ 160,281
5 1/2% Senior Notes due 2013	349,617	357,581
5 3/8% Medium Term Senior Notes due 2014	249,063	239,963
5 3/8% Medium Term Senior Notes due 2015	249,779	237,959
Total	$ 997,872	$ 995,784

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

6. Derivative Financial Instruments

The Company utilizes 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, 2009, the Company had $179.8 million in interest rate lock commitments and $124.5 million in forward sales of mortgage-backed securities.

The Company records its mortgage loans held-for-sale at fair value to achieve matching of the changes in the fair value of its derivative instruments with the changes in fair values of the loans it is hedging, without having to designate its 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, the Company records the fair value of the derivatives in other revenue in the Consolidated Statements of Operations with an offset to either prepaid and other assets or accrued liabilities in the Consolidated Balance Sheets, depending on the nature of the change. The changes in fair value of the Company s derivatives were not material during the three and nine months ended September 30, 2009 and 2008.

7. Balance Sheet Components

The following table sets forth information relating to accrued liabilities (in thousands).

	September 30, 2009	December 31, 2008
Accrued liabilities		
FIN 48 income tax liability	$ 64,680	$ 63,404
Warranty reserves	61,340	89,318
Insurance reserves	56,694	59,171
Accrued compensation and related expenses	21,178	22,245
Accrued interest payable	19,391	12,822
Land development and home construction accruals	17,681	22,941
Accrued executive deferred compensation	17,091	15,254
Legal reserves	9,975	7,575
Loan loss reserves	9,348	1,142
Customer and escrow deposits	7,322	4,820
Other accrued liabilities	24,757	34,133
Total accrued liabilities	$ 309,457	$ 332,825

8. Loss Per Share

For purposes of calculating loss per share (EPS), a company that has multiple classes of securities (for example, unvested restricted stock that has nonforfeitable dividend rights and

M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

outstanding shares of common stock) is required to utilize the two-class method for calculating earnings per share. The two-class method is an allocation of earnings between the multiple classes of securities that effectively treats each class of security as having rights to earnings that would otherwise have been available to common shareholders. 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 dividends. Currently, the Company has two classes of securities, which consist of shareholders of common stock and shareholders of unvested restricted stock. However, since the Company incurred a net loss for the three and nine months ended September 30, 2009 and 2008, the Company has excluded unvested restricted stock from its calculation of basic earnings per share because inclusion of this class of stock would be anti-dilutive and would decrease basic loss per share. Similarly, since the Company incurred a net loss for the three and nine months ended September 30, 2009 and 2008, the Company has not presented distributed and undistributed losses per share in accordance with the two-class method since that information would not be meaningful.

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, 2009 and 2008 excluded common stock equivalents because the effect of their inclusion would be anti-dilutive, or would decrease the reported loss per share. Using the treasury stock method, the weighted-average common stock equivalents excluded from diluted EPS were 0.4 million shares during the three and nine months ended September 30, 2009, and 0.5 million and 0.6 million shares during the three and nine months ended September 30, 2008, respectively.

The basic and diluted loss per share calculation is shown below (in thousands, except per share amounts).

	Three Months Ended September 30, 2009	Three Months Ended September 30, 2008	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
Basic and Diluted Loss Per Share				
Net loss	$ (32,048)	$ (117,971)	$ (102,483)	$ (291,517)
Weighted-average shares outstanding	46,597	46,219	46,515	46,094
Per share amounts	$ (0.69)	$ (2.55)	$ (2.20)	$ (6.32)

9. Interest Activity

The Company capitalizes interest on its senior notes and Homebuilding Line (as defined below) associated with its qualifying assets. The Company has determined that inventory is a qualifying asset during the period of active development and through the completion of construction of a home. When construction of a home is complete, such home is no longer considered to be a qualifying asset and interest is no longer capitalized on that home. The Company s qualifying assets have decreased significantly during 2008 and 2009 as a result of the significant decrease in inventory levels. As a result, the Company expensed $9.7 million and $29.1 million of interest that was incurred during the three and nine months ended September 30, 2009 that could not be capitalized. The Company

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expensed $10.7 million of interest incurred during both the three and nine months ended September 30, 2008 that could not be capitalized. Interest incurred on the senior notes or Homebuilding Line that is not capitalized and interest expense on the Mortgage Repurchase Facility (as defined below) are included in other income (expense) in the Consolidated Statements of Operations. Interest activity is shown below (in thousands).

	Three Months Ended September, 30		Nine Months Ended September, 30	
	2009	2008	2009	2008
Total Interest Incurred				
Corporate and homebuilding segments	$ 14,482	$ 14,475	$ 43,430	$ 43,392
Financial Services and Other	88	49	262	259
Total interest incurred	$ 14,570	$ 14,524	$ 43,692	$ 43,651
Total Interest Capitalized				
Interest capitalized, beginning of period	$ 32,089	$ 49,674	$ 39,239	$ 53,487
Interest capitalized, net of interest expense	4,810	3,749	14,354	32,666
Previously capitalized interest included in home cost of sales	(7,142)	(9,689)	(23,836)	(42,419)
Interest capitalized, end of period	$ 29,757	$ 43,734	$ 29,757	$ 43,734

10. Warranty Reserves

Warranty reserves presented in the table below relate to general and structural reserves, as well as reserves for known, unusual warranty-related expenditures. Warranty payments for an individual house may exceed the related reserve. Payments in excess of the reserve are evaluated in the aggregate to determine if an adjustment to the warranty reserve should be recorded, which could result in a corresponding adjustment to home cost of sales. During 2008 and continuing into the first nine months of 2009, the Company experienced significant downward trends in the amount of warranty payments incurred on its previously closed homes. Because the Company s warranty reserve balance at each period end is generally determined based upon historical warranty payment patterns, the foregoing downward trend in warranty payments have significantly impacted the Company s warranty reserves during 2009. As a result of the significant decline in warranty payments incurred on previously closed homes, the Company recorded adjustments of $3.7 million and $18.3 million during the three and nine months ended September 30, 2009, respectively, to reduce its warranty reserves for previously closed homes. Additionally, during the 2009 third quarter, the Company reached a settlement of a construction defect claim in the Nevada market of the West segment. As a result of this settlement, the costs of which have been paid by insurance providers, the Company released $7.1 million of warranty reserves that were established during previous reporting periods for these construction defect claims. The foregoing warranty reserve adjustments were recorded as a reduction to home cost of sales in the Consolidated Statements of Operations.

During the 2008 third quarter, the Company recorded decreases totaling $3.2 million to its warranty reserve, which reduced the Company s home cost of sales, primarily resulting from

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significant declines in the amount of warranty payments made during 2008. During the first nine months of 2008, the Company recorded adjustments to decrease its warranty reserve totaling $15.1 million. This decrease primarily resulted from adjustments totaling $11.6 million to reduce its warranty reserve resulting from the significant declines in the amount of warranty payments made during the nine months ended September 30, 2008. Also, during the first nine months of 2008, the Company recorded an additional $3.5 million decrease to its warranty reserve for non-warranty related items that had been recorded to the warranty reserve during previous reporting periods. As such, this adjustment did not impact the Company s home cost of sales, but resulted in a reduction to the Company s homebuilding general and administrative expenses during the nine months ended September 30, 2008.

The following table summarizes the warranty reserve activity for the three and nine months ended September 30, 2009 and 2008 (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Warranty reserve balance at beginning of period	$ 73,552	$ 96,431	$ 89,318	$ 109,118
Warranty expense provisions	1,576	3,208	4,922	9,977
Warranty cash payments	(2,974)	(3,096)	(7,539)	(10,641)
Warranty reserve adjustments	(10,814)	(3,163)	(25,361)	(15,074)
Warranty reserve balance at end of period	$ 61,340	$ 93,380	$ 61,340	$ 93,380

11. Insurance Reserves

The Company records expenses and liabilities for losses and loss adjustment expenses for claims associated with: (1) insurance policies and re-insurance agreements issued by StarAmerican Insurance Ltd. (StarAmerican) and Allegiant Insurance Company, Inc., A Risk Retention Group (Allegiant); (2) self-insurance, including workers compensation; and (3) deductible amounts under the Company s insurance policies. The establishment of the provisions for outstanding losses and loss adjustment expenses is based on actuarial studies that include known facts and interpretations of circumstances, including: (1) the Company s experience with similar cases and historical trends involving claim payment patterns; (2) pending levels of unpaid claims; (3) product mix or concentration; (4) claim severity; (5) frequency patterns such as those caused by natural disasters, fires, or accidents, depending on the business conducted; and (6) changing regulatory and legal environments.

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The following table summarizes the insurance reserve activity for the three and nine months ended September 30, 2009 and 2008 (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Insurance reserve balance at beginning of period	$ 59,395	$ 59,649	$ 59,171	$ 57,475
Insurance expense provisions	776	1,406	2,603	4,521
Insurance cash payments	(2,534)	(2,444)	(3,130)	(4,080)
Insurance reserve adjustments	(943)	(318)	(1,950)	377
Insurance reserve balance at end of period	$ 56,694	$ 58,293	$ 56,694	$ 58,293

12. Information on Business Segments

The Company s 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. The Company has identified its chief operating decision-makers (CODMs) as three key executives the Chief Executive Officer, Chief Operating Officer and Chief Financial Officer.

The Company has identified each homebuilding subdivision as an operating segment as each homebuilding subdivision engages in business activities from which it earns revenue primarily from the sale of single-family detached homes, generally to first-time and first-time move-up homebuyers. Subdivisions in the reportable segments noted below have been aggregated because they are similar in the following regards: (1) economic characteristics; (2) housing products; (3) class of homebuyer; (4) regulatory environments; and (5) methods used to construct and sell homes. The Company s homebuilding reportable segments are as follows:

(1) West (Arizona, California and Nevada)
(2) Mountain (Colorado and Utah)
(3) East (Delaware Valley, Maryland and Virginia)
(4) Other Homebuilding (Florida and Illinois)

During the 2009 first quarter, the Company changed the composition of its reportable segments by reclassifying the Delaware Valley market from the Other Homebuilding segment to the East segment. This reclassification resulted primarily from a change in the internal reporting structure of the Company. The Company has restated all prior period financial and operating measures of the Delaware Valley market to the East segment as a result of this reclassification in order to conform to the current year s presentation.

The Company s Financial Services and Other reportable segment consists of the operations of the following operating segments: (1) HomeAmerican Mortgage Corporation (HomeAmerican); (2) Allegiant; (3) StarAmerican; (4) American Home Insurance Agency, Inc.; and (5) American Home Title and Escrow Company. These 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

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the combined reported loss of all operating segments that reported losses; or (3) consolidated assets. The Company s Corporate reportable segment incurs general and administrative expenses that are not identifiable specifically to another operating segment, earns interest income on its cash, cash equivalents and marketable securities, and incurs interest expense on its senior notes.

The following table summarizes revenue for each of the Company s six reportable segments (in thousands). Inter-company adjustments noted in the revenue table below relate to Mortgage Loan Origination fees paid by the Company s homebuilding subsidiaries to HomeAmerican on behalf of homebuyers.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Revenue				
Homebuilding				
West	$ 94,079	$ 194,750	$ 250,519	$ 639,066
Mountain	61,945	72,565	163,720	230,452
East	33,033	61,950	113,004	192,796
Other Homebuilding	10,909	28,829	37,709	84,918
Total Homebuilding	199,966	358,094	564,952	1,147,232
Financial Services and Other	6,578	8,497	19,147	25,341
Corporate	-	173	50	550
Intercompany adjustments	(3,318)	(4,063)	(9,725)	(11,222)
Consolidated	$ 203,226	$ 362,701	$ 574,424	$ 1,161,901

The following table summarizes (loss) income before income taxes for each of the Company s six reportable segments (in thousands). Inter-company supervisory fees (Supervisory Fees), which are included in (loss) income before income taxes for each reportable segment in the table below, are charged by the Company s Corporate segment to the homebuilding segments and the Financial Services and Other segment. Supervisory Fees represent costs incurred by the Company s Corporate segment associated with certain resources that support the Company s other reportable segments. Transfers, if any, between operating segments are recorded at cost.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
(Loss) Income Before Income Taxes				
Homebuilding				
West	$ 6,037	$ (47,741)	$ 5,809	$ (142,723)
Mountain	(1,681)	(30,085)	(8,800)	(80,720)
East	(1,707)	(17,444)	(8,704)	(32,523)
Other Homebuilding	(2,724)	(3,798)	(4,232)	(14,850)
Total Homebuilding	(75)	(99,068)	(15,927)	(270,816)
Financial Services and Other	(4,344)	3,414	(108)	8,119
Corporate	(27,399)	(21,320)	(75,919)	(33,043)

Consolidated	$ (31,818)	$ (116,974)	$ (91,954)	$ (295,740)

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The following table summarizes total assets for each of the Company s six reportable segments (in thousands). Inter-company adjustments noted in the table below relate to loans from the Company s Financial Services and Other segment to its Corporate segment. The assets in the Company s Corporate segment primarily include cash, cash equivalents and marketable securities.

	September 30, 2009	December 31, 2008
Homebuilding		
West	$ 204,146	$ 255,652
Mountain	245,639	288,221
East	115,466	151,367
Other Homebuilding	24,569	38,179
Total Homebuilding	589,820	733,419
Financial Services and Other	116,629	139,569
Corporate	1,660,025	1,647,907
Intercompany adjustments	(45,957)	(45,957)
Consolidated	$ 2,320,517	$ 2,474,938

The following table summarizes depreciation and amortization of long-lived assets and amortization of deferred marketing costs for each of the Company s six reportable segments (in thousands).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Homebuilding				
West	$ 1,388	$ 5,800	$ 3,905	$ 17,476
Mountain	678	712	1,880	2,395
East	373	1,030	1,319	2,539
Other Homebuilding	79	322	259	1,184
Total Homebuilding	2,518	7,864	7,363	23,594
Financial Services and Other	169	189	555	573
Corporate	717	849	2,210	2,693
Consolidated	$ 3,404	$ 8,902	$ 10,128	$ 26,860

13. Commitments and Contingencies

The Company is often required to obtain bonds and letters of credit in support of its obligations for land development and subdivision improvements, homeowner association dues and start-up expenses, warranty work, contractor license fees and earnest money deposits. At September 30, 2009, the Company had issued and outstanding performance bonds and letters of credit totaling $122.4 million and $27.7 million, respectively, including $4.4 million in letters of credit issued by HomeAmerican. In the event any such bonds or letters of credit issued by third parties are called, MDC could be obligated to reimburse the issuer of the bond or letter of credit.

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In the normal course of business, the Company establishes reserves for potential losses associated with HomeAmerican s loan sale agreements pursuant to which mortgage loans are sold to third-parties. These reserves are created to address repurchase and indemnity claims by third-party purchasers of the mortgage loans, which claims arise primarily out of allegations of homebuyer fraud at the time of origination of the loan. These reserves are based upon, among other matters: (1) pending claims received from third-party purchasers associated with previously sold mortgage loans; (2) a current assessment of the potential exposure associated with future claims of homebuyer fraud in mortgage loans originated in prior periods loans; and (3) historical loss experience. As noted in reports in the mortgage loan industry during the 2009 third quarter, mortgage performance continued to deteriorate as evidenced by significant year-over-year increases in delinquency rates. Additionally, foreclosures and foreclosures in process have increased substantially. Similarly, HomeAmerican has experienced an increase in the number and magnitude of claims to repurchase previously sold mortgage loans. Accordingly, the Company increased its estimated mortgage loan loss reserve by $7.3 million during the 2009 third quarter. The Company s mortgage loan reserves are reflected as a component of accrued liabilities in the Consolidated Balance Sheets, and the associated expenses are included as a component of general and administrative expenses in the Consolidated Statements of Operations.

14. Lines of Credit and Total Debt Obligations

Homebuilding. The Company s homebuilding line of credit (Homebuilding Line) is an unsecured revolving line of credit with a group of lenders for support of our homebuilding segments which has a maturity date of March 21, 2011. Effective September 16, 2009, the aggregate commitment under the Homebuilding Line was reduced from $800 million to $100 million (the Commitment) and the aggregate sublimit for letters of credit was reduced from $300 million to $100 million. The Commitment and sublimit for letters of credit were reduced as the Company believes that it does not need the full borrowing capacity of the Homebuilding Line to meet its liquidity needs and that it will be able to fund its homebuilding operations through its existing cash and investment resources.

Interest rates for borrowings on the Homebuilding Line, if any, are determined by reference to an applicable London Interbank Offered Rate (LIBOR) or to an alternate base rate, each with a margin that is determined based on changes in our credit rating and leverage ratio. At September 30, 2009 and December 31, 2008, there were no borrowings under the Homebuilding Line and there were $22.6 million and $26.6 million, respectively, in letters of credit outstanding as of such dates. The outstanding letters of credit reduce the amount that is available to be borrowed under the Commitment. However, the outstanding letters of credit do not impact the calculation of the Company s borrowing capacity under the permitted leverage ratio. Additionally, while the Company s borrowing capacity may be reduced under the permitted leverage ratio, this reduction does not impact its ability to issue letters of credit up to the limits specified in the Homebuilding Line.

Mortgage Lending. As of September 30, 2009 HomeAmerican had a Master Repurchase Agreement (the Mortgage Repurchase Facility) with U.S. Bank National Association (USBNA) and the other banks that were parties to the Mortgage Repurchase Facility (the Buyers). The Mortgage Repurchase Facility provided liquidity to HomeAmerican by providing for the sale of eligible mortgage loans to USBNA (as agent for the Buyers) with an agreement by HomeAmerican to

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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 agent for the Buyers and 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 $100 million, now reduced to $70 million, and includes an accordion feature that permits the maximum aggregate commitment to be increased to $150 million, subject to the availability of additional commitments. The Mortgage Repurchase Facility was set to expire on November 11, 2009 but now has been extended, with an expiration date of October 28, 2010. Advances under the Mortgage Repurchase Facility carry a Pricing Rate based on the LIBOR Rate plus the LIBOR Margin or, at HomeAmerican s option, a Balance Funded Rate (the foregoing terms are defined in the Mortgage Repurchase Facility). At September 30, 2009 and December 31, 2008, the Company had $13.0 million and $34.9 million, respectively, of mortgage loans that it was obligated to repurchase under the Mortgage Repurchase Facility.

The Mortgage Repurchase Facility is accounted for as a debt financing arrangement. Accordingly, at September 30, 2009 and December 31, 2008, amounts advanced under the Mortgage Repurchase Facility, which were used to finance mortgage loan originations, have been reported under the mortgage repurchase facility in the Consolidated Balance Sheets.

The Mortgage Repurchase Facility replaced HomeAmerican s Fourth Amended and Restated Warehousing Credit Agreement, dated as of September 5, 2006, as amended on November 2, 2007 and May 23, 2008, with USBNA and the other banks that were parties to that facility.

General. The agreements for the Company s Homebuilding Line and HomeAmerican s Mortgage Repurchase Facility and the indentures for our senior notes require compliance with certain representations, warranties and covenants. The Company believes that it is in compliance with the requirements of its Homebuilding Line, and it is not aware of any violations of its Homebuilding Line covenants. As further discussed below, HomeAmerican was not in compliance with one of the covenants on its Mortgage Repurchase Facility as of September 30, 2009; however, as subsequently modified (retroactively effective to September 30, 2009) HomeAmerican is in compliance with the covenant.

The Homebuilding Line agreement covenants also include a consolidated tangible net worth test. Under this test, the Company s Consolidated Tangible Net Worth (as defined) must not be less than: (1) $850 million; plus (2) 50% of consolidated net income, as defined, earned by the Company and the Guarantors (as defined) after September 30, 2008; plus (3) 50% of the net proceeds or other consideration received by the Company for the issuance of capital stock after September 30, 2008; minus (4) the lesser of (A) the aggregate amount paid by the Company after September 30, 2008 to repurchase its common stock and (B) $300 million. Failure to satisfy this covenant test would not result in a default, but would result in a scheduled reduction in the amount of the Commitment.

In addition to the foregoing covenants, the Homebuilding Line agreement specifies that Consolidated Tangible Net Worth must not be less than the sum of: (1) $650 million; (2) 50% of the quarterly consolidated net income of Borrower and the Guarantors earned after September 30, 2008; and (3) 50% of the net proceeds or other consideration received for the issuance of capital stock after September 30, 2008. Failure to satisfy this covenant could result in a termination of the facility.

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The Homebuilding line also contains a cash flow/liquidity test. Under this test, if the Company fails to maintain for any fiscal quarter ending on and after December 31, 2008 an Interest Coverage Ratio (as defined) equal to or greater than 1.5 to 1.0 for the period of four consecutive fiscal quarters, then as of the end of such fiscal quarter and as of the end of all fiscal quarters thereafter until the Interest Coverage Ratio is greater than or equal to 1.5 to 1.0, the Company would have to maintain either (1) a ratio of (A) Adjusted Cash Flow From Operations (as defined) to (B) Consolidated Interest Incurred (as defined) of greater than or equal to 1.5 to 1.0 or (2) a sum of (A) Borrowing Base Availability (as defined) plus (B) Unrestricted Cash (as defined which includes, among other things, cash, cash equivalents, marketable securities and unsettled trades), to the extent such Unrestricted Cash is not included in calculating Borrowing Base Availability, less (C) principal payments due on Consolidated Indebtedness (as defined) within the next succeeding four fiscal quarters, equal to or greater than $500 million. The Company s compliance with the cash flow/liquidity test would be measured on a quarterly basis and failure to satisfy this test would not result in a default but would result in a scheduled reduction in the amount of the facility.

Additionally, pursuant to the Homebuilding Line, should there be a defaulting lender, the Company is required to: (i) prepay swing line loans or cash collateralize the defaulting lender s share of the swing line loans and (ii) cash collateralize the defaulting lender s share of the outstanding facility letters of credit.

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 (as defined) requirement, (ii) a minimum Adjusted Tangible Net Worth Ratio, (iii) an Adjusted Net Income requirement, and (iv) a minimum Liquidity (as defined) requirement (the foregoing terms are defined in the Mortgage Repurchase Facility). Adjusted Tangible Net Worth means the sum of (a) all assets of HomeAmerican less (b) the sum of (i) all Debt and all Contingent Indebtedness of HomeAmerican, (ii) all assets of HomeAmerican that would be classified as intangible assets under generally accepted accounting principles, and (iii) receivables from Affiliates. HomeAmerican s Adjusted Tangible Net Worth Ratio is the ratio of HomeAmerican s total liabilities (excluding permitted letters of credit) to the Adjusted Tangible Net Worth. HomeAmerican s Adjusted Net Income is a rolling twelve consecutive months of net income for HomeAmerican. HomeAmerican s Liquidity is defined as its unrestricted cash and Cash Equivalents plus the amount by which the aggregate Purchase Price of all Purchased Mortgage Loans at such time exceeds the aggregate Purchase Price outstanding for all Open Transactions at such time (the foregoing terms are defined in the Mortgage Repurchase Facility).

Failure to meet the foregoing negative covenants would constitute an event of default. In the event of default, USBNA may, at its option, declare the Repurchase Date for any or all Transactions to be deemed immediately to occur. Upon such event of default, and if USBNA exercises its right to terminate any Transactions, then (a) HomeAmerican s obligation to repurchase all Purchased Loans in such Transactions will become immediately due and payable; (b) the Repurchase Price shall be increased by the aggregate amount obtained by daily multiplication of (i) the greater of the Pricing Rate for such Transactions and the Default Pricing Rate by (ii) the Purchase Price for the Transactions as of the Repurchase Date, (c) all Income paid after the event of default will be retained by USBNA and applied to the aggregate unpaid Repurchase Price owed by HomeAmerican and (d) HomeAmerican shall deliver any documents relating to Purchased Loans subject to such

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Transactions to USBNA. Upon the occurrence of default, USBNA may (a) sell any or all Purchased Loans subject to such Transactions on a servicing released or servicing retained basis and apply the proceeds to the unpaid amounts owed by HomeAmerican, (b) give HomeAmerican credit for such Purchased Loans in an amount equal to the Market Value and apply such credit to the unpaid amounts owed by HomeAmerican, (c) replace HomeAmerican as Servicer, (d) exercise its right under the Mortgage Repurchase Facility with respect to the Income Account and Escrow Account, and (e) with notice to HomeAmerican, declare the Termination Date to have occurred. The foregoing terms are defined in the Mortgage Repurchase Facility.

During the 2009 third quarter, HomeAmerican increased its mortgage loan loss reserves and, as a result, it did not meet the Adjusted Net Income covenant as of September 30, 2009. On October 29, 2009, HomeAmerican amended its Mortgage Repurchase Facility and decreased the maximum aggregate commitment from $100 million to $70 million. Additionally, HomeAmerican revised certain covenants under the Mortgage Repurchase Facility, effective retroactively to September 30, 2009, as follows: (1) revised the Adjusted Net Income covenant to exclude $6.0 million of expense associated with certain mortgage loan loss charges; (2) increased the Adjusted Tangible Net Worth covenant from $15.0 million to $18.0 million; (3) decreased the Adjusted Tangible Net Worth Ratio from 12.5 : 1.0 to 8.0 : 1.0; and (4) increased the minimum Liquidity requirement from $5.0 million to $8.0 million. Under the Mortgage Repurchase Facility as amended on October 29, 2009 HomeAmerican s Adjusted Net Income as of September 30, 2009 was $5.7 million. Accordingly, with the amendment of the Mortgage Repurchase Facility on October 29, 2009, the Company is in compliance with the covenants under the Mortgage Repurchase Facility agreement.

The Company s senior notes are not secured and, while the senior notes indentures contain some restrictions on secured debt and other transactions, they do not contain financial covenants. The Company s senior notes are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by most of its homebuilding segment subsidiaries. The Company s debt obligations at September 30, 2009 and December 31, 2008 are as follows (in thousands):

	September 30, 2009	December 31, 2008
7% Senior Notes due 2012	$ 149,413	$ 149,282
5 1/2% Senior Notes due 2013	349,617	349,543
5 3/8% Medium-Term Senior Notes due 2014	249,063	248,947
5 3/8% Medium-Term Senior Notes due 2015	249,779	249,755
Total Senior Notes, net	$ 997,872	$ 997,527
Homebuilding line of credit	-	-
Total Corporate and Homebuilding Debt	997,872	997,527
Mortgage repurchase facility	13,010	34,873
Total Debt	$ 1,010,882	$ 1,032,400

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15. Income Taxes

The Company is required, at the end of each interim period, to estimate its annual effective tax rate for the fiscal year and use that rate to provide for income taxes for the current year-to-date reporting period. The Company s overall effective income tax rates were -0.7% and -11.5% during the three and nine months ended September 30, 2009, respectively, and -0.9% and 1.4% during the three and nine months September 30, 2008, respectively. The change in the effective tax rates during the nine months ended September 30, 2009, compared with the same period during 2008, resulted primarily from the recording of a $9.7 million income tax expense related to an IRS examination of the Company s 2008 net operating loss carryback to 2006 and the inability to carry back any net operating losses at September 30, 2009. The $9.7 million income tax expense resulted from a 2006 alternative minimum tax liability associated with the Company s 2008 net operating loss carryback, which should have been recorded during 2008.

The Company is required to recognize the financial statement effects of a tax position when it is more likely than not (defined as a likelihood of more than 50%), based on the technical merits, that the position will be sustained upon examination. Any difference between the income tax return position and the benefit recognized in the financial statements results in a liability for unrecognized tax benefits. During the three and nine months ended September 30, 2009, there have been no material changes in the Company s liability for unrecognized tax benefits.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The increase in the Company s total deferred tax asset at September 30, 2009 (per the table below) resulted primarily from an increase in the Company s federal net operating loss carry forward offset by a decrease in the Company s asset impairment charges.

A valuation allowance is recorded against a deferred tax asset if, based on the weight of available evidence, it is more-likely-than-not (a likelihood of more than 50%) that some portion, or all, of the deferred tax asset will not be realized. The Company had a valuation allowance of $339.1 million and $294.3 million at September 30, 2009 and December 31, 2008, respectively, resulting in a net deferred tax asset of zero. The Company s future realization of its deferred tax assets ultimately depends upon the existence of sufficient taxable income in the carryback or carryforward periods under the tax laws (currently 2 and 20 years, respectively). The Company will continue analyzing, in subsequent reporting periods, the positive and negative evidence in determining the expected realization of its deferred tax assets.

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The tax effects of significant temporary differences that give rise to the net deferred tax asset are as follows (in thousands).

	September 30, 2009	December 31, 2008
Deferred tax assets		
Asset impairment charges	$ 147,824	$ 197,670
Federal net operating loss carryforward	86,313	5,638
Warranty, litigation and other reserves	37,719	45,619
State net operating loss carryforward	29,415	22,426
Stock-based compensation expense	16,760	13,758
Alternative minimum tax credit carryforward	9,679	-
Accrued liabilities	9,075	9,661
Inventory, additional costs capitalized for tax purposes	8,765	5,951
Property, equipment and other assets, net	3,435	3,826
Charitable contribution carryforward	542	542
Deferred revenue	344	792
Total deferred tax assets	349,871	305,883
Valuation allowance	(339,073)	(294,269)
Total deferred tax assets, net of valuation allowance	10,798	11,614
Deferred tax liabilities		
Deferred revenue	5,377	6,024
Inventory, additional costs capitalized for financial statement purposes	697	722
Accrued liabilities	564	709
Other, net	4,160	4,159
Total deferred tax liabilities	10,798	11,614
Net deferred tax asset	$ -	$ -

16. Supplemental Guarantor Information

The Company s senior notes and Homebuilding Line are fully and unconditionally guaranteed on an unsecured basis, jointly and severally, by the following subsidiaries (collectively, the Guarantor Subsidiaries), 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.

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

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 West Virginia, Inc.

Subsidiaries that do not guarantee the Company s senior notes and Homebuilding Line (collectively, the Non-Guarantor Subsidiaries) primarily include:

American Home Insurance
American Home Title
HomeAmerican
StarAmerican
Allegiant

The Company has determined that separate, full financial statements of the Guarantor Subsidiaries would not be material to investors and, accordingly, supplemental financial information for the Guarantor Subsidiaries is presented.

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Balance Sheet

September 30, 2009

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
ASSETS					
Cash and cash equivalents	$ 1,423,477	$ 3,456	$ 21,942	$ -	$ 1,448,875
Marketable securities	151,260	-	-	-	151,260
Unsettled trades, net	2,133	-	-	-	2,133
Restricted cash	-	933	-	-	933
Receivables	6,831	18,421	48,088	(45,957)	27,383
Mortgage loans held-for-sale, net	-	-	42,704	-	42,704
Inventories, net					
Housing completed or under construction	-	325,257	-	-	325,257
Land and land under development	-	177,888	-	-	177,888
Investment in subsidiaries	79,208	-	-	(79,208)	-
Other assets, net	77,038	61,964	5,082	-	144,084
Total Assets	$ 1,739,947	$ 587,919	$ 117,816	$ (125,165)	$ 2,320,517
LIABILITIES					
Accounts payable	$ 47,929	$ 43,354	$ 584	$ (45,957)	$ 45,910
Accrued liabilities	140,566	99,472	69,419	-	309,457
Advances and notes payable to parent and subsidiaries	(400,688)	412,363	(11,675)	-	-
Mortgage repurchase facility	-	-	13,010	-	13,010
Senior notes, net	997,872	-	-	-	997,872
Total Liabilities	785,679	555,189	71,338	(45,957)	1,366,249
STOCKHOLDERS EQUITY	954,268	32,730	46,478	(79,208)	954,268
Total Liabilities and Stockholders Equity	$ 1,739,947	$ 587,919	$ 117,816	$ (125,165)	$ 2,320,517

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Balance Sheet

December 31, 2008

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
ASSETS					
Cash and cash equivalents	$ 1,279,684	$ 3,536	$ 21,508	$ -	$ 1,304,728
Marketable securities	54,864	-	-	-	54,864
Unsettled trades, net	57,687	-	-	-	57,687
Restricted cash	-	670	-	-	670
Receivables	176,522	30,100	43,889	(45,957)	204,554
Mortgage loans held-for-sale, net	-	-	68,604	-	68,604
Inventories, net					
Housing completed or under construction	-	415,500	-	-	415,500
Land and land under development	-	221,822	-	-	221,822
Investment in subsidiaries	77,617	-	-	(77,617)	-
Other assets, net	79,832	63,213	3,464	-	146,509
Total Assets	$ 1,726,206	$ 734,841	$ 137,465	$ (123,574)	$ 2,474,938
LIABILITIES					
Accounts payable	$ 46,794	$ 27,397	$ 559	$ (45,957)	$ 28,793
Accrued liabilities	135,417	136,759	60,649	-	332,825
Advances and notes payable to parent and subsidiaries	(534,452)	540,509	(6,057)	-	-
Mortgage repurchase facility	-	-	34,873	-	34,873
Senior notes, net	997,527	-	-	-	997,527
Total Liabilities	645,286	704,665	90,024	(45,957)	1,394,018
STOCKHOLDERS EQUITY	1,080,920	30,176	47,441	(77,617)	1,080,920
Total Liabilities and Stockholders Equity	$ 1,726,206	$ 734,841	$ 137,465	$ (123,574)	$ 2,474,938

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Statements of Operations

Three Months Ended September 30, 2009

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
REVENUE					
Home sales revenue	$ -	$ 190,134	$ -	$ (3,318)	$ 186,816
Land sales and other revenue	-	9,826	6,584	-	16,410
Equity in (loss) income of subsidiaries	3,445	-	-	(3,445)	-
Total Revenue	3,445	199,960	6,584	(6,763)	203,226
COSTS AND EXPENSES					
Home cost of sales	-	154,915	(1)	(3,318)	151,596
Asset impairments, net	-	1,197	-	-	1,197
Marketing and commission expenses	-	16,439	-	-	16,439
General and administrative and other expenses	19,736	27,803	11,293	-	58,832
Total Operating Costs and Expenses	19,736	200,354	11,292	(3,318)	228,064
(Loss) income from Operations	(16,291)	(394)	(4,708)	(3,445)	(24,838)
Other income (expense)	(7,480)	117	383	-	(6,980)
(Loss) income before income taxes	(23,771)	(277)	(4,325)	(3,445)	(31,818)
Provision for income taxes	(8,277)	6,440	1,607	-	(230)
NET (LOSS) INCOME	$ (32,048)	$ 6,163	$ (2,718)	$ (3,445)	$ (32,048)

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Statements of Operations

Three Months Ended September 30, 2008

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
REVENUE					
Home sales revenue	$ -	$ 340,807	$ -	$ (4,063)	$ 336,744
Land sales and other revenue	171	17,290	8,496	-	25,957
Equity in (loss) income of subsidiaries	(98,218)	-	-	98,218	-
Total Revenue	(98,047)	358,097	8,496	94,155	362,701
COSTS AND EXPENSES					
Home cost of sales	-	289,455	(25)	(4,063)	285,367
Asset impairments	1,383	94,005	-	-	95,388
Marketing and commission expenses	-	31,094	-	-	31,094
General and administrative and other expenses	17,227	43,087	6,060	-	66,374
Total Operating Costs and Expenses	18,610	457,641	6,035	(4,063)	478,223
(Loss) income from Operations	(116,657)	(99,544)	2,461	98,218	(115,522)
Other income (expense)	(2,880)	378	1,050	-	(1,452)
(Loss) income before income taxes	(119,537)	(99,166)	3,511	98,218	(116,974)
Benefit from (provision for) income taxes	1,566	(1,191)	(1,372)	-	(997)
NET (LOSS) INCOME	$ (117,971)	$ (100,357)	$ 2,139	$ 98,218	$ (117,971)

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M.D.C. HOLDINGS, INC.

Notes to Unaudited Consolidated Financial Statements (Continued)

Supplemental Condensed Combining Statements of Operations

Nine Months Ended September 30, 2009

(In thousands)

	MDC	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminating Entries	Consolidated MDC
REVENUE					
Home sales revenue	$ -	$ 549,077	$ -	$ (9,725)	$ 539,352
Land sales and other revenue	50	15,869	19,153	-	35,072
Equity in (loss) income of subsidiaries	(18,659)	-	-	18,659	-
Total Revenue	(18,609)	564,946	19,153	8,934	574,424
COSTS AND EXPENSES					
Home cost of sales	-	454,771	(7)	(9,725)	445,039
Asset impairments, net	-	17,009	-	-	17,009
Marketing and commission expenses	-	46,512	-	-	46,512
General and administrative and other expenses	54,558	63,293	20,569	-	138,420
Total Operating Costs and Expenses	54,558	581,585	20,562	(9,725)	646,980